

Chapter 5:

The High Price of Bad Accounting: How Improper Accounting Practices Hurt Small Businesses in Malaysia

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ABSTRACT

Small businesses play a vital role in Malaysia's economy, yet many struggle with improper accounting practices that can lead to financial instability, regulatory penalties, and even business failure. This article explores common accounting issues faced by small business owners, such as poor record-keeping, failure to separate personal and business finances, and lack of compliance with tax regulations. These practices not only hinder financial decision-making but also expose businesses to legal risks and loss of trust. To mitigate these challenges, small business owners must adopt proactive financial management strategies, including the adoption of digital accounting tools, implementing internal controls, and seeking professional accounting assistance. Real cases of Malaysian businesses fined for non-compliance highlight the consequences of improper accounting practices. By improving financial literacy and adhering to regulations set by the Inland Revenue Board Malaysia (LHDN) and other regulatory bodies, small businesses can enhance transparency, build investor confidence, and ensure long-term sustainability. This article highlights the importance of proper accounting practices in strengthening the financial performance of small businesses, ultimately contributing to the nation's economic growth.

Key Words: Accounting Practices, Business Ethics, Financial Literacy, Small Business, Technology Adoption

1. INTRODUCTION

Proper accounting and financial management practices are imperative for any business regardless of size, to ensure stability, regulatory compliance, and long-term growth. However, many small businesses struggle with inconsistent or improper accounting practices, often due to a lack of financial knowledge, informal bookkeeping methods, or even unethical financial decisions driven by personal interests. While these issues may seem trivial at first, they can lead to serious consequences, including legal penalties, financial instability, and loss of business credibility. Businesses that do not maintain proper financial practice may find it difficult to secure funding from banks and other investors (Purag et. al, 2018). Limited funding could increase the risk of insolvency (Nik Abdullah et al. 2022) which can seriously affect the sustainability of the small business and resulted in low survival rate.

This article explores some of the most common improper accounting practices among small business owners in Malaysia, the consequences of these mistakes, and practical solutions to ensure better financial management. By understanding these risks, small business owners can take proactive steps to improve their accounting practices and ensure the sustainability of their businesses.

Common Improper Accounting Practices

One of the most common mistakes made by small business owners is not separating personal and business finances. Many small business owners utilise the same bank account for both personal and business transactions. This makes it challenging to differentiate business and personal revenues and expenses, which will lead to confusion and difficulty in determining the actual performance of the business (Zunaidi et al., 2022). Furthermore, combining personal and business expenses makes it more difficult to defend business-related deductions on tax returns, raising the possibility of audits and penalties from the Inland Revenue Board Malaysia (LHDN).

Another major issue is inconsistent record-keeping (Purag et al, 2028; Ramzi et al, 2022). Small business owners often do not maintain systematic financial records. Instead, they only record transactions, when necessary (for example when applying for a loan or business grants), or when required by external parties such as banks, auditors or tax authorities. This practice often led to missing or inaccurate financial data. Also, without a proper accounting system, businesses may struggle to manage cash flow, leading to poor decision-making and financial problems.

Many small businesses also do not issue proper invoices and receipts, which is not only a poor accounting practice but also a violation of tax regulations (LHDN). Some businesses, especially those relying on cash transactions, often do not have proper records or documentation for sales and expenses (Meiryani & Reyhan, 2021). This practice can create problems during audits, as the absence of invoices makes it difficult to verify business income and expenses. Furthermore, businesses that do not issue receipts may face disputes with customers and suppliers, damaging their reputation and trustworthiness.

Overstating expenses and underreporting income to lower tax obligations is a common but unethical practice (Zainal et al., 2025). A large number of Malaysian small businesses rely largely on cash transactions. While cash transactions can be convenient, failing to document them properly can lead to lost income records, untracked expenses, and potential mismanagement of funds. Without a clear record of cash flow, business owners may struggle to monitor financial performance, leading to inaccurate profit calculation and difficulty in financial planning. Moreover, an excessive reliance on unauthorized cash transactions raises questions about accountability and transparency, which could lead to internal fraud or financial mismanagement.

Finally, there is increasing concern about financial misrepresentation and unethical accounting activities among small business owners (Zainal et al., 2025). When applying for loans or company subsidies, some entrepreneurs falsify financial accounts to make their companies seem more profitable than they actually are. Others might improperly use the business' cash for personal reasons without providing enough transparency, or they might postpone expense recording in an attempt to artificially increase short-term earnings (Toumeh & Yahya, 2019). Although these immoral practices could offer short-term benefits, they eventually damage the company's reputation. If such tactics are found, they can harm relationships with lenders, investors, and other stakeholders.

The High Cost of Improper Accounting: Key Consequences

Among the key consequences of improper accounting practices are legal repercussions that may include fines and penalties, financial instability, loss of trust, and impaired growth opportunity.

Legal and tax fines are among the most severe and immediate impact of improper accounting. The tax authority requires business owners to accurately declare their income and keep proper financial records (LHDN). Failure to do so, whether through overstating expenses, underreporting income, or failing to maintain appropriate documentation, can have serious consequences for business owners. Businesses may have to pay back taxes with interest and penalties if differences are discovered during tax audit, which can be a stressful and time-consuming process. For small businesses, these costs can be too much to bear, which can result in more financial problems.

For example, in October 2017, the owner of a car accessories and parts company was fined RM37,000 by the court for inadequate reporting; or failure to keep business records as required by the Income Tax Act 1967 (The Star). The owner did not maintain records including sales ledgers, general ledgers, payment vouchers, and receipts between the assessment years of 2010 and 2015. A more recent example is when a cooking oil wholesaler in Perak was fined RM100,000 in April 2023. The business failed to maintain a stock book of controlled items and submitted false information regarding documents or invoices for the sale of cooking oil, which violated the Control of Supplies Act 1961 (The Malay Mail).

Another major impact of poor accounting practices is cash flow problems and financial instability. Small businesses depend on healthy cash flow to operate smoothly, pay suppliers, and invest in growth. However, inconsistent record-keeping, missing invoices, and undocumented cash transactions make it difficult to trace

money flowing in and out of the business (Zainal et al., 2025). Without a clear picture of financial health, business owners may overspend, accumulate unexpected debts, or struggle to meet financial obligations. In the worst cases, a lack of financial control can lead to business failure, as owners may not realize they are running at a loss until it is too late.

In addition to financial instability, businesses with poor accounting practices lose credibility and trust from financial institutions and within their own industry (Ramzi et al., 2022). When applying for loans or seeking financing for their business, banks and investors require transparent and well-documented financial statements. Lenders may refuse to approve financing if a business has inconsistent financial records, lacks proper documentation, or has a history of tax issues. Similarly, suppliers may hesitate to extend credit, fearing delayed or missing payments. Customers may also avoid businesses that are not transparent, or fail to provide proper receipts, leading to reputational damage and a decline in customer loyalty.

Improper accounting and lack of internal control also gives rise to ethical issues as they can create opportunities for employees to commit fraud, such as misappropriating funds, inflating expenses, or falsifying financial reports. Additionally, business owners who manipulate financial statements for personal gain—whether to attract investors, evade or minimise tax, or access loans under false pretences—are engaging in unethical behaviour. While some small business owners, especially sole proprietors, may take this issue lightly as they claim the business is ‘solely theirs’, such actions actually carry legal risks and can damage the business owner’s professional reputation. If unethical practices are exposed, it can lead to a loss of trust among stakeholders, making it difficult to rebuild relationships and sustain long-term business growth.

Furthermore, without a clear understanding of revenue, costs, and profit margins, decision-making becomes reactive rather than strategic. Small businesses may miss opportunities to optimize operations, introduce new products, or enter new markets simply because they lack the financial data to support informed decisions (Purag et al., 2018). In the long run, this can prevent businesses from scaling and achieving long-term success.

In the end, the repercussions of poor accounting extend beyond numbers on the financial statements. Legal troubles, financial instability, reputational damage, ethical risks, and missed business opportunities can all have adverse effect towards the sustainability of the business. Small business owners need to realise that proper accounting is not just a regulatory requirement but a fundamental aspect of business sustainability. The few aforementioned incidents highlighted the serious consequences of improper accounting practices, emphasizing the need for small businesses to maintain proper and transparent financial records.

How Small Businesses Can Avoid These Pitfalls

Firstly, it is essential to apply the separate entity principle in which personal and business finances are distinct and should be recorded separately. Small business owners can open a specific business bank account and use it exclusively for business transactions. This helps to maintain clear financial records and ensures compliance with tax regulations. Additionally, implementing good internal control such as preparing bank reconciliation statements regularly, can help prevent fraud and financial discrepancies.

Secondly, small business owners must adopt proactive financial management strategies. This includes adopting technology to improve their accounting practices (Hassan et al., 2022). The business can consider investing in accounting software for effective financial management. Accounting software, such as QuickBooks or Xero, can help track income and expenses systematically, minimise human error or missing transactions, and facilitate the owners in certain accounting tasks such as generating financial statements. Additionally, in support of the green technology, most of the receipts and bills can be provided and kept in digital formats. This also aligns with the LHDN reinforcement of e-invoice, which encourages the business to adopt digital bookkeeping solutions. Properly documented source documents such as invoices, receipts, and bank statements can help to improve transparency and accountability.

In addition, business owners can also consider using cloud-based systems such as OneDrive, GoogleDrive, and Bukku. Bukku is a cloud accounting software designed for SMEs and accountants in Malaysia to track and manage sales, expenses and cash-flow efficiently (bukku.my). It automates tedious accounting and invoicing tasks in a few clicks to provide better insights on how the business is doing in real-time, anytime, anywhere with any devices, at an affordable price. The cloud system is also a great investment for small businesses due to its ease of accessibility. Though subscription fees for software and cloud storage may seem expensive for small businesses (Aziz et al., 2022; Hassan et al., 2022); owners need to understand that in the long-run, the adoption of technology is actually more cost-effective.

Another effective way to avoid accounting pitfalls is to seek professional assistance in preparing accounting records. Hiring a qualified accountant or bookkeeper can ensure that financial records comply with regulatory standards and tax laws. As small businesses may not be able to afford hiring a full-time accountant, outsourcing

accounting services on a periodic basis can be a cost-effective alternative (Rezazade et al., 2023). More importantly, small business owners should continue to improve their financial literacy by attending workshops or trainings on basic accounting, taxation, and financial management. Higher learning institutions can also help by providing courses and trainings tailored for small business owners at affordable prices (Zunaidi et al., 2022).

Lastly, business owners should be aware of tax regulations and generally accepted accounting practices. Though they may not have to prepare audited financial statements, small business owners still need to adhere to requirements set by the Inland Revenue Board Malaysia (LHDN) as well as other relevant acts and regulations to avoid non-compliance penalties. Thus, it is recommended that they join and participate in business associations' activities, and also engage with agencies that are responsible to help small business such as Majlis Amanah Rakyat (MARA), SME Corp. and Amanah Ikhtiar Malaysia (AIM). This can provide valuable insights into certain business rules and regulations. By adopting these best practices, small businesses can improve financial stability, build investor confidence, and ensure long-term sustainability.

2. CONCLUSION

In conclusion, improper accounting practices among small business owners poses significant risks to both the individual businesses and their owners, as well as and the broader economy. These practices lead to inaccurate financial statements, hinder good decision-making, and limit access to funding; altogether jeopardizing the sustainability and growth of the small businesses. Addressing these issues through awareness programs, technology adoption, and financial literacy can improve financial management, strengthen stakeholder trust, and enhance competitiveness. Moving forward, collaboration between small business owners, government agencies, accounting professionals, industry associations and higher learning institutions is essential to promote ethical and transparent accounting practices. By inculcating a culture of accountability and providing proper records and reports for all stakeholders, Malaysia can create a robust business environment that enables small businesses to thrive. This will not only support the long-term success of the business but also contribute to the nation's economic growth, ensuring a brighter future for businesses and society as a whole.

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