

# **A study of Financial Accounting Practices of Small and Medium Scale Enterprises (SMEs) in Ho Municipality, Ghana**

**Justice Stephen Tetteh Zotorvie**

Department of Accounting and Finance, Faculty of Business and Management Studies,  
Ho Technical University, Ghana

*Email: zjusticetetteh@yahoo.com*

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## **ABSTRACT**

This paper examined the financial accounting practices of SMEs drawing on a survey of 225 owner-managers in Ho Municipality. The results revealed that majority of SMEs failed to keep proper accounting records pertaining to their businesses. Consequently, it was difficult for the owner-managers to determine the profit earned or loss suffered in the business during a particular accounting period in addition to the position of assets and liabilities to be able to strategize and make certain adjustments on their businesses. The major reasons for the entities failure to maintain proper accounting records and prepare a complete set of financial statements included high cost of hiring qualified accountants and lack of accounting knowledge on the part of some owner-managers. It is recommended that the National Board for Small Scale Industries (NBSSI) in collaboration with the accounting bodies should organize accounting training programmes for owner-managers of SMEs on proper bookkeeping and accounting practices.

**Keywords:** Accounting Information, Accounting Practices, Accounting records, Small and Medium Scale Enterprises (SMEs), Owner-Managers

## **1. INTRODUCTION**

There is a growing recognition of the important roles Small and Medium-Scale Enterprises (SMEs) play in the economic growth and sustainable development of every nation (Ghartey, 1988; Moore, Petty, Palich & Longenecker, 2008). For example, Ghartey, (1988) described SMEs as the bedrock of both developed and developing countries. The percentage contribution of SMEs to Gross Domestic Product (GDP) ranges from 60% in China, 57% in Germany, 55.3% in Japan, 50% in Korea and 47.3% in Malaysia. SMEs in Ghana provide about 85% of manufacturing employment and are believed to contribute about 70% to Ghana's GDP (Frimpong, 2013).

These important roles of SMEs can best be sustained through the implementation of fundamental financial and accounting practices (Schwenk & Schrader, 1993). However, it has been reported that many SMEs failed to keep adequate accounting records to generate the much needed accounting information that owner-managers and other users require for their decision making purposes which led to major problems (Howard, 2009; Madurapperuma, Thilakerathne, & Manawadu, 2016). Larson & Clute, (1997) further reported of weak internal accounting systems of some SMEs which resulted in poor planning, weak expense control, low collection of accounts receivable, poor financial condition, and inadequate information for decision making purposes.

Okoli, (2011) in his work linked proper record keeping of SMEs to profitability and asserted that as a result of inadequate record keeping, small scale business operators could not effectively assess their financial performance. Therefore, he suggested that SMEs should keep adequate records which would help the owner-managers to keep track of the performance of their businesses and also enhance their continuity.

Inefficient use of accounting information to support financial decisions of owners-managers of SMEs can negatively affect the financial status and long term sustainability of the business of the SMEs whether large or small.

In recent times, several education and training programmes have been organized for SMEs in Ghana on proper bookkeeping and accounting practices. However, the findings of (Mbroh & Attom, 2011; Dawuda & Azeko, 2015; Ankrah, Mensah, & Ofori-Atta, 2015) gave evidence that SMEs still failed to keep proper books of accounts due to low levels of education and inadequate knowledge in accounting on the part of the Owner-managers and lack of money to hire qualified accountants. In view of the importance of SMEs to the economic development and growth of a country, this study has been designed to examine whether the findings of Mbroh & Attom (2011); Dawuda & Azeko, (2015); Ankrah, Mensah, & Ofori-Atta, (2015) still persist or there has been a mark improvement in the accounting practices of SMEs especially in the Ho Municipality. The study anchored on three main objectives:

1. To examine the types and completeness of accounting records kept by SMEs as a source of information for economic decision making.
2. To examine the challenges of SMEs in keeping proper books of accounts as a source of information for economic decision making.
3. To examine the effects of improper accounting records on the businesses of SMEs in Ho Municipality.

The outcome of this study may help owner-managers of SMEs to appreciate and adopt basic accounting practices for the success of their businesses. The result may also facilitate the work of Ghana Revenue Authority (GRA) officials in developing strategies to extend the tax net to cover such enterprises which form significant proportion of the Ghanaian business community.

### **3. LITRATURE REVIEW**

#### **3.1 Definition and Characteristics of SMEs in Ghana**

Small and Medium Enterprises (SMEs) are defined differently by researchers (Abor & Quartey, 2010). In Ghana, the definitions used are based on capital requirements and on employment size. Enterprises qualify as micro, small or medium-scale enterprises if they fulfill the maximum ceilings for staff headcount and capital investment. (See Table-1 below)

**Table 1: Definition and Characteristics of SMEs in Ghana**

Enterprise Category	Employment Size	Non-Current Assets (Excluding Land & Building) Not Exceeding
Micro	1-5	\$10,000
Small	6-29	\$100,000
Medium	30-100	\$1000,000

**Source: National Board for Small Scale Industries (NBSSI, 1990), Ghana Statistical Service, (GSS, 1987) and Venture Capital Trust Fund (VCTF) Act 2004 (Act 680)**

Statistics from the Registrar General’s Department in Ghana suggests that 92% of businesses registered are micro, small and medium enterprises. SMEs in Ghana are categorised into urban and rural

enterprises. The former can be subdivided into 'organised' and 'unorganised' enterprises. Organised ones tend to have employees with a registered office and are mostly solely owned by an individual whereas the unorganised ones are mainly made up of artisans who rely mostly on family members or apprentices. Rural enterprises are largely made up of family groups, individual artisans, women engaged in food production from local crops. The major activities within this sector include: soap and detergents, fabrics, clothing and tailoring, textile and leather, village blacksmiths, timber and mining, bricks and cement, beverages, food processing, wood furniture, electronic assembly, agro processing, chemical based products and mechanics. This sector is characterised by low levels of education and training of the self-employed. They are mostly family owned businesses and there is little separation of the business finances from that of the owners even to the point that the owners or operators personal account is the same as that of the business (Liedholm & Mead, 1987; Osei et al., 1993) as cited by (Kayanula & Quartey, 2000).

Majority of SMEs are female-owned businesses, which more often than not are home-based compared to those owned by males; they are operated from home and are mostly not considered in official statistics (Aryeetey *et al*, 1994; Abor & Biekpe, 2006).

### **3.2 Accounting Practices of SMEs**

Accounting forms an integral part of the management process in an organization, where it provides essential information to the business in its planning, evaluating, controlling and decision making process (Mahfar & Omar, 2004). Accounting information is provided by accounting systems. Accounting system comprises all the procedures necessary to record transactions, assets and liabilities in the books of accounts which will form a reliable basis for the preparation of the financial statements (Hussein, 1983), as cited by Sathyamorthi (2001). Without an accounting system, it would be very difficult for SMEs to determine performance, identify customer and supplier account balances and forecast future performance of the organization (Stefanou, 2006). Padachi, (2012) also observed that proper system of accounting indicates how well the business is performing and what decisions are necessary to be made in order to keep the business in the market and emphasized the need for businesses to maintain proper books of accounts.

Businesses are required to keep proper books of account and prepare financial statements which give a true and fair view of the business's financial affairs. Proper accounting records must show and explain the enterprise's transactions, disclose with reasonable accuracy the enterprise's financial position at any time, and enable the directors to ensure that any accounts prepared therefrom comply with the appropriate financial reporting framework. They must also include entries from day to day of all money received and paid out together with a record of all assets, liabilities and owners' equity. This can be done either mechanically or electronically by using a computer. Ademola, Samuel & Ifedolapo, (2012) noted that in keeping proper accounting records, policies, systems, procedures, operations and personnel are required to administer the records. According to Reed, (2010), proper record keeping provides evidence of how the transactions were handled and substantiates the steps that were taken in order to comply with business standards.

The success or failure of any business depends on keeping accurate and timely accounting information to give a clear financial business image (Ankrah, Mensah & Ofori-Atta, 2015). However, prior research reported that most SMEs did not keep complete records of accounts assigning several reasons. For example, a study by Maseko & Manyani (2011) established that most SMEs did not keep complete records of accounts due to lack of knowledge in accounting and the cost of engaging professional accountants. Consequently, the use of accounting information to support measurement of financial performance by SMEs was ineffective. The study proposed that regulatory bodies must develop

specific guidelines for SME accounting and organise accounting training programmes for entrepreneurs in small businesses. They also recommend the application of mandatory record keeping to improve accounting practices of SMEs. Mbroh & Attom (2011) in their study also reported that majority of SMEs in Ghana did not practice formal accounting at all due to low levels of education and inadequate knowledge in accounting on the part of the owner-managers which made it difficult for them to appreciate the need to practice proper accounting in their business.

The development of a sound accounting system in SME's depends on the owner-manager's level of accounting knowledge (Ismail & King 2005). However, Abor & Quartey, (2010) bemoaned that even though majority of SME owner-managers did not have adequate accounting knowledge; they failed to seek professional advice on technical challenges and rather tend to take crucial financial decisions themselves. Proper accounting practices can actually help a business to succeed. Ojaide (1999) concluded that hiring qualified accounting personnel, exercising financial discipline and taking charge of working capital management can greatly ensure that SMEs outlive their owner-managers and grow to be multinationals.

#### **4. METHODOLOGY**

##### **4.1 Study Area**

The study was conducted in Ho Municipality in the Volta Region of Ghana. The area was chosen for this study because it is the home of a number of industrial and commercial units in the Region. It thus, makes it a viable source of information for this research.

##### **4.2 Mode of Enquiry**

The survey approach was adopted for this research. This approach enabled the researcher to collect large amount of data in a short time for fairly low cost (Kelly, Clark, Brown & Sitzia, 2003).

##### **4.3 Sample and Sampling**

The target population comprised of owner-managers of registered SMEs in Ho Municipality. A total of 225 owner- managers of SMEs in the municipality constituted the sample size for this research. The purposive sampling method was employed in this research to ensure that only members of the population were included in the survey.

##### **4.4 Instrumentation and Data Collection**

Based on the research objectives, a printed survey questionnaire was developed. The questionnaire was divided into five sections: the demographic profile of respondents, characteristics of SMEs, accounting practices of SMEs, challenges faced by SMEs in keeping proper accounting records and the benefits of keeping proper books accounts to SMEs. The questionnaires were personally administered by the researcher to 250 owner- managers of SMEs. The questionnaires were distributed and left with respondents for a week to allow them enough time to respond in good faith. A total of 225 of the distributed questionnaires were returned and were accepted as complete for the purpose of data analysis. This gave a return rate of 90%. Participation in the survey was voluntary and the respondents were assured of confidentiality

##### **4.5 Data Analysis Technique**

Data from the field were edited and coded appropriately to make meaning out of them. Editing was done to correct errors, check for non responses, and accuracy of answers. Coding was done to facilitate data entering and a comprehensive analysis. Descriptive statistics, mainly frequency tables and percentages were the medium used for the analysis. The software used was the IBM Statistical Package for Social Science (SPSS) version 20.

## 5. RESULTS AND DISCUSSION

### 5.1 Demographic Profile of Respondents

The demographic profile of the respondents is displayed in Table-1. There were 36.9% male respondents and 63.1% female respondents. This implies that females dominated the SME sector relative to their male counterparts. This confirmed the findings of Aryeetey et al, (1994) and Abor & Biekpe, (2006) that majority of SMEs in Ghana are female-owned businesses compared to those owned by males. Also, 42.2% of respondents were between the ages of 31 - 40 years. Cumulatively, 44.5% (31.6% +12.9%) of respondents were above 41 years and 13.3% were between the ages of 21-30 years. With reference to respondents' educational background, most of the respondents (40.9%) had up to secondary level education. The second largest group of respondents (28%) had up to basic level of education, 19.1% of them had tertiary education, and the remaining 12% of respondents had no formal education.

**Table -2: Demographic Profile of Respondents (N=225)**

Characteristics	(n) Frequency	Percent
<b>Gender</b>		
Male	83	36.9
Female	142	63.1
<b>Total</b>	<b>225</b>	<b>100</b>
<b>Age Group</b>		
21-30	30	13.3
31-40	95	42.2
41-50	71	31.6
Above 50	29	12.9
<b>Total</b>	<b>225</b>	<b>100</b>
<b>Level of Education</b>		
No formal Education	27	12.0
Basic	63	28.0
Secondary	92	40.9
Tertiary	43	19.1
<b>Total</b>	<b>225</b>	<b>100</b>

**Source: Author's field data, 2016**

### 5.2 Characteristics of SMEs

This section identifies the characteristics of SMEs in the municipality with respect to legal ownership, number of years in business and number of employees; the results of which are shown in tables 3 and 4. With regard to legal ownership of SMEs, Table-3 reveals that the majority (56%) of SMEs in the municipality are family own. This is followed by 38% of SMEs which function as sole proprietorships, (the remainder of the respondents were 4.9% Cooperatives, 4% partnerships, and 3.1% limited liability Companies. The result also revealed that most of the SMEs 121(53.8%) is involved in trading activities, 59(26%) render services and the remaining 45(20%) are into manufacturing

**Table- 3: Legal Ownership of SMEs**

Industrial Sector	Family Business	Cooperatives	Sole Proprietor	Partnership	Limited Company	Total
Trading	77	2	36	3	3	121
Manufacturing	19	4	15	4	3	45
Services	30	5	21	2	1	59
<b>Total</b>	<b>126</b>	<b>11</b>	<b>72</b>	<b>9</b>	<b>7</b>	<b>225</b>
<b>Percentage (%)</b>	<b>56</b>	<b>4.9</b>	<b>32</b>	<b>4</b>	<b>3.1</b>	<b>100</b>

Source: Author’s field data, 2016

With regard to the number of years in business, Table-4 reveals that majority of SMEs (43.1%) have been in business between 11- 20 years, 24.4% of SMEs have been in existence for less than 10 years, and 11.6% of them have been in business between 31-40 years. Only 4.9% of SMEs have been in existence for more than 41 years. In terms of the number of employees, Table-4 indicates that majority of respondents (64.5%) had 1-5 employees, 22.2% of them had 6-10 employees, 10.7% of them had 11-15 employees, and only about 3% of them had between 16-20 employees. Based on employment size, majority of the businesses are mainly micro and small enterprises.

**Table -4: Characteristics of SMEs**

Description	(n) Frequency	Percent
<b>Number of years in Business</b>		
Less than 10years	55	24.4
11-20	97	43.1
21-30	36	16.0
31-40	26	11.6
More than 41 years	11	4.9
<b>Total</b>	<b>225</b>	<b>100</b>
<b>Number of Employees</b>		
1 – 5	145	64.4
6 – 10	50	22.2
11-15	24	10.7
16-20	6	2.7
<b>Total</b>	<b>225</b>	<b>100</b>

Source: Author’s field data, 2016

### 5.3 Accounting Practices of SMES

Table-5 presents the response to whether respondents keep proper books of accounts pertaining to their business. According to the responded questionnaires, majority of respondents (57.3%) did not keep proper books of accounts; only 42.7% kept proper books of accounts. However, respondents who did not keep proper books of accounts kept notes that guide them to keep track of trade debtors and creditors. This supports the findings of Mensah, Tribe, & Weiss, (2007); Mbroh & Attom (2011); Dawuda & Azeko, (2015) and Ankrah, Mensah, & Ofori-Atta, (2015) that most SMEs in Ghana do not keep proper books of accounts pertaining to their business.

**Table -5: Keeping of Proper Books of Accounts**

Description	(n) Frequency	Percent
Yes	96	42.7
No	129	57.3
<b>Total</b>	<b>225</b>	<b>100</b>

**Source: Author's field data, 2016**

From Table-6, it can be seen that out of the 96 respondents who keep accounts pertaining to their business, 30.2% of them use the computer method which involved the use of accounting software for recording business transactions and financial reporting while 69.8% use paper based (manual) method. The paper based record keeping involves employees performing the whole accounting cycle manually on a periodic basis: they calculate trial balances, journalize transactions, and prepare financial statement reports and other routines (Weber, 2017). This study found out that those respondents using the paper based method maintained files of invoices and receipts, journals, ledgers, vouchers, cash book, payroll records and assets register. These records should enable respondents to prepare a complete set of financial statements as required by IASB (2013) for SMEs. However, only the Income Statement and Statement of Financial Position were prepared by them. This implies that respondents are only interested in the results of operations and financial position of their business. Clearly, this will not give the SMEs operators an up-to-date picture of how their business is going, and also to be able to plan and forecast their future situation.

**Table -6: Methods of Record Keeping**

Description	(n) Frequency	Percent
The paper based method	67	69.8
The computer method	29	30.2
<b>Total</b>	<b>96</b>	<b>100</b>

**Source: Author's field data, 2016**

This section of the paper sought to find out who was responsible for the bookkeeping and accounting functions. From Table-7, out of the 96 operators who keep financial records of their business, 44.8% of them indicated that they are in charge of the bookkeeping and accounting functions for their business, 25.0% use sales personnel and only 30.2% (19.8%+10.4%) use accounting staffs and consultants. This finding is consistent with that of Madurapperuma, Thilakerathne & Manawadu, (2016) who reported that owner- managers dominated preparers of financial statements in SMEs. As pointed out by Ikechukwu, (1993) proper records keeping are crucial for the successful performance of a business. It requires a trained and qualified professional to prepare and present accurate and timely financial reports that show the financial progress and condition of the business.

**Table-7: Responsibility for Bookkeeping and Accounting Functions**

Description	(n) Frequency	Percent
Owner-managers	43	44.8
Accounting staff	19	19.8
Sales Personnel	24	25.0
Consultants	10	10.4
<b>Total</b>	<b>96</b>	<b>100</b>

**Source: Author's field data, 2016**

#### **5.4 Major challenges faced by SMEs in keeping proper accounting records**

Table-8 reveals that majority of respondents (48%) attributed their inability to keep proper accounting records to high cost of hiring a qualified accountant. This is followed by lack of accounting knowledge on the part of owners-managers and lack of guiding or specific accounting standards for SMEs as indicated by 20% and 17.33% of the respondents respectively. This finding supports the observation of Evaraert et al., (2006) and Jayabalan & Dorasamy, (2009), as cited by Ezejiofor, Ezenyirimba & Olise, (2014) that the high cost of contracting professional accountants has left SME owners with no better option but to relegate accounting information.

**Table -8: Major Challenges Faced In Keeping Proper Accounting Records**

<b>Inhibiting factors</b>	<b>Frequency</b>	<b>Percent</b>
High cost of hiring a qualified accountant	108	48.00
Lack of accounting knowledge	45	20.00
Accounting reports too difficult to understand	18	8.00
Lack of guiding or specific accounting standard for SMEs	39	17.33
Accounting reports do not add value to the business	15	6.67
<b>Total</b>	<b>225</b>	<b>100</b>

**Source: Author's field data, 2016**

#### **5.5 Effects of Improper Accounting Records**

Respondents were asked to select from a given list of effects of improper accounting records on their businesses. Table-9 shows that, "difficulty in determining the results of operation" ranked highest with 27.1%, and "difficulty in determining the financial position of the business" ranked second with 20.4%. "Inefficient, improper and untimely decision making" ranked third with 18.7%. Owner-managers need to know the profit earned or loss suffered in the business during a particular accounting period in addition to availability of cash, position of assets and liabilities to be able to strategize and make certain adjustments on their business. It is, therefore, necessary that they keep proper accounting records of their businesses on consistent basis in order to achieve these objectives.

Again, "difficulty in accessing credit/finance" ranked fourth with 14.7%. The inability of the SMEs to access credit from the banks and other financial institutions could affect the growth of the business. If the business seeks alternative financial means such as a bank loan, the bank would want to view the accounts to see if the business could pay back the loan in full within the agreed timescale. If the accounts are up to date and are positive, then the business would probably be accepted for the loan.

"Difficulty in tracking account receivables and payables" (10.7%); "Difficulty in filing accurate profits tax returns" (5.3%) and "inability to detect losses and theft in the business" (3.1%) were the other effects of not keeping proper books of accounts. They were ranked 5<sup>th</sup>, 6<sup>th</sup>, and 7<sup>th</sup> respectively. Keeping of proper accounting records is a legal requirement under the rules of assessment. So, by being organised, SMEs will be able to stay within the law.

**Table-9: Effects of Improper Accounting Records**

<b>Effects of Improper Accounting Records</b>	<b>Frequency</b>	<b>Percent</b>	<b>Ranking</b>
Inefficient, improper and untimely decision making	42	18.7	3 <sup>rd</sup>
Difficulty in accessing credit/finance.	33	14.7	4 <sup>th</sup>
Difficulty in determining the results of operation	61	27.1	1 <sup>st</sup>
Difficulty in tracking account receivables and payables	24	10.7	5 <sup>th</sup>
Difficulty in filing of accurate profits tax returns.	12	5.3	6 <sup>th</sup>
Difficulty in determining the of financial position of the business	46	20.4	2 <sup>nd</sup>
Inability to detect losses and theft in the business	7	3.1	7 <sup>th</sup>
<b>Total</b>	<b>225</b>	<b>100</b>	

**Source: Author's field data, 2016**

## **6. CONCLUSIONS AND RECOMMENDATIONS**

This paper examined the financial accounting practices of SMEs drawing on a survey of 225 owner-managers in Ho Municipality. The results revealed that majority of SMEs in the municipality are family owned and are involved in trading activities having about 1-5 employees. The results also revealed that majority of SMEs did not keep proper accounting records pertaining to their business. The major reasons for the entities failure to maintain proper accounting records and prepare a complete set of financial statements were high cost of hiring qualified accountants and lack of accounting knowledge on the part of some owner-managers. It was therefore difficult for the owner-managers to determine the profit earned or loss suffered in the business during a particular accounting period in addition to availability of cash, position of assets and liabilities to be able to strategize and make certain adjustments on their businesses. However, some of the SMEs kept records of their business using the paper based method. This category of SMEs maintained files of invoices and receipts, journals, ledgers, vouchers, cash book, payroll records and assets register. Also, in most cases owner-managers are in charge of the bookkeeping and accounting functions for their business; only few MSEs employed the services of accounting staffs and consultants.

In other for the SMEs to grow, there is the need for a more effective and efficient accounting practices coupled with good control procedures translating into preparation of complete set of financial statements not only for internal users but also to external users. As most owner-managers lack the education and experience to handle all of their business accounting needs, hiring an accounting practice to assist with the accounting functions of the business is a great way to ensure the books are in line with ethical standards and the law. Also, with the development of information technologies there is the need for SMEs to acquire computer software to improve the accuracy of their record keeping and financial reporting. SMEs in the municipality should form a union through which a consultant would be hired to prepare accounts for them at shared cost to be settled by the clients through the union. In this way, the problem of high cost of accounting services that prevent most SMEs from preparing proper books of account would have been greatly resolved. Lastly, national regulators such as National Board for Small Scale Industries (NBSSI) in collaboration with the Institute of Chartered Accountants, Ghana (ICAG) should organize accounting training programmes for owner-managers of SMEs to equip them with basic accounting knowledge and skills.

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