

Financial Reporting in Small and Medium Enterprises (SMEs) in Nigeria. Challenges and Options

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Abstract *This study is on financial reporting in Small and Medium Enterprises (SMEs) in Nigeria: challenges and options. The study was carried out to determine the challenges facing Small and Medium Enterprises (SMEs) in adopting effective financial accounting reporting in Nigeria and to ascertain the contribution of poor credit facilities to inadequate accounting records in SMEs in Nigeria. Survey method and time series data were used and data were collected through the use of questionnaire and CBN statistical bulletin. Data generated were analyzed with simple percentage table. The study found that the challenges facing SMEs in preparation and presentation of financial reports are: inadequate accounting books and records, manpower, accounting system and non-running their transactions through the banking system. The study recommends among others that since keeping proper books of account and preparation of financial records can only be done by professional accountants, the two main bodies in Nigeria: ICAN and ANAN should encourage their members to offer free professional service to SMEs in Nigeria.*

Key words Financial reporting, small and medium enterprises, challenges and options

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1. Introduction

There are many accounting standards in the world, with each country using a version of their own generally accepted accounting principles (GAAP). These allow firms to report their financial statements in accordance with the GAAP that applies to them. The complication arises when whether the firm does business in multiple countries (Modugu and Eragbhe, 2001). However, the harmonization and international convergence of accounting standards and practices are of interest to researchers in both developed and developing countries. For the past decade, members of the accounting profession have been anticipating the adoption of the IFRS (Securities and Exchange Commission, 2010 as cited in Winney, Marshall, Bender, Swiger, 2010) and this anticipation has prompted a lot of academic research on the subject of adoption of IFRS by different countries of the world- Nigeria is not exempted. As a result of this, the Financial Reporting Council of Nigeria (FRCN) announced the transition date for adopting IFRS for SMEs in Nigeria to begin from January 1, 2012 (Report of the Committee on Road Map to the Adoption of International Financial Reporting Standards in Nigeria, 2010).

Modugu and Eragbhe (2013) affirmed that Small and Medium Enterprises (SMEs) contribute over 90% of the private sector production and they are the prime sources of jobs in developing countries and play a crucial role in income generation especially for the poor. There is currently no clear cut definition of an SME in Nigeria. In the context of IFRS, SMEs are entities that do not have public accountability and publish general purpose financial statements or follow generally accepted accounting principles (GAAP). Public accountability in this context connotes entities with or seeking to have their securities traded in a public market or have assets in a fiduciary capacity as their main business activities.

Since the official announcement of the mandatory adoption and implementation of IFRS in the European Union in 2002, accounting research has examined the process, especially the impact, progress and difficulties it entails (Callao *et al.*, 2007). However, most of the previous studies on adoption of international accounting standards by countries are country specific (Gyasi, 2010) and the focus of most literature have been larger firms, sometimes only listed firms (Anacoreta and Silva, 2005). The level of

preparedness of Nigeria for the adoption of IFRS for SMEs with regards to the roadmap announced by the FRCN is not known with empiricism.

The place of sound accounting and internal control systems in any business, irrespective of its scale, cannot be overemphasized. A vast majority of small-scale businesses cannot afford the complexity of a detailed accounting system even if they would have, hence, the existence of single entries in their books and in some cases on incomplete records (Wood, 1979; Onaolapo *et al.*, 2011). Audits of small scale enterprises have proven to be among the most worrisome for professional accountants because of the inadequacy of the internal controls. Except for statutory demands, small and medium scale enterprises hardly give serious thoughts to the process of sound accounting, yet the inadequacy and ineffectiveness of accounting processes have been responsible for untimely collapse of a host of them (Mukaila and Adeyemi, 2011). Much of studies have been conducted on financial reporting in SMEs in Nigeria etc. Some of these works include Fowokan (2011), Okafor and Ogiedu (2011), Eke, Onafalujo and Akinlabi (2011). Moreover, there has been limited research on those challenges and their effect on small and medium enterprises in Nigeria.

1.1. Objective of the study

1. To determine the challenges facing Small and Medium Enterprises (SMEs) in adopting effective financial accounting reporting in Nigeria.
2. To ascertain the contribution of poor credit facilities to inadequate accounting records in SMEs in Nigeria.

1.2. Research questions

1. What are those challenges facing Small and Medium Enterprises (SMEs) in adopting effective financial reporting in Nigeria?
2. To what extent do poor credit facilities contribute to inadequate accounting records in SMEs in Nigeria?

1.3. Hypotheses

1. *H₀: There are challenges facing Small and Medium Enterprises (SMEs) in adopting effective financial accounting reporting in Nigeria.*
2. *H₀: Poor credit facilities to SMEs in relation to other private sector do not contribute to inadequate accounting records of SMEs in Nigeria.*

2. Literature review

2.1. Conceptual framework

The definition of SMEs differs with jurisdiction (PricewaterhouseCoopers, 2009) and there is no consensus on the real definition of Small and Medium scale enterprises (SMEs) as the terms, 'Small' and 'Medium' are relative and they differ from industry to industry and country to country. Besides, no single definition can reflect the difference between firms, sectors and countries due to the varying level of development (Holt, 2009). On the relevance of the accountant to SMEs, Association of Certified Chartered Accountants (ACCA) has carried out a number of researches to empirically investigate the particular circumstances where the accountants are really relevant. *ACCA research report No.18, which indicates the potential role of the profession in supporting small business (Chittenden *et al.*, 1990).

ACCA research report No.64, which highlights the role of accountants in assisting with networks providing advice on business performance and ensuring learning takes place for SMEs, particularly at the early stages of the business life-cycle(Deakins *et al.*, 2001). In Nigeria, definition of SMEs differs with different organizations. The Nigerian Bank for commerce and Industrial (NBCI) defined small scale business as one with total capital not exceeding N750, 000 (excluding cost of land but including working capital). The Federal Ministry of Industry's guidelines to NBCI defined a small - scale enterprise as one with a total cost of not exceeding N5m (excluding cost of land but including working capital).

2.2. Theoretical framework

2.2.1. Theoretical Exposition of Accounting Records in SMEs

Different opinions have continued to emerge on how accounting records can affect growth of the small scale businesses in Nigeria. Some aspects of the existing research delve into the relationship between record keeping and performance of firms. Tanwongsva and Pinvanichkul (2008) comment on the reasons why SMEs prepare financial statements, and argue that on the list, SMEs rank assessing profitability second to the purpose of tax returns. According to Cooley and Edwards (1983), owners of SMEs consider profit maximization as the most important financial objective. This has led to the argument that SME owners pay attention to profitability and measurement of net profit when they evaluate their firms performance. Holmes and Nicholls (1998) concludes that the extent of accounting practices in SMEs depend on a number of factors such as age of business, size of the business, and the nature of the industry. They further point out that most SME owners and managers engage public accountants to prepare required information.

According to Ismail and King (2007), the development of a sound accounting system in SMEs hinge on owners level of accounting knowledge and skills. Some authors have argued that small businesses use professional accounting firms for preparation of annual reports and for other accounting needs (Keasy and Short, 1990; Bohman and Boter, 1984). Lalin and Sabir (2010), reports that the main drivers why SMEs prepare financial statements is pressure from regulatory authorities.

Hussein (1983) notes that, a good accounting system is not only judged by how well records are kept but by how well it is able to meet the information needs of both internal and external decision-makers. Clute and Gitman (1980) uphold that it is common for qualified accountants to do a good job of keeping records up to date but they fail to provide information needed by decision-makers. Interestingly, however, others argue that the high cost of contracting professional accountants has left SME owners with no better option but to relegate management of accounting information (Evaraert *et al.*, 2006; Jayabalan and Dorasamy, 2009). Zhou (2010) has proposed the use of accounting software to improve accounting practices, albeit he laments the unavailability of medium-sized software for SMEs.

2.3. Empirical review

Modugu and Eragbhe (2013) examined the implications of the International Financial Reporting Standards adoption for SMEs in Nigeria. By January 1, 2014 all SMEs in Nigeria that have met the criteria defined by the International Accounting Standards Board (IASB) will be required to prepare and present their financial statements in line with the global standards. The study chronicled the challenges imminent in the adoption and implementation decision. These include people, systems and process, business and reporting. Obamuyi (2007) state some standard criteria to assess the creditworthiness of borrowers as follows; financial strength, profitability, network, track record, management quality, relations and payment records with other banks, business prospects, business risks and collateral securities. All the above criteria cannot be good assessments without adequate accounting. It is because of the deficiency in the record keeping of SME that compels the banks to insist on collateral as a “must” for SME.

Adetula *et al.* (2014) studies the readiness of small and medium scale enterprises (SME) in Lagos State, Nigeria for the adoption of International Financial Reporting Standards (IFRS) and the likely challenges that may be encountered in the adoption process. The work employed a descriptive survey design and data were collected from primary source. Results show that a major factor why IFRSs would be adopted by Nigeria is because other countries have adopted them. Again results show that the IFRS for SMEs adoption process is currently confronted with diverse challenges that may prevent the effective adoption and implementation of IFRS for SMEs in Nigeria in 2014 if they are not addressed with promptness. Ojeka and Mukoro (2011) in the topic titled, “International Financial Reporting Standard (IFRS) and SMEs in Nigeria: Perception of Academic” found that there is still need to enlighten people especially the SME operators on the usefulness of the IFRS for SMEs. The accountant will really have a lot of work to do to implement the IFRS for SMEs in Nigeria. The listed advantages of IFRS for SMEs includes; improving the comparability of information presented in financial statement, increasing confidence in global annual invoices, SMEs reduce cost associated with maintaining accounting standards, presence of a complete set of accounting principles simplified for each type of entity; increased satisfaction of the needs of users of financial statements.

3. Methodology of research

Survey and time series data research were used for the study. Primary and secondary data were used for the study. Population of the study centered on 2983 SME registered with Anambra State Ministry of Commerce and Industry as at 2010 and as a backup, 491 professional accountants in Anambra State as at 2013 made of 371 ANAN members and 120 ICAN members was also used for the study, while the secondary data was collected from CBN Statistical Bulletin (1992 to 2012).

To determine the sample size, Yaro Yamane’s formula was used to determine actual sample size for SMEs and the professional accountants. Thus using the formula:

$$n = \frac{N}{1 + N(e)^2} \tag{1}$$

Where: n = Sample size; N = Population of the study; e = error margin or level of significance;
 1 = Constant.

Applying the formula for SME:

$$n = \frac{2983}{1 + 2983 (0.05)^2} = 300$$

n = app. 300

Twenty (20) of these professional accountants sampled are staff of commercial banks in Anambra State.

For the professional accountant ANAN:

$$n = \frac{371}{1 + 371 (0.05)^2} = 192$$

n = 192

ICAN

$$n = \frac{120}{1 + 120 (0.05)^2} = 92$$

n = 92

In collecting primary data, two sets of questionnaires were administered; one for SMEs and another for professional accountants. Five points Likert scale of Strongly Agreed (SA), Agreed (A), Disagreed (D), was used. Simple percentages were used to provide answers to the research questions.

3.1. Method of Data Analysis

Data collected for hypotheses one and two were analyzed by the researcher using five point Likert scales. The two hypotheses formulated for the study were tested using simple regression analysis with aid of Statistical Package for Social Sciences (SPSS) version 20.0 software package.

Decision rule:

If f-value is equal or greater than “Sig” value there is significant interaction effect or significant difference i.e. f-value value \geq sig value we reject Null and accept alternate hypothesis.

Analysis

The data collected was analyzed using descriptive statistics like percentages to answer the research questions. Simple percentage was used to determine the direction of their perception and belief concerning the study.

Decision Parameter

Using simple percentage, when the percentage of a particular response is greater, we accept it as the answer to the research question.

Research question 1: Do SME have sound accounting system?

Table 2. SMEs responses on soundness of accounting system

Statement	Responses				
	SA	A	U	SD	D
SMEs have sound accounting system		10	30	20	240

Research question 2: Do SMEs employ qualified person to prepare their financial reports?

Table 3. Professional Accountants responses on soundness of SME accounting system

Statement	Responses				
	SA	A	U	SD	D
SMEs have sound accounting system			9	272	3

Table 4. MSMEs responses on SMEs employment of qualified personnel to prepare financial reports

Statement	Responses				
	SA	A	U	SD	D
SMEs employ qualified persons to prepare its financial reports			30	220	50

Table 5. Professional Accountants responses on whether SMEs employ qualified personnel to prepare financial reports

Statement	Responses				
	SA	A	U	SD	D
SMEs employ qualified persons to prepare financial reports			18	264	2

Research question 3: Do SMEs financial reports comply with the relevant accounting standards

Table 6. SMEs financial reports comply with the relevant accounting standards

Statement	Responses				
	SA	A	U	SD	D
SMEs financial reports comply with accounting standards		10	10	260	20

Table 7. Professional Accountants responses on whether SMEs financial reports comply with accounting standards

Statement	Responses				
	SA	A	U	SD	D
SMEs comply with accounting standards in preparation of their financial reports		5	6	271	2

Research question 4: What constraints do SMEs face in assessing commercial bank loans?

Table 8. SMEs responses on constraints in assessing commercial bank loans

Statements	Responses				
	SA	A	U	SD	D
Poor and inadequate record keeping	230		60		10
Non recruitment of qualified personnel	200		80		20
Low access to information	210	40	40		10
Improper bankable business plan	240	30	20	10	
Not running transactions through banking system	180	50	7	2	

Table 9. Professional Accountants responses on SMEs constraints in assessing commercial bank loans

Statements	Responses				
	SA	A	U	SD	D
Poor and inadequate record keeping	280	3	1		
Non recruitment of qualified personnel	250	30	4		
Low access to information	245	38	1		
Improper bankable business plan	267	15	2		
Not running transactions through banking system	220	55	7	2	

Research question 5: What challenges do SMEs face in preparation and presentation of financial reports?

Table 10. SMEs responses on challenges in preparation and presentation of financial reports

Statements	Responses				
	SA	A	U	SD	D
Unavailability or inadequate accounting books and records	240	40	20		
Unavailability of accounting system	250	20	30		
Inadequate manpower	230	45	20	5	
Not running transactions through the banking system	210	20	45	15	

Table 11. Professional Accountants responses on challenges of SMEs in preparation and presentation of financial reports

Statements	Responses				
	SA	A	U	SD	D
Unavailability or inadequate accounting books and records	270	10	4		
Unavailability of accounting system	270	08	6		
Inadequate manpower	278	04	02		
Not running transactions through the banking system	240	35	7	2	

Research question 6: How can financial reports of SMEs be improved upon?

Table 12. SMEs responses on how its financial reports can be improved

Statements	Responses				
	SA	A	U	SD	D
Maintenance of adequate books of account	290	8	2		
Recruitment of qualified staff	265	26	6	3	
Introduction of sound accounting system	270	20	4	6	
Running transaction through the banking system	230	40	20	10	

Table 13. Professional Accountants responses on improvement in financial reports of SMEs

Statements	Responses				
	SA	A	U	SD	D
Maintenance of adequate books of account	270	10	4		
Recruitment of qualified staff	270	08	06		
Introduction of sound accounting system	270	08	6		
Running transaction through the banking system	240	35	7	2	

Research question 7: Have SMEs in Nigeria migrates to IFRS?

Table 14. SMEs migration to IFRS

Statement	Responses		
	Yes	No	Unaware
SMES have migrated to IFRS	0	300	0

Table 15. Professional Accountants responses on SMEs migration to IFRS

Statement	Responses		
	Yes	No	Unaware
SMES have migrated to IFRS	0	272	12

Table 16. Commercial Banks' Loans to Small Scale Enterprises

Period	Commercial banks loans to small scale enterprises (M)	Commercial banks credit to private sector (M)	Commercial banks loans to SMEs as f total credit (%)
1992	20,400.0	75,456.3	27.04
1993	15,462.9	88,821.0	17.41
1994	20,552.5	143,516.8	14.32
1995	32,374.5	204,090.6	15.86
1996	42,302.1	254,853.1	16.60
1997	40,884.3	311,358.4	13.12
1998	42,260.7	366,544.1	11.53
1999	46,824.0	449,054.3	10.43
2000	44,542.3	587,999.9	7.58
2001	52,428.4	844,486.2	6.21
2002	82,368.4	948,464.1	8.68
2003	90,176.5	1,203,199.0	7.49
2004	54,981.2	1,519,242.7	3.62
2005	50,672.6	1,991,146.4	2.54
2006	25,713.7	2,609,289.4	0.99
2007	41,100.4	4,820,695.7	0.85
2008	13,512.2	7,799,400.1	0.17
2009	16,366.5	9,667,876.7	0.17
2010	12,550.3	9,198,173.1	0.14
2011	38,321.15	9,523,961.8	0.41
2012	11,240.79	40,284,010.2	0.40

Source: CBN statistical bulletin.

Notes: This table contains revised figures.

The abolition of mandatory banks credit allocations of 20% of its total credit to small scale enterprises wholly owned by Nigerian took effect from October 1, 1996.

3.2. Test of hypotheses

Hypothesis one (null)

H_0 : There are challenges facing by Small and Medium Enterprises (SMEs) in adopting effective financial accounting reporting in Nigeria.

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	1.919	1	1.919	-2.295	.134 ^b
Residual	56.023	67	.836		
Total	57.942	68			

a. Dependent Variable: challenges of SMEs

b. Predictors: (Constant), accounting reporting

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	1.357	.215		6.301	.000
Accounting reporting	.146	.096	.182	-1.515	.134

a. Dependent Variable: Challenges of SMEs

Decision:

Since the F-Value is less than the Sig-value, $-2.295 > .134$ at 5% level of significance, we reject the alternative hypothesis and accept null hypothesis which uphold that There are challenges facing Small and Medium Enterprises (SMEs) in adopting effective financial accounting reporting in Nigeria.

Hypothesis two (null)

H₀: Poor credit facilities to SMEs in relation to other private sector do not contributes to inadequate accounting records of SMEs in Nigeria.

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	2674312398.816	1	2674312398.816	7.305	.014 ^b
Residual	6956052795.766	19	366108041.882		
Total	9630365194.583	20			

a. Dependent Variable: LoantoSMEs

b. Predictors: (Constant), LoantoPrivatesector

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	45944.855	5357.739		8.575	.000
LoantoPrivatesector	-.003	.001	-.527	-2.703	.014

a. Dependent Variable: LoantoSMEs

Decision Rule:

If f-value is equal or greater than “Sig” value there is significant interaction effect or significant difference i.e. f-value value \geq sig value we reject Null and accept alternate hypothesis.

since the f-value value $>$ sig-value ($7.305 > .014$), we reject null hypothesis and uphold the alternative hypothesis which states that Poor credit facilities to SMEs in relation to other private sector contributes to inadequate accounting records of SMEs in Nigeria.

4. Findings of the study

The hypotheses tested revealed that there are challenges facing small and medium enterprises (SME) in adapting effective accounting reporting in Nigeria. Also poor credit facilities to SMEs in relation to other private sectors contribute to inadequate accounting records of SMEs in Nigeria. The study found out that the following are challenges facing SMEs in preparation and presentation of financial reports, unavailability or inadequate accounting books and records, manpower, accounting system and not running their transactions through the banking system. The SMEs collaborative study 2013 – 2025 also highlighted these challenges as confirmed in this study. The study identified the following measures as ways of improving the financial records of SMEs; maintenance of adequate books of accounts, recruitment of qualified staff, introduction of sound accounting system, running of transactions through the banks, improved grant of credit facilities to SMEs.

The study further revealed that SMEs in Nigeria have not migrated to international financial reporting standards as required in the National Action Plan for implementation of IFRS in Nigeria.

5. Conclusions

There is no doubt that SMEs are engines of growth in any economy. Growth in the economy through the contributions of SME can largely be achieved through proper, effective and efficient financial reporting of transactions of SMEs.

6. Recommendations

In line with the findings, the following recommendations are hereby made:

Since keeping proper books of account and preparation of financial records can only be done by professional accountants, the two main professional bodies in Nigeria; ICAN and ANAN should encourage their members to offer free professional services to MSMEs in Nigeria. The various Ministries of Commerce and Industry in Nigeria including the Federal Ministry of Trade and Industry should establish a probono unit where SMEs can approach public employed professional accountants to assist them in setting sound accounting system, giving financial management advice and preparation of financial reports.

Commercial banks should also have a unit manned by professional accountants to assist SME in documentation for easy access to loans.

The newly formed National Council on SME should be replicated up to community level and its creation should be given immediate legislative backing.

The migration of SMEs financial reporting system to IFRS in 2014 should be adjusted to the next five years to enable the SME fashion out a way to cope with the manpower requirements.

Banks should increase the grant of credits to SMEs in Nigeria.

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