# ACCOUNTING INFORMATION AND MANAGEMENT OF SMES IN GHANA

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**Abstract:** This paper examines the accounting practices of SMEs in Ghana. The study revealed that SMEs in Ghana attach more importance to financial information by employing Chartered Accountants and degree holders to handle their accounting information. The study also shows that majority of the firms put in place internal control mechanisms to ensure accurate financial information and the safeguard of their properties. The study identifies three main sources of financial information used in the management of small firms: Income statement, Balance Sheet and Cash flow statements. Surprisingly majority of small firms contacted do not prepare cash flow statements and as a result could not indicate whether they have positive or negative cash flow. Majority of the respondents also comply with the provision in the Companies Code 1963, ACT 179 by filing their statutory accounts with the relevant Government agencies. There is weak emphasis on controlling cash and monitoring performance in the context of maintaining relations with the banks as only few submit any form of account to the banks.

*Keywords:* Accounting, Information, Management, SMEs, Ghana

## INTRODUCTION

The importance of accounting practices in any organisation be it private or public, small or large cannot be over-emphasised. It does not only facilitate proper control and safe guard of assets of the organisation, it also helps management (or owner manager) in its planning for the organisational objectives. Absence of an efficient accounting practice lead to a whole series of financial problems, fraud, frustration among employees, loss of public confidence and possibly, the collapse of the organisation.

Many people think of accounting as a highly technical field which can be understood only by professional accountants. Actually, nearly everyone practices accounting in one form or another on an almost daily basis. Whether you are preparing a household budget, preparing income tax return, or running a business, you are working with accounting concepts and information. Without accounting information as a basis for decisions, it is unlikely that efficient allocation of available resources would be achieved.

Accounting system is primarily a process whereby the daily transactions of a business are conveniently recorded (in the journals) then summarised (in the ledger) to show the position (the balance sheet) and progress (operating account) of the business. An accounting system therefore must record, classify and appropriately summarise accounting data into useful information for decision making. Invariably, therefore, the objective of an efficient accounting system

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is to make information available for predictive purposes by management, current and potential investors and other users of accounting information.

The purpose of this paper is to present new empirical evidence on the accounting practices of Small and Medium Enterprises (SMEs) in Ghana. The primary concern is with recognition, measurement of profits or balance sheet items, as well as in terms of disclosures in notes to the financial statements. The paper also looks at SMEs budgeting practices and their internal control systems. We also examine whether the absence accounting practices affect their operations.

## THEORETICAL AND CONCEPTUAL FRAMEWORK

Limited liability companies differ from sole proprietorships and partnerships as the former are subject to an extensive regulatory framework that obliges them to publish a considerable amount of financial information that would otherwise remained confidential. Financial disclosures are required in the public interest, as large public companies are to raise capital by offering their shares for sale to the public by obtaining a listing on the Ghana Stock Exchange. Private companies on the other hand cannot offer their shares to the public and therefore have fewer shareholders and like other forms of small businesses, are usually owner - managed. (Bolton, 1971, Carsberg et al, 1985 Poutziouris etal 1998).

No matter the form of business, all the companies in Ghana are required to keep proper accounting records (Companies Code, 1963, ACT 179.) Accounting is defined as an information system that measures, processes, and communicate financial information of an identified entity (Meigs and Meigs, 1993). Accounting practices can therefore be defined as the procedure used to measure, process and communicate financial information to interested parties. The purpose of accounting practice is to provide relevant and reliable financial information to users for making and evaluating decisions on the allocation of available resources to economic entities. Financial information is needed by managers to help them plan, organise and control the activities of the organisation. Outsiders who have some interest in the business need information about the business financial position and operating results. The most important function of accounting practices is to create a systematic record of the daily business activities in terms of receipts and disbursement of liquid assets such as cash and cash related transactions.

Accounting has two main branches, namely, financial and managerial accounting. The Financial accounting system designs information to help investors evaluate the performance of organisations' managers, while managerial accounting on the other hand, is an information system which is designed to help managers decide on how to use resources entrusted to them and to monitor how efficiently these resources are being used. According to Anthony and Recce (1983) irrespective of the branch of accounting, the accounting practices of any organisation provide three types of accounting information: operational information which has to do with the activities of the details of operation within the organisation; Financial accounting information which is used by both management and external interested parties; and management accounting information used internally for planning, controlling and co-ordination.

Niswonge and Foss (1997), state that the accounting information enable management perform three key functions: conduct effectively day-to-day operation of the business; determine the extent to which actual performance agree with the planned objective; and to know the extent to which other interested parties such as banks, investors government etc. rely on it for decision making.

The accounting tools that enable management discharge their duties effectively are: an effective internal control; a realistic budget statement; a sound cash flow statement; and performance report. Therefore the sort of accounting practices that must be prepared by NTEs should be a system which would not be too sophisticated yet meet the standard requirement of the accounting principles. The most expedient system is the one which is best suited to the particular circumstance of size, technology, etc. rather than a universal system. (Lupton, 1971, Pugh et al., 1969; Chapman, 1997). Despite the fact that most of NTEs are relatively young firms, it will be of a great value if they put in place a very good internal control system, develop a reasonable as well as realistic budget statement that will guide their operations, and endeavour to prepare cash flow statement. Finally, there is the need to prepare performance reports to enable them assess management efficiency as well as total efficiency of the organisation.

## Internal Control

According to Walters and Dunn (2000), internal control has been defined as the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the organisation in an orderly manner, safeguard its assets and secure as possible, the accuracy and reliability of its records. Meigs and Meigs (1993), added that the objectives of internal control system are: to protect firm's resources against waste, fraud and inefficiency, ensure accuracy and reliability in accounting and operation data; secure compliance with company policies; and evaluate the level of performance in all divisions of the firms. To achieve the above objectives, control measures that are used by a business are administrative and accounting control. Helmkenp, Imdieke and Smith (1986), defined administrative controls as procedures that are used to help maintain an efficient operation and ensure adherence to prescribed company policies. They include manual, specifying purchasing and sales procedures and various performance report required from employees. According to Helmkenp, Imdieke and Smith (1986), accounting controls on the other hand are procedures, techniques and methods used to protect assets and ensure that accounting information is reliable. They include procedures used to authorise various business transactions and to separate record-keeping duties from the custody of a firm's assets. For an effective control over the expenses of SMEs, all purchases to be made must be done by means of purchases order so that proper authorisation is given to the purchases before the vendor supplies the goods for subsequent payment. With references to SMEs, the following internal control system when put in place may reduce fraud and inability to meet basic accounting requirement.

Based on the above consideration, Aklvin and Loebbecka (1994) proposed the following internal control system for small businesses: all goods bought and export (sold) must be recorded in the cash book; voucher and receipts must be issued immediately after purchases and sales of goods respectively; all payment except for petty cash must be made by cheques quoting the serial numbers of the cheques on payment vouchers; preparation of monthly or quarterly financial statement designed to disclose significant variation of any category of revenue and expenditure.

From the above analysis, a good system of internal control is therefore based on the following three factors: reasonable level of internal check; regular internal audit; and a proper plan of the organisation. Having an effective internal control alone is not enough. Accounting practices also call for the establishment of a realistic budget that will guide the operations of the business.

## Budgeting

According to Drury (2000), the success of a firm, its survival, its ability and willingness to maintain operation and to invest in fixed and working capital are largely determined by it financial policies, past and those planned for the future. He added that those detailed plans for the future are usually referred to as budget. Producing budget assist SMEs to plan their annual operations, co-ordinate the activities of the various parts of the organisation and also to ensure that the parts are in harmony with one another.

## Reporting System

The reporting system of any organisations is predominantly in two parts; external and internal reporting systems. External reporting is basically for the consumption of external parties such as government agencies like Internal Revenue Service (IRS), Registrar General Department (RGD) etc. Current shareholders, potential investors, creditors, financial advisers and investment analysts may also use a firm's report. The external report would therefore be expected to conform to certain legislature and legal requirement. According to Johnson and Kaplan (1987), financial information of SMEs is driven by financial reporting requirements. In Ghana, the company code, 1963, requires every company to prepare and send to its members and other interested bodies a profit and loss accounts and balance sheet prepared in accordance with the 4th schedule of Act 179. It has therefore become apparent that in the case of SMEs which are limited liability companies, the following would essentially constitute their statutory external reporting practices; Income statement; balance sheet; and statement of cash flow and notes accompanying the accounts.

## Cash Flow

The profit and loss statement is designed to measure the success or failure of the business in achieving its objective of profitable operation. However, the ability of a business to remain solvent involves not only evaluating the liquid resources, but also the amount of cash and cash equivalents the business receive during the year, the source of these cash inflows, the expenditure necessary for operations, investment and capital expansion of the cash flows involved in financing the business. According to Meigs and Meigs (1993), a cash flow statement is used to summarise the information required and to find any problems. They added that the statement of cash flows is intended to assist investors, creditors and others in assessing the ability of the business to: generate positive cash flows in future periods; meet its obligations and pay dividends, invest in new equipment or projects; and raise sufficient finance as and when needed. It is widely recognised that banks are the main source of finance for small businesses (Chittenden et al, 1990; Cosh and Hughes, 1998) as they normally find it difficult to be listed on the capital market (Jarvis, 1996).

## RESEARCH METHODOLOGY

The research design was based on a survey methodology using a sample of systematically selected firms from Association of Ghana Industries (AGI). Out of the total of 150 questionnaires, 62 responses were received from respondents representing a response rate of 41%. Whilst this might not seem a high percentage, empirical studies involving SMEs have been known to generate far lesser percentage response rates. The basic research instrument used in this research was a structured questionnaire with both open and close ended questions. The closed ended questions were not only geared at eliciting specific answers from respondents but also to simplify and meet the time needs of the respondents who had other time-pressing issues to attend to. The few open ended questions were meant to give the respondents the opportunity to speak their minds on such issues. The questionnaire sought to find out from the respondents, book-keeping and accounting practices, the essence of financial information, the level of awareness, usage and benefits obtained from the financial information. Apart from questionnaires, in-depth interviews with the respondents was also conducted with the respondents because the researchers felt that, because of the technical nature of the subject matter, accounting principles, there could be latent issues that could only be uncovered by open discussions. The findings were presented by use of descriptive statistics.

## PRESENTATION AND DISCUSSION OF RESULTS

### Profile of Sampled Firms

**Table 1:** *Industries Represented by Firms*

| Industry | Respondents | Percentage |
|---|---|---|
| Manufacturing | 35 | 56 |
| Transport | 1 | 2 |
| Agriculture | 1 | 2 |
| Commerce | 14 | 23 |
| Information and Technology | 11 | 18 |
| **Total** | **62** | **100** |

**Source:** Survey results 2005

Table 1 above shows industries represented by the firms surveyed Thirty-five representing 56% are manufacturing firms. Fourteen firms are in the commercial industry, 11 (18%) firms are in the information and technology industry. One (2%) firm each are in transport and agriculture industries.

**Table 2:** *Types of Business Establishment*

| Business Types | Respondents | Percentage |
|---|---|---|
| Sole Proprietorship | 18 | 29 |
| Partnership | 4 | 6 |
| Limited Liability Company | 40 | 65 |
| **Total** | **62** | **100** |

**Source:** Survey results 2005

Table 2 above indicates that 40 firms representing 65% of the respondents are limited liability companies. Eighteen representing 29% are sole proprietorship (one man business) and 4 representing 6% are partnership firms. Thus majority of SMEs sampled for this study are companies limited by shares.

**Table 3:** *Ownership of Firms*

| Ownership | Respondents | Percentage |
|---|---|---|
| Ghanaian-owned | 55 | 89 |
| Foreign-owned | 7 | 11 |
| **Total** | **62** | **100** |

**Source:** Survey results 2005

## Main Findings

Table 3 shows the ownership of the firm contacted. Out of the 62 valid respondents, 55 representing 89% of the respondents are Ghanaian-owned firms and the remaining 7 representing 11% are foreign-owned companies.

**Table 4:** *Qualifications of Accounts Staff*

| Ownership | Respondents | Percentage |
|---|---|---|
| SSCE | 3 | 5 |
| G.C.E. 'O and A' Level | 20 | 38 |
| Degree/HND | 22 | 42 |
| Chartered Accountants | 8 | 15 |
| **Total** | **53** | **100** |

**Source:** Survey results 2005

Accounting is defined as an organisational component which accumulates, classified and analyses and communicates relevant financial oriented information for decision making. Effective and efficient decisions depend on the quality and accuracy of accounting information and the quality of accounting information also depends on the quality and qualification of accounting staff. Table 4 indicates that a large proportion of the firms (42%) employ degree/HND holders and 38% employ personnel with GCE 'O' and 'A' levels. This gives some indication of the importance placed on record keeping and controlling. Nearly one sixth (15%) employ qualified accountants. Most the SMEs surveyed tend to have considerable financial expertise available to aid in the generation and analysis of financial information.

**Table 5:** *Control System*

| Variable | Segregation | | Internal Check | | Physical Control | |
|---|---|---|---|---|---|---|
| | Respondents | % | Respondents | % | Respondents | % |
| Yes | 43 | 69 | 53 | 85 | 52 | 84 |
| No | 19 | 31 | 9 | 15 | 10 | 16 |
| Total | 62 | 100 | 62 | 100 | 62 | 100 |

**Source:** Survey results 2005

Table 5 depicts that 69%, 85% and 84% of the respondents use segregation, internal check and physical control respectively as a control mechanism. Nineteen, representing 31% of the respondents do not use segregation as a control tool, 15% do not use internal check while 16% do not use physical control as a control system.

**Table 6:** *Preparation of Budget Statement*

| Preparation of Budget | Respondents | Percentage |
|---|---|---|
| Yes | 41 | 66 |
| No | 21 | 34 |
| **Total** | **62** | **100** |
| **Purpose** | | |
| Compel Planning | 10 | 24 |
| Provide Performance Criteria | 7 | 17 |
| Promote Communication | 1 | 2 |
| Facilitate Co-ordination | 2 | 5 |
| All the Above | 21 | 50 |
| **Total** | **41** | **100** |

**Source:** Survey results 2005

Out of 62 respondents, 41 representing 66% of the respondents prepare budgets while 34% mentioned that they do not prepare budget. As to why a budget is prepared, 21 (50%) prepare it to compel planning, provide performance criteria, promote communication process and to facilitate co-ordination. Ten (24%) prepare budget to compel planning, 17% mention that they prepare budget to provide performance criteria, 5% prepare budget to facilitate co-ordination while 2% of the respondents prepare budget to promote communication process.

**Table 7:** *Management Information*

| Variable | Income Statement | | Balance Sheet | | Cash flow Statement | |
|---|---|---|---|---|---|---|
| | Respondents | % | Respondents | % | Respondents | % |
| Yes | 47 | 76 | 47 | 76 | 35 | 56 |
| No | 15 | 24 | 15 | 24 | 27 | 44 |
| Total | 62 | 100 | 62 | 100 | 62 | 100 |

**Source:** Survey results 2005

As indicated in table 7 above, 76% of the respondents prepare income statement and balance sheet while 24% do not prepare income statement and balance sheet at all. This shows that some of the firms do not know whether they are doing well or not and that they do not know their financial position by way of balance sheet. With regard to cash flow statement, 44% of the respondents do not prepare cash flow statement and can not tell whether their cash flow statement.

**Table 8:** *Usage of Financial Information*

| Purpose | Respondents | Percentage |
|---|---|---|
| Internal Revenue Service | 40 | 65 |
| Statutory Accounts for Registrar | 20 | 32 |
| Banks | 3 | 5 |
| Others | 15 | 24 |
| **Total** | **62** | **100** |

**Source:** Survey results 2005

Table 8 above indicates that 65% of the respondents comply with legal requirements by submitting their financial statements to Internal Revenue Services, 32% file their account with the Registrar General Department. Three (5%) prepare financial statements purposely for loan application. Fifteen (24%) also submit their accounts to some other bodies but failed to specify.

## CONCLUSION

This study examines the accounting practices of SMEs in Ghana. The study revealed that SMEs in Ghana attached more importance to financial information by employing degree /HND holders (42%) to handle their accounting information. The study also shows that majority of the firms put in place internal control mechanisms (Physical control, Segregation and Internal Check) to ensure accurate financial information and safeguard of their properties. Majority (66%) of the SMEs surveyed prepared budget to promote communication, provide performance criteria, promote communication and to facilitate co-ordination. The study identifies three main sources of financial information used in the management of small firms: Income statement, Balance Sheet and Cash flow statement. Surprisingly, as much as 44% of the small firms contacted do not prepare cash flow statement. However, the study reveals that majority of the respondents prepare income statement and balance sheets as these help them to gauge their performance and establish their financial position. Majority of the respondents comply with the provision in the Companies Code 1963, ACT 179 by filing their statutory accounts with IRS and the Registrar General Departments. There is a weak emphasis on controlling cash and monitoring performance in the context of maintaining relations with the banks as only 5% of the sample report indicated that they prepare accounts for loan application purposes.

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