

## Towards growth and financial stability: The case of SMEs' accounting practices in Lae City, Papua New Guinea

Luis R. Alamil, CPA, FFA-Aus., Ph.D\_BA\*

School of Business Studies. PNG University of Technology, Lae, Papua New Guinea.

### \*Corresponding Author

Luis R. Alamil

School of Business Studies,  
PNG University of  
Technology, Lae, Papua  
New Guinea.

Orcid ID:

[0000-0001-5663-6399](https://orcid.org/0000-0001-5663-6399)

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### Abstract:

**Purpose:** This study determined the impact of accounting practices on the small and medium business enterprises' growth and financial stability in Lae City, Morobe Province, Papua New Guinea.

**Methodology:** This study adopted a descriptive study design and used primary data gathered through questionnaire consisting of dichotomous questions and Likert scale on the parameters of each variable. The study surveyed 75 small and medium enterprises established in Lae City. Data were analyzed using descriptive analysis with the aid of rank, percentage, weighted mean and standard deviation. Chi-square test of independence was used to test the relationship of accounting practices to the business growth and financial stability of SMEs in the cited city.

**Finding:** The demographic profiles of sampled SMEs in Lae City are varied as well as their methods and systems in practicing accounting. The influence of sound accounting practices to the business growth and sustainability of SMEs was high; while practicing accounting improperly had relative effect to the business. SMEs faced great challenges in implementing sound accounting practices. The research also found a significant relationship between sound accounting practices and business growth and financial stability.

**Implications:** The small business entrepreneurs in Lae City, PNG should invest more resources in gaining accounting knowledge and developing skills of the contemporary and sound accounting practices. Accounting knowledge and skills is an important tool of SMEs towards analysis of results of the business operations and financial health; and, advantage points to their risk management implementation along operations, financing, and investment decision making. The availability of systematic records determines how they manage their funds. Good accounting practices can help SMEs assess risk levels due to fraud and theft, uncollected receivables, delay in settling payables, and high penalties in reporting incorrect income and expenses to government agencies.

**Value:** The findings of this study would be of value to the SME participants to improve on their decision making, budget preparation, monitoring and control of expenses, receivables, payables and other related areas. The same findings would also be valuable to government agencies tasked to assist and further the development of entrepreneurship in Lae City, the Morobe Province and Papua New Guinea.

**Keywords:** Accounting practices, growth, financial stability, SMEs, Lae City, Papua New Guinea.

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## 1.0 Introduction

Small and medium enterprises (SMEs) are forces promoting economy (Khan and Jawaid, 2004) and back-up enormously a country's economic development (Abor et al., 2010). They play significant role in job creation, rise in GDP, entrepreneurship and innovation leading to socio-economic growth of both developed and developing economies (Karadag, 2020).

In Papua New Guinea (PNG), SMEs are acknowledged with extreme importance. The government introduced the 2016 SME

Policy that aims at promoting and driving inclusive economic growth through employment and wealth creation. The policy's overall vision is for the SME sector becomes a major contributor toward PNG become a middle-income country by 2030; and a high-income country by 2050 (PNG Ministry of Commerce & Industry, 2016).

An important growth and development factor of SME is its hold on financial ground. This means that financial advancement requires knowledge and skills in accounting and finance. These areas are apart from business management; human resource,

production/operations and marketing management knowledge that SMEs must also possess and soundly practice. Meeting payment deadlines, managing cash flow, tracking of invoices, regulating debt collection process are examples of essential need outcomes provided by accounting and finance. They can be properly executed when SMEs are knowledgeable of accounting standards and procedures.

The current business development has resulted in increased needs of capital for most SMEs. Personal savings are no longer enough as capital source for business expansion. Reliance on loans from financial institutions particularly banks is best option. To obtain additional capital from banks, SME owners are required to make accounting information available. Hence, financial statements outlining their business activities are necessary. The importance of internal accounting system as source of information for SME owners and other stakeholders is steadily growing. According to the European Commission (2015), "it is of crucial importance that the accounting systems applied by SMEs meet their needs, providing necessary information while avoiding unjustified administrative burden".

A number of studies about SMEs' performance have been undertaken in PNG. However, there is a dearth of studies on the influences of accounting constructs and practices towards the growth and financial stability of PNG SMEs. This study explored how accounting practices create more business value leading to the growth and financial stability of SMEs in Lae City, Papua New Guinea.

### Research Problem

This study explored the effect of accounting practices to the growth and financial stability of small and medium enterprises (SMEs) in Lae, Morobe Province, Papua New Guinea. Specifically, it determined the demographic profile, business characteristics and accounting methods and systems; the perceived impact of accounting practices accruing to the SMEs' business growth and financial stability; the challenges faced that hinder SMEs implement appropriate accounting systems and practices; and sought answer whether the current accounting practices of SMEs have significant effect to the growth and financial stability of their businesses.

### Hypothesis of the study

Ho: The current accounting practice does not significantly affect SMEs' business growth and financial stability.

Ha: The current accounting practice significantly affects SMEs' business growth and financial stability.

## 2.0 Methodology

This study used primary data through questionnaire distributed and accomplished by SME owners in Lae City, Papua New Guinea. The research sample consisted of 75 SMEs currently registered and operating in the city. It utilized the descriptive method. Simple descriptive analysis was employed to explore SME owners' perceptions on the impact or effects of accounting practices accruing to their respective enterprises. The challenges faced hindering SMEs to implement appropriate accounting systems and practices were likewise processed using the same method. Mean, rank, per cent and standard deviations were used as analytical tools. Chi-square test was used to find out whether

the current accounting practices of SMEs have significant effect to the growth and financial stability of their respective businesses.

The questions on the aspects of influence of accounting practices to business growth and financial stability; and, the challenges faced which hinder SMEs in using appropriate system and accounting practices were evaluated based on five Point Likert-scales. A mean of 4.50 – 5.00 means the level is very high, mean of 3.50 – 4.49 means the level is high; mean of 2.50 – 3.49 means the level is moderate; a mean of 1.50-2.49 means the level is low; and a mean of 1.00 – 1.44 means that level is very low.

## 3.0 Review of literature

When SME grows, funding from financial institutions like banks is increasingly necessary. This is true not only to micro, small or medium enterprises but to large enterprises. To obtain credit from banks, SMEs are required to submit financial statements. These financial statements are the by-products of accounting cycle and standards done with due diligence. Therefore, financial statements contain useful, comparable, and understandable information about economic and business activities; and, reflect results and standing of business for a given period (White, et al, 2003; Weygrandt, et al, 2011). For this matter, a financial statement is the main means by which companies communicate financial information to people outside the company.

### 3.1. Accounting, systems, standards and principles

Many definitions of accounting abound in the literature. The American Institute of Certified Public Accountants (AICPA) published perhaps the most comprehensive definition of accounting (Tramplin, 2023). In quoting AICPA, accounting is "the art of recording classifying and summarizing in a significant manner and in terms of money transactions and events which are in part of at least a financial character and interpreting the result thereof". In 1966, AICPA further defined accounting as "the process of identifying, measuring and communicating economic information to permit informed judgement and decisions by the uses of accounts". The former definition provides the process known as the accounting cycle. The latter serves to guide business owners and stakeholders in their decision making process.

In view of the above premises, accounting consolidates financial information to make it clear and understandable for all business stakeholders. Its main goal is to record and report firm's financial transactions, financial performance, and cash flows. Thus, accounting is known as the "language of business" (Powell, 2023; Lane, 2013).

Accounting objectives are crafted serving the primary purposes for implementing accounting systems. The accounting objectives applicable to SMEs and large enterprises are: (i) keep complete record of business transactions according to specified rules; (ii) to help avoid the possibility of omission and fraud; (iii) to ascertain the net profit earned or loss suffered on account of business transactions during a particular period; (iv) to know the exact reasons leading to net profit or net loss; (v) so owners know and ascertain the financial condition and health of the business; (vi) ascertain the progress of the business from year to year; (vii) prevent and detect errors and frauds; and, (viii) to communicate the accounting information to various interested parties" (Franklin, et al, 2019; Needles, et al, 2013; Weygrandt, et al, 2002). Per Okafor, et al, (2019), "If SME owners are knowledgeable of the purposes

and objectives, they maybe encourage implementing sound accounting practices and make judicious decisions about the business entity”.

Financial institutions like banks require client-borrowers to submit audited financial statements for at least 3 years. Audited final statements are statements which were duly examined by certified practicing accountants. The accountants as auditors examined the statements versus accounting records provided by the business management. Auditor has to issue an opinion after examining the books of accounts. The opinion deals with the reliability of the accounting information reflected in the statements and their adherence to accounting standards. The auditor’s opinion makes financial statements credible. That is why hiring accountants to examine the books of accounts of an individual or business entity commands high fees.

Accountants are guided by generally accepted accounting principles or commonly known as GAAP (Puri, 2023). GAAP are combination of authoritative standards set by Financial Accounting Standards Policy Boards. They define the commonly accepted ways of recording and reporting accounting information. The common guiding standards are the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). According to Ahmad (2023), “GAAP’s aim is to improve the clarity, consistency, and comparability of financial information as reflected in the financial statements”. Therefore, the standardized reporting makes the financial statements transparent, reliable, and accurate. It also allows the firm’s owner to assess both historical and current financial data for the benefits all stakeholders.

Recognizing the importance of much more simplified than the complete IFRSs financial reporting of SMEs, the IFRS for SMEs have been formulated by FASB. It is in response to an international requirement of the developed and emerging economies in the process of globalization. The aim is to have a rigorous and common set of international accounting provisions (standard, rule, regulation) specifically for SMEs. The area where the IFRS for SMEs are applicable includes all the profit-oriented entities that prepare the general financial statements and do not have the public accountability (Ionescu & Ilincuta, 2009).

In view of the above provisions, several countries have introduced these standards for SMEs financial reporting. Indonesia has its financial accounting standards intended to meet the financial reporting needs of small-to-medium businesses, the SAK EMKM (Kartikahadi, et al, 2016; Hasanah, et al (2018). Likewise, Sri Lanka has its own known as the 2015-SLFRS (slaasc.lk). In Australia, the Australian Accounting Standards Board (AASB) released in July 2010 an Australia-specific differential reporting standard known as the Reduced Disclosure Requirements (RDR) standard. The RDR is based on the measurement and recognition principles of the International Accounting Standards Board’s (IASB’s) International Financial Reporting Standard (IFRS) with reduced disclosure and is targeted at non-publicly accountable reporting entities, like SMEs (Handley, 2013).

In Papua New Guinea, the government seriously advocates on furthering the development of SMEs. The Accounting Standards Board of PNG (ASBPNG) recognized the importance of accounting and financial reporting standards and approved the IFRS for SMEs as an accepted financial reporting standard for use

to provide significant benefit to most small and medium enterprises operating in the country (PWC-PNG, (2017).

### 3.2. Accounting practices

Accounting practices are collective procedures and systematic approaches. They are formal techniques and mechanisms of an entity to manage accounting needs (ICAN, 2009). These needs include updating the day-to-day accounting records to comply with the regulatory authorities. Procedures and standards are employed to record the business transactions. As formal techniques and mechanisms, accounting practices guide the gathering, organizing, and communicating financial information about the business’ financial activities.

It is worth mentioning in this section the basic accounting principles that have general applicability to SMEs. They are: (1) Full disclosure principle dictates accountant and management that the financial statements should convey information and not conceal it; (2) Matching principle requires the business enterprise to report expenses on its income statement for the period when the related revenue is earned; (3) the Historical cost principle states that the price paid for business asset at the time of its acquisition is the basis for its treatment in subsequent accounting periods; and, (4) Objectivity principle specifies that the accounting data should be definite, verifiable, and free from the personal bias of the accountant or the owner (Onaolapo, et al, 2011; Needles, et al, 2013; Weygrant, et al, 2002).

Sound accounting practice is systematic. It is done according to the processes encapsulated in the accounting cycle that reckon accounting standards, principles and procedures. For a better understanding of an accounting cycle, SMEs must have a good grasp of basic accounting principles and policies. Per Franklin, et al (2019), the steps of the accounting cycle are as follows: “(1) identifying and analysing transactions, (2) chronologically recording transactions in a journal (3) posting transactions in the ledger, (4) preparing unadjusted trial balance, (5) preparing the worksheet, (6) preparing and recording the adjustment entries properly, (7) preparing the adjusted Trial Balance (8) preparing the financial statements, and (9) closing the books “( Weygant, et al, 2013; Williams, et al, 2008; White & Fred, 2003;).

Per the European Commission (2008), SME’s sound accounting practices must adhere to the principles used in SME accounting. These practices include: (1) use of general ledger, one of the most important records for SMEs whether they follow traditional paper accounting or a digital financial accounting process; (2) double-entry system - a balanced system showing both the debit and credit columns on either side of the ledger; (3) money transactions, the basic accounting practice showing how money flows in SME; (4) preparing Balance Sheet, a statement showing how the SME is doing financially at any given point of time and provides an account of the current assets and fixed assets; (5) preparing Income Statement, a financial statement that shows the income earned and expenses incurred by an SME at any given point in time.

In practicing accounting, SMEs can choose either cash accounting or accrual accounting method. In cash accounting, transactions are only recorded when cash is spent or received. This method is the most typically used by small businesses in USA, according to the Internal Revenue Services (IRS, 2018). The transactions under accrual accounting are recorded when they are incurred rather than when payment is actually made. It matches the timing of the

realization of revenues and expenses. The matching of revenues with expenses gives a more accurate picture of a company's true financial position, according to (Laitinen, 2020).

The JAXA Chartered Accountants (2021) cited that: "If SMEs implement accounting practices soundly they could have systematic records of financial information and business transactions. Importantly, they could meet legal requirements". In terms of meeting legal requirement, the PNG Internal Revenue Commission (IRC) use standardized financial statements. It is easier to assess a company's declared gross revenue and net income with these statements. Likewise, the system of accounting helps to ensure that a company's financial statements are legally and accurately reported.

The current trend of recording and storing financial transactions is the computerized accounting. As its name suggests, computerized accounting is accounting done with the aid of a computer. Computerized accounting is a software application system for processing financial transactions as per GAAP to produce reports as per user demands. It tends to involve dedicated accounting software and digital spreadsheets to keep track of a business or client's financial transactions. Computerized accounting is a beneficial use of current technological advances. (UK CRTD, 2019; St Joseph College, 2019, Kumar, 2011; Kicher, 1955). The aim is to produce financial reports according to requirements in a faster means. The storage framework and data processing is known as operating environment, which is dependent on the accounting system (Sharma, 2022; NCERT, 2015).

There are different types of computerized accounting software applications - customised, ready-to-use and tailored (NCERT, 2015). A customised accounting system is suited for large and medium businesses. It is used to meet the special requirement of the user. For example, inventory status should be updated immediately upon entry of sales voucher and report be printed. The cost of installation and maintenance of this software is relatively high. The high cost is to be paid to the vendor for customisation. The training costs are therefore high.

The ready-to-use accounting software is suited to small or conventional business where the volume of accounting transactions is very low. The cost of installation is generally low and number of users is limited. It is relatively easier to learn even by non-accounting personnel. However, the level of secrecy using this software is relatively low and is prone to data frauds. The training needs are simple and sometimes the supplier of software offers the training on the software free. However, this software offers little scope of linking to other information systems.

Tailored accounting software is generally for large business organisations with multi users and geographically scattered locations. This software requires specialised training and designed to meet the specific requirements of the users. It is an important part of the organisational management information systems (MIS). The secrecy and authenticity checks are robust in such softwares. They offer high flexibility in terms of number of users.

### 3.3. SMEs financial growth and financial sustainability

Performance measures for SMEs have substantial differences. Kotane (2015) points out that "financial and non-financial indicators measure business performance". Moorthy et al., (2012) cited net turnover, cash flow report, current ratio, asset turnover,

accounts receivable turnover, inventory turnover, accounts payable turnover, total debt ratio, debt-to-equity ratio, gross profitability, return on assets, return on equity, return on sale, return on investment, profitability, and the debt service coverage ratio constitute the financial indicators as measures of SMEs business performance. Thus, the roles of accounting practices and accounting information on aspect of SMEs' financial growth and stability are wide-ranging.

The above mentioned measurements are used by owners, investors, creditors or bankers, etc. in the course of business operation. In view of these findings, knowledge of accounting is a must for small and medium entrepreneurs. As a decision maker, an entrepreneur should know how to use financial information. Having accounting knowledge, entrepreneurs could internalize and apply several types of analytical and control procedures to their businesses.

In Nigeria, bookkeeping and accounting knowledge as well as financial management practices have significant effect on MSE growth (Okafor & Daferighe, 2019). This finding implies that MSEs will experience continuous growth if they acquire accounting knowledge and apply such knowledge in financial management practices in their business operations.

### 3.4. The influence and impact of accounting practices

The person can understand everything about a business through the account books. The accounting books would help in deciding the future course of action for the business. Quality accounting record books has various other uses. They attract investors to invest and for financial institutions to provide finance (Tageo, et al. (2008). Evaluative tool means for suppliers to determine that the SMEs might experience financial distress and no longer perform their implicit contracts (Zhang & Wang (2013). The management's neglect on this matter has an impact that is not clearly visible, but will indirectly reduce the chances of success of SMEs in the future.

On the other hand, the European Federation of Accountants (2004) cited that many SME owners operate their business activities without any accounting or financial judgment, take many important investment and credit decision without any accounting and financial analysis. Due to the lack of proper accounting system, different stakeholders involved with the SMEs face a lot of difficulties. In this view, it is established that the lack of accounting information system's use was the major reason why most small businesses make unsound decisions.

The performance level of SMEs has traditionally been attributed to some organizational activities. This includes: manufacturing, administration, marketing, etc., accounting practices may have a significant impact on their performance and growth (Fatoki, 2010; Neneh & Van Zyl, 2012; Dzisi (Padachi, 2012). & Ofosu, 2014). In many cases SMEs are found relying on single entry, manual and unsystematic accounting practices. Poor accounting practices and accounting system create threat for the growth, expansion and sustainability of SMEs (European Federation of Accountants, 2004). Many SMEs make important investment and credit decision without any accounting and financial analysis. Different stakeholders involved with the SMEs face a lot of difficulties. Specifically, the effects of poor accounting practices and accounting system are: (1) inefficient business operation; (2) inefficient business control (3) poor liquidity management (4) poor credit management (5) poor investment evaluation & asseyt

management, (6) poor business & strategic decision, (7) disorganized as the firm grows, (8) lead to SME crumbling, and (8) low business survival rate (Chakraborty, 2015; Kofi, 2014; Ntim, 2014; Germain (2010); Mia and Chenhall, 2003).

How does one understand if the practice followed by their firms is good or poor? Some examples of poor accounting practices that can have a negative impact on businesses: (1) improper expense tracking system; (2) not keeping documents, bills, and other records systematically; (3) business and personal finances are not separated properly; (4) statutory obligations have not complied on time; (5) not reconciling books of accounts and cash and bank books; (6). not grouping ledgers appropriately; (7) not tracking the work-force; (8) not recording inventory; (9) not taking professional help; and, (10) not using the right accounting system/ software (Alfartoosi & Jusoh, 2020).

There are other reasons that make entrepreneurship successful. They are: transparency, governance, insolvency and creditors' rights, and accounting and auditing. Business financial health can have a major impact on the overall success of the company. Accounting for all the business's financial transactions and liabilities is crucial. Learning why accounting is important can help businesses determine whether they need more accounting resources to create a better financial management system for the company (World Bank Group, 2015; indeed editorial team, 2022).

### 3.4. Challenges in complying sound accounting practices

The International Accounting Standard Board (2009) defines SME as “business entities that do not have public accountability and not publishing general purpose financial statements. The ownership structure is based on individual or family member that’s why there is lack of effective and systematic accounting practice.” Even in recent times, many SMEs are found to recruit a bunch of smart sales personnel rather appointing accounting or finance practitioner. The main reasons behind having such poor accounting environment are the lack of public accountability, lack of

regulations, lack of mandatory audit requirement, and lack of resources. They all pose as challenges for sound accounting practices by SMEs.

Other researchers have also identified challenges SMEs have. Some of them are: inability to afford the complexity of a detailed accounting system; financial reporting has been inadequately reviewed for business entities; SME is either based on individual owners or family members; and, lack of knowledge and awareness about the accounting and financial issues (Mkasiwa, 2014; Onaolapo, et al, 2011);

One of the major sources of finance in SMEs is banks and other financial institutions. However, SMEs are often facing challenges and difficulties on their loan proposal with banks. The reasons are: lack or absence of proper accounting and financial records; do not have systematic accounting practices; lack of accountability, and audit requirement (Kwok, 2002; William, et al, 2008; Siyanbola, et al, 2019). Financial information is one of the primary measures used by banks to assess the capacity of a business to effect payment of credit. It is given that due to the lack of quality accounting information many SME owners are found to take inaccurate and clumsy decisions regarding investment, credit, operations, etc. Such inaccurate and faulty business and strategic decisions results excess costs of capital, investments in the low return even in the loss project, inefficient business operations, etc. These are evaluation indicators being used by financial institutions to gauge the capacity of SMEs to pay credits.

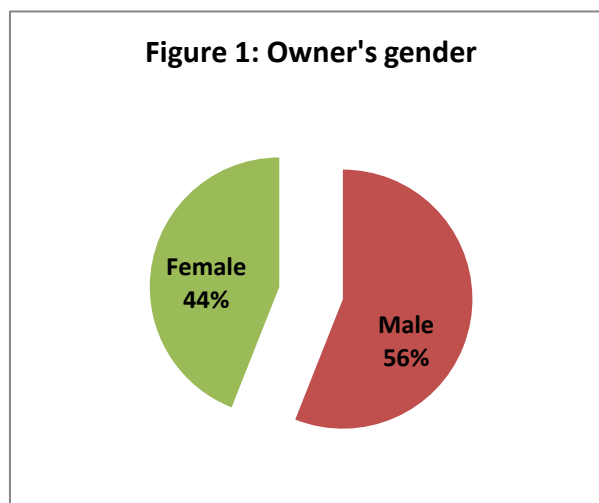
In PNG, many SMEs operate in the informal sector or cash economy view the fees of consulting and advisory services as too high. More SMEs are starting to become aware of consulting services, but are put off by the high fees. When they realize that they can employ consultants on a part-time basis, and that cloud-based technology means can service them anywhere, they start to see the benefit (Mishra & Smyth, 2018).

## 4.0 Findings of the study

### 4.1. Socio-demographic profile

#### 4.1. a. Gender

The demographic profile of the respondents in terms of gender is shown in Figure 1.



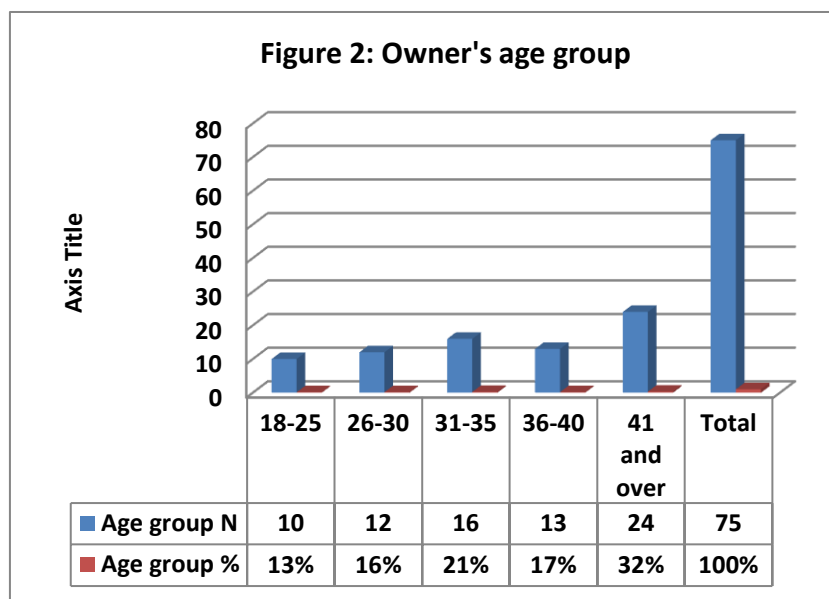
This study disclosed that male owners are mostly engaged in business activities requiring physical or manual labor. Examples are small scale manufacturing, fabricators; auto, machine and motor repair shops; and, trucking and delivery services. According to the respondents, such entrepreneurial activities challenged them to think and understand structured experimentation and design. For every project, it makes them curious and seeks new method opportunities even beyond the resources they currently have and controlled. New opportunity requires them run tests to determine if the client’s request is worthwhile pursuing.

The above finding implies that, people who are risk-taking and ambitious have more pronounced entrepreneurial intentions. Electing the nature of entrepreneurial activity depends on strong characteristic of a person impacting the decision he makes. “These traits are masculine traits and males dominated this type of SME sector”, according to the study of Ahl (2006).

Male and female entrepreneurs do not have the same approach in choosing entrepreneurial projects. In this study, the female respondents (48%) are mostly engaged either in wholesale or retail type of businesses. The respondents reasoned out for choosing these endeavors because they not so complex to manage. Besides, wholesaling or retailing provides faster return of capital. This finding implies that female entrepreneurs have a more pronounced fear of failure than male entrepreneurs. Such is a peculiar trait of an entrepreneur who wanted to start simple but assuring. As such, the business environment would result in economic gain to support for oneself and family. These traits are also considered a positive impact on the development of entrepreneurship among women.

**4.1. b. Age group**

The demographic profile of the respondents in terms of age is shown in Figure 2.



The study’s respondents belong to varied age groups. Mostly (total of 67%) are in their early adulthood (18 and 40 years old). According to Havighurst (1972), “an individual tends to establish oneself as an independent person at this stage. They decide on a career or in pursuit of a career direction.” These statements imply that the SME respondents have chosen entrepreneurship as their career. As such, they have embrace discipline, hard work and perseverance for a number of years to become successful. Hard work and perseverance are some basic traits of successful entrepreneurs.

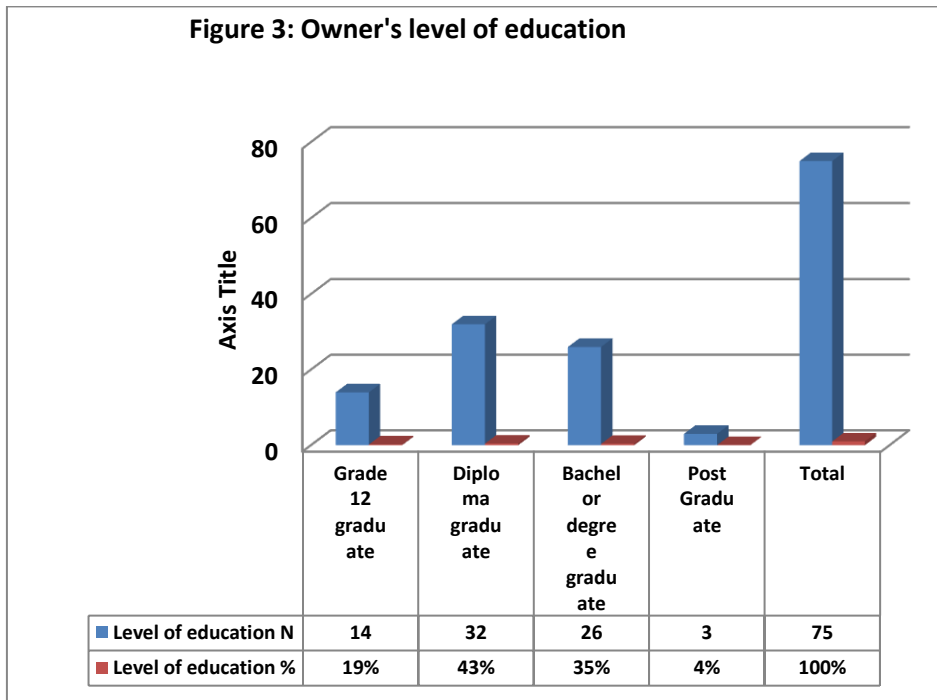
Thirty two (32%) per cent are in their middle adulthood (41 to 65 years old). As opined by Havighurst (1972), “the usual direction of an entrepreneur in this stage is to reach and maintain satisfaction in one’s occupation, welfare of their children as genuine concern”. Thus, the natural tendency of these entrepreneurs is to train their siblings as successors.

Fourteen percent have engaged in entrepreneurship at the beginning of early adulthood (18-25 years old). According to the respondents, they have to inherit the business from their parents for the sake of the family. This implies that they have developed self-confidence, optimistic attitude and adaptable to the intricacies of entrepreneurship.

**4.1. c. Level of education**

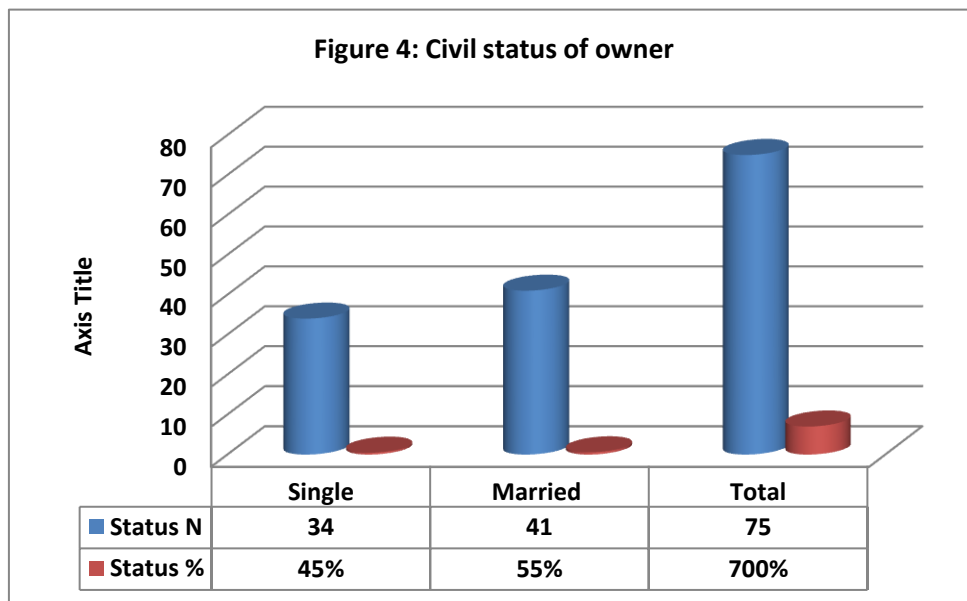
The profile of the respondents in terms of education is shown in Figure 3. Helping their parents or relatives manage the business is the common reason by respondents with grade 12 certificate. The same is true for respondents with diploma education. They gained entrepreneurial experiences through hands-on. As such, they became enamored leading them to put up business in partnership with family members or relatives. This finding implies that the respondents have the necessary knowledge on products or services and experiences to run business. According to the respondents, managing business is not an easy job. They have to deal with the risks inherent of the business every day. Thus, they have to embrace high level of self-confidence and the sense of adaptability to survive.

The respondents who have undergraduate bachelor’s degree and post-graduate degree claimed that entrepreneurship is their career and the means of livelihood for their respective families.



**4.1.d. Civil status**

As shown in Figure 4, 45% of the respondents are single. However most of the numbers are parents or head of the families. The rest of the respondents are married. According to the respondents, they are into entrepreneurial activities because they need to support their families and create employment opportunities to other members. These findings imply that with the given noble intention, entrepreneurial behavior becomes a way of life and means of livelihood. Given this, business performance, growth and existence are their responsibility. According to Uike (2019), “there is a relation between marital status and entrepreneurial intention of single and married people. Subjective norm do not affect single people but married people are affected by the subjective norm”.

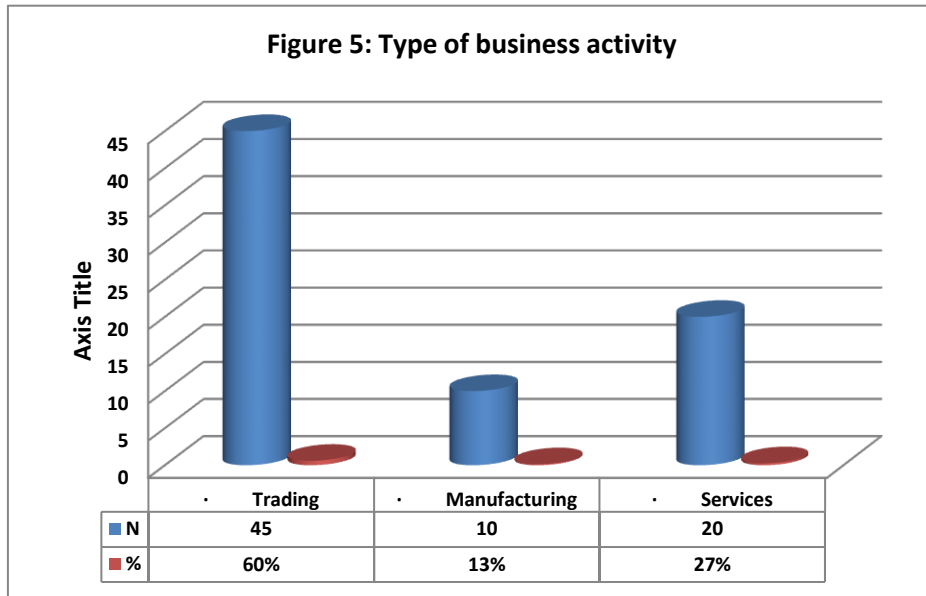


Supporting families and creating employment opportunities to other family members are few of the factors molding entrepreneurial intention of married and single people. This is part of the human trait of an entrepreneur.

**4.2 Characteristics of SMEs**

This section identifies the characteristics of SMEs in Lae City with respect to types of activities, legal ownership, number of years in business and number of employees.

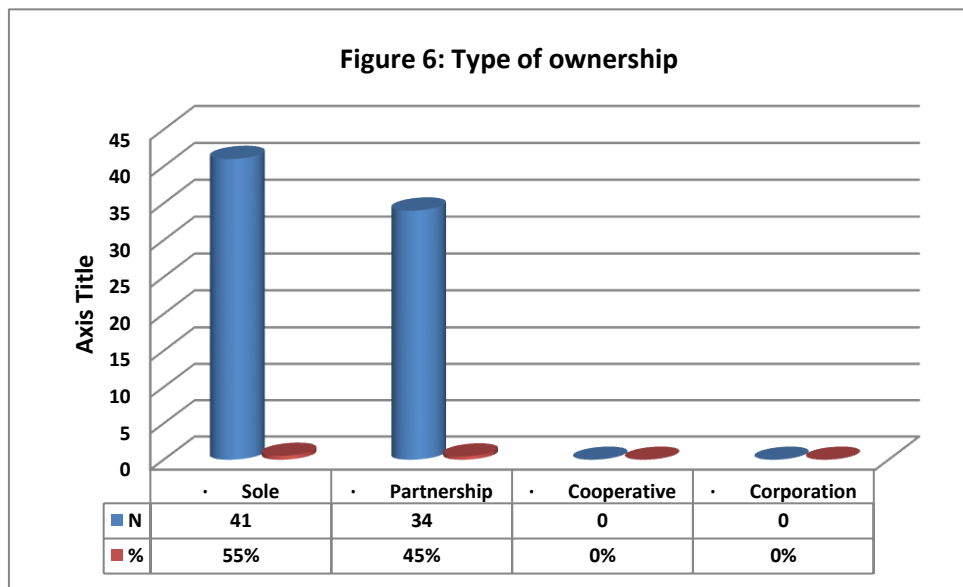
**4.2. a. Type of activities**



The result revealed that majority of the SMEs (59%) is involved in trading activities, (15%) venture into small scale of manufacturing and the remaining (26%) are into rendering of various services. As shown in the Figure 2, trading activities dominates the SMEs in the city because of opportunities surrounding the city. Lae City is the second largest city in Papua New Guinea. Due to its ports catering to international cargo vessels and domestic cargo and passenger vessels, it serves as the commercial hub servicing the needs of the nearby provinces of Highlands and the Momase regions.

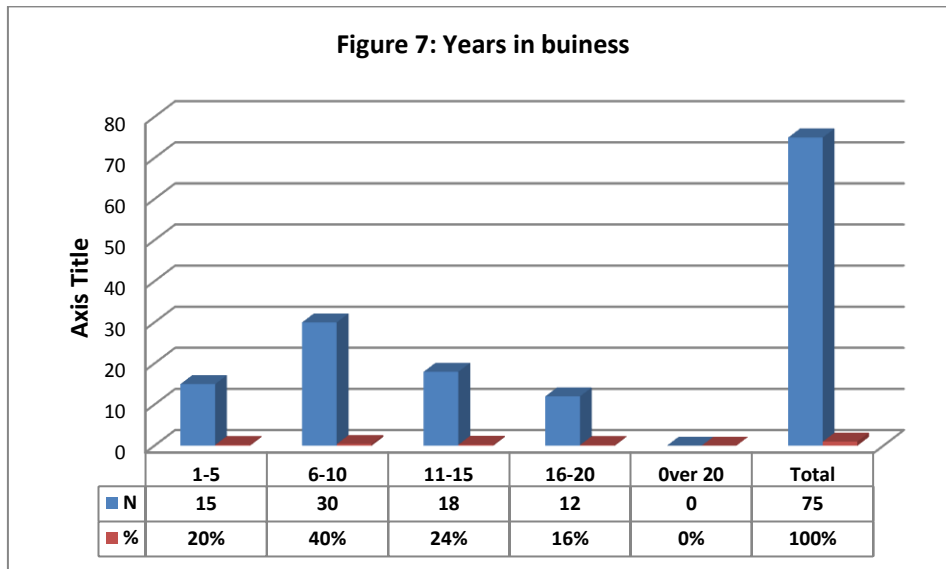
**4.2. b. Legal ownership**

As regards legal ownership of SMEs, Figure 6 reveals that the majority (total of 54%) of SMEs in the city is solely owned and the remainder of 46% is partnership. The partnership-owned enterprises are usually in association with either family members or tribe members. The finding implies that sole business is prevalent for it is easy to establish, manage and requires not big amount of capital.



**4.2. c. Years in business**

The respondents' business ventures are also varied in terms of years in existence as shown in Figure 7. The majority (27% + 31%) has been in business between 11-20 years and 11% have existed over 20 years. These findings imply that the SMEs have experienced a number of intricate situations but able to solve them. Hence, they are still existing up-to this time.



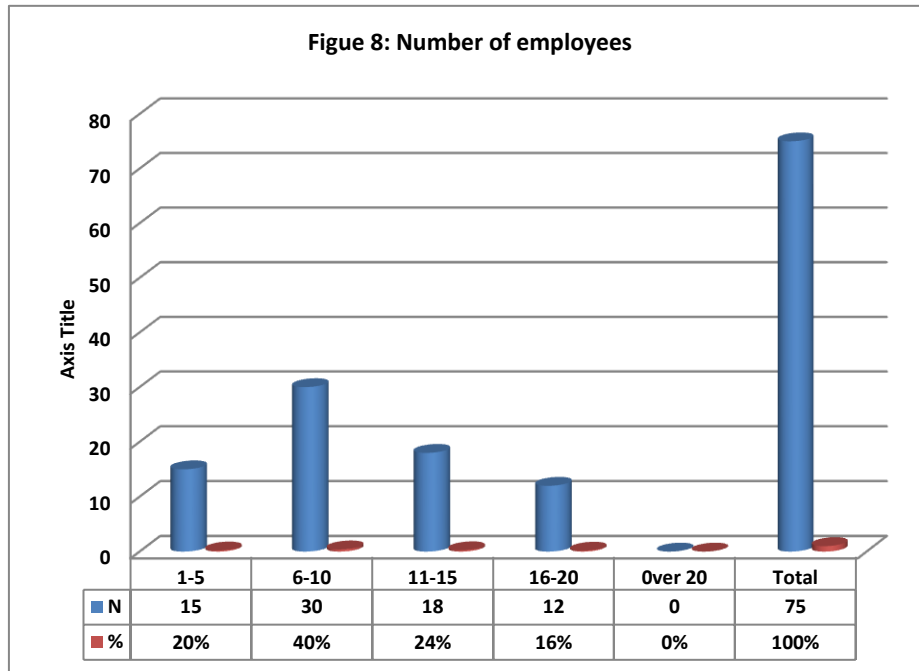
The 12% of the respondents business have just passed the 1-4 trial years. This implies that they survived delicate start-up stage. This finding conforms to Kofi (2014) study that “two-thirds of new businesses survive for at least two years and only 44% survive for at least four years because of poor management in the areas of finance, to be precise lack of proper financial accounting practice”.

The remaining 20% (6-10 years) are on the period of balancing business affairs and stability. The current business environment is characterized as volatile.

**4.2. d. Number of employees**

Figure 8 shows that majority of respondents (total of 60%) had 1-10 employees, 25% had 11-15 employees, and 15% had in between 16-20 employees. 10.7% of them had 11 - 15 employees, and 3% had employees of 16 -20. Based on employment size, the SME participants belong to the SME category as defined by PNG National SME Policy Framework of 2016.

Based on the findings, the SMEs in Lae City obviously are sources of employment opportunity for the community where they do businesses.

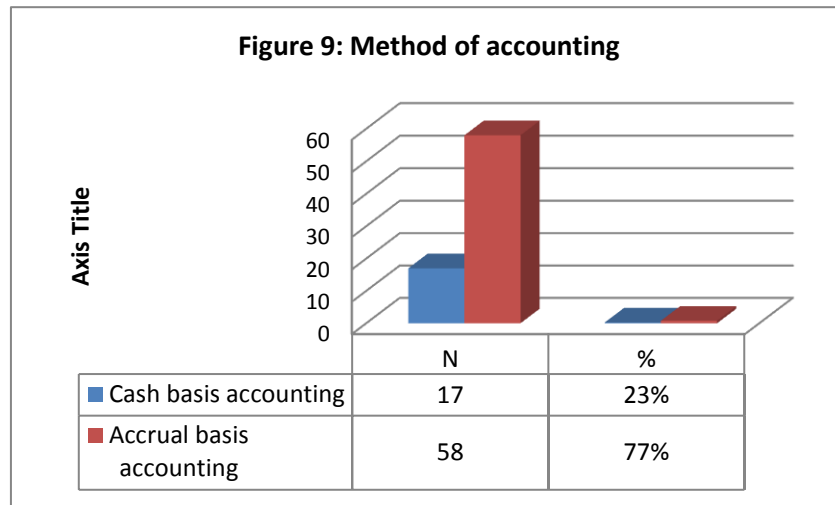


**4.3. Accounting systems and methods**

This section deals with the method and the nature of accounting system being practiced by the SMEs in Lae City.

### 4.3.a. Accounting method

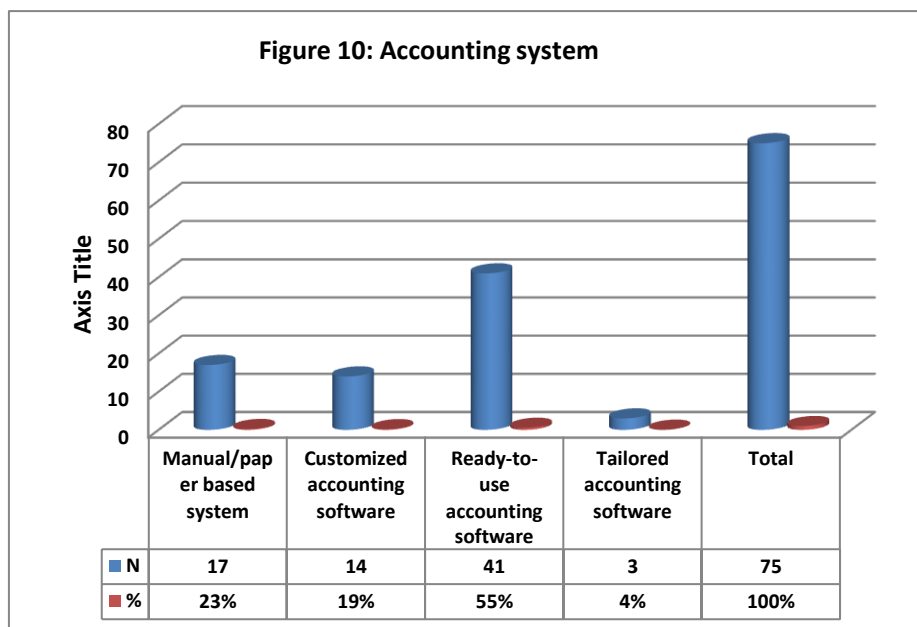
Figure 9 demonstrates that 23% of the SME owners use the cash basis of accounting while the remaining percentage is currently on the accrual basis of accounting.



The respondents using the cash-basis accounting claimed that the system is just simple to perform. They have been recording their business transactions with cash basis method since they started business. For grade 12 graduates, the method quickly shows cash on hand or cash at bank's balances at any given time. It allows them to control expenses too. It jibes their objective to do business budget according to the liquid resources available. However, they have to prepare and monitor separate listings of payables and receivables. They have to engage accountant's services to prepare tax returns. Especially when filing a GST refund with Internal Revenue Commission (IRC) of PNG. Thus, the business has to entail additional costs.

Interview with the respondents using the accrual basis of accounting disclosed that they have accurate and transparent picture of the business' money matters. It helps them decide properly as they recognize the equivalent value of money spent in the business. Hence, they learn how to minimize expenses and control unnecessary disbursement of funds. Importantly, it frees them from worrying during the IRC examiners' audit. For the respondents with lesser knowledge of accounting claimed the method to be complex. They are obliged to hire accounting staff or consultants. This process is expensive.

### 4.3. b. System of financial transactions' record keeping

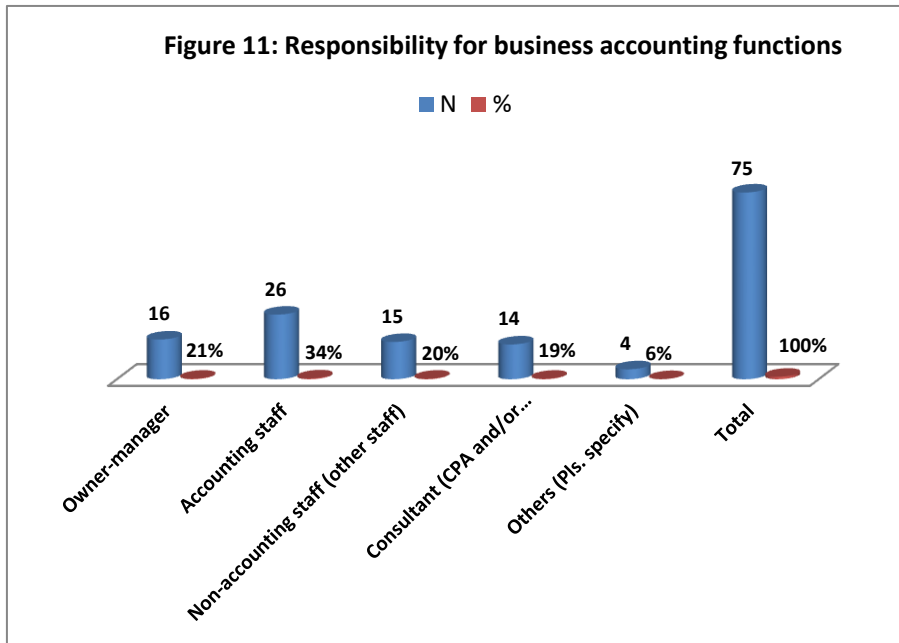


It can be seen from Figure 10 that 23% of SMEs are using the manual system of recording financial transactions. This finding implies that they have to maintain files of invoices and receipts, journals, ledgers, vouchers, cash book, payroll records and assets register. They are tedious activities, according to the SME-respondents. Without the cited records, the business cannot prepare a complete set of financial statements. The manual system requires employees to perform the whole accounting cycle manually on a periodic basis. The owners make just a simple income statement. This implies that the respondents are only interested in the results of their businesses' financial operations.

Two thirds of the respondents used the customized (19%), ready-to-use (54%) or tailored accounting softwares (4%) in recording business transactions. The system saves them more time in recording transactions. Financial reports can be generated automatically by just a click of the mouse. These findings imply that the respondents recognized the value of saving time and the importance of report generation. Importantly, their decision making are based on accurate figures. Per interview, the respondents disclosed that they have to spend additional budget for the maintenance of these systems. They also spend additional expenses yearly maintenance fees. Consultant fee of IT personnel is likewise high.

**4.3. c. Responsibility for accounting functions**

As shown in Figure 11, 21% of the SME owners claimed that they are doing the major accounting functions. It includes doing banking transactions and cash reconciliation for their businesses. This implies that owners have accounting knowledge and adept in accounting works.



A total of 53% (34% + 19%) SME participants have the financial capacity to hire accounting staff or consultants. Consultants are contracted to up-date accounting records twice or thrice a month on retainer’s basis. They are also paid separately for preparing and filing tax returns of filing GST refunds. These findings implied that these businesses recognized the value of accounting practices to their businesses. Up-dating books and cost accounting works are necessary for the business. They know the value of organized financial records making tax preparation much easier, save time and reduce stress.

On the other hand, 20% of the enterprises’ accounting functions are done by non-accounting staff. It is a normal practice in retail stores. Sales personnel and front cashiers are required to prepare cash and sales reports at the close of business day. It implies that the particular businesses use cash basis of accounting.

Meanwhile, the remaining 6% of the enterprises’ record keeping functions are done by their relatives’ children. The SME owners assist them for school fees.

The above findings imply that SMEs in Lae City are knowledgeable on the importance of accounting records in their business. Some of them are constrained of limited resources and operating on a tight budget. Proper records keeping are crucial for the success of a business. Per Adela, et al (2023) study, “record or bookkeeping practices and owners’ accounting skills have significant positive effects on the performance of SMEs.”

**4.4. Influence of sound accounting practices to SMEs’ business growth and financial stability**

From Table 1, the overall influence of sound accounting practices to SMEs’ business growth and financial stability is high. This finding suggests that the accounting practices implemented by SMEs in Lae City have greatly contributed to their respective businesses.

Tracking assets and payables is the leading benefit that greatly impacted by good accounting practices. This particular item refers to the timing of collection of receivables from customers and paying suppliers. Up-dated list of receivables and payables can be generated anytime if the recording of transactions is done daily. Daily recording is a characteristic of sound accounting practice. This is also a characteristic of an automated accounting and the use of subsidiary ledgers.

Updated list of receivables accrues to the timely collection of customers’ debts to the business. Once they are collected on time the business has a good cash flows. Budgeting is easier. On the other hand, if the business tracks its payables, it can pay the suppliers on time. Most suppliers grant credit to businesses with discounts if payment is made within the specified date. This means that the business generates additional income through the suppliers’ discounts.

Table 1

**Impact of sound accounting practices**

Indicator	Scale					N	sd	wm	Rank	
	5	4	3	2	1					
Accounting reports assist owners/managers track assets and liabilities.	23	24	14	11	3	75	8.75	3.71	1	
Guide managers/owners understand the business' bottom line and financial standing.	22	21	21	8	3	75	8.86	3.68	2	
Show case business credibility through reports useful for financing and credit access.	23	19	17	13	3	75	7.62	3.61	3.5	
Owners/managers easily comply with taxation and other legal requirements.	20	23	18	11	3	75	8.03	3.61	3.5	
Provide owners and managers systematic and accurate business transaction records.	19	23	19	7	7	75	7.48	3.53	5	
Assist owners and managers to measure and enhance business performance.	21	18	17	15	4	75	6.52	3.49	6	
Provide owners/managers ideas to control fraud and risk.	24	14	15	16	6	75	6.40	3.45	7	
End reports serve owners/managers as effective tools in financial budgeting and planning.	20	17	17	15	6	75	5.34	3.40	8	
End reports assist owners/managers to appropriately manage cash flow.	20	17	15	19	4	75	6.44	3.40	9	
Provide owners/managers reliable information for business decision making.	15	19	20	16	5	75	5.96	3.31	10	
Overall								7.14	3.52	

Legend: wm – weighted mean; sd – standard deviation; very high: 4.50-5.00; high: 3.50-4.99; moderate: 2.50-3.49; Low: 1.50-2.49; very low: 1.00-1.49

The second item highly rated by SME owners is on understanding the business' bottom line and financial health. Sound accounting practices improves the accuracy of prepared financial statements. It also improves detection of errors. Likewise, practicing accounting properly follows the double-entry system of accounting. This means that financial transactions' equal and opposite value in at least two different accounts affected are shown immediately. The finding indicates that using a method according to user's needs could achieve his desired objective.

Ease in complying with legal requirements is also highly perceived result of good accounting practice. Based on interview with respondents, the availability of accounting records and financial reports enhance the business credibility. It makes financing and credit access with banks easier. Credible information is a measure to assess the capacity of a business to effect payment of credit.

**4.5. Effect of unsound accounting practices to SMEs' business growth and financial stability**

Figure 2 reflects the processed data on the SME owners' perceptions regarding unsound accounting practices. In the overall, this kind of practices has moderate (3.27) effect on the SMEs' business growth and financial stability. It implies that this nature of the SMEs' accounting practices provide relative difficulty to their needs.

Table 2

## Impact of unsound accounting practices

Indicator	Scale					N	sd	wm	Rank
	5	4	3	2	1				
Difficulty in determining the real financial condition of the business.	22	20	18	9	6	75	6.06	3.57	1
Difficulty in determining business cash flow.	19	19	18	11	8	75	5.15	3.40	2.5
Inability to detect business losses due to fraud and theft.	19	18	18	14	6	75	5.39	3.40	2.5
Difficulty in filing accurate tax returns.	18	17	18	13	9	75	3.94	3.29	4
Difficulty in determining the actual results of financial operations.	17	18	19	11	10	75	4.18	3.28	5.5
Difficulty in tracking receivables and payables.	19	17	16	12	11	75	3.39	3.28	5.5
Poor management of borrowed funds.	18	17	18	12	10	75	3.74	3.28	5.5
Difficulty in accessing credit financing from financial institutions.	16	19	15	14	11	75	2.92	3.20	8
Forgone business opportunity due to unsound basis of manager's financial decision.	15	16	17	15	12	75	1.92	3.09	9
Greater issues and problems on accountability of staff.	12	11	21	19	12	75	4.64	2.89	10
<b>Overall</b>							4.3	3.27	

Legend: wm – weighted mean; sd – standard deviation; very high: 4.50-5.00; high: 3.50-4.99; moderate: 2.50-3.49;

Low: 1.50-2.49; very low: 1.00-1.49

The SME owner-respondents rated highly difficult determining the real business' financial condition. This is one of the negative effects of unsound accounting practices. It could also be the result of cash basis accounting or level of education of the entrepreneurs. Management decision process becomes guess work if actual business' condition at a given time is undetermined. Sound management decisions are based on facts and priority needs. Good accounting practice is a key. For example, decision on capital structuring, expansion and development, or innovating products and services are capital intensive matters. Management cannot just implement them by not knowing first the business' actual financial condition. Otherwise, the business might struggle with the daily operating funds. These scenarios are within the opinion of the European Federation of Accountants' (2004) "that managing the capital is considered obstacle on the way of growth and expansion of SMEs".

#### 4.5. Challenges faced by SMEs in their accounting practices

As shown in Table 3, the challenges faced by SME owners in implementing accounting practices are high (3.62). This finding may imply that the SMEs in Lae City are aware of the importance of good accounting practices. However, they cannot just do it because of constraints they have currently.

Table 3

**Challenges faced by SMEs in their accounting practices**

Indicator	Scale					N	sd	wm	Rank
	5	4	3	2	1				
Lack of training and capacity of owner to adapt to contemporary system of accounting practices.	30	21	6	12	5	74	10.62	3.80	1
High cost of hiring professional accountant.	27	22	12	9	5	75	9.19	3.76	2
Information keeping tends to be disorganized as the firm grows.	26	25	7	12	5	75	9.92	3.73	3
Difficulties assessing the loan proposal of those SMEs that do not have proper accounting and financial records.	29	18	10	12	6	75	8.94	3.69	4
Lack of guiding or specific accounting standards for SMEs	25	21	11	12	5	74	8.07	3.66	5.5
Lack of accounting knowledge.	25	23	9	12	6	75	8.51	3.65	5.5
Accounting reports too difficult to prepare and understand.	29	15	13	12	6	75	8.51	3.65	5.5
Preparing the legal requirement in terms of financial records and statements.	20	23	14	11	7	75	6.52	3.51	8
Inaccurate or incorrect financial information can actually cause problems which may threaten the solvency of the business.	15	26	16	12	6	75	7.28	3.43	9
Accounting reports have no value to the business.	16	15	26	12	6	75	7.28	3.31	10
Overall							8.49	3.62	

Legend: wm – weighted mean; sd – standard deviation; very highly agree: 4.50-5.00; highly agree: 3.50-4.99; moderate: 2.50-3.49; Low: 1.50-2.49; very low: 1.00-1.49

The leading challenge faced by the SME owners is connected with training and adaptation with contemporary system of accounting (3.80, high). According to the SME participants, this challenge is theoretically faced by SME owners belonging to over 40 years age group, and enterprises having 2 or more outlets in the city where the accounting process gets more complicated.

Sixty five per cent considered hiring professional accountant or consulting services’ high fees also a big challenge (3.786, high). Accordingly, the high cost of hiring accountants is an additional financial burden to the business. Many of them are just recovering from the effect of Covid 19 pandemic. This finding conforms to the study of Mishra % Smyth (2018) that “high fees of consultant services pose as challenge to small businesses”.

The SME owners highly agree that when the firm expands, the information keeping tends to be disorganized as challenging. This situation happened during transitioning from cash basis to accrual accounting. The same is true when changing paper based method to computerized recording of business transactions. The SME owners claimed to be convenient of the old and then feel disorganized with the current system.

**4.6 Impact of accounting practices to SMEs business growth and financial sustainability**

Table 4 presents the chi-square test results. As shown on the same table, the critical value of  $\chi^2$  with 2 degrees of freedom is 1.119. Since 1.119 is lower than 5.991, the null hypothesis is rejected. The result implies that accounting practices have significant impact on the business growth and financial stability of SMEs at a 5% level of significance.

Table 4

Chi-square test of independence

Intervention	Outcome	Observed	Expected	$O - E$	$(O - E)^2$	$(O - E)^2 / E$
Trading	Agree	21	10	11	121	0.4368231
	Disagree	23	12	11	121	0.4368231
Mfg	Agree	5	2	3	9	0.03249097
	Disagree	6	3	3	9	0.03249097
Services	Agree	10	5	5	25	0.09025271
	Disagree	10	5	5	25	<u>0.09025271</u>
Total						<u>1.11913357</u>
Degree of freedom (r1)*(c1) = (2-1)(3-1) = 2						2
Alpha level						0.05
Critical statistics for alpha level of 0.05 degree of freedom						5.991

### 5.0 Conclusions and Recommendations

The results of this research demonstrate that SME ownership is dominated by men, majority are within the age group of 26-40, the most common education level of respondents is diploma graduate, and mostly are married. The SMEs in Lae is dominated by trading activity, mostly sole in ownership, majority employed 6-15 staff, and majority have been in existence for 11-20 years. In terms of accounting methodology and system used, mostly applied the accrual basis of accounting, and mostly utilized computer accounting ready-to-use accounting software in recording and storing accounting information. The responsibility of accounting functions and accounting records keeping are mostly done by accounting staff and accounting consultants.

The sound accounting practices have high effects to the business growth and financial stability. There is a moderate effect of implementing accounting improperly. The high fees of private accountants and consulting services posed big challenge to the SMEs.

Through chi-square test, the result leads to a conclusion that accounting practices have significant impact on the business growth and financial stability of SMEs at a 5% level of significance.

This study recommends that: (1) the government agencies tasked to develop SMEs in PNG should provide and implement capability building programs and aspects of accounting, finance knowledge and skills emphasizing the contemporary system of accounting and practices for SMEs; (2) SMEs should ensure using accounting records regularly, properly keeping specific organizational documents vital for decision making; and, embrace appropriate accounting records keeping techniques to attain success in their financial performance; (3) Replication of this study in other cities, towns, or provinces in Papua New Guinea where SMEs proliferate.

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