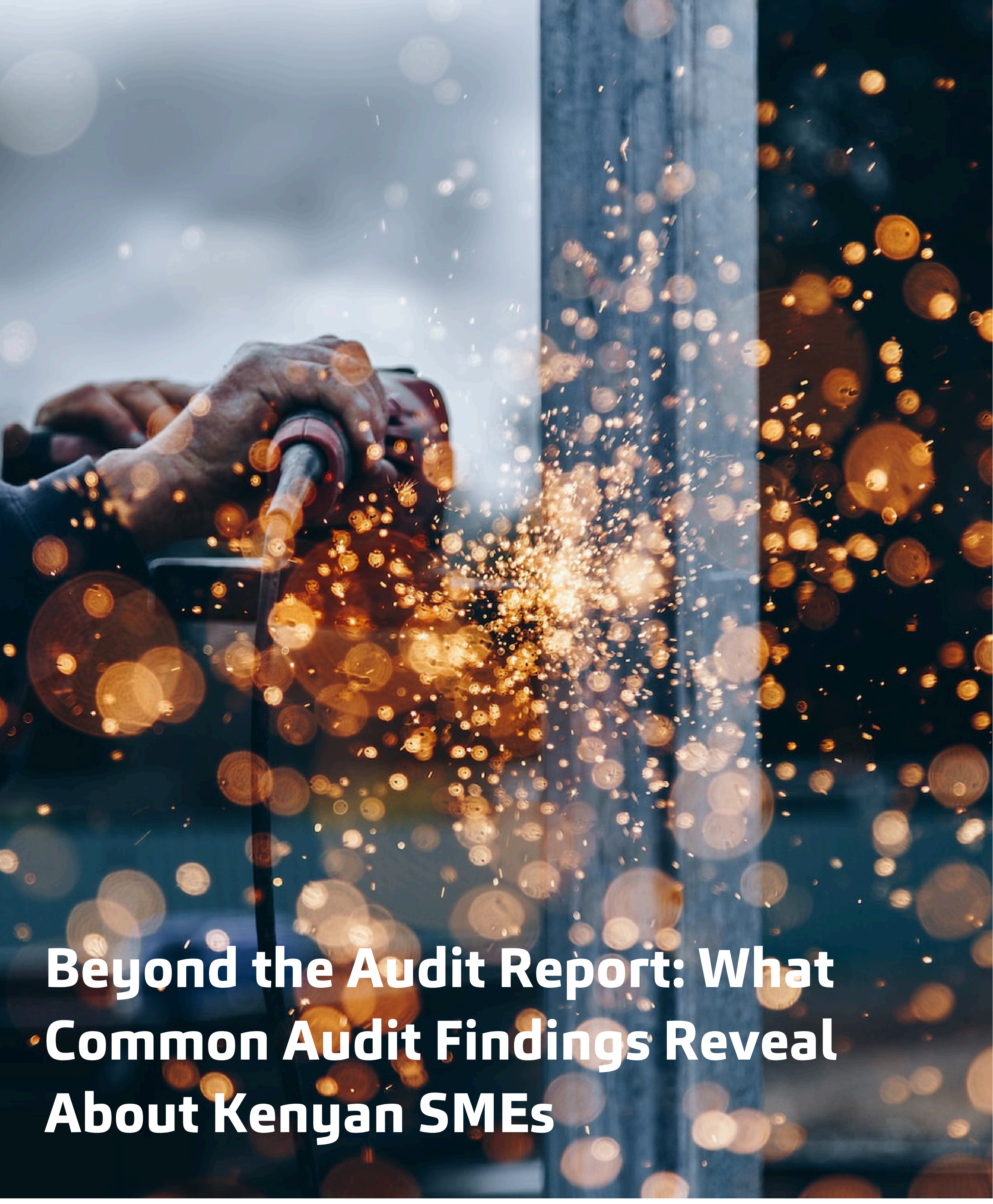

Beyond the Audit Report: What Common Audit Findings Reveal About Kenyan SMEs

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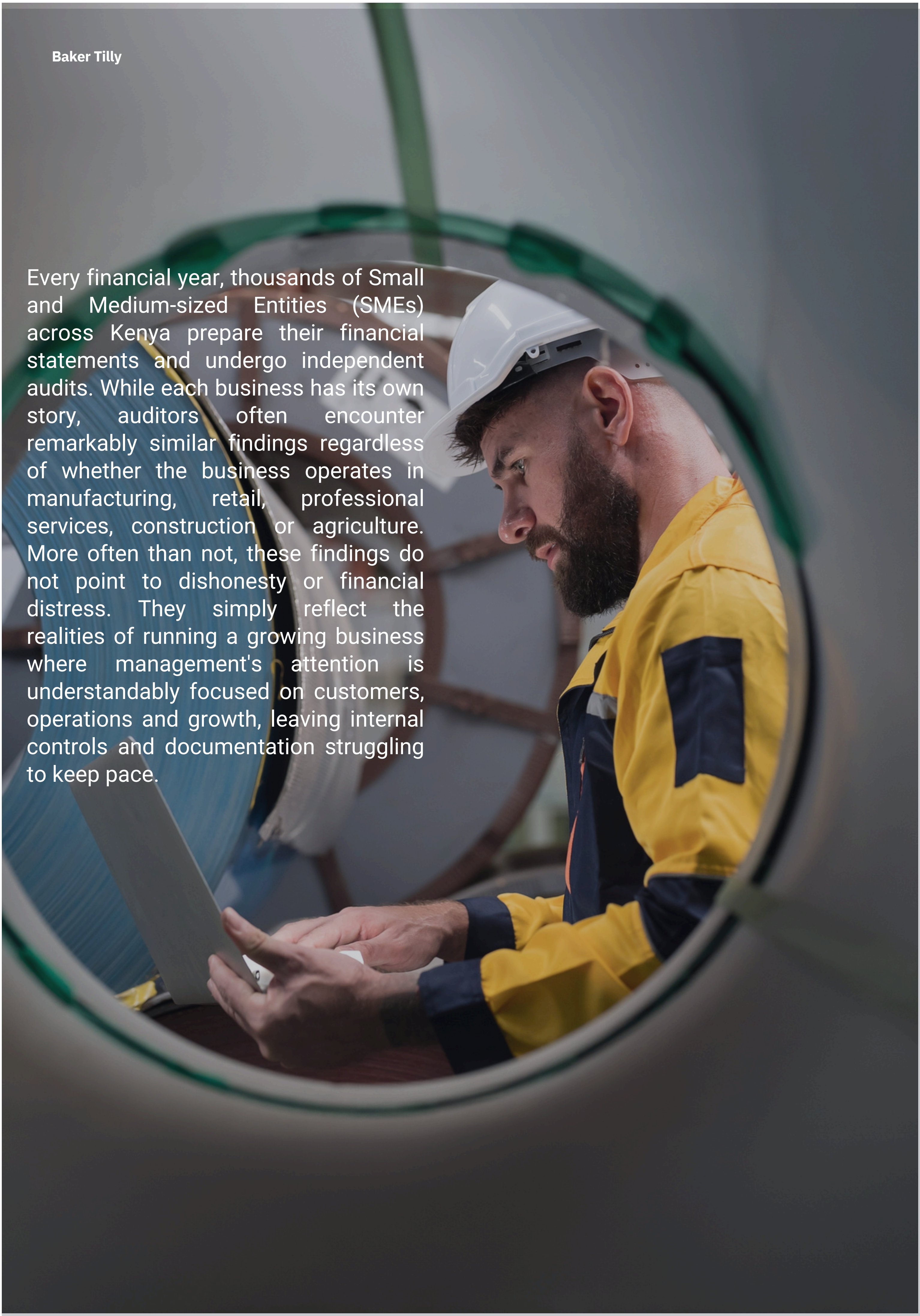
Auditors are sometimes compared to doctors. We ask many questions, request numerous documents, and occasionally deliver news that management would rather not hear. The difference is that our prescription is usually stronger controls rather than medication.



Every financial year, thousands of Small and Medium-sized Entities (SMEs) across Kenya prepare their financial statements and undergo independent audits. While each business has its own story, auditors often encounter remarkably similar findings regardless of whether the business operates in manufacturing, retail, professional services, construction or agriculture. More often than not, these findings do not point to dishonesty or financial distress. They simply reflect the realities of running a growing business where management's attention is understandably focused on customers, operations and growth, leaving internal controls and documentation struggling to keep pace.

- Operating in Kenya requires businesses to navigate an increasingly demanding regulatory environment. The Companies Act, 2015 requires companies to maintain proper accounting records, while tax legislation places significant emphasis on accurate reporting and timely compliance. At the same time, many SMEs prepare their financial statements under the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs), which promotes transparency and consistency in financial reporting. Against this backdrop, an audit serves a purpose far greater than satisfying a statutory requirement. It offers management an opportunity to identify weaknesses, improve governance and strengthen confidence among investors, lenders and other stakeholders.

- One of the first areas that attracts audit attention is the quality of supporting documentation. It is not uncommon to find payments supported only by a mobile money notification, supplier invoices that cannot be located, or expense claims without sufficient evidence of the underlying transaction. While management may have complete -confidence that the expenditure was genuine, auditors—and, indeed, tax authorities—require objective evidence before recognising it. An old accounting saying reminds us that "if it isn't documented, it becomes difficult to prove." Maintaining organised records, whether in physical or electronic form, significantly reduces audit queries, supports tax deductions and provides an effective defence during regulatory reviews.

- Closely linked to documentation is the broader issue of internal controls. Many SMEs operate with lean finance teams where a single individual may raise invoices, receive customer payments, record transactions and reconcile the bank account. Such arrangements are often driven by practicality rather than poor governance, yet they expose the business to unnecessary risks. Even the most trustworthy employee benefits from operating within a system of checks and balances. As Ronald Reagan famously observed, **"Trust, but verify."** Segregating responsibilities where possible, introducing supervisory reviews and leveraging approval workflows within accounting software can substantially reduce the likelihood of errors and irregularities.

- The importance of strong controls becomes particularly evident when reviewing bank reconciliations. Cash is the lifeblood of every business, yet bank reconciliations are sometimes prepared several months after the transactions have occurred—or not prepared at all. Delayed reconciliations can conceal duplicate payments, unidentified bank charges or long-outstanding transactions that gradually become more difficult to explain. Preparing reconciliations monthly enables management to identify discrepancies promptly while providing greater confidence in the accuracy of cash balances reported in the financial statements.

- Revenue recognition presents another area where businesses occasionally encounter challenges. In the enthusiasm of closing a successful month or year, there may be a temptation to recognise income once an invoice has been issued or payment has been received, even where goods have not yet been delivered or services have not been fully rendered. IFRS for SMEs requires revenue to reflect the transfer of goods or services rather than simply the movement of cash. Applying this principle consistently ensures that financial statements present a fair view of business performance and reduces the likelihood of significant audit adjustments.

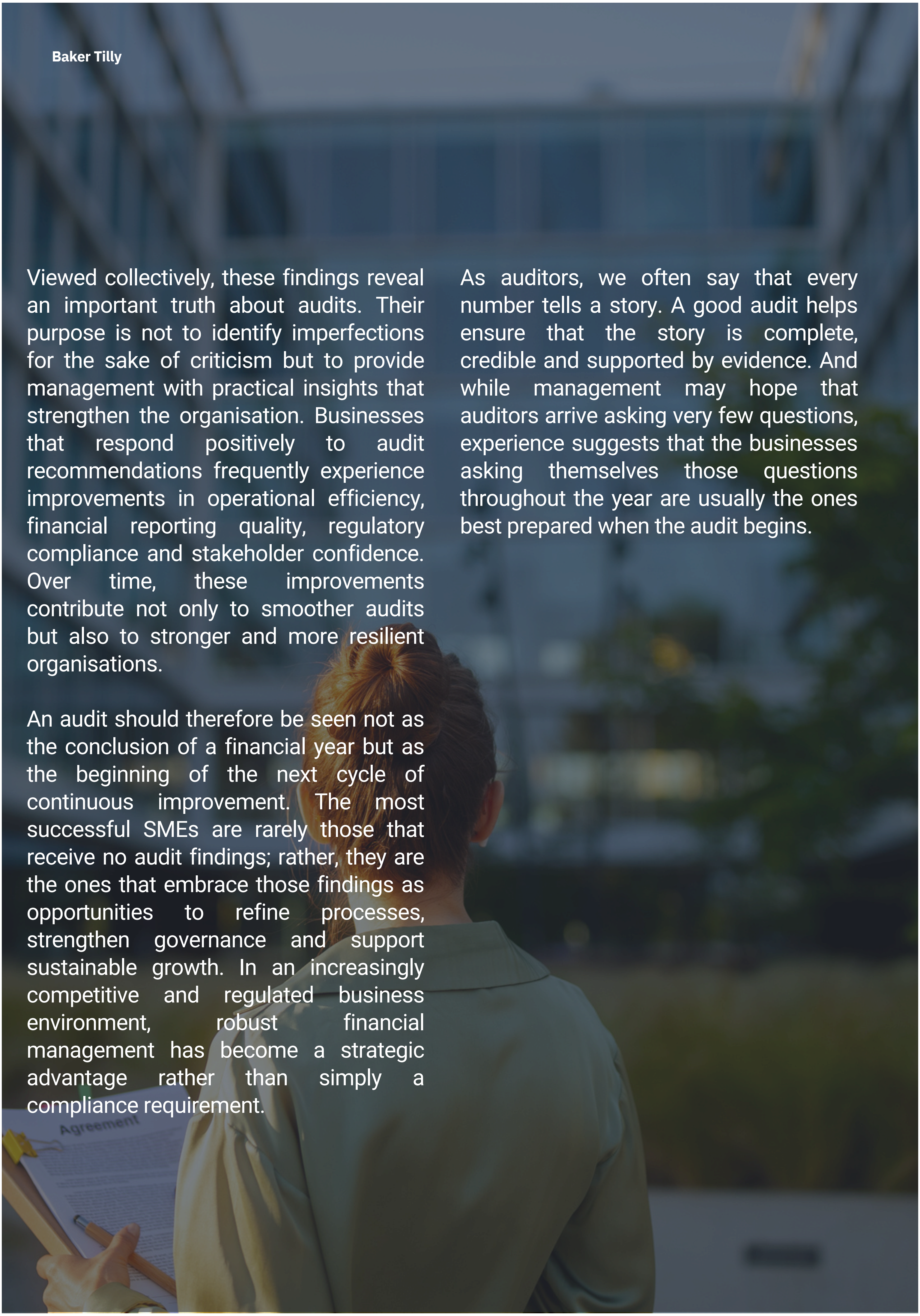
As businesses invest in growth, attention also shifts to property, plant and equipment. During audits, it is not unusual to encounter fixed asset registers that continue listing equipment that was disposed of years earlier or, conversely, fail to capture recently acquired assets. Occasionally, the register appears to have more assets than the business premises themselves—a situation that usually generates a smile during the audit, but also highlights the importance of maintaining accurate records. Regular physical verification, timely updates of acquisitions and disposals, and proper asset tagging contribute to reliable financial reporting and more effective asset management.

Relationships with directors, shareholders and related businesses are equally common within SMEs and are often essential to their operations. However, transactions between related parties deserve careful documentation and transparent disclosure. Whether the transaction involves loans, shared services or the sale of goods, maintaining appropriate agreements and ensuring proper disclosure in the financial statements enhances transparency and demonstrates sound corporate governance. Clear documentation also assists in responding to potential questions from regulators and tax authorities.

Tax compliance continues to feature prominently in many audits. Differences between accounting records and tax returns, unreconciled tax balances, incorrect Value Added Tax (VAT) treatment or late statutory filings frequently emerge during audit procedures. In many cases, these issues arise not because businesses intentionally disregard their obligations, but because tax legislation evolves continuously and operational demands often take precedence over periodic reconciliations. Conducting regular tax health checks and reconciling tax returns with accounting records throughout the year can help minimise penalties, interest and unnecessary disputes while promoting confidence that the business remains compliant.

The audit process also provides an opportunity to evaluate the quality of financial reporting itself. Although financial statements may balance mathematically, they do not always fully comply with the disclosure requirements of IFRS for SMEs. Accounting policies may not have been updated for several years, important disclosures may be omitted, or certain balances may be presented under inappropriate classifications. Preparing financial statements should be viewed as more than an exercise in producing figures; it is an opportunity to communicate the financial story of the business accurately, consistently and transparently.

Inventory management is another area where practical challenges frequently arise. For businesses that hold stock, differences between physical quantities and accounting records can have a significant impact on reported profitability and working capital. Periodic stock counts, prompt investigation of variances and effective inventory management systems help ensure that financial records reflect operational reality. After all, inventory that exists only in the accounting records is unlikely to satisfy customer demand.
Perhaps one of the most valuable conversations arising from an audit concerns the future rather than the past. While profitability remains an important measure of success, liquidity often determines whether a business can continue operating comfortably. A company may report healthy profits while simultaneously experiencing cash flow pressures that affect supplier payments, payroll or expansion plans. Preparing rolling cash flow forecasts and monitoring working capital throughout the year enables management to anticipate challenges before they become crises.



Viewed collectively, these findings reveal an important truth about audits. Their purpose is not to identify imperfections for the sake of criticism but to provide management with practical insights that strengthen the organisation. Businesses that respond positively to audit recommendations frequently experience improvements in operational efficiency, financial reporting quality, regulatory compliance and stakeholder confidence. Over time, these improvements contribute not only to smoother audits but also to stronger and more resilient organisations.

An audit should therefore be seen not as the conclusion of a financial year but as the beginning of the next cycle of continuous improvement. The most successful SMEs are rarely those that receive no audit findings; rather, they are the ones that embrace those findings as opportunities to refine processes, strengthen governance and support sustainable growth. In an increasingly competitive and regulated business environment, robust financial management has become a strategic advantage rather than simply a compliance requirement.

As auditors, we often say that every number tells a story. A good audit helps ensure that the story is complete, credible and supported by evidence. And while management may hope that auditors arrive asking very few questions, experience suggests that the businesses asking themselves those questions throughout the year are usually the ones best prepared when the audit begins.

The most successful businesses are not necessarily those with no findings—they are those that use the findings to improve, adapt and prepare for what comes next.

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The question isn't whether your business has audit findings. It's what you do with them.

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