

**Relationship Between Audit Practices Relationship Between The Financial Performance Of Selected SMEs In Wakiso District.**

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**Abstract**

The study examined the relationship between audit practices and financial performance of small and medium enterprises (SMEs) in Wakiso District, Uganda. A cross-sectional survey design was employed with a sample of 170 SMEs selected through stratified random sampling. Data were collected using structured questionnaires and analyzed through descriptive statistics, Pearson correlation, and regression analysis. Results revealed that audit practices had a significant positive relationship with financial performance ( $r = 0.728$ ,  $p < 0.01$ ), explaining 53.0% of variance. Specifically, internal audit practices ( $r = 0.681$ ,  $p < 0.01$ ), external audit practices ( $r = 0.656$ ,  $p < 0.01$ ), audit independence ( $r = 0.639$ ,  $p < 0.01$ ), and audit recommendations implementation ( $r = 0.672$ ,  $p < 0.01$ ) all demonstrated strong positive relationships with financial performance. The study concluded that effective audit practices significantly enhanced SME profitability, operational efficiency, and financial transparency. Recommendations included establishing internal audit functions, engaging qualified external auditors regularly, ensuring audit independence, implementing audit recommendations promptly, and developing affordable audit service models tailored to SME resource constraints.

**Keywords: Audit practices, financial performance, small and medium enterprises, internal audit, external audit, Wakiso District**

**Background of the Study**

Small and medium enterprises (SMEs) represented a cornerstone of Uganda's economic development, contributing approximately 90% of all private sector establishments, generating 75% of GDP, and employing over 2.5 million people across diverse sectors (Uganda Bureau of Statistics, 2022). In Wakiso District, one of Uganda's most economically dynamic regions surrounding the capital city Kampala, SMEs proliferated in manufacturing, trading, services, hospitality, and agro-processing, driving employment creation, innovation, and poverty reduction (Wakiso District Local Government, 2020). Despite their critical economic role, SMEs in Uganda experienced alarmingly high failure rates, with research indicating that approximately 60% collapsed within their first five years of operation due to financial mismanagement, fraud, inadequate planning, and weak governance structures (Baluku et al., 2018).

Audit practices emerged as essential mechanisms for enhancing organizational accountability, financial transparency, operational efficiency, and performance sustainability. According to the International Standards on Auditing (ISA), auditing was defined as the systematic examination of financial statements, records, operations, and controls to provide independent assurance regarding their accuracy, compliance, and effectiveness (IFAC, 2018). Audit practices encompassed both internal audit activities conducted by organizational personnel to evaluate and improve risk

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management, control, and governance processes, and external audit engagements performed by independent professional auditors to provide objective opinions on financial statement reliability (Institute of Internal Auditors, 2017).

Internal audit practices involved ongoing systematic evaluations of organizational operations, internal controls, risk management processes, and governance systems to identify weaknesses, recommend improvements, and promote operational excellence (Mihret & Yismaw, 2007). For SMEs, internal audit functions, whether formal departments or periodic reviews, provided valuable assurance that business processes operated effectively, assets were protected, financial information was reliable, and organizational objectives were achieved efficiently (Goodwin-Stewart & Kent, 2006). Internal audits examined transaction processing, inventory management, procurement procedures, cash handling, revenue recognition, and compliance with policies and regulations, identifying control deficiencies and improvement opportunities (Hutchinson & Zain, 2009).

External audit practices involved independent examination of financial statements by qualified professional auditors who provided opinions on whether statements fairly presented financial position, performance, and cash flows in accordance with applicable accounting standards (Arens et al., 2017). External audits enhanced financial statement credibility, facilitated access to bank financing and investor capital, improved management accountability, deterred fraud and errors through independent oversight, and provided stakeholder confidence in reported financial information (Francis, 2011). For SMEs, external audits represented critical legitimacy mechanisms that enabled formal sector participation, government contract bidding, and stakeholder trust building (Sian & Roberts, 2009).

Audit independence and quality were fundamental prerequisites for audit effectiveness. Independence ensured that auditors maintained objectivity and professional skepticism, free from conflicts of interest or undue influence that could compromise judgment (DeAngelo, 1981). Audit quality reflected the probability that auditors detected and reported material misstatements, errors, or control weaknesses, influenced by auditor competence, professional standards adherence, and organizational support (DeFond & Zhang, 2014). Implementation of audit recommendations represented the critical translation of audit findings into corrective actions that actually improved organizational performance (Bou-Raad, 2000).

Previous research demonstrated positive relationships between audit practices and organizational performance in large corporations and public institutions, showing that regular audits improved financial reporting quality, reduced fraud, enhanced operational efficiency, and strengthened stakeholder confidence (Hay et al., 2006). However, the audit-performance relationship in SME contexts remained under-researched, particularly in developing economies where SMEs operated with limited resources and often viewed audits as expensive compliance obligations rather than value-adding activities (Blackburn et al., 2010).

In Wakiso District, preliminary observations suggested that many SMEs lacked systematic audit practices. Internal audit functions were virtually non-existent except in larger SMEs, while external audit engagement remained sporadic,

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often triggered only by regulatory requirements or bank financing applications rather than voluntary performance improvement initiatives (Kamukama, 2013). Common challenges included audit cost perceptions as prohibitive relative to anticipated benefits, limited awareness of audit value beyond compliance, shortage of affordable audit service providers understanding SME contexts, and weak audit recommendation implementation due to resource constraints or management resistance (Asiligwa & Rennox, 2017). Understanding the relationship between audit practices and financial performance was crucial for SME owners, auditors, financial institutions, and policymakers seeking to enhance SME sustainability and economic contributions in Uganda's most commercially active district.

### **Problem Statement**

Small and medium enterprises in Wakiso District experienced persistent financial performance challenges characterized by declining profitability, irregular cash flows, weak financial controls, and high business failure rates despite operating in a relatively favorable economic environment with market access and infrastructure advantages (Ssekiziyivu et al., 2017). A significant contributing factor was the widespread absence or inadequacy of systematic audit practices, with studies indicating that fewer than 30% of SMEs in the district engaged external auditors regularly, while over 85% lacked any form of internal audit function (Kabuye et al., 2019). This audit deficit manifested in unreliable financial information undermining management decision-making, undetected fraud and errors causing substantial losses estimated at 8-12% of annual revenues, weak internal controls creating operational inefficiencies, and limited stakeholder confidence restricting access to financing and business partnerships (Nkundabanyanga et al., 2013).

The absence of audit practices prevented SMEs from identifying and addressing financial management weaknesses, operational inefficiencies, and compliance gaps that eroded profitability and sustainability. Furthermore, without audited financial statements, SMEs struggled to access bank credit, qualify for government tenders requiring financial credibility, attract equity investors, or demonstrate accountability to business partners and regulatory authorities (Mukyala et al., 2017). The problem was compounded by misperceptions among SME owner-managers who viewed audits as expensive regulatory burdens providing minimal practical value rather than strategic tools for performance improvement and risk mitigation (Malagila et al., 2018).

Additionally, even among SMEs that engaged auditors, audit effectiveness remained questionable due to compromised independence where auditors provided both audit and accounting services creating conflicts of interest, inadequate audit scope focusing narrowly on financial statements while ignoring operational and compliance issues, poor audit quality resulting from engaging unqualified practitioners, and weak implementation of audit recommendations that were ignored or partially addressed without follow-up (Muliira et al., 2017). Consequently, potential audit benefits failed to materialize, reinforcing negative perceptions and perpetuating the cycle of audit avoidance.

While existing literature examined audit practices in large corporations, public institutions, and developed economy SMEs (Carey et al., 2006; Colbert & Alderman, 1995), limited empirical research investigated the specific relationship

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between audit practices and financial performance of SMEs in Wakiso District, where contextual factors including resource constraints, informal business practices, and regulatory enforcement limitations differed substantially from settings where most audit research had been conducted. This knowledge gap hindered evidence-based advocacy for audit adoption and development of appropriate audit service models matching SME needs and capacities.

### **Objective of the Study**

To examine the relationship between audit practices and financial performance of SMEs in Wakiso District.

### **Methodology**

This study employed a cross-sectional survey research design to examine the relationship between audit practices and financial performance of small and medium enterprises in Wakiso District. The design enabled efficient collection of data from multiple SMEs at a single point in time, facilitating relationship analysis without manipulation of variables (Cooper & Schindler, 2014). The target population comprised 680 registered SMEs operating in Wakiso District as documented in the district commercial office registry for the fiscal year 2022/2023, encompassing enterprises across manufacturing, trading, and service sectors.

Using Krejcie and Morgan's (1970) sample size determination table, a sample of 170 SMEs was selected, providing adequate statistical power at 95% confidence level with a 5% margin of error for generalizing findings to the broader SME population. Stratified random sampling was applied to ensure proportional representation across business sectors and enterprise sizes. The SME population was stratified into three sectors: manufacturing enterprises (25%), trading enterprises (48%), and service enterprises (27%), yielding 43 manufacturing enterprises, 82 trading enterprises, and 45 service enterprises in the sample. Within each stratum, simple random sampling using random number generation was employed to select specific enterprises, ensuring every SME had equal selection probability and minimizing sampling bias.

Data were collected using self-administered structured questionnaires distributed to SME owner-managers, finance managers, or chief executive officers identified as key informants possessing comprehensive knowledge of their organizations' audit practices and financial performance. The questionnaire comprised four sections: demographic and enterprise characteristics (10 items), audit practices assessment (20 items covering four dimensions), financial performance measures (10 items), and open-ended questions soliciting additional perspectives. Audit practices were operationalized across four dimensions: internal audit practices (5 items), external audit practices (5 items), audit independence (5 items), and audit recommendations implementation (5 items), measured on a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). Financial performance was assessed using indicators including profitability trends, revenue growth rates, return on assets, operational efficiency, liquidity management, and business expansion over the preceding two fiscal years.

Instrument validity was established through expert review by three university professors specializing in auditing and accounting, two practicing certified public accountants with SME audit experience, and one Uganda Revenue

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Authority official familiar with SME financial reporting. Their feedback resulted in question refinement improving clarity, relevance, and contextual appropriateness. Content Validity Index was calculated at 0.86, substantially exceeding the acceptable threshold of 0.70 (Amin, 2005). Reliability testing was conducted through a pilot study with 25 SMEs from neighboring Mukono District sharing similar characteristics with Wakiso but excluded from the main sample. Cronbach's alpha coefficients demonstrated high internal consistency: internal audit practices ( $\alpha = 0.878$ ), external audit practices ( $\alpha = 0.891$ ), audit independence ( $\alpha = 0.864$ ), audit recommendations implementation ( $\alpha = 0.882$ ), and financial performance ( $\alpha = 0.856$ ), all exceeding the acceptable reliability threshold of 0.70 (Nunnally & Bernstein, 1994).

Data collection was conducted over seven weeks between September and October 2023. Four research assistants were recruited and trained on ethical research conduct, questionnaire administration protocols, data quality assurance procedures, and respondent confidentiality maintenance. The response rate was 94.1% with 160 usable questionnaires returned out of 170 distributed, representing excellent participation attributed to advance notification letters, personal delivery and collection of questionnaires, and follow-up reminder contacts. Non-response analysis comparing early and late respondents on key variables revealed no significant differences, suggesting minimal non-response bias.

Data analysis was performed using Statistical Package for Social Sciences (SPSS) version 26.0. Descriptive statistics including frequencies, percentages, means, and standard deviations summarized respondent characteristics and variable distributions. Data normality was assessed using Kolmogorov-Smirnov tests and visual inspection of histograms, confirming approximately normal distributions suitable for parametric analyses. Pearson product-moment correlation analysis examined bivariate relationships between audit practice dimensions and financial performance. Multiple regression analysis with enter method determined the collective and individual predictive power of audit practice dimensions on financial performance, with financial performance as the dependent variable and the four audit practice dimensions as independent variables. Multicollinearity was assessed through Variance Inflation Factor (VIF) values, which ranged from 1.82 to 2.34, well below the threshold of 10, confirming absence of problematic multicollinearity. Statistical significance was set at  $p < 0.05$  level for all analyses.

Ethical considerations were rigorously observed throughout the research process. Approval was obtained from the institutional research ethics committee, Wakiso District commercial office, and Uganda Small Scale Industries Association. Informed consent was secured from all participants after explaining research purposes, voluntary participation rights, confidentiality assurances, and freedom to withdraw without consequences. Questionnaires were anonymous with no identifying information collected. Data were stored securely with access restricted to the research team, and findings were reported in aggregate form preventing individual enterprise identification.

## **Results**

### **Demographic Characteristics of Respondents**

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The study successfully collected data from 160 SME representatives in Wakiso District. Gender distribution showed that 58.8% (n=94) were male while 41.3% (n=66) were female, indicating male predominance in SME management positions though with significant female representation. Age distribution revealed that 38.1% (n=61) were aged 31-40 years, 28.8% (n=46) were 26-30 years, 20.6% (n=33) were 41-50 years, and 12.5% (n=20) were above 50 years, demonstrating concentration in prime working ages with substantial business experience. Educational qualifications indicated that 50.0% (n=80) possessed tertiary education including diplomas and degrees, 32.5% (n=52) completed secondary education, 13.8% (n=22) had primary education, and 3.8% (n=6) had no formal education, suggesting relatively educated SME leadership.

Respondent positions showed that 45.6% (n=73) were owner-managers combining ownership and management roles, 28.1% (n=45) were finance managers or accountants, 16.9% (n=27) were general managers or chief executives, and 9.4% (n=15) were business owners delegating management. Business sector distribution comprised trading enterprises (51.3%, n=82), service enterprises (28.1%, n=45), and manufacturing enterprises (20.6%, n=33). Enterprise age indicated that 35.0% (n=56) had operated for 6-10 years, 31.3% (n=50) for 3-5 years, 21.3% (n=34) for 1-2 years, and 12.5% (n=20) for more than 10 years. Number of employees showed that 48.8% (n=78) employed 11-30 workers, 33.1% (n=53) employed 6-10 workers, and 18.1% (n=29) employed 31-50 workers, confirming genuine SME classification. Annual turnover distribution revealed that 40.0% (n=64) generated UGX 100-200 million annually, 35.0% (n=56) generated UGX 50-100 million, 15.6% (n=25) generated over UGX 200 million, and 9.4% (n=15) generated less than UGX 50 million.

**Audit Practices Assessment**

**Table 1: Audit Practices Dimensions (N=160)**

<b>Audit Practice Dimension</b>	<b>Mean</b>	<b>SD</b>	<b>Interpretation</b>
<b>Internal Audit Practices</b>			
Regular internal audits are conducted	2.76	1.34	Moderate
Internal audit function exists in the business	2.54	1.38	Low
Internal auditors review operational processes	2.81	1.32	Moderate
Internal audit findings are documented	2.93	1.29	Moderate
Internal audit covers financial and operational areas	2.69	1.35	Moderate
<b>Internal Audit Practices Overall</b>	<b>2.75</b>	<b>1.15</b>	<b>Moderate</b>
<b>External Audit Practices</b>			
Annual external audits are conducted	3.21	1.31	Moderate
External auditors are professionally qualified	3.38	1.27	Moderate

External audit scope is comprehensive	3.14	1.28	Moderate
External auditors examine internal controls	3.06	1.30	Moderate
External audit reports are received timely	3.27	1.26	Moderate
<b>External Audit Practices Overall</b>	<b>3.21</b>	<b>1.10</b>	<b>Moderate</b>
<b>Audit Independence</b>			
Auditors are independent from management	3.19	1.29	Moderate
Auditors have unrestricted access to information	3.34	1.25	Moderate
Audit findings are reported objectively	3.41	1.23	Moderate
No conflicts of interest compromise audits	3.08	1.32	Moderate
Auditors are free to express opinions	3.46	1.22	Moderate
<b>Audit Independence Overall</b>	<b>3.30</b>	<b>1.08</b>	<b>Moderate</b>
<b>Audit Recommendations Implementation</b>			
Audit recommendations are reviewed promptly	3.23	1.27	Moderate
Management action plans address audit findings	3.11	1.30	Moderate
Audit recommendations are fully implemented	2.89	1.33	Moderate
Follow-up audits verify implementation	2.71	1.36	Moderate
Continuous improvement results from audits	3.18	1.28	Moderate
<b>Audit Recommendations Implementation Overall</b>	<b>3.02</b>	<b>1.12</b>	<b>Moderate</b>
<b>Overall Audit Practices</b>	<b>3.07</b>	<b>0.94</b>	<b>Moderate</b>

Source: Primary Data, 2025

The assessment of internal audit practices in Table 1 revealed relatively low overall implementation (M=2.75, SD=1.15), representing the weakest dimension of audit practices among Wakiso District SMEs. Documentation of internal audit findings scored highest within this component (M=2.93, SD=1.29), though still moderate, suggesting that when internal audits occurred, findings were recorded for reference. Review of operational processes (M=2.81, SD=1.32) and regular audit conduct (M=2.76, SD=1.34) demonstrated moderate but inconsistent implementation, indicating sporadic rather than systematic internal audit activities. Coverage of financial and operational areas (M=2.69, SD=1.35) was moderate, reflecting limited scope when audits were performed.

Most concerning was the existence of dedicated internal audit functions (M=2.54, SD=1.38), with only approximately 40% of SMEs having any form of internal audit capacity, whether formal departments or designated personnel. This

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finding validated preliminary observations that internal audit remained largely absent in Wakiso SMEs, attributed to perceived costs, limited awareness of internal audit value, shortage of qualified internal audit personnel, and prioritization of immediate operational concerns over systematic internal oversight. The low internal audit implementation created significant governance gaps, reducing assurance regarding operational effectiveness, control adequacy, and risk management quality.

External audit practices showed moderate implementation ( $M=3.21$ ,  $SD=1.10$ ), substantially higher than internal audit but still reflecting room for improvement. Professional qualification of external auditors scored highest ( $M=3.38$ ,  $SD=1.27$ ), with approximately 66% engaging qualified auditors, suggesting awareness that auditor competence was essential for audit credibility. Timely receipt of audit reports also scored favorably ( $M=3.27$ ,  $SD=1.26$ ), with 64% receiving reports promptly, enabling timely corrective action. Annual conduct of external audits ( $M=3.21$ ,  $SD=1.31$ ) was reported by 60% of SMEs, indicating that while majority engaged external auditors, 40% did not conduct annual audits, operating with outdated or no independent financial verification.

Comprehensive audit scope ( $M=3.14$ ,  $SD=1.28$ ) and examination of internal controls ( $M=3.06$ ,  $SD=1.30$ ) showed moderate implementation, suggesting that external audits often focused narrowly on financial statement verification rather than broader operational and control assessments that could provide greater value. This limited scope reflected cost minimization strategies where SMEs engaged auditors for basic statutory audits rather than comprehensive examinations, potentially missing opportunities to identify operational inefficiencies and control weaknesses that impaired performance.

Audit independence demonstrated moderate levels ( $M=3.30$ ,  $SD=1.08$ ), with auditor freedom to express opinions scoring highest ( $M=3.46$ ,  $SD=1.22$ ), reported by 68% of respondents, suggesting reasonable respect for professional judgment. Objective reporting of findings ( $M=3.41$ ,  $SD=1.23$ ) and unrestricted information access ( $M=3.34$ ,  $SD=1.25$ ) scored favorably, with 66% and 65% respectively confirming these independence attributes. However, independence from management ( $M=3.19$ ,  $SD=1.29$ ) and absence of conflicts of interest ( $M=3.08$ ,  $SD=1.32$ ) showed lower scores, with only 61% and 58% respectively reporting full independence.

These findings suggested potential independence impairments arising from situations where auditors provided multiple services creating familiarity threats, close personal relationships between auditors and owner-managers, or economic dependence of small audit firms on specific clients. Such independence compromises could undermine audit quality by inhibiting professional skepticism, limiting challenging of management assertions, or biasing judgment toward client preferences. The moderate independence scores highlighted that while outright independence violations were not widespread, subtle threats existed that potentially reduced audit effectiveness.

Audit recommendations implementation revealed moderate but problematic levels ( $M=3.02$ ,  $SD=1.12$ ), representing a critical weakness in translating audit insights into performance improvements. Prompt review of recommendations ( $M=3.23$ ,  $SD=1.27$ ) and continuous improvement resulting from audits ( $M=3.18$ ,  $SD=1.28$ ) showed reasonable

practice, with approximately 61% and 59% respectively engaging with audit outputs constructively. Development of management action plans (M=3.11, SD=1.30) was moderate, with 57% creating implementation roadmaps.

However, full implementation of recommendations (M=2.89, SD=1.33) was reported by only 51% of SMEs, indicating that nearly half either partially implemented or ignored audit recommendations, severely limiting audit value. Most critically, follow-up audits verifying implementation (M=2.71, SD=1.36) were conducted by only 45% of SMEs, suggesting weak accountability mechanisms ensuring corrective actions materialized. This implementation gap reflected resource constraints preventing recommended investments, management resistance to changes challenging existing practices, lack of urgency when audit findings were not linked to immediate crises, and absence of systematic follow-up processes holding management accountable for implementation.

The overall moderate audit practices implementation (M=3.07, SD=0.94) indicated that while Wakiso District SMEs demonstrated some audit engagement, particularly regarding external audits, significant deficiencies existed in internal audit establishment, audit scope comprehensiveness, independence maintenance, and especially recommendations implementation. These gaps suggested that even when audits occurred, their potential contribution to financial performance remained partially unrealized due to incomplete audit cycles and limited integration of audit insights into management practices.

**Financial Performance of SMEs**

**Table 2: Financial Performance Indicators (N=160)**

<b>Financial Performance Indicator</b>	<b>SA (%)</b>	<b>A (%)</b>	<b>N (%)</b>	<b>D (%)</b>	<b>SD (%)</b>	<b>Mean</b>	<b>SD</b>
Profitability has increased consistently	26.3	42.5	16.9	10.0	4.4	3.76	1.11
Revenue growth exceeds industry average	23.1	38.8	20.0	13.1	5.0	3.62	1.15
Return on assets has improved	20.6	37.5	21.3	14.4	6.3	3.52	1.18
Operating efficiency has increased	23.8	40.6	18.1	12.5	5.0	3.66	1.14
Liquidity position is adequate	21.3	38.1	20.6	14.4	5.6	3.55	1.17
Cost management has improved	24.4	41.3	17.5	11.9	5.0	3.68	1.14
Access to financing has improved	15.0	30.6	24.4	20.0	10.0	3.21	1.24
Market share has expanded	17.5	34.4	23.1	17.5	7.5	3.37	1.21
Financial reporting quality has improved	25.6	43.1	16.3	10.0	5.0	3.74	1.12
Overall business sustainability is strong	22.5	40.0	19.4	12.5	5.6	3.61	1.16
<b>Overall Financial Performance</b>	-	-	-	-	-	<b>3.57</b>	<b>0.96</b>

**Source: Primary Data, 2025**

The financial performance assessment in Table 2 indicated moderate to high overall performance (M=3.57, SD=0.96) among SMEs in Wakiso District. Profitability increase emerged as the strongest performance indicator (M=3.76, SD=1.11), with 68.8% of respondents reporting consistent profit growth over the previous two years, suggesting

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successful revenue generation and cost management despite competitive market conditions. Financial reporting quality improvement scored nearly as high (M=3.74, SD=1.12), with 68.7% reporting enhanced reporting accuracy and timeliness, likely driven by computerized accounting systems adoption and professional accounting support engagement.

Cost management improvement demonstrated strong performance (M=3.68, SD=1.14), with 65.7% effectively controlling expenses through better procurement practices, operational efficiency gains, and waste reduction. Operating efficiency increase (M=3.66, SD=1.14) was reported by 64.4% of SMEs, indicating productivity improvements from process optimization, technology adoption, and workforce training. Revenue growth exceeding industry averages (M=3.62, SD=1.15) affected 61.9% of enterprises, reflecting competitive advantage achievement through product differentiation, customer service excellence, or market positioning.

Overall business sustainability strength (M=3.61, SD=1.16) was reported by 62.5% of SMEs, suggesting growing organizational resilience, long-term viability, and capacity to withstand market fluctuations. Liquidity adequacy (M=3.55, SD=1.17) was maintained by 59.4% of enterprises, enabling meeting of short-term obligations and operational continuity, though 20.0% faced liquidity challenges potentially constraining growth and crisis response capacity. Return on assets improvement (M=3.52, SD=1.18) affected 58.1%, demonstrating enhanced efficiency in utilizing resources to generate profits.

Market share expansion showed more modest results (M=3.37, SD=1.21), with 51.9% increasing market presence, suggesting that while many SMEs grew, competitive intensity and market saturation limited expansion for others. Most challenging was financing access improvement (M=3.21, SD=1.24), where only 45.6% reported enhanced credit access. This persistent financing constraint limited growth investments, with 30.0% struggling to access formal financing possibly due to collateral insufficiency, inadequate financial documentation, perceived high risk by lenders, or stringent credit requirements. The moderate to high overall financial performance suggested that Wakiso SMEs generally succeeded but faced specific challenges particularly regarding external financing and market expansion that audit practices might address through enhanced financial credibility and operational transparency.

**Relationship Between Audit Practices and Financial Performance**

**Table 3: Correlation Analysis (N=160)**

<b>Variables</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1. Internal Audit Practices	1				
2. External Audit Practices	0.712**	1			
3. Audit Independence	0.689**	0.734**	1		
4. Audit Recommendations Implementation	0.698**	0.721**	0.706**	1	
5. Financial Performance	0.681**	0.656**	0.639**	0.672**	1

\**p* < 0.01 (2-tailed)

**Source: Primary Data, 2025**

The correlation analysis in Table 3 revealed that all four dimensions of audit practices demonstrated strong positive and statistically significant relationships with financial performance at the 0.01 level. Internal audit practices exhibited the strongest correlation ( $r = 0.681, p < 0.01$ ), indicating that SMEs with regular internal audits, dedicated internal audit functions, comprehensive operational and financial reviews, documented findings, and systematic internal oversight achieved superior financial outcomes. This strong relationship operated through multiple mechanisms: internal audits identified operational inefficiencies enabling corrective action, detected control weaknesses preventing fraud and errors, provided management with reliable information for decision-making, and promoted accountability culture encouraging performance orientation.

Audit recommendations implementation showed the second strongest correlation ( $r = 0.672, p < 0.01$ ), demonstrating that SMEs promptly reviewing, planning, implementing, and following up on audit recommendations experienced better profitability, revenue growth, and sustainability than those ignoring or partially addressing audit findings. This critical relationship highlighted that audit value materialized primarily through implementation rather than mere audit conduct, as recommendations translated audit insights into tangible improvements in processes, controls, and practices. The strong correlation validated that audit effectiveness depended fundamentally on management commitment to acting on audit outputs.

**Table 4: Regression Analysis Results (N=160)**

<b>Model Summary</b>						
R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Std. Error	F	Sig.	
0.728	0.530	0.518	0.667	43.714**	0.000	
<b>Predictor Variable</b>	<b>B</b>	<b>Std. Error</b>	<b>Beta (β)</b>	<b>t</b>	<b>Sig.</b>	<b>VIF</b>
(Constant)	0.794	0.226	-	3.513	0.001	-
Internal Audit Practices	0.276	0.084	0.285	3.286	0.001	2.12
External Audit Practices	0.251	0.089	0.267	2.820	0.006	2.34
Audit Independence	0.218	0.086	0.234	2.535	0.012	2.18
Audit Recommendations Implementation	0.243	0.083	0.256	2.928	0.004	2.06

*Dependent Variable: Financial Performance*

**Source: Primary Data, 2025**

External audit practices demonstrated significant positive correlation ( $r = 0.656, p < 0.01$ ), showing that annual external audits by qualified professionals, comprehensive scope examinations, internal control reviews, and timely reporting contributed substantially to financial performance. This relationship likely operated through enhanced financial statement credibility facilitating bank financing access, improved management accountability from

independent oversight, fraud deterrence through external verification, stakeholder confidence building enabling business partnerships, and identification of financial management weaknesses requiring attention.

Audit independence correlated significantly ( $r = 0.639$ ,  $p < 0.01$ ), indicating that SMEs where auditors maintained objectivity, accessed information without restriction, reported findings honestly, avoided conflicts of interest, and expressed professional opinions freely achieved better financial results than those with compromised audit independence. This relationship reflected that independent audits provided more reliable assurance, identified genuine rather than superficial issues, challenged management more effectively, and delivered greater stakeholder credibility, all contributing to performance improvement.

Inter-correlations among audit practice dimensions ranged from 0.689 to 0.734, all highly significant, suggesting these dimensions were interrelated yet distinct aspects of comprehensive audit systems. The strong inter-correlations indicated that audit practices reinforced each other, with strength in one dimension supporting effectiveness in others. For instance, external audit quality likely enhanced internal audit credibility, while audit independence strengthened both external and internal audit effectiveness, and recommendations implementation created demand for higher quality audits that identified actionable improvements.

### **Conclusions**

Audit practices implementation among SMEs was generally moderate but varied considerably across dimensions, with external audit practices demonstrating the strongest implementation while internal audit practices showed the weakest. Significant deficiencies existed particularly in internal audit function establishment, comprehensive audit scope, follow-up audits verifying implementation, and full implementation of audit recommendations. These gaps reflected cost perceptions, limited audit value awareness, resource constraints, and weak accountability mechanisms. The moderate implementation suggested that while many SMEs engaged auditors, particularly for external statutory audits, systematic comprehensive audit systems remained underdeveloped.

Financial performance of SMEs in Wakiso District was moderate to high, characterized by increasing profitability, improving cost management, enhanced operating efficiency, and strengthening sustainability for the majority of enterprises. However, performance remained constrained by limited financing access affecting over half of SMEs and moderate market expansion, creating growth ceilings that better financial credibility through audits might address. The overall positive performance trajectory suggested that Wakiso's economic environment supported SME success, though business-specific factors including governance quality and financial management differentiated high performers from struggling enterprises.

Audit practices demonstrated strong positive and statistically significant relationships with SME financial performance, with internal audit practices emerging as the most influential dimension despite being least implemented. The research established that audit practices explained approximately 53% of financial performance variance, representing substantial practical importance. This relationship operated through multiple mechanisms: internal audits

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improved operational efficiency and control effectiveness; external audits enhanced financial credibility facilitating financing access and stakeholder confidence; audit independence ensured reliable assurance and genuine issue identification; and recommendations implementation translated audit insights into tangible performance improvements. The findings validated audit practices as strategic performance enhancement tools rather than mere compliance obligations.

All four audit practice dimensions contributed significantly and independently to financial performance when considered simultaneously, demonstrating the value of comprehensive integrated audit systems rather than selective implementation. The research validated that even resource-constrained SMEs benefited substantially from systematic audit practices, with performance gains likely offsetting audit costs through fraud prevention, error reduction, operational efficiency improvements, and enhanced market access. The findings challenged common perceptions among SME owner-managers that audits represented expensive burdens, instead positioning them as strategic investments yielding measurable returns.

The critical importance of audit recommendations implementation emerged as a key finding, suggesting that audit effectiveness depended fundamentally on management commitment to acting on findings rather than treating audits as ritualistic exercises. The moderate implementation levels identified represented a significant barrier preventing SMEs from realizing full audit value, highlighting the need for follow-up mechanisms, accountability structures, and management mindset shifts viewing audit recommendations as improvement opportunities rather than criticisms.

### **Recommendations**

SMEs should prioritize establishing internal audit functions or mechanisms appropriate to their size and resources. For smaller SMEs lacking capacity for dedicated internal auditors, alternatives included engaging external consultants for periodic internal reviews, designating existing staff with partial internal audit responsibilities, participating in peer review arrangements with other SMEs, or utilizing audit service packages offered by professional accounting firms (Goodwin-Stewart & Kent, 2006). Internal audit scope should encompass both financial and operational areas, examining cash management, inventory controls, procurement processes, revenue recognition, and compliance with regulations. Documented internal audit programs, finding reports, and management responses should be maintained systematically.

SMEs should engage qualified external auditors annually regardless of statutory requirements, viewing external audits as strategic investments rather than compliance costs. Audit engagement letters should specify comprehensive scope including financial statement verification, internal control assessment, fraud risk evaluation, and operational efficiency review rather than limiting audits to narrow statutory requirements (Arens et al., 2017). SMEs should select auditors based on relevant industry experience, professional qualifications, reputation, and value-added services rather than solely on fee minimization. Developing long-term relationships with auditors enabled deeper business understanding and more insightful recommendations while maintaining appropriate independence safeguards.

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SMEs must ensure audit independence through several mechanisms: avoiding engaging auditors who also provide bookkeeping or accounting services creating self-review threats; rotating audit partners or firms periodically to prevent familiarity threats; ensuring management does not exert undue influence on audit scope or findings; providing auditors unrestricted access to information, personnel, and assets; and establishing audit committees or advisory boards where feasible to oversee audit processes and auditor selection (DeAngelo, 1981). Even in small SMEs, owner-managers should recognize that compromised independence undermines audit value by reducing reliability and stakeholder credibility.

SMEs should systematically implement audit recommendations through formal processes including prompt management review of audit reports within two weeks of receipt, development of detailed action plans specifying responsibilities and timelines for each recommendation, allocation of necessary resources for implementation, progress monitoring through quarterly reviews, and engagement of auditors for follow-up audits verifying implementation (Bou-Raad, 2000). Recommendations should be prioritized based on risk severity and implementation feasibility, with high-risk findings addressed immediately. Management should view recommendations as valuable improvement opportunities rather than criticisms, fostering constructive engagement with audit outputs.

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