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Wangechi, Mary  
*Strathmore Business School*  
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**FACTORS INFLUENCING THE ADOPTION OF VOLUNTARY AUDITS FOR  
SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY, KENYA**

**MARY WANGECHI**

**085015**

**A Research Thesis Submitted to the Strathmore Business School in Partial  
Fulfillment for the award of a Degree of Master of Commerce Degree (MCOM)  
of Strathmore University.**

**August 2020**

## DECLARATION

This thesis is my original work and has not been presented for the award of a degree in any other University. Any work done by other people has been duly acknowledged. The thesis has been examined by a board of examiners of Strathmore University.

MARY WANGECHI (085015)

Signature..... Date.....

### Approval

This thesis has been submitted for examination and was reviewed and approved by the following;

DR. JAMES NDEGWA

Lecturer Accounting and Finance, Strathmore University Business School

Strathmore University

Dr. Alfred Kitawi

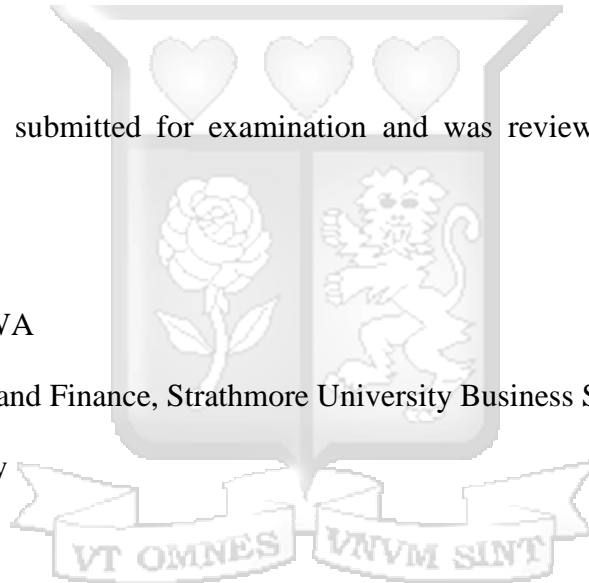
Dean, School of Graduate studies

Strathmore University

Dr. George Njenga

Dean, School of Business Studies

Strathmore University



## DEDICATION

This project is a special dedication to my family. You were always there for me whenever I needed you. Thanks a lot



## ACKNOWLEDGEMENTS

I thank the most high God for granting me good health, understanding, knowledge, resources friends and wisdom to carry on this research project. It is through the hand of the most high that I have completed this project. I would also like to recognize my supervisor for encouraging me and guiding me throughout the research process. In addition I would like to thank the administration in Strathmore University for providing a conducive environment which facilitated the completion of this project. Further, I am also thanking my parents, siblings, colleagues, friends and any other person who might have contribution towards completion of this research project. May God expand your territories.



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## ACRONYMS AND ABBREVIATIONS

<b>CEO:</b>	Chief Executive Officer
<b>ILO:</b>	International Labor Organization
<b>MLHRD:</b>	Ministry of Labor and Human Resource Development
<b>NACOSTI:</b>	National Commission of Science and Technology Council
<b>SMEs:</b>	Small and medium enterprises
<b>SPSS:</b>	Statistical Package for Social Sciences
<b>TSE:</b>	Tehran Stock Exchange



## DEFINITION OF TERMS

**Auditing:** This is a step by step process of obtaining evidence and evaluating it based on certain assertions concerning specific economic actions as well as events to determine the extent of correspondence between the assertions and the laid down framework then communicating the end results to the interested parties (Oaya & Mambula, 2017).

**Compliance with tax regulations:** This is the extent to which a business enterprises comply with the rules of the land regarding taxation for instance through declaration of income, filing returns as well as making timely payment of the tax due (Collis, Jarvis & Skerratt, 2014).

**Credit Access Requirements:** These are conditions set by a financial institution for an enterprise to obtain a loan or credit (Oaya & Mambula, 2017).

**Firm characteristics:** These are aspects of an organization that are seen as “drivers” to business relations and they comprise of size, firm age, profitability and board size (Afrifa & Padachi, 2016).

**Ownership:** This refers to the ability of an individual to have exclusive rights and control over a business enterprise and its operations (Allee & Yohn, 2009).

**Small and medium enterprises:** These are business organizations with employees between 10 and 99 and an annual turnover of between Ksh. 500,000 and Ksh. 800 million

**Voluntary audits:** This is an official inspection of an organization's accounts that is exercised by choice and not compelled or mandated by law (Aziz & Omoteso, 2014).

## ABSTRACT

Small and medium enterprises play a major role in economic development and in the provision of employment and poverty alleviation. Auditing has many benefits to small and medium enterprises, which include bringing about financial discipline and preventing money laundering, fraud and other illegal activities. However, SMEs in Kenya show a low adoption and utilization. This study therefore sought to investigate on the factors influencing the adoption of voluntary audits for SMEs in Kenya. The study also sought to determine the influence of firm characteristics, credit access requirements, compliance with tax regulations and ownership-control characteristics on the adoption of voluntary audits for SMEs in Kenya. This research study used a descriptive research design. The group of interest was all the SMEs in Gikomba market registered with Nairobi City County. Nairobi City County License register of 2018, there are 1040 business enterprises in Gikomba market with between 10 and 99 employees. Therefore, the target population of this study was 1,040 managers/owners of business enterprises in Gikomba market. A stratified random sampling method was used to choose 288 owners/managers from the target population. The study used primary data, which was collected by use of semi-structured questionnaires. The study conducted pilot test to assess the validity and reliability of the research instruments. In this research, both qualitative data and quantitative data were retrieved from semi-structured questionnaire. Different methods of data analysis were adopted to analyze this data. Thematic analysis was adopted to analyze qualitative data after which the results were presented in a prose form. Further, both inferential statistics and descriptive statistics were adopted to analyze quantitative data. This was done with the help of SPSS version 22. The study found that firm characteristics, credit access requirements, compliance with tax regulations and ownership control positively and significantly influence the adoption of voluntary audits among SMEs. The study concludes that firm characteristics, credit access requirements, compliance with tax regulations and ownership control have a significant influence on the adoption of voluntary audits for small and medium enterprises in Nairobi County. From the findings, this study recommends that the SME owners/managers should ensure proper record of all financial documents which includes cash flow statements. The study also recommends training programmes by the financial institutions to the SME owners/manager so as to increase the knowledge and skills on preparation of financial statements. Further SME owners/managers should ensure regular auditing of the financial statements so as to boost their access to credit facilities from financial institutions. To the management of SMEs the study provides information that can be used to develop strategies to enhance utilization of voluntary financial audits as a way of improving growth and performance among SMEs. To the policy makers the study provides information that can be used to formulate policies to enhance voluntary audits among SMEs in Kenya.

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Globally, Small and medium enterprises (SMEs) play a significant role in economic development (Aminu & Shariff, 2015). SMEs, in most countries, are considered as the backbone of economic growth as they are key catalysts of innovation, employment and entrepreneurial skills. Small and medium enterprises form 95 per cent of total enterprises around the world, account for 55 per cent of the total production and 66 percent of total employment (Afrifa & Padachi, 2016). Therefore, a growing and health SME sector is considered crucial for economic development and sustainable competitive advantage at local, regional and international level. In the last one decade, concerns for corporate accountability have been rising, which is associated with the need for appropriate risk management as well as both internal and external auditing (Cowling & Liu, 2013).

The key aim of auditing is to ensure accuracy, reliability as well as fairness of representing the financial statements of firms and then avail the information to the stakeholders. Collis (2013) indicates that for SMEs to flourish, they must apply basic financial management skills in the management of cash flow, access financing and credit and comply with tax legislations. However, for SMEs to meet these criteria, they must have their financial statements audited. An audit helps in bringing about financial discipline in an organization. Also, it is considered to be a major deterrent of money laundering, fraud and other illegal activities. Even though, auditing is generally not design to detect fraud, in its absence, errors and fraud are likely to occur unnoticed and undetected.

Voluntary audits lead to improved financial performance among the small and medium enterprises. According to Collis (2013) auditing informs decision making in small and medium enterprises by equipping the top management with credible and accurate information that leads to better decision making hence improving the financial position of the firm. Gahman and Ali (2015) indicate that effective voluntary audit helps in improving the confidence of creditors concerning SMEs in terms of their financial reporting and governance. Through voluntary audits, small and medium enterprises ensure proper

monitoring and efficiency in financial performance which are the key performance indicators.

Gahman and Ali (2015) indicates that an external audit increases the credibility of the financial statements of small and medium enterprise, thus increasing their access to credit facilities from banks and other financial institutions. Further, information being the lifeblood of modern business, inaccurate and misleading information may lead to wrong decisions (Kaji, Shrestha & Wai, 2011). Therefore, auditing informs decision making in small and medium enterprises by equipping the management with credible and accurate information that leads to better decision making. However, while prior studies have shown that the effective audit function has a positive impact on a firm's operational performance, financial performance and corporate governance, most small and medium enterprises around the world do not conduct voluntary audits consistently.

In the United Kingdom, Collis (2013) found that 22 per cent of micro-companies were conducting voluntary audits, 45 per cent considered the benefits of audits to outweigh the costs and 33 per cent were not conducting audits at all. In a synthesis of literature, Haapamaki (2018) classified factors influencing voluntary auditing into four categories: firm attributes, management characteristics, ownership control characteristic and agency relationship features. Firm characteristics entail board size, profitability, organization characteristics and firm complexity. The features of ownership control entails percentage of ownership by directors and officers and family-ownership (Kaji, Shrestha. & Wai, 2011). Agency relationship attributes comprise of lender's requirement of demand for auditing, owner-supplier relationship as well as credit accessibility. Management characteristics include need for information in decision making and improvement of financial information quality. Other studies have highlighted different factors influencing voluntary audits' adoption and small businesses.

In Finland, Ojala, Collis and Troberg (2016) found that the main drivers of voluntary audits among micro-companies included the growth of the company, need for tax reporting credibility, ownership structure, ensuring security of supply from trade creditors and financial stability of the microenterprise. Similarly, Ojala, Niskanen and Pajunen (2014)

established that reliability of the creditors, existence of electronic systems had an influence on the adoption and perceived benefits of audits by small and medium enterprises.

In Malaysia, Ronkko, Paananen and Vakkuri (2018) found that the determinants of voluntary internal audits include ownership structure, firm size, risk management committees, financial industry requirements, risk managers, ownership structure, audit committees, board composition, profitability, organizational growth and organizational complexity. In Sweden, Kaji, Shrestha and Wai (2011) found that audit exempted SMEs in Sweden were voluntarily conducting financial statements audit are so as to easily get loans, pay the right amount of tax and create a better relationship with creditors, suppliers and investors. Most small and medium enterprises are characterized by limited non-financial and financial resources. They have less access to credit as compared to large organizations. However, commercial banks and microfinance institutions provide loans to SMEs with credible and reliable financial statements. As such, financial institutions prefer audited financial statements when extending credit facilities to borrowers since these statements are good predictors of safe and risky borrowers.

In South Africa, Oseifuah and Gyekye (2013) highlighted the low adoption of voluntary audit among small businesses in Vhembe District, which was at 45 percent. The factors found to affect voluntary adoption include firm size, annual turnover and professional accounting knowledge. In Kenya, Gahman and Ali (2015) indicate that the main factors influencing financial audit in SMEs in Mombasa County include internal control systems, compliance with accounting standards and audit evidence. On the other hand, Kipsang (2012) found that the SME sector in Kisii County is characterized by low levels of compliance with accounting legislation. The main factors found to contribute to adoption of financial audits include lack of accounting knowledge, firm size and lack of financial resources.

### **1.1.1 Small and Medium Enterprises in Kenya**

In Kenyan context, SMEs perform a key role in development of an economy. Situation in Kenya is of no difference to other parts of the world as far as support and recognition of micro business is involved. Nevertheless, sector emphasis, which has been acknowledged as "Jua Kali" and informal, did not occur until after the year 1972 following report of ILO on

program of World Employment (Sessional Paper No. 2, 1992). The report emphasized on the likelihood of small business and informal sector creating jobs and also generating income to most of the people in Kenya. The sector was provided with considerable attention due to this recognition in the following Governments plans. All over Kenya, SMEs are defined in terms of their size which is indicated by the number of workers. Under this classification; we have micro-enterprises which have less than ten workers, small enterprises which have a range of 11-50 workers then the large enterprises that contain more than 50 workers. Hence, SMEs includes variety of establishments, comprising of activities which are informal economy that entails one or more enterprises and persons in formal economy creating jobs for up to 50 individuals. Ministry of Labor and Human Resource Development which is currently leading agency of the government in SME sector, provides formal and also informal enterprises, categorized into non-farm as well as on-farm categories, creating jobs for 1-50 personnel (KNBS, 2015). Registration of SMEs across Kenya is guided and regulated by the Companies Act 2015 No. 17 of the year 2015. According to the Companies Act No. 17 of 2015, small and medium enterprises can be limited companies, companies which are limited by shares, companies which are limited by guarantee, private companies and unlimited companies.

Even though SME sector carry out an important role in creating employment, generation of income is the foundation for Country industrializing, because of its features as it experiences constraints which lower their particular resilience to danger and inhibits them from improving and achieving economies of scale. Short-comings are found in areas of working capital, financing investment, development of human resource, access to market and access to current IT. Financial resources access is constrained by internal and also external factors (Economic survey, 2015). Most of SMEs internally lack management capacity and creditworthiness; hence they have challenges in securing finance for their activities in business which include purchase of products, raw materials and investing in equipment and plant machinery (Kenya National Bureau of Statistics, 2015). SMEs are considered as costly and insecure businesses to deal withfrom external perspective since they lack necessary collateral and also have the ability to only absorb little amount of finance from financial organizations. Therefore, in their access to credit they are rationed out due to high costs of intermediation, including monitoringcost and loan contracts enforcement.

This research study will emphasis on SMEs in Gikomba market. Gikomba Market covers both sides of the Nairobi River and then extends into the informal settlements of Pumwani and Majengo. Informal trade evolution in Gikomba area during the colonial period had many economic influencing factors. One of the factors was transport routes from upcountry where terminus in Gikomba was used in supplying goods for sale in the market. There also existed a high population with low purchasing power in the neighboring residential areas. A third factor was the land and business restrictions imposed by the authorities thus making most of the traders in the area informal traders. As the rising cost of living continued to hit the low-income population of Nairobi, several of these low-income earners set up informal kiosks and stalls where they could operate businesses so as to boost their income (Olotch, 2017).

Generally, Gikomba market is considered the largest open-air market and receives tens of thousands of visitors trading, purchasing goods, hawking, gathering or just trying to live. While in the market most of the businesses are informal, there is SMEs mushrooming within the market and which are more formal (Achesa, 2016). Products in Gikomba market range from food, hardware, fish, household goods, vegetables and its most popular brand “mitumba” as it is locally known or second hand clothes. These clothes and shoes are exported to Kenya via ships in huge quantities which are then sold at Gikomba either in bales or individual items. Some of the main challenges facing Gikomba market include lack of sufficient funds to finance the growth of the enterprises, lack of market access, low capital, and frequent fires that occur several times yearly destroying properties worth of millions (Ngugi, 2014).

## **1.2 Statement of the Problem**

SMEs perform an essential task in economic growth through poverty eradication, creating employment, wealth creation, and new firms creation. SMEs sector had highest share of job creation accounting to 82.7% of total employments (Economic survey, 2015). In global economy, SMEs are highly acknowledged as engines of development and growth and are the basis of any economy in various developed nations. However, Sharu and Guyo (2013) show that small and medium enterprises in Kenya have very low survival rate, with 60 per cent of new SMEs collapsing in the first three years of their operations. However, Collis (2013)

shows that voluntary auditing can be used to improve the financial performance and growth of SMEs. This is because it increases credit accessibility, leads to informed decision making in operations and management and enables easier compliance with tax regulations.

Despite the many benefits of auditing, small and medium enterprises in Kenya show a low adoption and utilization. For instance, Kipsang (2012) found that only 14 per cent of the SMEs studied were conducting voluntary financial audits. According to Kamarudin, Abidin and Smith (2012) shows that one of the main causes of small businesses failure is poor and careless financial management. Also, Ojala, Collis and Troberg (2016) found that small firms that engaged the services of qualified accountants in conducting financial audits, had significantly less incidences of illiquidity, failure, business stagnation and lack of credit access compared to those that had not. In addition, Oaya and Mambula (2017) indicate that small and medium enterprises have significantly high incidences of illiquidity and lack of credit access. According to International Finance Corporation (2015), about 65% of SMEs in Gikomba market did not benefit from financial assistance from financial entities in the year 2015. Due to the role of SMEs in economic development, it is important to ensure their growth and improved performance.

Various studies have been done globally and locally on adoption of auditing and accounting services. In Kenya, Kipsang (2012) conducted a study on the factors influencing the use of accounting services by SMEs in Kisii County and Gahman and Ali (2015) investigated on the determinants of financial audit in SMEs in Mombasa County. Nevertheless, this research was done on specific counties (Kisii County and Mombasa County) and therefore the results are not generalizable to other Counties in Kenya. The current research therefore sought to investigate on the factors influencing the adoption of voluntary audits for SMEs in Kenya.

### **1.3 Objectives of the study**

#### **1.3.1 General Objective**

The general objective of the study was to investigate the factors influencing the adoption of voluntary audits for SMEs in Nairobi County

### **1.3.2 Specific Objectives**

The specific objectives of the study were;

- i. To assess the influence of firm characteristics on the adoption of voluntary audits for SMEs in Nairobi County
- ii. To assess the influence of credit access requirements on the adoption of voluntary audits for SMEs in Nairobi County
- iii. To assess the influence of compliance with tax regulations on the adoption of voluntary audits for SMEs in Nairobi County
- iv. To assess the influence of ownership control on the adoption of voluntary audits for SMEs in Nairobi County

### **1.4 Research Questions**

The study was guided by the following research questions;

- i. What is the influence of firm characteristics on the adoption of voluntary audits for SMEs in Nairobi County?
- ii. How do credit access requirements influence the adoption of voluntary audits for SMEs in Nairobi County?
- iii. What is the influence of compliance with tax regulations on the adoption of voluntary audits for SMEs in Nairobi County?
- iv. How does ownership control influence the adoption of voluntary audits for SMEs in Nairobi County?

### **1.5 Significance of the Study**

This research is of huge benefit to SME owners, policy makers, government and also other researchers and academicians. To management of SMEs this study offers information on how various factors influence the adoption of voluntary audits. This particular information can be

adopted to create strategies to enhance utilization of financial audits as a means of increasing growth and performance among SMEs

SMEs perform an important task in the national economic and hence their growth and performance is important to County governments as well as national government. Hence, to policy makers this study gives information on various factors that influences the adoption of voluntary audits among SMEs which can be utilized to create policies so as to increase voluntary audits. In addition, the failure of SMEs to conduct financial audits implies that they pay inaccurate taxes and hence empowerment of SMEs to conduct financial audits would lead to an increase in revenue collection. This study supports policymakers in planning strategies which are more effective and aimed at improving quality audit levels in SMEs.

To the body of knowledge, this research study adds extra information on factors which influence adoption of voluntary audits among SMEs. To other academicians and researchers performing studies on voluntary audits, this research gives information which can be adopted as literature review. Further, the research creates a foundation upon which more research can be performed on adoption of voluntary audits among SMEs.

### **1.6 Scope of the Study**

This study was conducted in Starehe Sub County. Being the capital City in Kenya, Nairobi County was selected because it has the highest number of SMEs in Kenya. In addition, the County is used by business people to trade goods from all over the country. Also, business people from all over the country obtain goods such as Second hand clothes (Mitumba) from Nairobi County. The target population comprised of all the audit firms and SMEs in Gikomba market registered with Nairobi City County. Nairobi City County License register of 2018, there are was 1040 business enterprises in Gikomba market with between 10 and 99 employees. Therefore, the target population of this comprised of heads of the 13 audit firms and 1,040 managers/owners of business enterprises in Gikomba market.

### **1.7 Organization of the Thesis**

This project is organized into five chapters. The first chapter entails background of the study, statement of the problem, objectives, research questions, significance of the research together

with scope of the study. Chapter two reviews both theoretical and empirical literature on the factors influencing the adoption of voluntary audits for SMEs. Further, the section entails introduction, theoretical review, empirical review, summary of research gap, conceptual framework together with the chapter summary. Under chapter three, the research methodology describes the research design, the target group of interest, sampling method, sample size, research instruments, validity and reliability of the research instruments, data collection procedures together with data analysis techniques and ethical consideration. The fourth chapter deals with analysis of the collected data, interpretation of the results and presentation of the findings. The last chapter presents the summary of the findings as per the specific objectives of the research, study limitation, conclusion and recommendations for further studies.



## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

This section reviews the existing literature on the factors influencing the adoption of voluntary audits for SMEs. The chapter entails theoretical review, empirical review, summary of the reviewed literature, the research gaps, conceptual framework together with the chapter summary.

#### **2.2 Theoretical Review of Literature**

This section presents the theoretical review on the effect of firm characteristics, credit access requirements, compliance with tax regulations and ownership control on the adoption of voluntary audits for SMEs. This study is anchored on the capital need theory and agency theory.

##### **2.2.1 Capital Need Theory**

This theory was developed by Gray *et al.*, (1995). The theory helps in explaining why companies disclose information voluntarily. The theory holds that firm managers benefit from disclosing additional information that increase the capability of those firms to raise capital on the best available terms. According to Umoren (2016) there is high tendency of information disclosure from firm managers with an aim of making capital market transaction. This in turn ensures minimum information asymmetry problem hence minimizing the external cost of financing.

According to this theory, increases in the rate of voluntary information disclosure from the top management of firms leads to minimization of the firm's capital cost through reduction of investor's uncertainty. In this perspective, Bulatovic, Treis and Lindholm (2016) argued that stock market liquidity is enhanced through addition disclosure of information. This in turn leads to low cost of equity capital either through increased the demand for the organization shares or minimizing the transaction cost. Therefore with an aim of increasing trading in organizational shares and minimize the uncertainties associated with the future organizational performance, there is need for increased voluntary information disclosure (Kolsi, 2012). The

theory argues that more new investors are attracted through availing more information in the annual reports of the company. This in turn helps in ensuring the high demand of the organizational shares is maintained. Further, the theory argues that firms disclosing more information have a tendency of gaining increased stock price in the long run.

According to Ikpore and Ozor (2016) minimization in the fluctuation of shares within an organization is ensured through increased information disclosure of the firm's annual report. For instance, Lang and Lundholm(2012) reveal that the fluctuation of the firm's share price is as a result of poor information disclosure in the annual reports. This in turn leads to poor allocation of economic capital resources. Bhuiyan and Tuhin (2014) indicate that the motivation of increased information disclosure in firms is as a result of managers' aim to inflate the investors' expectations of the firm's value. According to Pandula (2010) there are three capital market effects that can result from firms' voluntary information disclosure. These effects include; improvement in liquidity of the firms' shares in the stock market, increased firms' financial analysts and decrease in firms' cost of capital. More specifically, disclosure of the firms information in the capital market will lead to evaluation of the companies by the shareholders.

Nanyondo, (2014) indicates that in spite of the high advantages associated with the increased disclosure of firms' financial information and nonfinancial information in the firms' annual reports which entails improved liquidity as well as reduced cost of capital; it is argued that withholding information by the firms' managers has some incentives since inadequate information limits the ability of investors and other information users to effectively monitor the organization.

In relation to this study, the capital need theory was used to investigate the factors (firm characteristics, credit access requirements, compliance with tax regulations and ownership control) influencing the adoption of voluntary audits for small and medium enterprises. Organizations require capital for them to smoothly run their operations, ensure maximum utilization of their assets and employees and maximize their profits. To increase their capital, organizations obtain credit from financial institutions through a process that requires proper book keeping, cash flow projects and audited statements. The capital needs theory holds that firm managers benefit from disclosing additional information that increases the capability of

those firms to raise capital on the best available terms. It also indicates that there is high tendency of information disclosure from firm managers with an aim of making capital market transaction. In the calculation of their profits (return on assets), small and medium enterprises use profit after tax as the income. While voluntary disclosure enables proper filing of tax, it also ensures accurate calculation of profitability.

### **2.2.2 Agency theory**

It was developed by Jensen and Meckling in the year 1976 (Jensen & Meckling, 1976). The theory assumes that agent and principal objectives may not be aligned therefore the principal should use diverse methods in order to control that particular agent. At such point audit can assist contribute with agent control. The principal prevents the agent behaving in its own interest and lowers the irregularity of the information since controls carried out by an auditor have an aim of assuring accuracy of financial reports. Nevertheless, the principal has an interest particularly competence of an agent and hence cannot control him or her perfectly. Further, it is stated that in small groups, social relationships are compound and culture of a business may perform a task (Mzenzi & Gaspar, 2015).

One way of displaying information asymmetry in circumstances where agent owns private information concerning an assignment is either through actions withheld from the principal, knowledge which is not shared concerning the cost or value of an operation. “Nonverifiability”, is another issue which is mentioned regarding information asymmetry which means that the agent and principal share certain information that is not accessible by a third party. All these issues will however cause agency costs, meaning there will be information insufficiency for the principal at contract signing. This contract is utilized to lessen agency costs.

Jensen and Meckling (1976) state that agency challenges takes place in situations where principal requires to make agent delegations. They claim that when they both make such decisions which are mostly benefitting their own interest, agent will engage in decisions making which are not maximizing utility for the principal. Jensen and Meckling (1976) also highlight incentives as a strategy which is commonly utilized for minimizing agency costs, and causing consequences which are negative to the agent when they behave in a manner which is unwanted.

Tillema and Bogt (2016) and Mihret (2014) suggest that auditor is selected in the welfare of management and third parties. A company is considered as a web of contracts. Various groups (bankers, suppliers, employees, clients) make contribution of certain kind to a company in a given price. Management task is to organize these contracts and groups and also attempt to optimize them: high price on goods which are sold, purchased supplies of low price, loans on minimal interest rates, high prices of shares and low employees' wages. In this association, management is the agent, which attempts to acquire contributions from various principals (employees, bankers, shareholders).

In line with this study the agency theory was used to assess the influence of ownership control on the adoption of voluntary audits for SMEs in Nairobi County. Under private organizations, the firm managers act as the agents of the owners of the organization (principal). Most of the family businesses are owner-led, thereof the accountants (internal or external) act as agents. In case the organization takes in an external expert in accounting, it implies that the owners (principal) needs to control the external expert in accounting (the agent) who in this case has a higher knowledge than the owner of the business. This implies that through use of the audit controls, the auditors could be used by the owner of the business as a control mechanism. In addition, the type (family or partnership), structure and concentration of ownership influence the decisions of the organization to involve external auditors.

## **2.3 Empirical Review of Extant Literature**

### **2.3.1 Firm Characteristics and Adoption of Voluntary Audits for SMES**

The characteristics of a firm includesize of a firm (in terms of overall assets), profitability, number of personnel, leverage and turnover. Umoren (2016) assessed disclosures of accounting and corporate features of 52 firms in Nigeria listed in Stock Exchange of Nigerian in the year 2006 between Jan-Dec, using unweight procedures of indexing on six variables which are explanatory and182 information items. His finding on traditional multivariate regression analysis implies that size of a company and type of auditor gives a satisfactory foundation for describing attitude of recorded companies in Nigeria concerning disclosure of

information on accounting. Remaining variables (listing age of a company, profitability, type of the industry as well as multinational parents) made no meaningful contributions.

In Sweden, Bulatovic, Treis and Lindholm (2016) analyzed the outcome of firm features on voluntary auditing. This study deployed descriptive study design. Findings showed that industry characteristics and turnover are the most significant forecasters for voluntary auditing. Whereas cash flow and profitability are the greatest negative forecasters, turnover has positive effect on auditing. Uyar, Kilic and Bayyurt (2013) empirically investigated factors which affect disclosure level of voluntary information on manufacturing companies in Turkish registered in Borsa Istanbul (BIST). The results demonstrated a positive correlation between disclosure level of voluntary information and variables which include size of auditing firm and firm size. Nevertheless, ownership diffusion and leverage were indicated to have significant and negative relationship with degree of voluntary disclosure. Moreover, remaining variables, including, listing age, profitability, and board size were indicated to be insignificant.

Firm size has an ability to influence disclosure of company practices. From the agency theory perspective, Watson et al. (2012) claimed that great public inspection inspires big organizations to disclose information of higher quality, which consequently minimizes agency cost. In addition, big organizations have a higher tendency to give finer transparency disclosure compared to small organizations since they have additional resources and cash. They require more external capital to attract potential investors, they are subject to additional regulatory scrutiny and rigorous public and they are intended to gather additional information for internal usage. Moreover, because of higher number and variety of projects in large firms and operations, they usually “have additional information demand”.

Kolsi (2012) quoting Singhvi and Desai (1971) gave three explanations for the differences in the degree of firms’ financial disclosure of various sizes. First, the charge of gathering particular information is higher for small organizations compared to large organizations. Secondly, need for disclosure is higher in larger firms since their securities are normally dispersed through a more different network of exchanges. Thirdly, lesser corporation management is possible to strongly believe more than larger corporation management, that the total information disclosure could threaten its competitive position.

Collis et al. (2014) in their study claim that the more the size of a firm, the greater usual of separation of management and ownership to exist. In addition as size of a firm increases, the audit demand also goes higher. Collis et al. (2014) measured size of companies by use of Turnover, number of personnel and Total Balance Sheet, so as to examine use of size criterion for legislation of audit exemption. Another research study which was carried out in New Zealand by Hay and Davis (2011) assessed selection of Voluntary Audit in certain incorporated organizations. The study revealed an optimistic association between size of the firm and financial statements which were audited

Ikpor and Ozor (2016) performed a study to evaluate influence of size of a firm, type of audit on voluntary disclosure of looking forward information in Nigerian banking sector. The results indicate that firms' size significantly influence voluntary information level disclosed in Nigerian account banks and in annual reports. Furthermore, audit quality, profitability and Board Composition also influence disclosed level of voluntary information by Nigerian banking sector.

Another significant variable which influence extent of practices disclosure in most companies is profitability level. Managers who are in firms with high profitability give better disclosure, assuming that firms with high profit have additional information to reveal concerning businesses they engage in (Lang & Lundholm, 2012). Higher disclosure levels of information additionally indicate that a firm is doing well and therefore may influence future career positively and remuneration of a manager. Former scholars provide inconclusive outcome on correlation between voluntary disclosure of information and profitability. While certain studies report a relationship which is positive (Hanniffa & Cooke, 2002), other studies recorded insignificant relationships (Inchausti, 2011). In Bangladesh, Islam, Bhuiyan and Tuhin (2014) found that in explaining voluntary disclosure level of financial information, profitability is not in any way significant. Possibly the peculiar banks' nature is clear factors as banks are involved in kind of business where there are required returns. Mechanism of making profit is influenced mainly in the way banks effectively carry out their borrowing and lending activities.

### **2.3.2 Credit Access Requirements and Adoption of Voluntary Audits for SMES**

Pandula (2010), states that in retrieving credit from any financial institutions, financial statements which are audited happen to be very helpful. Frequently banks need financial statements which are already audited prior to granting credit. However, most SMEs in South Asia have challenges in acquiring credit from financial institutions which are formal in nature since they lack suitable financial records. In addition, most SMEs normally keep numerous sets of different books and based on reliable standards' of accounting they lack financial statements which are audited therefore, acquiring loans at a greater interest rates.

A study conducted by McKenzie and Baker (2011) and also Olawale (2010) claim that financial statements quality however should function as a security between SMEs and bank so as to forecast perceived risk level. This implies that reporting of financial statements in a fair manner reveals transparency in cash flows, financial position and income predictions of SMEs to enable loaning parties to come up with informed decisions so as to increase finance. Ball (2006) argue that financial statements quality should function as an anchor in order to influence finance access. This is founded on a premise that bank are capable of estimating perceived risk and also extend SMEs finance once information asymmetry level is reduced by financial statements. According to a research done by Nanyondo, (2014) established that financial statements quality have a positive and significant relationship with finance access. Moreover, Nanyondo, (2014) indicates that if there is no relationship which is revealed between finance access and financial statement quality and this may mean that ignorant of owners/managers of SMEs on how their financial statements quality, information inequality and perceived risk influence their chances of finance access. In terms of implication of a policy this may imply that so as to increase SMEs finance access, owner/managers of SMEs will require some training.

According to firms Wanjohi, (2009) many SMEs within Kenya face a challenge in credit accessing from financial institutions which are formal as a result of inappropriate financial documentations. Most SMEs preserve many sets of various records and lack financial statements which are audited based on standards of accounting which are reliable therefore acquiring loans at greater interest rates as banks view them as greater risk debtors.

Credit-worthiness variables have been mentioned in a number of studies for instance Pandula (2010) narrates that the information sources that notify the credit value of a firm is the financial statement data. When various banks are dealing with companies, reports on audit are the greatest reliable basis of information used in order to understand as well as assess ability of a firm to repay its debt. Sacerdoti (2005) noted that banks are very reluctant to giving loans to small firms who don't have audited accounts and financial statements which are formal and this is attributed to information asymmetry. Allee and Yohn (2009) asserts that on that note companies owning financial statements which are audited benefit from a greater likelihood of acquiring credit and minimize credit cost compared to their counterparts that do not have the same.

Riva and Salotti (2015) conducted a study on the adoption of standard on international accounting by entities of small as well as medium-size and its impact on granting credit. Statistical analyses comprised of a sample of enterprises totaling to 179 subject to Technical Pronouncement of Brazil–Accounting for Entities with Small and Medium-Size. Evidence proposes a weak relationship between measures of accounting quality information (exposure and disclosure of an adoption on standard of accounting based on CPC) banking credit cost for these enterprises. Minnis (2011) examined the value of verifying financial statement in debt financing among Private US companies. The results indicated that significantly lower debt cost is observed in audited firms and that lenders give more emphasis on financial information which is audited in coming up with interest rate. The study provided proof of a mechanism for the improved usefulness of financial statement: increase from financial statements which are audited are better forecasters of cash flows in future. The findings imply that financial statements which are audited have more information and this influences decisions of lenders significantly.

In Kenya, Thuku (2017) assessed the role of value of audited financial statements on approachability to credit by small as well as medium businesses within Kenya. This investigation employed a descriptive study design. Findings on features and also access to credit revealed that respondents agreed that they have adequate book keeping records hence easy access to credit and audited financial statements.

### **2.3.3 Compliance with Tax Regulations and Adoption of Voluntary Audits for SMES**

The IRS's policy of audit enforcement is founded on the rule that taxpayers are discouraged from cheating by audits and hence improves compliance of voluntary tax. However, for more than the past 40 years, there has been significant debate on whether greater rates of audit really contribute to improved compliance of voluntary tax (Ramli et al., 2015).

Today various scholars highly believe that "deterrence theory" is not correct because entire data does not concur with this theory. Taxpayers, hence, must comply voluntarily with their obligations tax for reasons rather than an improved likelihood of getting audited. Whereas this conclusion may be true for overall tax returns for individual income, it seems there are particular sub-groups of tax returns over which audits usually matter (Plumley, 2013). For these particular groups, audits may influence compliance levels of voluntary tax more directly. Two essential strategic goals are published by IRS: increase service so as to enable voluntary compliance to be easier; and also enforce the law to make sure that everyone attains their responsibilities to pay taxes. Hence, the two goals have a shared aim: to improve voluntary compliance tax. Based on these two particular strategic goals, an individual can make a conclusion that a superior audit program is important for voluntary compliance for those taxpayers groups who intentionally underreport tax (Musimenta et al., 2017). For those taxpayers who unintentionally underreport, improved audits may have less influence on voluntary compliance in future. Instead, a strong education program and taxpayer service is possibly a better means of increasing voluntary compliance for those taxpayers who are in this group because their underreporting is more likely a result of ignorance or a mistake of complex rules on tax.

Ojala et al. (2013) assessed adjustments of tax return and audit opinion in a voluntary environment. Using a large data set proprietary obtained acquired from Finnish Tax Administration, this study assessed factors which hasten changes by tax authority to reported taxable income by almost 25,000 small private firms in their rate of tax returns. Following regulation of tax aggressiveness as well as other significant factors, this study established that having an audit which is voluntary and with an unqualified opinion of audit lowers the probability of not trusting reported taxable income by tax authority. At same time, it

regulates the otherwise positive significant influence effect of aggressiveness of a tax on probability of making adjustments by tax authority.

Plumley (2013) examined the effect of IRS on voluntary compliance on tax. The study employed an econometric data analysis accumulated yearly by state, which comprised of variables for seven activities of IRS extra to a wide tax policy variety of chances, and demographic/economic determining factor of voluntary compliance. In addition, five of IRS activities were seen to have a significant statistically effect on compliance, including criminal investigations and audits.

Mendoza, Wielhouwer and Kirchler (2017), the study used data in country-level from 2003–2014, to examine the relationship between level of audit (calculated as number of action verification acquired by tax authorities in each country per 100 taxpayers) and tax compliance which is measured as executives of a business view of tax evasion. The results indicated there that exist U-shaped relationship between tax evasion and auditing. This implies that compliance rises until a particular level of auditing is reached, and reduces beyond that particular level (an elevated auditing level backfires).

#### **2.3.4 Ownership-Control and Adoption of Voluntary Audits for SMES**

Separation of control and ownership increases as a firm investor base grows. As a result, there are seen to be highly complex conflicts of traditional agency in entities with larger bases of owner. Companies with numerous investors, owners are usually smaller and inadequately informed concerning their rights of control. Hence, ownership dispersion and separation of control and ownership can create an audit demand (Ronkko, Paananen & Vakkuri, 2018).

Concentration on ownership can be viewed as a supplementary for other devices of control and minimizes the need for mechanisms on corporate governance. This situation is more so seen in social democracies pressing firms in European to favor employment opportunities instead of capital invested (Bozec & Bozec, 2007). In addition, argument of substitution effect proposes that a strong controlling shareholder improves owners monitoring and as a result reduces benefits of other mechanisms of governance, in which function of internal audit is proposed to be a significant element by past studies (Carcello et al., 2005; Sarens,

2009). Moreover, the present literature has a negative association between independent board members and greater ownership concentration. Further, other findings indicate that existence of large block holders or concentrated ownership improves direct monitoring of shareholders, and management interference (Connelly et al., 2010). Block holders are also proposed to have incentives in order to enjoy benefits which are not shared with minority of shareholders (Connelly et al., 2010). These findings proposes that high concentration of ownership may reduce need for interest or improve control system which is internal, and accordingly stress on utilizing internal audit when visibility of the owner actions in management increases.

The association between managers and shareholders is a usually like the agent-principal association. This explains why the separating the control of an organization and the ownership of the organization is most likely to be faced by the problem of agency (Jensen & Meckling, 1976). It is argued that the agent should not always act in favor of the principal in his/her line of duty and that the necessary incentives as well as the monitoring mechanisms like auditing should be put in place with an aim of counteracting the divergences of interest. In addition, Jensen and Meckling (1976) argues that the organization owners more very much willing and able to afford monitoring costs provided the benefits from the monitoring outweighs the expenses (the agency cost). According to Carey *et al.* (2000) the agency theory provides a theoretical based explanation on how demand for auditing is influenced by non-family managers and directors. This is because interest conflicts and information asymmetry between managers and owners can result from separation of control and ownership. In this case it is assumed that the organization owners mostly prefer auditing as a tool which is used to ensure that the management actions are in line with the interest of the organization owners.

Among other phenomena, foreign ownership has been proposed as a determining factor which improves information asymmetry between managers and owners, and as a result increases the monitoring demand (Leuz et al., 2010). Monitoring is needed so as to hinder controlling owners and managers from giving unclear financial information as well as earnings of management. As management moves away from foreign control owners it may influence internal audit demand. Chenga and Courtenay (2014) examined the relationship between voluntary disclosure level and board monitoring which gives new evidence that companies with a greater proportion of independent board of directors are related with higher

voluntary disclosure levels. Although CEO duality and board size are not related with voluntary disclosure, boards with great number of independent directors have significantly greater voluntary disclosure levels than companies with equal boards.

Ronkko, Paananen and Vakkuri (2018) explored the determining factor of internal audit: Evidence from structure of ownership. In this study logistic model of regression is centered on data from firms totaling to 107 registered on NASDAQ OMX Helsinki. It indicates that significant determining factor of ownership structure is internal audit. Particularly, the study indicates that dispersed ownership, foreign ownership and state ownership improves the probability of a firm in using internal audit.

In Saudi Arabia, Mgammal (2017) examined effect of structure of ownership on voluntary disclosure. This study employed a cross-sectional survey design and the findings revealed that ownership structure (government level of ownership, family member in the panel and managerial ownership) has a significant influence on voluntary disclosure on non-financial firms registered with Saudi Stock Exchange. Ho and Tower (2011) assessed the association between voluntary disclosure and ownership structure in corporate yearly reports of Malaysian registered firms. Descriptive study design was adopted in this study and a period of eleven-years from 1996 to 2006 was used. The results revealed that concentration of ownership frequently shows positive relationship with voluntary disclosure. Furthermore, firms with institutional ownership and higher foreign have significantly and positive correlation with levels of voluntary disclosure whereas firms which have family ownership show minimal voluntary disclosure. Different structures of ownership have different monitoring influence on agency costs with agency theory consistency and clearly affect disclosure practices of firm.

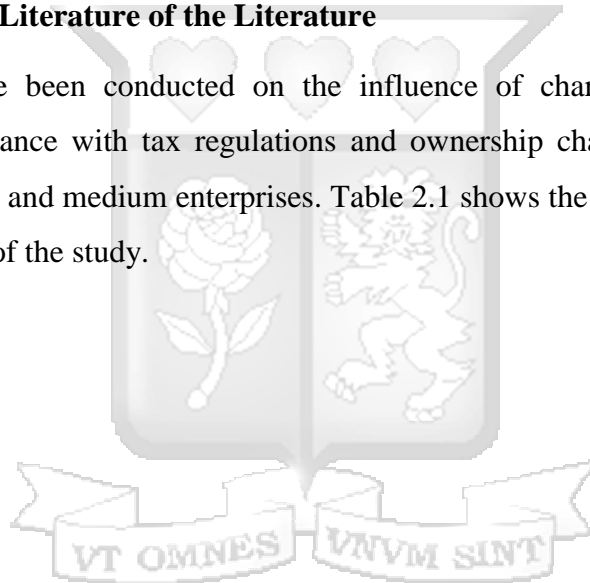
Kangarlouei, Birjandi and Motavassel (2015) investigated influence of ownership structure on voluntary disclosure within Tehran Stock Exchange. Descriptive study design was deployed during the study and sample size comprised of 101 firms registered in TSE whose board reports and financial statements are studied between the period of 2009 and 2011. Regression model is used to test each hypothesis, through assistance of SPSS software which leads to a comprehensive analysis of multivariate regression. The findings indicate that association between components of ownership structure (corporate ownership, managerial

and institutional) and voluntary disclosure of financial reporting of firms registered in TSE is positive and significant

In Kenya, Barako, Hancock and Izan (2012) conducted a longitudinal assessment of practices on voluntary disclosure in the yearly reports of registered companies within Kenya starting from 1992 to 2001. This study examined the degree to which qualities of ownership structure and corporate governance affect practices of voluntary disclosure. The findings indicated that proportion of directors who are non- executive on board is seen to be significantly and negatively correlated with degree of voluntary disclosure. Additionally, structure of board leadership lack a significant effect on voluntary disclosure level by Kenyan companies.

#### **2.4 Summary of the Literature of the Literature**

Various studies have been conducted on the influence of characteristics, credit access requirements, compliance with tax regulations and ownership characteristics on voluntary auditing among small and medium enterprises. Table 2.1 shows the summary of the literature as per the objectives of the study.



**Table 2. 1: Summary of the Literature**

Study	Jurisdiction	Focus of the Study	Methodology	Findings	Gap in Knowledge
<b>Firm Characteristics and Adoption of Voluntary Audits for SMES</b>					
Umoren (2016)	Nigeria	The effect of accounting disclosure on performance of listed companies in Nigeria.	The study used a longitudinal study design	accounting disclosures had insignificant impact on firm performance	The study was conducted in listed firms in Nigerian Stock Exchange and hence the findings cannot be generalized to SMEs in Kenya
Bulatovic, Treis and Lindholm (2016)	Sweden	Organization attributes and voluntary auditing.	The study adopted descriptive research design	Voluntary auditing is mostly predicted through use of turnover attributes and industry attributes.	The research failed to address the influence board size, profitability and organization size which are key indicators of firm

					attributes. This is a gap that the current study sought to fill
Islam, Bhuiyan and Tuhin (2014)	Bangladesh	The role of profitability in the level on adoption of audits	The study used a cross-section study design	Profitability is not significant in explaining the level of voluntary disclosure of financial information	The research was limited to profitability and failed to address the influence of organization size and board size which are key indicators of firm attributes
<b>Credit Access Requirements and Adoption of Voluntary Audits for SMES</b>					
Riva and Salotti (2015)	Brazil	Credit access and adoption of international accounting standards by SMEs	The study adopted a descriptive research design	The research revealed weak association between credit access and adoption of international accounting standards	The dependent variable adoption of international accounting which is different from voluntary audits
Minnis (2011)	United States of	Debt financing and the value	The study used a cross-sectional	Financial statement verification significantly influence debt	Nevertheless, the research failed to

	America	of financial statement verification in Private US organizations	design	financing on private firms	show the influence of proper book keeping, cash flow and projection hence the results cannot be adopted
Thuku (2017)	Kenya	Quality of audited financial statements and credit access by SMEs in Kenya	A descriptive research design was employed	The results revealed that audited statements facilitate access to credit facilities by SMEs	The study did not show how credit access requirements influence voluntary auditing
<b>Compliance with Tax Regulations and Adoption of Voluntary Audits for SMES</b>					
Ojala et al. (2013)	Finland	audit opinion and tax return adjustments in a voluntary audit environment	The study used a survey research design	The results indicated that the qualification of the audit opinion determines the likelihood of the tax authority to accept the reported tax income	Nevertheless, this research never addressed the effect of proper filing and voluntary compliance on voluntary audits

Plumley (2013)	Malaysia	Impact of the IRS on voluntary tax compliance	The study used a case study design	It was found that voluntary tax compliance is significantly influenced by IRS activities. Further, criminal investigation also influences tax compliance.	The study was limited to Malaysia
Mendoza, Wielhouwer and Kirchler (2017)	Netherlands	The backfiring effect of auditing on tax compliance	The study used a longitudinal research design	It was revealed that tax compliance is significantly influenced through auditing	The study did not show how tax regulations influence voluntary audits.
<b>Ownership-Control Characteristics and Adoption of Voluntary Audits for SMES</b>					
Mgammal (2017)	Saudi Arabia	Effect of ownership structure on voluntary disclosure	The study adopted a cross-sectional study design	The results indicated that ownership structure (managerial ownership) influence adoption of voluntary audits by listed firms in	Nevertheless, this research focused on managerial ownership and failed to address the influence of ownership concentration and family concentration hence the findings cannot be generalized.

Kangarlouei, Birjandi and Motavassel (2015)	Iran	Ownership control and voluntary information disclosure by listed firms	The study used a descriptive research design	Ownership control (managerial ownership and corporate ownership) influence information disclosure by listed firms	The indicators for ownership-control in this research were managerial ownership and corporate ownership which are different from the ownership concentration, ownership structure and family ownership.
Barako, Hancock and Izan (2012)	Kenya	Factors affecting voluntary disclosure practices of listed companies	The study used a longitudinal study design	It was found that the degree of information disclosure is negatively affected by the proportion of non-executive directors	Having been conducted in listed companies the findings cannot be generalized to SMEs.

## 2.5 Research Gap

Even though various studies have been conducted on factors influencing voluntary audits, these studies have been limited to specific countries, industries and institutions. For instance, Semiu, Sunday and Ini Etete (2015) conducted a study on the determinants of demand and supply of accounting and audit services in SMEs in Nigeria; Stewart and Kent (2017) conducted a study on the factors affecting the voluntary use of internal audit in Canada; and Ismael and Roberts (2018) assessed the factors affecting the voluntary use of internal audit in the United Kingdom. However, different countries use different policies regarding auditing and are characterized by different economic, political and social environments.

In Kenya, Gahman and Ali (2015) investigated the determinants of Financial Audit in SME in Kenya. However, the study was limited to audit firms in Mombasa and hence the findings cannot be generalized to SMEs in Nairobi County. In addition, Kipsang (2012) examined factors influencing the use of accounting services by SMEs in Kenya. However, the study was limited to factors such as competence, growth as well as Legislation and use of accounting services. Therefore, this study seeks to investigate the influence of firm characteristics, credit access requirements, compliance with tax regulations and ownership characteristics on voluntary auditing.

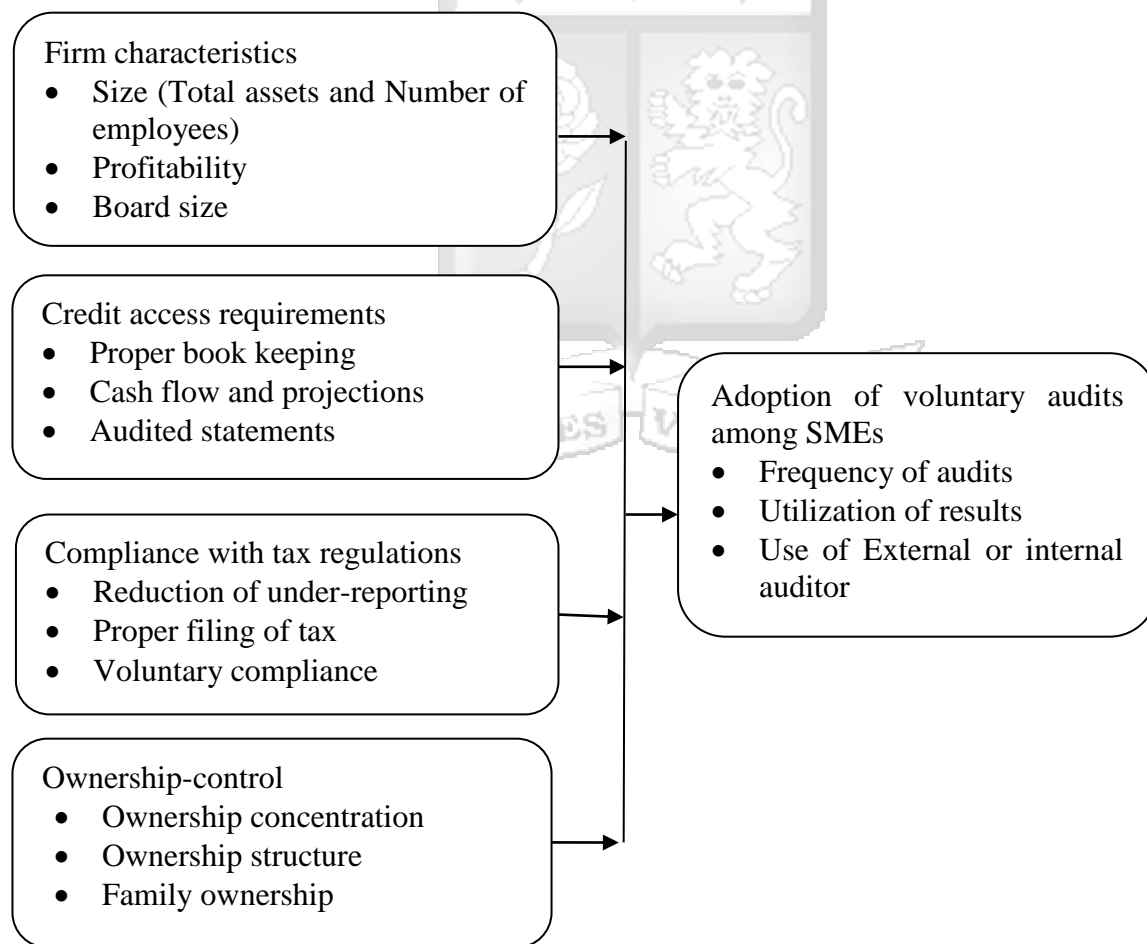
## 2.6 Conceptual Framework

A conceptual framework is the diagrammatic representation of the concepts selected for research and their relationship. The conceptual framework is very much appropriate when given the research problem being investigated. Figure 2.1 shows the hypothesized relationship between the independent variables and the dependent variable.

The inspired theory of confidence is based on auditors' social responsibility together with the auditors function. The general function of the auditor in the society is derived from the need of independent opinion, expert and independent examination on the basis of that examination. Most of the SMEs conduct audits because they are a requirement in credit access and in the compliance with tax regulations. In addition, voluntary audits depend on the characteristics of

the firm and the owner-ship control. Otieno and Theuri (2018) report that firm characteristics considerably influence the quality audit for firms listed in the NSE in Kenya.

In regard to agency theory, most of the family businesses are owner-led thereof the accountants (internal or external) act as agents. Under private organizations, the firm managers act as the agents of the owners of the organization (principal). Most of the family businesses are owner-led, thereof the accountants (internal or external) act as agents. In case the organization takes in an external expert in accounting, it implies that the owners (principal) needs to control the external expert in accounting (the agent) who in this case has a higher knowledge than the owner of the business. The independent variables included firm characteristics, credit access requirements, compliance with tax regulations and ownership characteristics. The dependent variable was the adoption of voluntary audits of SMEs.



**Independent variables**

**Dependent variable**

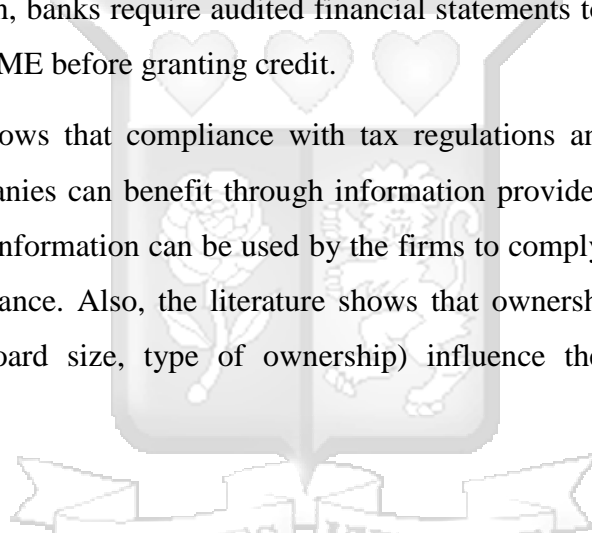
**Figure 2. 1: Conceptual Framework**

## 2.7 Summary of the Chapter

The study was anchored on theory of inspired confidence and agency theory. Theory of inspired confidence addresses demand and the supply for audit services. The authors indicate that accountability is realized through auditing and the issuance of periodic financial reports. The theory assumes that agent and principal objectives may not be aligned therefore the principal should use diverse methods in order to control that particular agent.

The literature review showed that firm characteristics (firm size (in terms of total assets), profitability, number of employees, leverage and turnover) had varying influences on voluntary auditing. In addition, the literature shows that credit access requirements influence the adoption of voluntary audits. Often, banks require audited financial statements to verify credit worthiness and ability to pay of an SME before granting credit.

The literature further shows that compliance with tax regulations and adoption of voluntary audits for SMES. Companies can benefit through information provided by auditors concerning tax compliance and this information can be used by the firms to comply with tax laws and avoid penalties for non-compliance. Also, the literature shows that ownership-control characteristics (ownership structure, board size, type of ownership) influence the adoption of voluntary auditing.



## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

The chapter presents the plan and methods that was used to carry out the study. It contains the research design, research philosophy, the target population, sampling frame, sample size and sampling technique, data collection instruments, pilot test, data collection procedures and data analysis and presentation.

#### **3.2 Research Philosophy**

This research adopted pragmatism research philosophy. Pragmatics recognize that there exists different ways of carrying out a research and interpreting a world and no single opinion, perspective or position can provide the entire picture or a phenomenon (Halfpenny, 2015). Interpretivism and positivism are two extreme mutually exclusive paradigms in regard to sources and nature of knowledge and both have their own advantages and disadvantages (Wilson, 2010). Pragmatic combines both, interpretivism and positivist perspectives within the scope of a single research study according to the research question's nature (Creswell, 2014). This study combined both qualitative and quantitative research methods. The advantage of pragmatic research paradigm is that it recognizes that every procedure or method tend to have its own limitations hence the different liberal approaches (interpretivism and positivism) are complementary. Henceforth, the technique was used in determining the effects of firm characteristics, credit access requirements, compliance with tax regulations and ownership characteristics on the adoption of voluntary audits of SMEs.

#### **3.3 Research Design**

Research design is the method deployed in conducting a research (Cooper & Schindler, 2006). This research study used a mixed methods research design. This is a method of carrying out a research through the collection, analysis and integration of both qualitative (interviews and focus groups) and qualitative (questionnaires) research approaches (Cooper & Schindler, 2006). Quantitative research involves the analysis of data in terms of numbers while qualitative research involves description of people, events and phenomenon scientifically without necessarily using

numbers. Since both methods are useful and valid, it is possible for a study to make use of both research approaches. Even though the main focus of this study was quantitative approach, qualitative approaches will also be used to increase understanding and insight in the interpretation of the quantitative results.

### 3.4. Population

In statistics, population means particular population on which particular information is expected. Creswell (2014) proposes that a population is a well-explained or set of elements, people, events, services, group of households or things under investigation. There are several markets in Starehe Sub County, which include Gikomba market, Kariokor market, Muthurwa market, Kamukunji Market, Wakulima market. However, this study focused on Gikomba market as it has the highest number of SMEs. The target population was all the audit firms in Staree Sub-County and SMEs in Gikomba market registered with Nairobi City County. Nairobi City County License register of 2018, there are was 1040 business enterprises in Gikomba market with between 10 and 99 employees (Nairobi City County government, 2018). The unit of observation in this study was managers/owners of business enterprises in Gikomba market as well as the heads of audit firms Gikomba market. Therefore, the target population of this study was 1,040 managers/owners of business enterprises and 13 audit firms in Gikomba market

**Table 3. 1: Target Population**

	<b>Target Population</b>
Food	54
Hardware	132
Fish	89
Household goods	153
Vegetables	58
Second hand clothes (Mitumba)	554
Audit firms	13
<b>Total</b>	<b>1053</b>

**Source: Nairobi City County government (2018)**

### **3.5 Sampling Frame**

Creswell (2006) argues that a sampling frame comprised of the elements, items or objects that have similar features that have been defined through use of the sampling criteria laid down by the researcher. The sampling frame of this study was all the 1,040 business enterprises and 13 audit firms in Gikomba market (food, hardware, fish, household goods, vegetables and second hand clothes (Mitumba)).

### **3.6 Sample and Sampling Technique**

A sample is a group of the target population of interest that has been selected for study to represent the entire population (Cooper & Schindler, 2006). A sample size is used to estimate the number of items, objects or even individual samples that have been selected for the experiment.

. Slovin's Formula was used for determination of the sample size. A sampling technique is a process used to choose the sample of the study (Creswell, 2014). For this study, a stratified random sampling method was used to choose 288 owners/managers from the target population. This method of sampling is characterized by strata which are based on the participants' traits and attributes. The study's strata was made up of the types of business that include food, hardware, fish, household goods, vegetables and second hand clothes (Mitumba). The researcher took a random sample from each of the stratum in line with the samples size compared to the total population. The samples from the strata are then combined to come up with a randomly chosen sample (Creswell, 2014). Stratified random sampling helps the researcher get a sample that is a representative of the total population that is not biased and no segment of the population is under or over represented. To choose the number of employees from each category, proportionate sampling was used. This is a method that selects a random sample from every stratum that is in line with the stratum size and in relation to the total population size (Kothari, 2004).

**Table 3. 2: Sample Size**

	<b>Target Population</b>	<b>Sample Size</b>
Food	54	15
Hardware	132	37
Fish	89	25
Household goods	153	42
Vegetables	58	16
Second hand clothes (Mitumba)	554	153
Audit firms	13	13
<b>Total</b>	<b>1053</b>	<b>301</b>

### **3.7 Data Collection Instrument**

In research studies data can be classified into two categories: primary data as well as secondary data. It is only primary data which was employed in this research and which was both quantitative and qualitative. Quantitative data is usually gathered using questionnaires while qualitative data is usually gathered using discussions of focused group, interview guides, and observations checklists. In this study, primary data was gathered via questionnaires as well as key informant interview guide. This study utilized key informant interview guide to gather data from the leaders of audit firms located in Gikomba market.

Mostly, questionnaires are structured as per study objectives. Moreover, one of the major advantages of using questionnaires is because in terms of cost and time they are economical. This implies that they are less time-consuming and costly than in discussions of focused group and interview guides (Cooper & Schindler, 2006). This study used semi-structured questionnaires, which denotes that it will contain both unstructured (open ended) and structured (closed ended) questions. Closed ended queries included Nominal scale and Likert scale. Nominal scale was used in the demographic information and the Likert scale was utilized in independent and dependent variables. A scale of five point was used where 1 stands for strongly disagree, 2 stands for disagree, 3 stand for Neutral, 4 stands for agree and 5 stands for strongly agree. In effort to conserve money and time, structured questions were adopted and also enhance smooth analysis as they are in their direct usable form. Unstructured questions were deployed as

they inspire participants to give highly felt and deep answers without any fear to reveal information required in the study (Creswell, 2014).

Questionnaire consisted of five sections. Section one comprised of questions on general information. Further, second up to the fourth sections comprised of questions of three independent variables whereas fifth section consisted of questions on dependent variable.

### **3.8 Data Collection Procedures**

Researcher was requested for research permit from National Commission of Science, Technology and Innovation((NACOSTI)) prior to going to the field. Letter of transmittal of instruments of collecting data was written by the researcher to the participants. Follow-ups on daily basis were then done to monitor respondents' progress in filling questionnaires. The exercise of collecting data was anticipated to take around two weeks.

### **3.9 Research Quality**

This refers to a trial and small duplicate of key study, which assists in assessing research instruments' validity and reliability which will be adopted, and also operational considerations during questionnaires administration (Bhattacharjee, 2012). Pilot test is necessary in recognizing different infirmities which are more likely to take place, insufficiencies of research and also different problems which are most likely to emerge in research process (Creswell, 2014). Pilot test was carried out with number of SMEs which will be randomly selected in Nairobi Central Business District. Pilot group in this study consisted of 10% of sample size.

#### **3.9.1 Validity of Research Instruments**

Bryman and Cramer (2012) propose that validity means degree on which outcome attained from process of data analysis essentially symbolizes phenomenon being investigated. Validity is categorized into two groups. Face validity as well as content validity. Moreover, face validity is the likelihood that a question may be misunderstood or misinterpreted. Cooper and Schindler (2006) suggests that pre-testing is a suitable way of improving likelihood of face validity. Content validity means the extent on which a measure portrays all facets of a certain social construct. Content validity in this survey, was increased through requesting for opinions from

experts in the field of study specifically the supervisors. Furthermore, face validity of study instrument was increased by conducting a pilot test as well as altering any ambiguous or unclear question.

### 3.9.2 Reliability of the Research Instrument

Reliability refers to the extent to which research instrument provides same outcome every time it is utilized on same subjects in same condition. Reliability of instrument in this research will be computed by measuring responses' internal consistency. Cronbach's Alpha method will be adopted to compute internal consistency method, where alpha values were between 0 and 1, with reliability rising as alpha value rises. The commonly deployed reliability of coefficient is between 0.6 and 0.7, with more than or equal to 0.8 showing a good reliability (Kothari, 2004). In this research study, a Cronbach's Alpha of 0.7 and beyond was considered okay, but a Cronbach's Alpha which is less than 0.7 required modification of research instrument. Nevertheless, data acquired during pilot test was not included in the initial study.

From the findings, the construct adoption of voluntary audits among SMEs had an average Cronbach's reliability alpha of 0.9445, firm characteristics had a Cronbach's reliability alpha of 0.872, credit access requirements had an average Cronbach's reliability alpha of 0.754, compliance with tax regulations had a Cronbach's reliability alpha of 0.760 and ownership-control had an average Cronbach's reliability alpha of 0.824. This shows that the study questionnaire met the reliability criteria ( $\alpha > 0.7$ ).

**Table 3. 3: Reliability Test Results**

Variable	Cronbach's Alpha	Number of items	Interpretation
Adoption of Voluntary Audits among SMEs	0.9445	9	Excellent
Firm Characteristics	0.872	8	Excellent
Credit Access Requirements	0.754	8	Excellent
Compliance with Tax Regulations	0.760	9	Excellent
Ownership-Control	0.824	7	Excellent

### 3.10 Data Processing and Analysis

In this research, both qualitative and quantitative data were generated by the semi structured questionnaire which was used for data collection. This data was analyzed through use of different methods. To start with, the researcher adopted thematic analysis to analyze qualitative data where the results were presented through a narrative form. Under thematic analysis, the researcher did not just analyze the data but also interpreted the results and drew a sense from it. Thematic analysis technique majors on highlighting the patterns, examining them and recording those patterns in the data set. Themes refer to the data set patterns that give a vital description of the study problem. The research questions in a research have an association with the study themes. Combination of the themes gives the categories of analysis which are then presented in a narrative form.

Before the quantitative data could be analyzed, the researcher ensured the data was checked for completeness, followed by data editing, data coding, data entry, and data cleaning. This ensured completeness and consistency. On the other hand, the research analyzed quantitative data through use of inferential statistics and descriptive statistics. This was done through the help of SPSS version 22. The summary of the background information was done through use of descriptive statistics. In this research, descriptive statistics entailed percentages, mean, standard deviation and frequencies. Tables and figures were used in presentation of the study results. This included pie charts and bar charts.

The study also used spearman correlation analysis to assess the association between the categorical variables. Factor analysis was used to reduce the variables and focuses only on the most influential variables and in addition to factor analysis also include ordinal regression analysis. Ordinal regression analysis is used to predict an ordinal variable which refers to a variable with its value existing on an arbitrary scale in which significance lies on the ordering between different values. In this research the dependent variable was measured in a five point likert scale, where 1= strongly disagree, 2 = disagree, 3= Neutral, 4 = agree and 5=strongly agree.

### 3.11 Ethical Issues in Research

The researcher considered ethical issues so as to avoid credibility loss during the investigation. To start with, all information gotten from other writers was highly recognized so as to avoid plagiarism. Moreover, only individuals who will be willing to take part during the study were given questionnaires to give their responses. Persons who were not ready to partake in the research, for any reasons, were not however forced to take part. The study further followed strict confidentiality; therefore no information was given to unauthorized person. So as to increase participants' anonymity, participants were given assurance on integrity of their information and the respondents were not permitted to indicate their personal information. The researcher further applied for research permit from NACOST.



## CHAPTER FOUR

### RESEARCH FINDINGS AND DISCUSSIONS

#### 4.1 Introduction

This chapter comprises of data analysis, interpretation of results and presentation of study's findings in relation with the general and the specific objectives of the study. The purpose of the study was to investigate the factors influencing the adoption of voluntary audits for SMEs in Nairobi County. The chapter begins with a response rate, followed by demographic data, descriptive analysis of the independent variables and ordinal regression analysis.

#### 4.2 Response Rate

The target sample in this research was 301 and it entailed of managers/owners of business enterprises in Gikomba market as well as the heads of audit firms Gikomba market. The researcher distributed 288 questionnaires and sought to conduct 13 interviews. However, out of 288 questionnaires that were distributed, 268 questionnaires were completely filled and returned them to the researcher. In addition, 7 interviews were successfully conducted hence making a total response rate of 275. Thus, the response rate of was 91.36%. According to Bryman and Cramer (2012) to proceed with data analysis and reporting of results the response rate should be more than 50% however a turn up of 70% and above is considered excellent. Nulty (2011) indicates that in order to make conclusions and a recommendation concerning a certain group of interest a response rate of 75% is adequate. Further, Fincham (2010) argues that for analysis to be conducted a response rate of 60% and above is acceptable. Further, Kothari (2012) indicates that a response rate of 50% should be considered average, 60% to 70% considered adequate while a response rate of above 70% should be regarded as excellent. In this research the turn up rate for the participants was within the accepted rate to proceed with data analysis and reporting of the study results.

**Table 4. 1: Response Rate**

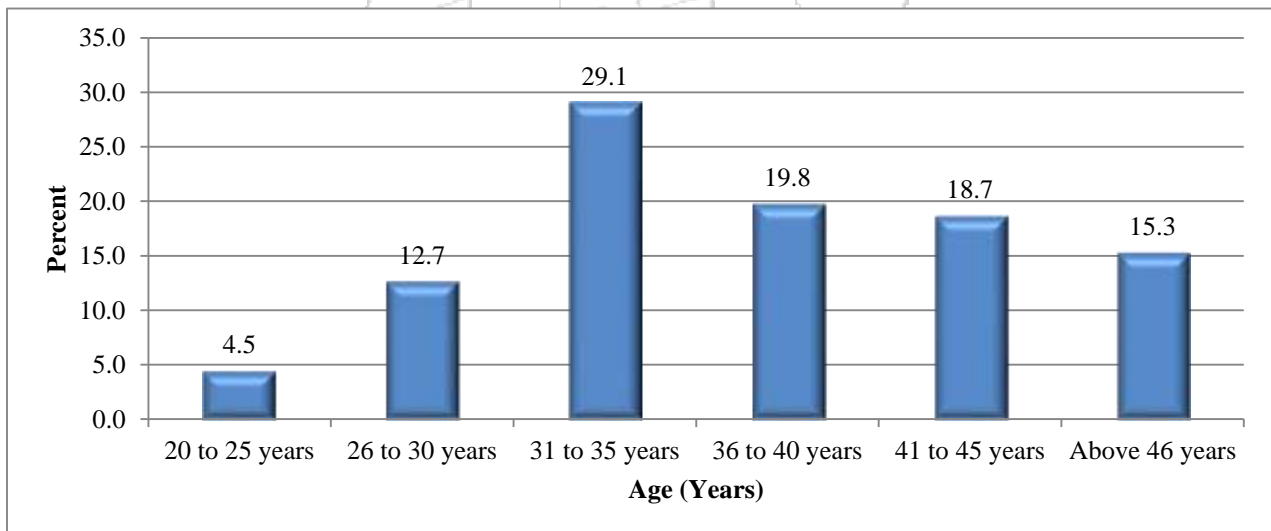
	<b>Sample Size</b>	<b>Response</b>	<b>Response Rate</b>
Food	15	10	66.7
Hardware	37	35	94.6
Fish	25	22	88.0
Household goods	42	40	95.2
Vegetables	16	14	87.5
Second hand clothes (Mitumba)	153	147	96.08
Audit firms	13	7	53.8
<b>Total</b>	<b>301</b>	<b>275</b>	<b>91.36</b>

### 4.3 Demographic Data

The demographic information of the participants comprised of their age bracket, education level and number of years in business, and the category of their business enterprises.

#### 4.3.1 Age of the Respondents

The participants were also asked to indicate their age brackets. The results were as depicted in Figure 4.1. From the results, 29.1% of the respondents specified had between 31 and 35 years, 19.8% had between 36 years and 40 years, 18.7% had between 41 and 45 years, 15.3% were above 46 years in age, 12.7% were aged between 26 and 30 years and 4.5% were aged between 20 and 25 years. This implies that most of the respondents were aged between 31 and 35 years.



**Figure 4. 1: Age of the respondents**

### 4.3.2 Education Level of the Respondents

The respondents were also requested to indicate their highest level of education. The results were as shown in Figure 4.2. From the findings, 39.2% of the respondents specified that they had secondary school education as their highest level of education, 23.5% indicated that they had college education, 21.3% had primary education, 10.4% had undergraduate degrees and 5.6% had postgraduate degrees. This implies that most of the managers/owners of business enterprises in Gikomba market have secondary education.

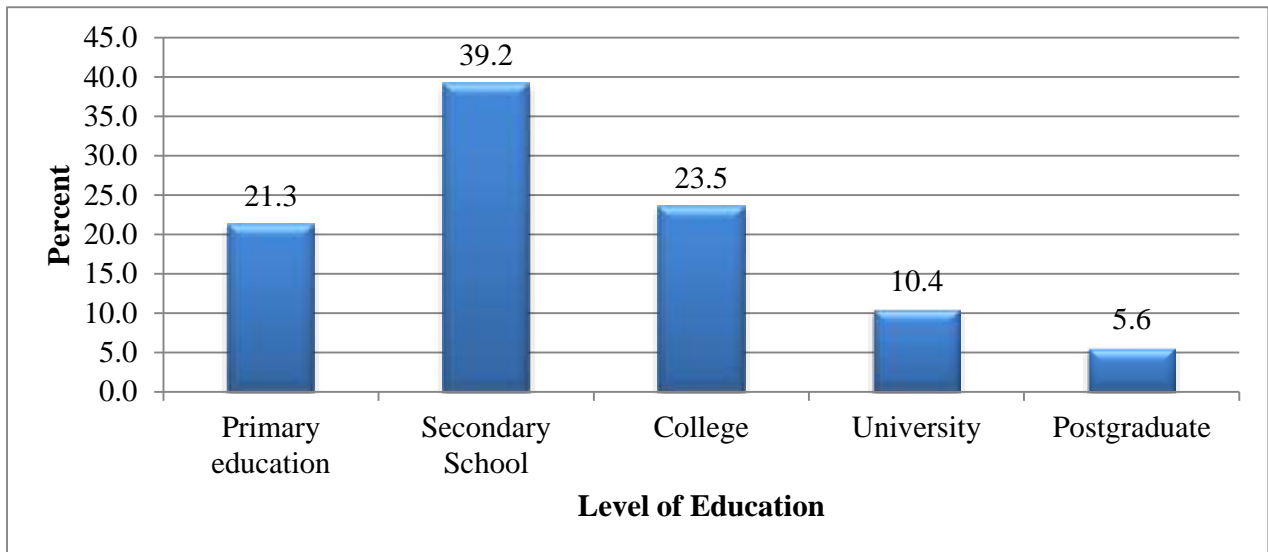
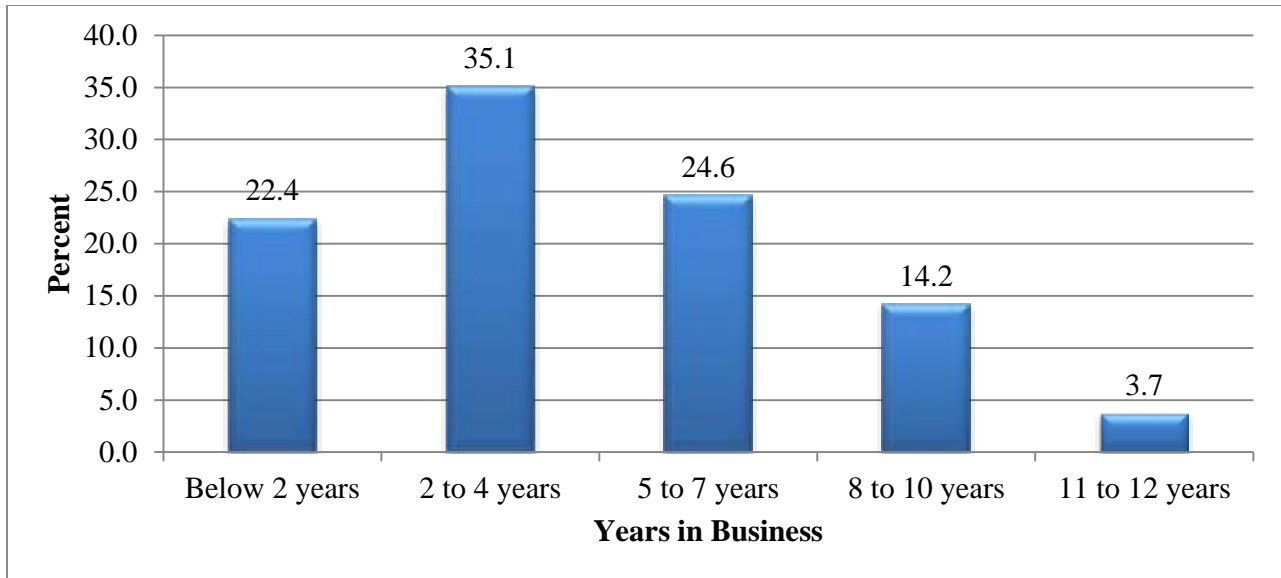


Figure 4. 2: Education Level of the Respondents

### 4.3.3 Duration of time in Business

The participants were to specify the period of time they have been in business. The results were as depicted in Figure 4.3. From the results, 35.1% of the respondents indicated that they had been in business for a period of between 2 and 4 years, 24.6% indicated between 5 and 7 years, 22.4% indicated below 2 years, 14.2% indicated between 8 and 10 years and 3.7% indicated between 11 and 12 years. This shows that majority of the SME owners had operated their business for a period of between 2 years and 4 years.



**Figure 4. 3: Duration of Time in Business**

#### **4.4 Firm Characteristics**

The first specific objective of the study was to assess the influence of firm characteristics on the adoption of voluntary audits for small and medium enterprises in Nairobi County.

##### **4.4.1 Firm Characteristics on the Adoption of Voluntary Audits**

The participants were to rate various statements relating to firm characteristics and adoption of voluntary audits among SMEs. A 5 point Likert scale was used where by 1 =strongly disagree, 2 = disagree, 3 =Neutral, 4 = agree and 5 = strongly agree. The results were depicted in Table 4.2. From the results, the managers/owners agreed with a mean of 3.817 (std. dv = 0.292) that big firms disclose information more openly as compared to small firms. This shows that there is a strong relationship between larger firms and adoption of voluntary audits as compared to smaller firms adopting voluntary audits. In addition, the participants also agreed with a mean of 3.616 (std. dv = 0.256) that the size of firm has the potential to influence the disclosure practices of firms. This shows that the size of the firm has a strong relationship with disclosure practices and adoption of voluntary audits.

With a mean of 3.567(std. dv = 0.220) the participants also agreed that smaller firms find it hard to reveal the financial information as compared to larger firms. These findings imply that the size

of the firm (smaller or larger) has a strong relationship with revealing of financial information, which in turn influences voluntary audits. Bulatovic, Treis and Lindholm (2016) indicated that disclosure of financial information is more open in big firms than small firms. This is because large firms need huge credit facilities so they must disclose a lot of information to convince the creditors.

As shown by a mean of 3.884 (std. dv = 0.309), the managers/owners agreed that board composition affect the level of voluntary information disclosed by firms. This shows that there is a strong relationship between board composition and adoption of voluntary audits. These findings agree with Ikor and Ozor (2016) findings that board composition affects the level of voluntary information disclosure. Nevertheless, the participants were neutral on the statement indicating that there is high comprehensiveness in corporate reporting of firms with large boards as shown by a mean of 3.160 (std. dv = 0.174). These findings show that larger boards have greater corporate reporting comprehensiveness, which has a significant relationship with adoption of voluntary audits.

**Table 4. 2: Firm Characteristics on the Adoption of Voluntary Audits**

	<b>Median</b>	<b>Mean</b>	<b>Std. Deviation</b>
Information disclosure practices in an organization is influenced by the firm size	4.00	3.616	0.256
Information disclosure in large firms is better as compared to information disclosure in small firms	4.00	3.817	0.292
Smaller firms find it hard to reveal the financial information as compared to larger firms	4.00	3.567	0.220
Profitability level of a firm determines the level of voluntary information disclosed	2.00	2.310	0.309
In more profitable organization, the top management tends to disclose better information	2.00	2.552	0.451
Better performance of the firm is indicated through better information disclosure	3.00	2.888	0.325
There is a high comprehensiveness of corporate reporting in firms with larger boards	3.00	3.160	0.174
The extent of voluntary information disclosure is influenced by the board composition	4.00	3.884	0.309

#### **4.4.2 Effects of Firm Characteristics on Adoption of Voluntary Audits**

The respondents were asked to state in their own view how else firm characteristics influence adoption of voluntary audits among SMEs in Kenya. From the findings, the respondents indicated firm turnover together with the company characteristics are key predictors to adoption of voluntary auditing. Further, the key informants indicated that large firms in terms of total assets, number of employees and sales turnover provide better information disclosure as compared to small businesses since they have more financial resources as compared to small firms. The managers/owners also indicated that in highly profitable firms the top management tends to disclose more detailed information since they need to attract more investors through showing how better their company is performing as compared to other companies in the same industry. In addition, the key informants reported that size (total assets and number of employees), profitability and board size influence voluntary auditing.

*Small and medium enterprises with a high number of employees and assets are more likely to conduct voluntary auditing to ensure accountability among staff and as a method of internal control. In addition, firms making more profits and use voluntary auditing to ensure continuous increase in profits KII01*

The key informants also reported organizations with a large board size are more likely to conduct voluntary audits as compared to those sole proprietorship enterprises. These findings agreed with Collis *et al.* (2014) observation that firm size and firm profitability influences level of voluntary information disclosed in the annual reports and accounts.

#### **4.4.3 Factor Analysis for Firms Characteristics**

Firm characteristics had a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.861, which was above the threshold of 0.5. According to Malhotra and Dash (2007), high Kaiser-Meyer-Olkin (KMO) values of 0.5 and above indicate that factor analysis is appropriate.

Exploratory factor analysis using Principal Component Analysis (PCA) with promax rotation revealed that the factor loadings of all the 8 items were above the acceptable threshold of 0.5. According to Hair *et al.* (2010), factor loading estimates should be higher than 0.5 to be acceptable for further analysis. Therefore, firm characteristics were found to be significant and thus suitable for further analysis since their factor loadings were  $> 0.5$  as indicated in Table 4.3.

**Table 4. 3: KMO and Bartlett’s Testfor Firms Characteristics**

	Factor Analysis			
	KMO	Bartlett’s (p value)	PCA component loading	variance extracted
Firm Characteristics	.861	4790.121 (0.000)	>0.5	90.000

#### **4.5Credit Access Requirements**

The second specific objective was to determine the impact of credit access requirements on the adoption of voluntary audits for SME in Nairobi County.

##### **4.5.1 Credit Access Requirements and the Adoption of Voluntary Audits**

The manager/owners were requested to rate various aspects of credit access requirements and adoption of voluntary audits among SMEs. The results were depicted in Table 4.4. From the results, the managers/SME owners agreed with a mean of 4.101 (std. dv = 0.995) that lack of proper financial records by SMEs hinders them from accessing to credit facilities from banks. Further, the managers/SME owners also agreed with a mean of 4.037 (std. dv = 1.098) that most SME lack proper financial records. These findings imply that lack of proper financial records has a strong relationship with access to credit, and hence adoption of voluntary audits.

However, with a mean of 3.037 (std. dv = 0.095) the managers/SME owners were neutral on the statement indicating that their firms keep proper record of all financial documents. These findings show that keeping of proper record of all financial documents has a strong relationship with the adoption of voluntary audits. These findings agree with Wanjohi, (2019) argument thatmost of the SMEs rarely have audited statements which poses a challenge when it comes to securing credit facilities from financial institutions since most financial institutions term these businesses as risky borrower

With a mean of 4.485 (std. dv = 0.690) the managers/SME owners agreed that cash flow statements together with projection reports are requirements for credit facilities. These findings imply that cash flow statements together with projection reports are requirements for credit facilities has a strong relationship with adoption of voluntary audits. These findings agree with Riva and Salotti (2015) observation that banks prefer audited reports when evaluating the credit worthiness of companies hence making it easy to identify the risk and safe companies. Furthermore, the participants also agreed with a mean of 4.478 (std. dv = 0.543) that most SME

owners have little knowledge in relation to preparing cash flow statements. These findings show that knowledge in relation to preparing cash flow statements has a strong relationship with adoption of voluntary audits.

The participants agreed with a mean of 4.243 (std. dv = 0.738) that audited statements are key requirements for one to access credit facilities. These findings show that since audited statements are key requirements for one to access credit facilities they have a strong relationship with adoption of voluntary audits. These findings agree with Allee and Yohn (2019) assertion companies that have audited financial statements have very high chances of benefiting from credit facilities offered by financial institutions as compared to those companies lacking the audited financial statements. In addition, the participants also agreed with a mean of 3.724 (std. dv = 0.951) that most SMEs have financial statements which are not audited as per the guidelines of accounting standards. These findings show that audited financial statements based on reliable accounting standards have a strong relationship with adoption of voluntary audits.

**Table 4. 4: Credit Access Requirements and the Adoption of Voluntary Audits**

	<b>Median</b>	<b>Mean</b>	<b>Std. Deviation</b>
Most SME lack proper financial records	4.00	4.037	1.098
SMEs face difficult in accessing loan from financial institutions due to lack of audited financial statements	4.00	4.101	0.995
Our firm keeps proper record of all financial documents	3.00	3.037	0.095
Cash flow statements together with projection reports are requirements for credit facilities	5.00	4.485	0.690
Most SME owners have little knowledge in relation to preparing cash flow statements.	4.50	4.478	0.543
Our firm prepares cash flow statements on regular basis	2.00	2.369	0.197
Most SMEs lack audited financial statements based on reliable accounting standards	4.00	3.724	0.951
Audited statements are key requirements for one to access credit facilities	4.00	4.243	0.738

#### **4.5.2 Effects of Credit Access Requirements on Adoption of Voluntary Audits**

The respondents were requested to indicate how else credit access requirements influence adoption of voluntary audits among SMEs in Kenya. From the responses, the managers/SME owners indicated that financial statements are key requirements for companies to access credit facilities. In addition the SME owners revealed that it hard for SMEs to access credit facilities

since most of them lack audited financial statements which are key requirements by the financial institutions. In this sense, most SMEs are termed as high risk borrowers since they lack key statements. Further the key informants indicated that most SMEs lack proper financial records which hinder them from accessing bank loans. These findings agree with Sacerdoti (2015) argument that banks are very reluctant to giving loans to small firms who do not have formal financial statements and audited accounts and this is attributed to information asymmetry.

*Most SMEs in Gikomba market have difficulty accessing credit facilities from financial institutions due to lack of audited statements which are key requirements KII02.*

The managers/SME owners indicated that financial institutions use the audited financial statement of companies to determine their creditworthy. This indicates that financial statements are the link between lenders and borrower. Therefore the amount of credit extended to borrowers depends on the fairness of presentation of these statements. Further, the transparency of the SMEs depends on presentation of the financial statements. The managers/SME owners further indicated that presenting audited statements enable the financial institutions to make informed decisions concerning awarding of credit facilities to borrowers.

#### **4.5.3 Factor Analysis for Credit Access Requirements**

Credit access requirements had a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.859, which was above the threshold of 0.5. According to Malhotra and Dash (2007), high Kaiser-Meyer-Olkin (KMO) values of 0.5 and above indicate that factor analysis is appropriate.

Exploratory factor analysis using Principal Component Analysis (PCA) with promax rotation revealed that the factor loadings of all the 8 items were above the acceptable threshold of 0.5. According to *Hair et al.* (2010), factor loading estimates should be higher than 0.5 to be acceptable for further analysis. Therefore, credit access requirements were found to be significant and thus suitable for further analysis since their factor loadings were  $> 0.5$  as indicated in Table 4.5.

**Table 4. 5: KMO and Bartlett’s TestforCredit Access Requirements**

	Factor Analysis			variance extracted
	KMO	Bartlett’s (p value)	PCA component loading	
Credit Access Requirements	.859	3508.251(0.000)	>0.5	84.385

#### 4.6 Compliance with Tax Regulations

The third specific objective of the study was to assess the influence of compliance with tax regulations on the adoption of voluntary audits for SMEs in Nairobi County.

##### 4.6.1 Compliance with Tax Regulations and the Adoption of Voluntary Audits

The managers/SME owners were asked to rate various aspects of compliance with tax regulations and adoption of voluntary audits among SMEs. The results were depicted in Table 4.6. From the results, the managers/SME owners agreed that underreporting is a result of ignorance of complex tax rules. This is indicated by mean of 3.567 (std. dv = 1.326) .These findings show that addressing of ignorance of compliance tax rules has a strong relationship with adoption of voluntary audits. With a mean of 3.522 (std. dv = 1.364), the respondents also agreed that some of the SME taxpayers underreport unintentionally. This shows that underreporting of taxes unintentionally has a strong negative relationship with adoption of voluntary audits. These findings are in line with Musimenta *et al.*, (2017) assertion that auditing tend to have less impact on taxpayers who unintentionally underreport their income level. The findings further indicated that voluntary tax compliance among taxpayers who underreport unintentionally could be increased through tax education program and strong tax payer service. However, as indicated by a mean of 3.224 (std. dv = 1.050) the SME owners/managers were neutral on the statement indicating that most SMEs under report the financial position to reduce the tax to be paid. This implies that underreporting to reduce the tax to be paid has a strong negative relationship with adoption of voluntary audits.

The SME owners/managers agreed with a mean of 4.063 (std. dv = 1.067) that some of the SME owners fail to file tax since they lack proper understanding of tax filing. This implies that proper understanding of tax filing has a strong relationship with adoption of voluntary audits. These findings concur with Mendoza, Wielhouwer and Kirchler (2017) observation that tax training

should be availed to SME owners in order to advance their knowledge on the essence of tax compliance. As shown by a mean of 3.460 (std. dv = 0.948), the SME owners/managers were neutral on the statement indicating that their firms file tax on a regular basis. This implies that filing taxes on a regular basis has a strong relationship with adoption of voluntary audits. The respondents agreed with a mean of 3.944 (std. dv = 1.115) that lack of knowledge on tax compliance hinders voluntary compliance. This shows that knowledge on tax compliance has a strong relationship with adoption of voluntary audits. These findings are in line with Plumley, (2013) argument that most of the SME owners lack knowledge on taxation, which is important in ensuring tax compliance.

**Table 4. 6: Compliance with Tax Regulations and the Adoption of Voluntary Audits**

	Median	Mean	Std. Deviation
Most SMEs under report the financial position to reduce the tax to be paid	3.00	3.224	1.050
Some of the SME taxpayers underreport unintentionally	4.00	3.522	1.364
Underreporting is a result of ignorance of complex tax rules	4.00	3.567	1.326
Most SMEs in ensure proper filing of tax	3.00	2.974	1.240
Some of the SME owners fail to file tax since they lack proper understanding of tax filing	4.00	4.063	1.067
Our firm files tax on a regular basis	4.00	3.460	0.948
Most of the SMEs ensure voluntary tax compliance	3.00	2.933	1.291
Lack of knowledge on tax compliance hinders voluntary compliance	4.00	3.944	1.115
Through SME training on tax compliance the level of voluntary compliance among SMEs has improved	2.00	2.575	1.538

#### 4.6.2 Effects of Compliance with Tax Regulations on Adoption of Voluntary Audits

The respondents were requested to state how else compliance with tax regulations influence adoption of voluntary audits among SMEs in Kenya. From the results, the SME owners/managers indicated that inadequate knowledge on tax regulations hinders tax compliance and hence most of the SMEs do not see the need to conduct voluntary audits. Therefore, most of the small and medium enterprises underreport their income and hence pay less taxes unintentionally. These findings agree with Musimenta *et al.* (2017) findings that through extending education on tax compliance to tax payer's increases the level of tax compliance since some of the tax payers have inadequate information regarding tax compliance. In addition, the taxpayer education as well as taxpayer service facilitates the extent of tax compliance. The key

informants indicated that SMEs were using voluntary auditing to reduce underreporting, ensure proper filing of tax and improve tax compliance.

*By conducting voluntary auditing, some of the small and medium enterprises ensure that they correctly report their sales and income, which plays a major role in reducing underreporting. Therefore, with voluntary auditing, small and medium enterprises can ensure that they properly file their taxes and comply with taxation policies KII09*

#### 4.6.3 Factor Analysis for Compliance with Tax Regulations

Compliance with tax regulations had a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.926, which was above the threshold of 0.5. According to Malhotra and Dash (2007), high Kaiser-Meyer-Olkin (KMO) values of 0.5 and above indicate that factor analysis is appropriate.

Exploratory factor analysis using Principal Component Analysis (PCA) with promax rotation revealed that the factor loadings of all the 8 items were above the acceptable threshold of 0.5. According to *Hair et al.* (2010), factor loading estimates should be higher than 0.5 to be acceptable for further analysis. Therefore, compliance with tax regulations were found to be significant and thus suitable for further analysis since their factor loadings were > 0.5 as indicated in Table 4.7.

**Table 4. 7: KMO and Bartlett’s Test for Compliance with Tax Regulations**

	Factor Analysis			variance extracted
	KMO	Bartlett’s (p value)	PCA component loading	
Compliance with Tax Regulations	.926	4331.512(0.000)	>0.5	86.517

#### 4.7 Ownership-Control

The fourth specific objective of the study was to assess the influence of ownership control on the adoption of voluntary audits for SMEs in Nairobi County

##### 4.7.1 Ownership Control and the Adoption of Voluntary Audits

The SME owners/managers were requested to rate various aspects relating to ownership control and adoption of voluntary audits among SMEs. The results were depicted in Table 4.8. From the

results, the owners/managers agreed with a mean of 3.781 (std. dv = 0.309) that ownership concentration improves internal control systems within a firm. This implies that an improvement in internal control systems within a firm has a strong relationship with the adoption of voluntary audits. These findings are in line with Ho and Tower (2011) findings that firms with higher foreign and institutional ownership are more likely to have high voluntary disclosure levels while firms with family ownership exhibit lower voluntary disclosure. However, the participants were neutral on the statement indicating that the ownership structure of most SMEs defines the duties and responsibilities of the members as shown by a mean of 3.422 (std. dv = 0.019). This is a clear indication that defining of duties and responsibilities in the ownership structure has a strong relationship with the adoption of voluntary audits.

Further, with a mean of 3.198 (std. dv = 0.136), the SME owners/ managers were neutral on the statement indicating that in ownership concentration, there is increased need for audits to ensure good transparency and accountability. This implies that increased need for audits to ensure good transparency and accountability has a strong relationship with adoption of voluntary audits.

With a mean of 3.534 (std. dv = 0.211), the respondents agreed that family owned SMEs lacks proper audit record. These findings imply that the ownership of SMEs has a strong relationship with the adoption of voluntary audits. In addition, with a mean of 3.520 (std. dv = 0.269), the participants agreed that through ownership structure each member performs his or her duties without interference. This shows that attending duties without interference has a strong relationship with adoption of voluntary audits. This is in agreement with Kangarlouei, Birjandi and Motavassel (2015) findings that a clear and well structure organization structure ensures proper delegation of duties and responsibilities. Further, the participants agreed that most SMEs lack well defined ownership structures as shown by a mean of 3.508 (std. dv = 0.425). This implies that defining ownership structures has a strong relationship with adoption of voluntary audits. However, as shown by a mean of 3.060 (std. dv = 0.356), the participants were neutral on the statement indicating that most SMEs are family owned. This shows that ownership of business (family ownership) has a strong relationship with adoption of voluntary audits.

**Table 4. 8: Ownership Control and the Adoption of Voluntary Audits**

	Median	Mean	Std. Deviation
Ownership concentration improves internal control systems within a firm	3.00	3.781	0.309
In ownership concentration, there is increased need for audits to ensure good transparency and accountability	3.00	3.198	0.136
The ownership structure of most SMEs defines the duties and responsibilities of the members	3.00	3.422	0.019
Most SMEs lack well defined ownership structures	3.00	3.508	0.425
Through ownership structure each member performs his or her duties without interference	3.00	3.520	0.269
Most SMEs are family owned	3.00	3.060	0.356
Family owned SME lacks proper audit record	3.00	3.534	0.211

#### 4.7.2 Effects of Ownership Control on Adoption of Voluntary Audits

The respondents were asked to indicate how else ownership control influences adoption of voluntary audits among SMEs in Kenya. From the findings, the SME owners/managers revealed that when the ownership concentration is very high, the chances of controlling the internal affairs of the organization decrease since the business owners prefer and put more trust on internal auditing. Moreover, the SME owners/managers argued that it is very vital to have proper monitoring mechanisms put in place to control the business and prevent the top management from providing false financial information. As a result this facilitates the demand for internal audit since the business management shifts from the owners control to the top management control. The Key informants also indicated that ownership control in terms of ownership concentration, ownership structure and family ownership influence the adoption of voluntary audits.

*With high ownership concentration, business owners use internal governance mechanism including auditing in which owners can control and influence the management of the firm to protect their interests. However, most of the SMEs are family owned and hence they do not see the need to carry out voluntary audits*

KII07

The key informants added that business enterprises employing managers to run their business make use of voluntary audits to protect their interests. The association between the firm owners and the organization managers is compared to principal-agent relationship that prevails in the

agency theory (Jensen & Meckling, 1976). The theory argues that agents should not always act in favor of the principal (owner of the business) to ensure maximization of the agent's own wealth. In addition, there should be proper mechanisms and incentives like auditing put in place. These mechanisms should be established to ensure counteracting of the divergence of interest.

#### 4.7.3 Factor Analysis for Ownership-Control

Ownership-control had a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.919, which were above the threshold of 0.5. According to Malhotra and Dash (2007), high Kaiser-Meyer-Olkin (KMO) values of 0.5 and above indicate that factor analysis is appropriate.

Exploratory factor analysis using Principal Component Analysis (PCA) with promax rotation revealed that the factor loadings of all the 8 items were above the acceptable threshold of 0.5. According to *Hair et al.* (2010), factor loading estimates should be higher than 0.5 to be acceptable for further analysis. Therefore, ownership control was found to be significant and thus suitable for further analysis since their factor loadings were  $> 0.5$  as indicated in Table 4.9.

**Table 4. 9: KMO and Bartlett's Test for Ownership-Control**

	Factor Analysis			
	KMO	Bartlett's (p value)	PCA component loading	variance extracted
Ownership control	.919	3055.776 (0.000)	$>0.5$	89.270

#### 4.8 Adoption of Voluntary Audits among SMEs

The SMEs owners/ managers were requested to rate various aspects of adoption of voluntary audits among SMEs in Nairobi County. Table 4.10 shows the results. The SME owners agreed that most of the SMEs carry out their audit process on annual basis as shown by a mean of 4.019 (std. dv = 0.110). This implies that most of the SMEs were carrying out their audit process on annual basis.

However, the SMEs owners/ managers were neutral on the statement indicating that their firms have a criteria which is used to determine the audit frequency as depicted by a mean of 3.187 (std. dv = 0.342). These findings show that most of the SMEs have guidelines that determine how frequent an audit is conducted in an year. These results concur with Gahman and Ali (2015) argument that most SMEs have no regular basis of auditing. This is due to lack of knowledge on

the essence of external auditing, other SMEs are managed by the owners hence they finding no need for auditing at all. Further, as indicated by a mean of 3.086 (std. dv = 0.156), the SMEs owners/ managers were neutral on the statement indicating that audit in their firms performed voluntary audits on monthly basis. This shows that about one half of the SMEs were conducting voluntary audits on monthly basis.

The participants were neutral on the statement indicating that their SME implements the auditor's recommendations as shown by a mean of 3.26 (std. dv = 0.326). This shows that about half of the SMEs implement the auditor's recommendations as per the auditors' reports. Ngugi, (2014) had earlier found that among the few SMEs who have adopted external auditing on regular basis, very few of them implement the recommendations for the external auditors. Further, as indicated by a mean of 3.183 (std. dv = 0.142), SMEs owners/ managers were neutral on the statement indicating that their business enterprises utilize results from the voluntary audits. The results show that business enterprises utilize results from the voluntary audits. As shown by a mean of 3.157 (std. dv = 0.114), SMEs owners/ managers were neutral on the statement indicating that the management of the business supports the use of the audit results. The results imply that most of the management of the SMEs support the use of the audit results.

From the findings, SMEs owners/ managers agreed that most of the SMEs cannot afford to hire external auditors as indicated by a mean of 3.672 (std. dv = 0.262). The findings show that some of the SMEs cannot afford to hire external auditors. Further, as indicated by a mean of 3.646 (std. dv = 0.345) SMEs owners/ managers agreed that external auditors provide reliable audit information since they are independent unlike the internal auditors. The results clearly show that external auditors provide reliable audit information since they are independent unlike the internal auditors

As indicated by a mean of 3.086 (std. dv = 0.331) the participants were neutral on the statement indicating that SMEs hires external auditors to audit their firms. The findings imply that since most of the SME owners have no knowledge on auditing, they hire external auditors to audit their firms. Kipsang (2012) found that the SME sector in Kisii County is characterized by low levels of compliance with accounting legislation. The main factors found to contribute to adoption of financial audits include lack of financial resources.

**Table 4. 10: Adoption of Voluntary Audits among SMEs**

	<b>Median</b>	<b>Mean</b>	<b>Std. Deviation</b>
Our firm has a criteria which is used to determine the audit frequency	3.00	3.187	0.342
Audit in our firm is performed on monthly basis	3.00	3.086	0.156
Most of the SMEs carry out their audit process on annual basis	4.00	4.019	0.110
Our business enterprise utilizes results from the voluntary audits	3.00	3.183	0.142
Our SME implements the auditors recommendations	3.00	3.26	0.326
The management of the business supports the use of the results	3.00	3.157	0.114
SMEs hires external auditors to audit their firms	3.00	3.086	0.331
Most of the SMEs cannot afford to hire external auditors	4.00	3.672	0.262
External auditors provide reliable audit information since they are independent unlike the internal auditors	4.00	3.646	0.345

#### 4.8.1 Factor Analysis for Adoption of Voluntary Audits among SMEs

Adoption of voluntary audits had a Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy of 0.927, which were above the threshold of 0.5. According to Malhotra and Dash (2007), high Kaiser-Meyer-Olkin (KMO) values of 0.5 and above indicate that factor analysis is appropriate.

Exploratory factor analysis using Principal Component Analysis (PCA) with promax rotation revealed that the factor loadings of all the 8 items were above the acceptable threshold of 0.5. According to *Hair et al.* (2010), factor loading estimates should be higher than 0.5 to be acceptable for further analysis. Therefore, adoption of voluntary audits were found to be significant and thus suitable for further analysis since their factor loadings were > 0.5 as indicated in Table 4.7.

**Table 4. 11: KMO and Bartlett's Test for Adoption of Voluntary Audits**

	<b>Factor Analysis</b>			
	<b>KMO</b>	<b>Bartlett's (p value)</b>	<b>PCA component loading</b>	<b>variance extracted</b>
Adoption of Voluntary Audits	.927	5307.453 (0.000)	>0.5	92.901

#### 4.10 Ordinal Regression

Ordinal regression analysis was used to show the relationship between the independent variables and the dependent variable. Table 4.12 presents the case summary for all the independent variables and the dependent variable. The total number of observations was 268 and there were no missing values.

From the findings, 29.1% of the participants were neutral on the adoption of Voluntary Audits among SMEs, 23.9% strongly agreed, 17.9% disagreed, 15.7% agreed and 13.4% strongly disagreed. In addition, 38.4% were neutral on firm characteristics statements, 22.0% agreed, 14.9% strongly agreed, 13.4% disagreed and 11.2% strongly disagreed. Further, 35.8% of the respondents agreed with statements on credit access requirements, 29.1% were neutral, 23.9% strongly agree and 11.2% disagreed. Also, 25.4% of the respondents were neutral on the statements on compliance with tax regulations, 24.6% disagreed, 19.4% agreed, 15.7% strongly disagreed and 14.9% strongly agreed. The results also show that 28.0% of the respondents were neutral on statements on ownership-control, 26.5% strongly agreed, 20.9% agreed, 13.4% disagreed and 11.2% strongly disagreed.

**Table 4. 12: Case Processing Summary**

		<b>N</b>	<b>Marginal Percentage</b>
Adoption of Voluntary Audits among SMEs	Strongly Disagree	36	13.4%
	Disagree	48	17.9%
	Neutral	78	29.1%
	Agree	42	15.7%
	Strongly Agree	64	23.9%
Firm Characteristics	Strongly Disagree	30	11.2%
	Disagree	36	13.4%
	Neutral	103	38.4%
	Agree	59	22.0%
	Strongly Agree	40	14.9%
Credit Access Requirements	Disagree	30	11.2%
	Neutral	78	29.1%
	Agree	96	35.8%
	Strongly Agree	64	23.9%
Compliance with Tax Regulations	Strongly Disagree	42	15.7%
	Disagree	66	24.6%
	Neutral	68	25.4%
	Agree	52	19.4%
Ownership-Control	Strongly Agree	40	14.9%
	Strongly Disagree	30	11.2%
	Disagree	36	13.4%
	Neutral	75	28.0%
	Agree	56	20.9%
	Strongly Agree	71	26.5%
Valid		268	100.0%
Missing		0	
<b>Total</b>		<b>268</b>	

The model fitting information results provide results of ordinal regression versus reduced model (intercept) with complimentary log-log link function. The existence of an association between

the independent variables and the dependent variable relies on the statistical significance of the final model. According to the findings, as shown in Table 4.13, the -2 Log Likelihood of the model with only intercept was 740.362 and the -2 Log Likelihood of the model with intercept and the independent variables is 0.000. The difference (Chi-square statistics) is  $740.362 - 0.000 = 740.362$  which is significant at  $\alpha=0.05$ , as the p-value is 0.000. This implies that there is a significant relationship between dependent and independent variables in complementary Log-log link function.

**Table 4. 13: Model Fitting Information**

<b>Model</b>	<b>-2 Log Likelihood</b>	<b>Chi-Square</b>	<b>df</b>	<b>Sig.</b>
Intercept Only	740.362			
Final	.000	740.362	11	.000

Link function: Logit.

In statistics, Pearson is used in determining the extent of the relationships between variables that are linearly related. Deviance refers to the measure of the extent to which the data is unfit between the used model and the data. In general, high rate of deviance indicates poor data set fit.

There is a larger chi-square sample between the difference of deviance  $D_0$  and  $D_1$  whereby the degree of freedom is equal to the variation in the estimated parameters. In this case the null hypothesis holds that there is a consistency in the observed data with the fitted model. This indicates that the null hypothesis is accepted and a conclusion is made that there is a consistency between the observed data and the estimated values in the fit model whereby the p was insignificant,  $p = 1.00 > 0.05$ .

**Table 4. 14: Goodness-of-Fit**

	<b>Chi-Square</b>	<b>df</b>	<b>Sig.</b>
Pearson	.937	41	1.000
Deviance	1.865	41	1.000

Link function: Logit.

There are several measures in ordinal regression models intended to mimic the r-squared analysis, although none of them is an r-squared. Therefore, the interpretation is not the same as that of r-squared, although they can be interpreted as an approximate variance in the outcome. Cox & Snell's pseudo R-squared has a maximum value that is not 1 thus the full model predicts the outcome almost perfectly as the likelihood value is 0.937. Nagelkerke full model perfectly

predicts the outcome as its likelihood of R-squared = 0.979. McFadden's the ratio of the likelihoods suggests the model predicted the outcome perfectly as its likelihood is 0.880.

**Table 4. 15: Pseudo R-Square**

	<b>Pseudo R-Square</b>
Cox and Snell	.937
Nagelkerke	.979
McFadden	.880

Link function: Logit.

The Parameter Estimates table presents the coefficients, their standard errors, the Wald test and associated p-values (Sig.), and the 95% confidence interval of the coefficients. The results show that firm characteristics had a significant influence on the adoption of voluntary audits for SMEs in Nairobi County. Business owners who agreed with the statement that “firms with larger boards have greater corporate reporting comprehensiveness” were more likely to adopt voluntary audits (Exp(44.494), P-value=0.000) that those who were neutral (Exp(16.074), P-value=0.018) and those who disagreed (Exp(15.099), P-value=0.031). These findings concur with the findings of Bulatovic, Treis and Lindholm (2016) that firm characteristics significantly influence voluntary auditing among SMEs.

The results also show that credit access requirements have a significant influence on the adoption of voluntary audits for SMEs in Nairobi County. Business owners who strongly agreed that audited financial statements based on reliable accounting standards are required in credit access were more likely to adopt voluntary audits (Exp(31.288), P-value=0.000) as compared to those who agreed (Exp(18.154), P-value=0.018) and those who were neutral (Exp(13.085), P-value=0.022). The findings are in line with that of Nanyondo, (2014) who found that credit access requirements and quality of financial statements has a significant association with voluntary auditing.

In addition, the findings show that compliance with tax regulations has a significant influence on the adoption of voluntary audits for SMEs in Nairobi County. The business owners who agreed that they ensure voluntary tax compliance were more likely to adopt voluntary audits (Exp(28.278), P-value=0.003) as compared to those who were neutral (Exp(18.123), P-value=0.016) and those who disagreed. These findings concur with the findings of Plumley

(2013) that compliance with tax regulations has a statistically significant impact on adoption and utilization of voluntary audits.

Further, the results show that ownership control has a significant influence on the adoption of voluntary audits for SMEs in Nairobi County. The business owners who indicated that ownership concentration improves internal control systems within a firm were more likely to adopt voluntary audits (Exp(25.838), P-value=0.016) as compared to those who were neutral (Exp(20.783), P-value=0.016) and those who disagreed. The findings are in line with those of Mgamal (2017) who found that ownership structure (managerial ownership, family member on the board and government ownership level) has a significant influence on voluntary disclosure in non-financial companies listed on the Saudi Stock Exchange.

**Table 4. 16: Parameter Estimates**

			Estimate	Std. Error	Wald	df	Sig.	95% Confidence Interval	
								Lower Bound	Upper Bound
Threshold		[DV = 1.00]	39.026	9.210	17.953	1	.000	57.078	20.974
		[DV = 2.00]	29.278	8.427	12.069	1	.001	45.795	12.760
		[DV = 3.00]	18.582	7.663	5.880	1	.015	33.601	3.562
		[DV = 4.00]	7.469	6.624	1.271	1	.260	20.452	5.514
Location	Firm Characteristics	[IV1=1.00]	6.597	11.797	.313	1	.576	29.718	16.524
		[IV1=2.00]	15.099	8.817	.5167	1	.031	21.201	11.201
		[IV1=3.00]	16.074	13.408	5.437	1	.018	42.354	10.205
		[IV1=4.00]	44.494	11.727	14.396	1	.000	67.478	21.510
		[IV1=5.00]	0 <sup>a</sup>	.	.	0	.	.	.
	Credit access requirements	[IV2=2.00]	0 <sup>a</sup>	.	.	0	.	.	.
		[IV2=3.00]	13.085	9.796	4.784	1	.022	32.285	6.116
		[IV2=4.00]	18.154	11.284	4.589	1	.018	40.270	3.961
		[IV2=5.00]	31.288	10.899	.8.998	1	.000	47.872	12.673.
	Compliance with tax regulations	[IV3=1.00]	0 <sup>a</sup>	.	.	0	.	.	.
		[IV3=2.00]	4.100	2.944	1.939	1	.164	9.871	1.671
		[IV3=3.00]	18.123	6.536	6.880	1	.016	31.562	4.736
		[IV3=4.00]	28.278	7.232	11.189	1	.003	44.795	11.760
		[IV3=5.00]	0 <sup>a</sup>	.	.	0	.	.	.
	Ownership control	[IV4=1.00]	.032	4.077	.000	1	.994	-7.958	8.022
		[IV4=2.00]	4.238	5.598	.573	1	.449	15.209	6.733
[IV4=3.00]		20.783	9.893	8.839.	1	.013	35.737	6.783	
[IV4=4.00]		25.838	6.990	8.782	1	.011	39.780	9.780	
[IV4=5.00]		0 <sup>a</sup>	.	.	0	.	.	.	

Link function: Logit.

a. This parameter is set to zero because it is redundant.

The model adequacy was judged through use of parallel line test which was designed by the researcher. The model null hypothesis holds that there are equal slope coefficients in the model

all through the response categories. The p value was 1.000 >0.05 which is significant and it indicates that the corresponding slope co-efficient all through the response categories had no significant difference. This implies that there was no violation of the model assumption of parallel lines with the Complementary Log-log link.

**Table 4. 17: Test of Parallel Lines<sup>a</sup>**

<b>Model</b>	<b>-2 Log Likelihood</b>	<b>Chi-Square</b>	<b>df</b>	<b>Sig.</b>
Null Hypothesis	.000			
General	.000 <sup>b</sup>	.000	33	1.000

The null hypothesis states that the location parameters (slope coefficients) are the same across response categories.

a. Link function: Logit.

b. The log-likelihood value is practically zero. There may be a complete separation in the data. The maximum likelihood estimates do not exist.



## **CHAPTER FIVE**

### **DISCUSSION, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter presents limitations of the study, discussion of the findings, conclusions and recommendations for practice and recommendation for further studies. The main purpose of the study was to investigate the factors (firm characteristics, credit access requirements, compliance with tax regulations and ownership control) influencing the adoption of voluntary audits for SMEs in Nairobi County.

#### **5.2 Discussion of the Findings**

##### **5.2.1 The Influence of Firm Characteristics on the Adoption of Voluntary Audits for SMEs**

The study found that firm characteristics significantly influence the adoption of voluntary audits among SMEs. SMEs with larger boards were more likely to adopt voluntary audits than those with smaller boards. The study found that transparency in terms of information disclosure is very high in large firms as compared to small firms. In addition, it was found the extent of information disclosure depends on the size of the firm. Smaller firms find it hard to reveal the financial information as compared to larger firms. The findings concur with the findings of Ikpor and Ozor (2016) who found that that firm characteristics (firm size, profitability and board size) influence the extent of voluntary information disclosure by the listed firms in Nigeria.

The study also found that information disclosure is very high in firms making high profits and having good performance as compared to their competitors. However, profitability levels of a firm do not determine the level of voluntary information disclosed. The study revealed that board composition affect the level of voluntary information disclosed by firms. Nevertheless, firms with larger boards do not necessarily have greater corporate reporting comprehensiveness.

The study findings revealed that the key indicators of voluntary auditing in firms include the organization turnover ratio and firm characteristics. IN addition the larger the firm in terms of total assets, turnover ratio and the number of employees the higher the level of information disclosure. These results concur with the results of Kolsi (2012) large firms tend to disclose more financial information as compared to small firms since their securities are diversely distributed

over a wide exchange network. In addition, the top management in well performing organizations tends to provide more information since the more the profit the more the information to disclose. Also, size (total assets and number of employees), profitability and board size influence voluntary auditing. Organizations with a large board size are more likely to conduct voluntary audits as compared to those sole proprietorship enterprises. These findings are in line with the arguments of the capital need theory. The theory holds that firm managers benefit from disclosing additional information that increase the capability of those firms to raise capital on the best available terms. Large firms need huge capital to operate hence the need to voluntarily disclose more information to the auditors to be able to access the credit facilities

### **5.2.2 The Influence of Credit Access Requirements on the Adoption of Voluntary Audits for SMEs**

The results revealed that credit access requirements significantly influence adoption of voluntary audits among SMEs in Kenya. The results concur with those of Nanyondo, (2014) who revealed that credit access requirement (quality of financial statements, cash flow and projections) has a significant positive association with access to finance. Business owners who believed that audited financial statements based on reliable accounting standards are required in credit access were more likely to adopt voluntary audits than those who did not. The study found that SMEs lack proper financial records. However, firms rarely keep proper record of all financial documents. In addition most of the SMEs lack audited financial statements which are key requirements by financial institutions when extending credit facilities. As a result, these firms tend to be charged very high interest rates on loans extended to them since they are termed as risky borrowers by the financial institutions. This makes it hard for the small businesses to access credit facilities from financial institutions.

The study revealed that cash flow statements together with projection reports are requirements for credit facilities. Further, it was found that financial institutions rely on the audited financial information to differentiate between defaulters and risk borrowers. The results concur with the findings of McKenzie and Baker (2011) and Olawale (2010) who indicated that the only linkage between financial institutions and SMEs is the audited financial information which is used by the banks to determine the risky and safe borrowers. In addition, most SME owners have little knowledge in relation to preparing cash flow statements. However, SMEs do not prepare

cash flow statements on regular basis. The probability for accessing credit facilities from financial institutions is high for firms with audited statements as compared to firms without audited statements. These results concur with the results of Allee and Yohn (2009) who indicated that audited financial statements are key requirements by the financial institution to be able to extend credit facilities and lower cost of credit as compared to those firms lacking audited financial statements. Nonetheless, most SMEs lack audited financial statements based on reliable accounting standards.

The study established that most of the SMEs have financial statements but the statements are never audited hence this makes it a challenge for financial institutions to extend credit facilities using unaudited financial statements since the level of risk involved is very high. This is in line with the findings of Sacerdoti (2005) who noted that banks are very reluctant to give loans to small firms who don't have formal financial statements and audited accounts and this is attributed to information asymmetry. Further, most SMEs lack proper financial records which hinder them from accessing bank loans.

Findings established that financial statements determine the amount of credit to be extended by the financial institutions to the SMEs. This indicates that transparency in terms of presenting audited financial statements which include cash flow statements, as well as revenue projections by the SMEs increase the willingness of the banks to extend loans to SMEs. Nevertheless, most of the SME owners put less concern on information asymmetry, financial statements and perceived risks which influence their accessibility to credit facilities. These findings are in line with the capital need theory. According to this theory, large firms need huge amount of credit, this indicates that they should disclose more information as compared to small firms.

### **5.2.3 The Influence of Compliance with Tax Regulations on the Adoption of Voluntary Audits for SMEs**

The study found that compliance with tax regulations has a significant influence on adoption of voluntary audits among SMEs. The findings are in line with that of Mendoza, Wielhouwer and Kirchler (2017) who found that tax compliance has a significant impact on voluntary audits. The business owners who ensure voluntary tax compliance are more likely to adopt voluntary audits as compared to those who do not. The study found that underreporting is a result of ignorance of complex tax rules. For taxpayers who underreport their income and taxes unintentionally won't

be impacted by increased tax audits since the compliance level will most probably remain the same. However, extending taxpayer education program and improving taxpayer service has a higher impact and leads to improved taxpayers compliance since knowledge on the complex tax rule is availed hence less mistakes in reporting. Nevertheless, the study found that most SMEs under report the financial position to reduce the tax to be paid.

The study established that some of the SME owners fail to file tax since they lack proper understanding of tax filing. Tax training should be availed to SME owners in order to advance their knowledge on the essence of tax compliance. Some of the small and medium enterprises file tax on a regular basis and ensure proper filing of tax. The study also established that lack of knowledge on tax compliance hinders voluntary compliance. In addition, most of the SMEs ensure voluntary tax compliance and through SME training on tax compliance the level of voluntary compliance among SMEs has improved.

The study found that inadequate knowledge on tax regulations hinders tax compliance and hence most of the SMEs do not see the need to conduct voluntary audits. Therefore, most of the small and medium enterprises underreport their income and hence pay less taxes unintentionally. In addition, the study found that taxpayer education is a better solution for improving tax compliance since through the education knowledge will be availed on the existing tax rules and the consequences for failing to provide true report. By conducting voluntary auditing, some of the small and medium enterprises ensure that they correctly report their sales and income, which plays a major role in reducing underreporting. These findings are supported by the results of (Plumley, 2013) who revealed that there is need for implementation of strong audit program to enhance tax compliance among those groups underreporting intentionally. Therefore, with voluntary auditing, small and medium enterprises can ensure that they properly file their taxes and comply with taxation policies. These findings are supported by the capital need theory. ME owners with adequate knowledge on tax compliance tend to disclose more information as compared to those with less knowledge.

#### **5.2.4 The Influence of Ownership Control on the Adoption of Voluntary Audits for SMEs**

Findings revealed that ownership concentration has a positive and significant influence on adoption of voluntary audits among SMEs. Business owners who believed that ownership concentration improves internal control systems within a firm were more likely to adopt

voluntary audits than those who did not. The findings concur with those of Mgammal (2017) who revealed that the extent of voluntary information disclosure by listed firms in Saudi is influenced by ownership concentration. The study found that ownership concentration improves internal control systems within a firm. In addition, it was revealed that information disclosure is high in organization with institutional ownership and low in firms with family ownership. However, the ownership structure of most SMEs moderately defines the duties and responsibilities of the members. Further, in ownership concentration, there is increased need for audits to ensure good transparency and accountability.

The study found that family owned SMEs lacks proper audit record. In addition, through ownership structure each member performs his or her duties without interference. A clear and well structure organization structure ensures proper delegation of duties and responsibilities. Further, most SMEs lack well defined ownership structures. Increased ownership concentration in most cases leads to decreased internal control system.in addition; internal audit is more preferred when there is increase in owner's concern on the actions of the top management.

In addition, the study found that clarity in the actions of the top management concerning financial information can be ensured through monitoring. The findings are in line with those of Chenga and Courtenay (2014) who opined that the level of information disclosure depends on the extent of independence on the board of directors. As a result this also influences the internal audit demand when there is shift from the top management control to control by foreign owners. In addition, ownership control in terms of ownership concentration, ownership structure and family ownership influence the adoption of voluntary audits. Business enterprises employing managers to run their business make use of voluntary audits to protect their interests.

The results established that the association between the firm owners and the organization managers is compared to principal-agent relationship that prevails in the agency theory .It is argues that agents should not always act in favor of the principal (owner of the business) to ensure maximization of the agent's own wealth. In addition, there should be proper mechanisms and incentives like auditing put in place. These mechanisms should be established to ensure counteracting of the divergence of interest. These findings are supported by the agency theory. Under the small and medium enterprises, the owner of the SME serves as the principal, whereas

the manager as the agent. Most of the family businesses are owner-led, thereof the accountants (internal or external) act as agents.

### **5.3 Limitations of the Study**

Limitations in a research refer to the drawbacks in the adopted methodology that can hinder the interpretations of the research findings. This research was done among SMEs in Starehe Sub-County. Since this study was limited to one Sub-County in Nairobi County, its findings cannot be generalized to other sub-Counties in Nairobi. It was also difficult to tell if the managers/owners were telling the truth. This was solved by the researcher through use of reliability and validity of the research instruments to determine whether the questions met the required standards.

Further, questionnaires were used in data collection. Greener (2008) indicated that there is low validity in questions since there is no accurate way of telling the extent of truth in the responses provided. Moreover, questionnaires are subject to recall bias since they rely on the respondents' ability to remember. To address this challenge, the researcher used both validity and reliability of the research instrument to ensure the items in the questionnaire cover what is supposed to cover. Data collection through use of questionnaires as a research instrument relies on the ability and the willingness of the respondents to answer. The researcher addressed this challenge through assuring the participants that any information provided during the data collection process was to be used with the utmost confidentiality. Further, the researcher sought a data collection permit from the university administration and NACOSTI

### **5.4 Conclusions**

The study concludes that firm characteristics positively and significantly influence the adoption of voluntary audits among SMEs. The study found that firm size (Total assets and Number of employees), profitability and board size influence the adoption of voluntary audits for small and medium enterprises in Nairobi County. This implies improvement in firm characteristic leads to improvement in the adoption of voluntary audits for small and medium enterprises in Nairobi County.

The study also concludes that compliance with tax regulations positively and significantly influences the adoption of voluntary audits among SMEs. From the findings it was established that reduction of under-reporting, proper filing of tax and voluntary compliance influence the adoption of voluntary audits for small and medium enterprises. This implies that improvement in compliance with tax regulations leads to improvement in adoption of voluntary audits for small and medium enterprises in Nairobi County.

The study further concludes that ownership control positively and significantly influences the adoption of voluntary audits among SMEs. From the findings it was established that ownership concentration, ownership structure and family ownership influences adoption of voluntary audits for small and medium enterprises in Nairobi County. This implies that improvement in ownership control leads to improvement in adoption of voluntary audits for small and medium enterprises in Nairobi County.

The study concludes that credit access requirements positively and significantly influences the adoption of voluntary audits among SMEs. From the findings it was found that proper book keeping, cash flow and projects and audited statements influence adoption of voluntary audits among SMEs. This implies that improvement in credit access requirements improves adoption of voluntary audits among SMEs.

## **5.5 Recommendations**

### **5.5.1 Managerial Recommendations**

The study found that Most SMEs lack proper financial records which are key requirements for credit facilities. This study therefore recommends that the SME owners/managers should ensure proper record of all financial documents which includes cash flow statements. This will enable the SMEs the easily access credit facilities from financial institutions.

The findings also revealed that most SME owners have little knowledge in relation to preparing cash flow statements. This study therefore recommends training programmes by the financial institutions to the SME owners/manager so at to increase the knowledge and skills on preparation of financial statements.

The study findings further revealed that audited statements are key requirements for one to access credit facilities. This study therefore recommends that SME owners/managers should

ensure regular auditing of the financial statements so as to boost their access to credit facilities from financial institutions.

The findings revealed that some of the SME owners fail to file tax since they lack proper understanding of tax filing. This study therefore recommends tax compliance training program to the SME owner. This will increase their knowledge on the complex tax rules hence increasing tax compliance among the SME owners/managers.

The study found that through ownership structure each member performs his or her duties without interference. This study therefore recommends that SME owners/managers should formulate and implement proper ownership structure which clearly indicates the duties and responsibilities of each and every employee. This ensures employees are aware of their ownership duties and responsibilities.

### **5.5.2 Policy Recommendations**

The study found that proper financial record keeping is a key requirement for SMEs to access credit facilities. This study recommends policy formulation on financial record keeping and access to credit facilities by small and medium enterprises. Besides setting policy framework for financial record keeping, more policies should be formulated on access to credit facilities.

This study recommends that SME policy formulators look into ways of boosting access to credit facilities through encouraging adoption of voluntary audits. This will boost the capacity of Small and Medium enterprises to sustainably meet the requirements of financial institutions to offer credit facilities

### **5.6 Recommendation for Further Studies**

The main purpose of the study was to investigate the factors influencing the adoption of voluntary audits for SMEs in Nairobi County. However, the research was limited to only four factors which include firm characteristics, credit access requirements, compliance with tax regulations and ownership control. Besides that, the study found that between 88 and 97.9 percent of the variation in adoption of voluntary audits for small and medium enterprises in Nairobi County can be explained by firm characteristics, credit access requirements, compliance with tax regulations and ownership control. Hence, the study recommends that further study

should be conducted so as to assess other factors that influence adoption of voluntary audits for small and medium enterprises in Kenya.



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## APPENDICES

### Appendix I: Questionnaire for Business Managers/Owners

This questionnaire is designed to collect information on the effect of firm characteristics, credit access requirements, compliance with tax regulations and ownership control on the adoption of voluntary audits for SMEs in Nairobi County. Confidentiality will be upheld on any information provided. Kindly fill the questionnaire appropriately.

#### A. General Information

##### 1. Age Bracket:

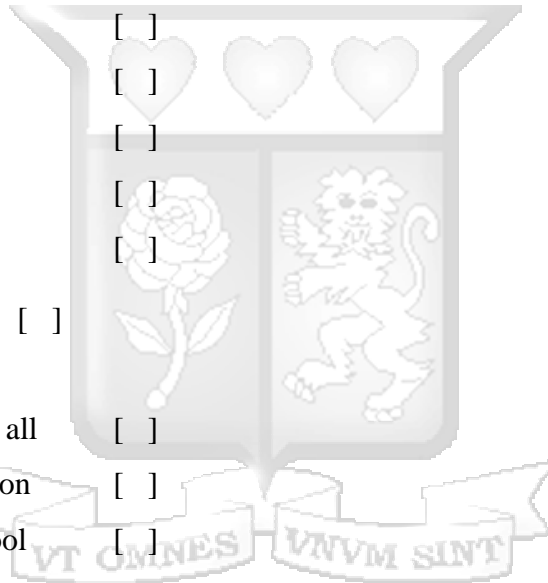
1. 20 to 25 years
2. 26 to 30 years
3. 31 to 35 years
4. 36 to 40 years
5. 41 to 45 years
6. Above 46 years

##### 2. Education level

1. No education at all
2. Primary education
3. Secondary School
4. Diploma
5. Undergraduate
6. Postgraduate

##### 3. For how long have you been in business?

1. Below 2 years
2. 2 to 4 years
3. 5 to 7 years
4. 8 to 10 years
5. 11 to 12 years



6. Above 12 years [ ]

4. In which category does your business enterprise fall?

- 1. Food [ ]
- 2. Hardware [ ]
- 3. Fish [ ]
- 4. Household goods [ ]
- 5. Vegetables [ ]
- 6. Second hand clothes (Mitumba) [ ]

**BFirm Characteristics**

5. To what extent do you agree with the following statements in relation to firm characteristics and adoption of voluntary audits among SMEs?

STATEMENT	1	2	3	4	5
<b>Size</b>					
Information disclosure practices in an organization is influenced by the firm size					
Information disclosure in large firms is better as compared to information disclosure in small firms					
Smaller firms find it hard to reveal the financial information as compared to larger firms					
<b>Profitability</b>					
Profitability level of a firm determines the level of voluntary information disclosed					
In more profitable organization, the top management tends to disclose better information					
Better performance of the firm is indicated through better information disclosure					
<b>Board size</b>					

There is a high comprehensiveness of corporate reporting in firms with larger boards					
The extent of voluntary information disclosure is influenced by the board composition					

6. How else do firm characteristics influence adoption of voluntary audits among SMEs in Kenya?

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**B Credit Access Requirements**

7. Kindly give your ratings on various aspects of credit access requirements and adoption of voluntary audits among SMEs?

STATEMENT	1	2	3	4	5
<b>Proper book keeping</b>					
Most SME lack proper financial records					
SMEs face difficult in accessing credit facilities from financial institutions due to lack of audited financial statements					
Our firm keeps proper record of all financial documents					
<b>Cash flow and projections</b>					
Cash flow statements together with projection reports are requirements for credit facilities					
Most SME owners have little knowledge in relation to preparing cash flow statements.					
Our firm prepares cash flow statements on regular basis					
<b>Audited statements</b>					
Most SMEs lack audited financial statements based on reliable accounting standards					

Audited statements are key requirements for one to access credit facilities.					
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8. How else do credit access requirements influence adoption of voluntary audits among SMEs in Kenya?

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**C Compliance with Tax Regulations**

9. 7. Kindly give your ratings on various aspects of compliance with tax regulations and adoption of voluntary audits among SME?

STATEMENT	1	2	3	4	5
<b>Reduction of under-reporting</b>					
Most SMEs under report the financial position to reduce the tax to be paid					
Some of the SME taxpayers underreport unintentionally					
Underreporting is a result of ignorance of complex tax rules					
<b>Proper filing of tax</b>					
Most SMEs in ensure proper filing of tax					
Some of the SME owners fail to file tax since they lack proper understanding of tax filing					
Our firm files tax on a regular basis					
<b>Voluntary compliance</b>					
Most of the SMEs ensure voluntary tax compliance					
Lack of knowledge on tax compliance hinders voluntary compliance					
Through SME training on tax compliance the level of voluntary compliance among SMEs has improved					

10. In your own opinion, indicated how else compliance with tax regulations influences adoption of voluntary audits among SME in Kenya?

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 .....  
 .....

**D Ownership-Control**

11.7. Kindly give your ratings on various aspects of ownership-control and adoption of voluntary audits among SME?

STATEMENT	1	2	3	4	5
<b>Ownership concentration</b>					
Ownership concentration improves internal control systems within a firm					
In ownership concentration, there is increased need for audits to ensure good transparency and accountability					
<b>Ownership structure</b>					
The ownership structure of most SMEs defines the duties and responsibilities of the members					
Most SMEs lack well defined ownership structures					
Through ownership structure each member performs his or her duties without interference					
<b>Family ownership</b>					
Most SMEs are family owned					
Family owned SME lacks proper audit record					

12. Indicate in your own opinion, how else ownership-control influences adoption of voluntary audits among SME in Nairobi County.

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 .....  
 .....

## E Adoption of Voluntary Audits among SMEs

13. 7. Kindly give your ratings on various aspects of Adoption of voluntary audits among SMEs in Nairobi County?

STATEMENT	1	2	3	4	5
<b>Frequency of audits</b>					
Our firm has a criteria which is used to determine the audit frequency					
Audit in our firm is performed on monthly basis					
Most of the SMEs carry out their audit process on annual basis					
<b>Utilization of results</b>					
Our business enterprise utilizes results from the voluntary audits					
Our SME implements the auditors recommendations					
The management of the business supports the use of the results					
<b>Use of external/internal auditors</b>					
SMEs hires external auditors to audit their firms					
Most of the SMEs cannot afford to hire external auditors					
External auditors provide reliable audit information since they are independent unlike the internal auditors					

## Appendix II: Key Informant Interview Guide for Auditors

This key informant interview guide is designed to collect information on the effect of firm characteristics, credit access requirements, compliance with tax regulations and ownership control on the adoption of voluntary audits for SMEs in Nairobi County. Confidentiality will be upheld on any information provided. Kindly answer the questions appropriately.

1. Which are the main functions of an auditor in SMEs?
2. Why do you think SMEs need to conduct voluntary auditing?
3. Which are the main factors influencing the adoption of voluntary audits for SMEs in Nairobi County?
4. Which firm characteristics influence the adoption of voluntary audits for SMEs in Nairobi County?
5. How do these firm characteristics influence the adoption of voluntary audits for SMEs in Nairobi County?
6. How do credit access requirements influence the adoption of voluntary audits for SMEs in Nairobi County?
7. How does the requirement to comply with tax regulations influence the adoption of voluntary audits for SMEs in Nairobi County?
8. How does ownership control influence the adoption of voluntary audits for SMEs in Nairobi County?

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