

# Financial management and governance issues for SMEs

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# Session objectives



- the role of appropriate governance frameworks for encouraging socially responsible behavior and commercial success among SMEs.
- Take a special focus on financial management issues for SMEs
- Reflect on audit matters of special concern incase of SMEs and risks issues for SMEs

# Governance issues for SMEs



- Governance is now seen as an essential building block of stable entities.
- It helps to protect the rights all stakeholders,
- Governance provides a framework for effective monitoring of management actions and performance and for encouraging better business results.
- for SMEs, corporate governance is mainly about improving business efficiency and performance, and less about monitoring the actions of management.



- Corporate governance structures can be seen as frameworks to help organizations achieve long-term success for their stakeholders.
- Corporate governance involves a set of relationships between a company's management, its board, its shareholders, and
- other stakeholders.

- Corporate governance provides
  - the structure through which the objectives of the company are set,
  - the means of attaining those objectives, and
  - monitoring performance are determined.
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- Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its stakeholders and should facilitate effective monitoring.

- The challenge for SMEs
- governance frameworks developed with focus on large companies and the codes may not reflect the characteristics of the SME,
- where owners may often be its managers as well, or
- where company ownership may be shared across family members, or
- SMEs may not have adequate resources to implement the framework fully

# Principal - Agent conflict



- In family-owned businesses and SMEs in general, the agent-principal issue is less likely to arise, or less likely to be so significant.
- Where the owners are also the managers, management and ownership interests are aligned, but these interests are not necessarily those of other stakeholders.
- For instance, where there are family shareholders who are not actively involved in running the business, some mechanisms may be required to protect their interests.

- The corporate governance framework applied to any business has to be fit for purpose, which includes being appropriate for the size and maturity of the business.
- In general, a robust and effective corporate governance framework includes a number of features and characteristics.



## Features of good governance framework

- Clear reporting lines and clarity about how decisions are made and risks controlled,
- Promote understanding of roles and responsibilities and limits of authority and set the balance the board
- Incentives for staff need to be supportive of board strategies
- Needs to be clear communication (of strategic goals, expected behaviour, etc) by the board to management
- Appropriate internal controls should be established, related to key risks.
- Good visibility of management actions and decision making, which includes the provision of high-quality information on business performance and risk management

# Financial management issues for SMEs



- Good financial management is critical to the success of any business. Without it, a business can be set for failure from the start.
- The ability to have the right finances in place and plan financial matters effectively can help a business grow and adapt to a changing economic environment.

# Common stages for SMEs



- Critical financial decision need to be made in the following stages
- Pre-start up - produce a business plan incorporating financial forecasts.
- Start up - cash management is key – small businesses fail when they run out of cash. Never enough cash to meet all need, a proper development plan with priority can help
- Small entity seek qualified independent financial advice before accessing finance to grow their business. Audit, assurance and management accounting will be helpful.
- Medium sized entity -

## Medium-sized entities

- Medium-sized entities may consider accessing a wider range of finance including
  - an Initial Public Offering (IPO),
  - Private placement or
  - private equity sale.
- Typically a three year track record of clean audited accounts is key and audits taken at earlier stages of a start-up's development will be more beneficial to this process.

- Audit and risks issues for SMEs



- Small companies who prepare their own accounts often need support to address financial and business issues including cash management, debt advice and management structures.
- Audit help to provide confidence on the entity state of affairs
- Companies act 2015 exclude small companies from mandatory audit (article 624)
- it has a turnover of not more than fifty million shillings;
- the value of its net assets as shown in its balance sheet as at the end of the year is not more than twenty million shillings; and
- it does not have more than fifty employees.

- The close involvement of an auditor provides companies with comfort when faced with tax, regulatory and access to finance issues as they grow in size.
- A prime example is the confidence an audit can provide to a credit rating score.



- Small companies grow, and may find themselves subject to a statutory audit requirement as staff numbers and turnover increase.

- Businesses who do not have an audit but are seeking to build confidence in their financial information should consider having an external assurance report.

# Considerations Specific to SME Audits



- Structure of Clarified ISAs heavily influenced by need to ensure applicability of ISAs to audits of entities of all sizes, in particular SMEs
  - Separate section for requirements to help readability and clarification of conditional requirements
  - Requirements capable of being applied proportionately
  - Additional guidance specific to SME audits

## Considerations Specific to SME Audits

- New guidance in application material of the ISAs providing considerations specific to audits of smaller entities
  - Typical qualitative characteristics of SMEs described in ISA 200
  - Guidance developed primarily with unlisted entities in mind; some considerations, however, may be helpful in audits of smaller listed entities
  - Considerations do not limit responsibility to comply with ISA requirements

# Audit risk consideration in audit of SMEs



- Demonstrated in requirements, e.g.,
  - ISA 260.13, where management = those charged with governance
  - ISA 315.17, absence of formal risk assessment process
  - ISA 540.13, choice of responses to assessed risks
- Demonstrated in application material, e.g., guidance on aspects of the audit which vary with size, complexity, and nature of an entity

# Risk Assessment

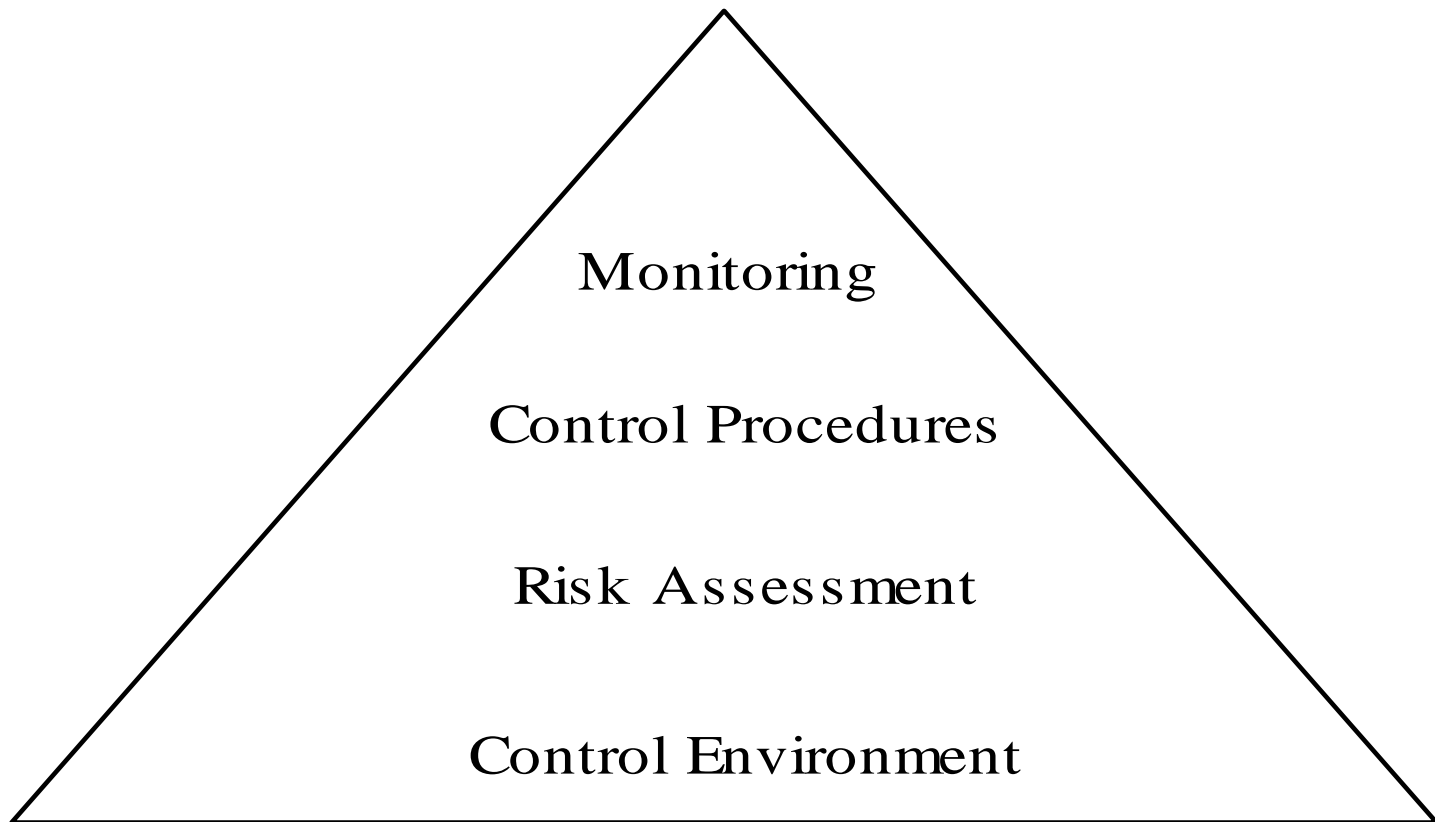
- Objectives related to operations, financial reporting, and compliance
- Identification and analysis of relevant risks
- A strategy to manage risks
- Incentives to maintain internal controls
- Identification of industry specific risks

# Assertion and audit risk



- the risk of misstatement for each assertion will vary according to the type of account.
- The auditor is more concerned about the higher risk assertions.
- For example, in general:
- Existence is a concern when auditing assets.
- Completeness is a concern when auditing liabilities.
- Occurrence is a concern when auditing sales.
- Completeness is a concern when auditing expenses.

# Profile of internal control





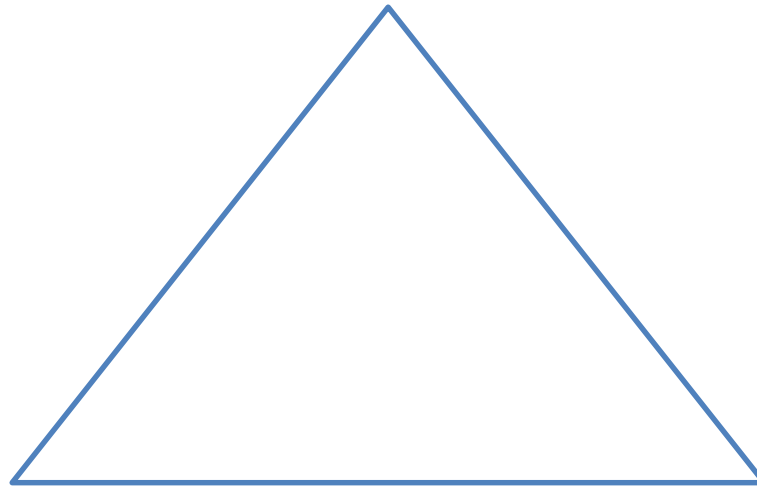
# Fraud risk for SMEs

## (Why Good People Do The Wrong Thing)

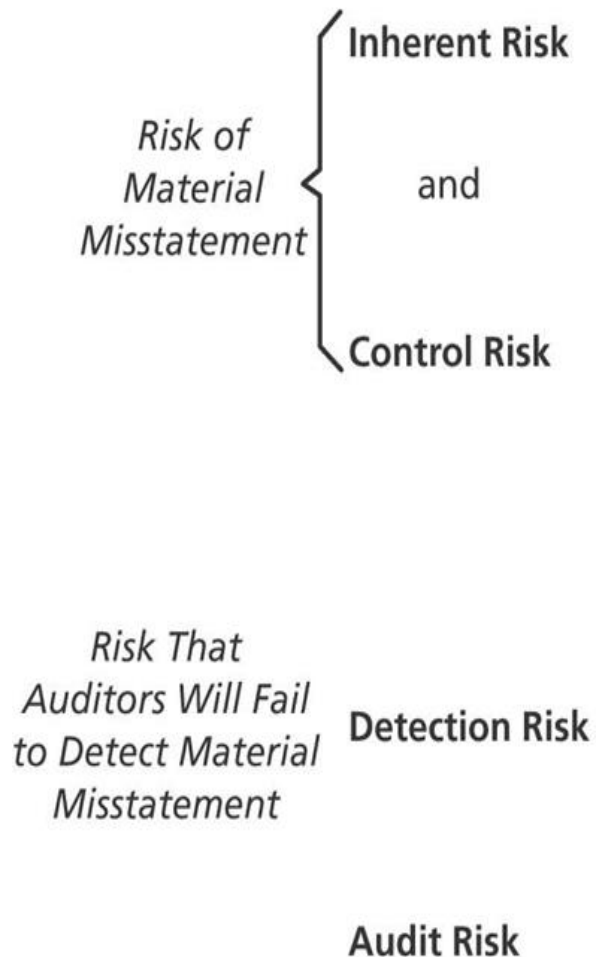


Pressure  
(Real or Perceived)

Opportunities,  
(Real or perceived)  
Failure in ICS



Rationalization  
(every one is doing it )  
(I will pay it back!)



Misstatements Likely to Occur in the Client's Financial Statements

Misstatements Prevented or Detected by Controls

Misstatements That Bypass the Client's Controls

Misstatements Detected by the Auditors' Procedures

Misstatements Undetected by the Auditors



**Thank you**

**Interactive session**

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