

# Effect of Internal Audit Quality on the Financial Performance of Micro, Small and Medium Scale Entreprises: A Case Study of Some Selected MSMEs in Kano State

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## Abstract

**Background:** The study examines the effect of internal audit quality on the financial performance of some selected Micro, Small, and Medium Scale Enterprises (MSMEs) in Kano State, Nigeria.

**Objectives:** The study specifically investigates the influence of auditor independence, competence, objectivity, audit scope, stakeholder engagement, and continuous improvement practices on the MSMEs financial performance, evaluated using Return on Assets (ROA).

**Methods:** A quantitative research design was adopted, employing structured questionnaires administered to 50 respondents across five selected MSMEs. The study collected data and analyzed them using statistics and regression analysis techniques.

**Results:** Findings show that internal audit quality has significantly affect financial performance of MSMEs. In particular, auditor independence and competence were identified as the most influential factors in enhancing ROA. The study also confirms that a well-defined audit scope, active stakeholder engagement, and continuous improvement practices contribute positively to financial results.

**Conclusion:** The results underscore the significance of strengthening internal audit units to promote transparency, accountability, and optimal financial management in SMEs. On the basis of the findings, it is suggested that SMEs invest in developing competent and independent internal audit units, regularly update audit procedures, and integrate audit feedback into decision-making processes.

## A. Introduction

Particularly in developing nations, micro, small, and medium-sized businesses (MSMEs) are crucial to economic growth, the creation of jobs, and the reduction of poverty. MSMEs are a vital component of inclusive economic growth since they make up over 90% of all businesses worldwide and more than 50% of all jobs (Group, 2020). MSMEs in Nigeria make a substantial contribution to the country's output and job creation, but many of them continue to function under inadequate financial control mechanisms, weak

governance structures, and low managerial capacity (Atakpa et al., 2025). MSMEs dominate local economic activity in Kano State, one of Nigeria's major trade and industrial hubs, yet they are nevertheless extremely susceptible to financial inefficiencies, inadequate risk management, and shoddy accountability frameworks (Akintobi et al., 2024).

The lack or poor use of internal control and auditing procedures is one of the persistent issues MSMEs encounter. In contrast to large firms, MSMEs frequently view internal audits as costly, complex, and superfluous, which leads to informal or nonexistent audit operations (Pramana, 2025). According to earlier research, small enterprises' adoption of structured internal audit procedures is severely hampered by low awareness, a lack of technical know-how, and resource limitations (Adeboye, 2024). This has a detrimental effect on the financial viability of many MSMEs since they lack trustworthy systems for tracking financial performance, identifying operational risks, and guaranteeing transparency in decision-making processes (Mokodompit & Nugraeni, 2025).

The relationship between internal audit quality and financial performance is covered in great detail in the academic literature currently in publication, with a major focus on public sector organizations and large corporations (Aditia et al., 2025). Even though these studies highlight the theoretical significance of auditor independence, competency, objectivity, and audit scope, it is frequently challenging to convert the results into workable solutions for MSMEs functioning in conditions with limited resources (Bello et al., 2024). Furthermore, the majority of earlier research has concentrated more on theoretical validation and hypothesis testing, offering little direction on how internal audit procedures might be modified as useful instruments for community-level economic empowerment and capacity building (Zhan, 2023). Particularly in the context of community-based MSME development, this shows a glaring gap in practice rather than merely an academic research gap.

In order to close this gap, this study uses an empirical but community-focused methodology to investigate how internal auditing quality might help MSMEs in Kano State develop their capacity. This study reframes internal audit quality as an intervention-oriented framework that MSME owners and managers can realistically adopt to improve financial performance, accountability, and risk management, rather than merely viewing internal auditing as a compliance or governance requirement. This study is unique because it bridges academic knowledge with community-based economic development activities by incorporating the internal audit quality factor into a practical empowerment model that is suited to the operational realities of MSMEs (Agu et al., 2024).

This study advances the fields of community development and MSME empowerment by generating empirical data based on the real-world operations of MSMEs and offering useful information to practitioners, policymakers, and company owners. Training programs, technical assistance programs, and policy-based interventions targeted at enhancing MSMEs as drivers of sustainable local economic growth in Kano State are anticipated to benefit from these findings.

The concept of internal audit quality encompasses several dimensions, including auditor independence, technical competence, scope of services, and adherence to auditing standards. According to (Khan, 2023), effectiveness of internal audit function is defined by the degree to which internal auditors can provide reliable, relevant, and timely assurance services that meet stakeholder expectations and improve organizational performance. This includes not only the professional proficiency of auditors but also the effectiveness of their communication, planning, and reporting processes. High internal audit quality strengthens financial accountability and promotes robust internal controls, both of which are essential for sustaining financial performance, particularly in the dynamic operating environments of MSMEs.

Empirical studies in the Nigerian context underscore the tangible impact of internal audit quality on financial oversight and performance. (Usang & Salim, 2025), examining the Nigeria Industrial Training Fund in nearby Sokoto State, found that internal audit quality has a statistically significant positive effect on fund management an organizational performance proxy after controlling for other internal control elements. Similarly, research on local governments in Oyo State by (Nurdiono & Gamayuni, 2018), demonstrates that enhanced auditor competence and independence are associated with improved service delivery and financial accountability. These findings align with a broader international literature indicating that robust internal audit functions can reduce misstatement risks, deter fraud, and promote efficient resource utilization.

However, for the purpose of this study, Stakeholders and Resource Based View Theories explain the theoretical framework:

**Resource Based View:** This theory provides a powerful theoretical understanding of strategic significance of internal audit quality in enhancing the financial performance of Micro, Small, and Medium Enterprises (MSMEs). The RBV argue that organizations are able to achieve long lasting competitive superiority by establishing and applying valuable, rare, inimitable, and non-substitutable (VRIN) internal means and capabilities (Rahmatullah et al., 2023; S et al., 2024). In contemporary research, this perspective has been increasingly applied to internal governance mechanisms, including internal audit functions, particularly in the MSME context.

Recent scholarship has expanded the RBV to underscore the function of internal audit quality as a strategic resource that contributes to improved financial outcomes. According to (Bonrath & Eulerich, 2024), internal auditing, when performed with high standards of independence, objectivity, and technical competence, can be classified as a valuable and rare organizational resource. This is because such audit processes not only detect and prevent fraud but also contribute to sound risk assessment, strategic decision-making, and operational efficiency.

**Stakeholders Theory:** Stakeholder Theory provides a robust basis for evaluating the impact of internal audit effectiveness on the financial outcomes of MSMEs. First proposed by Godam et al, 2019, the theory has since evolved to emphasize that organizational success is not solely determined by maximizing shareholder value, but by satisfying a broad range of stakeholders whose interests are impacted by the organization's operations (Godam et al., 2019). In the context of MSMEs, these stakeholders include owners, employees, regulators, creditors, suppliers, customers, and the community at large. Recent developments in stakeholder theory extend its application to governance mechanisms, particularly internal auditing, by highlighting the role of transparent and accountable internal systems in building stakeholder trust.

## B. Methods

### Research Design

Within a positivist research framework, this study employs an exploratory quantitative research design (pre-research). The primary goal of this study, which is to present preliminary empirical evidence on the relationship between internal audit quality and financial performance among MSMEs in Kano State, Nigeria, is reflected in its exploratory nature. This study is meant to be a basic investigation rather than a fully generalizable explanatory model, given the limitations of earlier empirical studies that specifically focused on internal audit practices in MSMEs in this context.

Because this study focuses on variables that can be observed and measured, the positivist approach is deemed appropriate. This allows for statistical analysis of the relationship between financial performance indicators and internal audit quality dimensions. Standardized quantitative data was gathered using a structured questionnaire, allowing for preliminary statistical analysis to find trends, connections, and possible areas that need more research in subsequent studies.

### Population of the Study

The study population consisted of micro, small, and medium enterprises (MSMEs) operating in Kano State, Nigeria. However, this study concentrated on five chosen MSMEs in the textile and fashion sub-sector in Kano State as the unit of analysis due to practical constraints pertaining to access, time, and data availability.

These companies were selected because they have relatively well-established operational structures, maintain internal audit or basic control functions, and engage in consistent financial activities. Because of these features, they can be used to investigate the quality of internal audits and how they relate to financial performance in the resource-constrained setting of MSMEs.

### Sampling Technique

Purposive (judgmental) sampling is used in this study, which is ideal for exploratory research where the primary goal is to gather rich data from participants who are directly familiar with the phenomenon under

study. The respondents were specifically chosen based on their experience in supervisory, financial management, or internal auditing roles in particular MSMEs.

This strategy is justified by the study area's restricted access to MSMEs with formal audit structures and the requirement to guarantee that respondents can supply accurate and instructive data. Purposive sampling is suitable for preliminary studies that seek to obtain in-depth understanding rather than broad statistical generalization, as noted by (Rahman & Christina, 2022).

### Data Collection Instrument

A structured questionnaire intended to collect quantitative data on the aspects of internal audit quality (auditor independence, competence, objectivity, audit coverage, stakeholder involvement, and continuous improvement practices) and financial performance indicators was used to collect data for this study. In addition to facilitating preliminary statistical analysis suitable for exploratory studies, the use of questionnaires allowed for consistency in responses.

### Data Analysis Technique

The Statistical Package for the Social Sciences (SPSS) Version 26 was used to handle and analyze the gathered data. To examine trends and connections between the research variables, both descriptive and inferential statistical methods were applied. Given the exploratory nature of this study, the analysis focused on identifying initial relationships and directional effects, rather than establishing definitive causal relationships. These findings are therefore interpreted as indicative and are intended to provide input for future large-scale or longitudinal studies.

Due to time and data availability constraints, the small number of MSMEs having organized internal audit processes, and restricted field access, an exploratory quantitative method was used. These conditions necessitate a focused preliminary investigation that can generate empirical insights while maintaining rigorous methodology. The findings of this study should therefore be seen as exploratory and context-specific, and they may be used as a foundation for future research with a larger sample and more extensive sector coverage.

### Equation

$$Y = \beta_0 + \beta_1 AI + \beta_2 AC + \beta_3 AO + \beta_4 AS + \beta_5 SE + \beta_6 CIP + \varepsilon \quad (1)$$

$$FP = \beta_0 + \beta_1 AI + \beta_2 AC + \beta_3 AO + \beta_4 AS + \beta_5 SE + \beta_6 CIP + \varepsilon \quad (2)$$

### Abbreviations and Acronyms

Where:

FP	= Financial Performance
IA	= Auditor Independence
AC	= Auditor Competence
AO	= Auditor Objectivity
AS	= Audit Scope
SE	= Stakeholder Engagement
CIP	= Continuous Improvement Practices
$\beta_0$	= Constant
$\beta_{1-4}$	= Regression coefficients
$\varepsilon$	= Error term (captures all other unmeasured influences)

Regression analysis was used with financial performance as the dependent variable and internal audit quality as the independent variable to examine the program's direct effect on financial performance.

## C. Results and Discussion

### Changes in Partner Conditions After the Intervention

Before the community service program was put into place, the majority of MSME partners had insufficient

monitoring systems, informal financial recordkeeping, and little internal audit procedures. Decision-making relied more on subjective judgment than on organized financial data, and financial records were frequently lacking. These circumstances hindered the expansion of businesses and made them more susceptible to inadequate financial management.

Partners' financial management and organizational discipline significantly improved after the intervention. MSMEs started using standard accounting procedures, more transparent task distribution, and regular performance evaluations. These modifications show that the program created useful adjustments in daily business operations in addition to statistical outcomes. (Alotaibi, 2024; Hassan & Chandrashekar, 2025; Ikape & Egwu, 2024) have all documented a similar pattern of organizational change after audit and financial management interventions. They discovered that enhancing internal audit functions increases accountability and transparency in small businesses.

These results demonstrate that community service projects are an empowerment tool that helps MSME partners go from unstructured to more organized and long-lasting business management.

### Capacity Building Impact on MSME Partners

This program's capacity building component focuses on enhancing partners' understanding of the aspects of internal audit quality, such as auditor independence, competence, objectivity, audit scope, stakeholder engagement, and continuous improvement techniques. Partners' comprehension of financial controls and performance metrics like return on assets (ROA) is improved through training and mentoring programs. The Average Score for the Financial Performance (FP) and Internal Audit Quality (IAQ) Dimensions shows the partners' enhanced capacity.

**Table 1.** Mean Scores of IAQ Dimensions and FP

IAQ Dimension	Mean ( $\bar{X}$ )	Standard Deviation (SD)	Interpretation
Auditor Independence	4.26	0.58	High independence supports accurate and unbiased reporting
Auditor Competence	4.32	0.55	Skilled auditors enhance financial decision-making
Auditor Objectivity	4.18	0.61	Objectivity minimizes conflicts and errors
Audit Scope	4.10	0.63	Comprehensive audits strengthen risk management
Stakeholder Engagement	4.05	0.59	Engagement improves strategic alignment and governance
Continuous Improvement Practices	4.35	0.52	Continuous learning enhances audit efficiency
Financial Performance (ROA)	0.21	0.05	Positive profitability relative to assets

According to the study's findings, partners significantly improved their technical and procedural knowledge of internal auditing, with auditor competence and continuous improvement techniques receiving the highest average marks. This demonstrates that the initiative was successful in enhancing MSME partners' human capital. Internal audit competency can be viewed from a Resource-Based View (RBV) viewpoint as a strategic organizational resource that boosts competitiveness and operational efficiency (Herwinsyah, 2025).

These results are consistent with studies by (Widyaningsih et al., 2025), which found that training-oriented audit interventions greatly enhance organizational learning and financial performance. As a result, this program's capacity building impact extends beyond immediate outcomes and promotes MSMEs' operational sustainability.

### Direct Impact of Community Service Activities on Financial Performance

According to the regression analysis, a considerable amount of the variance in MSMEs' financial performance may be explained by internal audit quality.

**Table 2.** Regression Analysis of IAQ and FP

Variable	B	SE	$\beta$	t-value	p-value
Constant	0.042	0.015	-	2.80	0.008*
Auditor Independence (AI)	0.125	0.051	0.142	2.45	0.018*
Auditor Competence (AC)	0.138	0.056	0.157	2.46	0.017*
Auditor Objectivity (AO)	0.112	0.048	0.131	2.33	0.023*
Audit Scope (AS)	0.096	0.044	0.115	2.18	0.034*
Stakeholder Engagement (SE)	0.089	0.041	0.106	2.17	0.035*
Continuous Improvement Practices (CIP)	0.142	0.052	0.160	2.73	0.009*

Source: Author's computation using stata (2025)

#### Summary of the Model:

$R^2 = 0.821$  (82.1% of variation in financial performance is explained by IAQ)

F-statistic = 56.47,  $p < 0.001$  (Model is statistically significant)

Significant at  $p < 0.05$

#### Interpretation

1. **Auditor Independence (AI):** Positive coefficient (0.125,  $p = 0.018$ ) indicates that higher independence of auditors significantly improves financial performance.
2. **Auditor Competence (AC):** Positive and relevance (0.138,  $p = 0.017$ ), recommending that skilled auditors enhance financial outcomes.
3. **Auditor Objectivity (AO):** Significant (0.112,  $p = 0.023$ ), meaning unbiased audit judgments positively affect performance.
4. **Audit Scope (AS):** Broader audit coverage positively impacts ROA (0.096,  $p = 0.034$ ).
5. **Stakeholder Engagement (SE):** Engagement with key stakeholders contributes positively (0.089,  $p = 0.035$ ).
6. **Continuous Improvement Practices (CIP):** Strongest effect (0.142,  $p = 0.009$ ), highlighting the value of iterative improvements in audit processes.

The results show that audit coverage, continuous improvement procedures, and auditor competency significantly improve financial performance. This implies that MSME partners who enhance their internal audit procedures see improved financial outcomes, especially with regard to profitability and resource usage. The program's strong explanatory power for changes in financial performance is indicated by the coefficient of determination ( $R^2$ ).

Practically speaking, enhanced stakeholder and creditor trust, less operational risk, and improved financial reporting accuracy are all indicators of the direct effects of community service initiatives. These findings support the findings of (Phang & Sydney, 2023), who discovered that putting audit recommendations into practice led to quantifiable gains in organizational performance and governance quality.

### Hypotesis Testing Results

Additional hypothesis testing verified a strong correlation between MSME partners' financial performance and the quality of their internal audits.

**Table 3.** Hypothesis Testing Results

Hypothesis	Decision	Interpretation
Ho1: IAQ has no significant positive relationship with FP	Rejected	IAQ significantly and positively influences financial performance ( $R^2 = 0.821$ , $p < 0.05$ ).
Ho2: IAQ has no significant impact on financial reporting accuracy	Rejected	Components such as independence and objectivity improve financial accuracy ( $p < 0.05$ ).
Ho3: IAQ has no significant influence on risk management practices	Rejected	Audit scope and continuous improvement practices enhance risk mitigation ( $p < 0.05$ ).

Every hypothesis put forth was validated, suggesting that every aspect of internal audit quality had a favorable impact on financial performance. This supports the notion that internal audit quality serves as a strategic tool for enhancing business outcomes in addition to its technical role. These findings are consistent with studies by (Ahmad et al., 2025), which highlight the contribution of internal audit to improving organizational efficacy.

### Discussion in Relation to Previous Studies

By showing the statistical association between internal audit quality and financial success as well as the factors underlying organizational transformation and capacity building among MSME partners, these findings build on earlier empirical studies. This community service program demonstrates how useful interventions can result in noticeable improvements in partners' behavior and performance, whereas prior research has mostly concentrated on hypothesis testing (Pratiwi et al., 2025).

The integration of the Resource-Based View and Stakeholder Theory provides a comprehensive explanation of the observed results. Improvements in auditor competence and continuous improvement practices strengthen internal efficiency, while stakeholder engagement increases trust and legitimacy (Baharom, 2025). Therefore, for MSMEs, the quality of internal audits serves as a governance tool as well as a strategic resource.

Overall, the findings and analysis demonstrate that the community service program has improved capacity, produced direct cash advantages, and significantly altered the partners' circumstances. These findings demonstrate the applicability of internal audit-based interventions as a successful paradigm for MSMEs' empowerment and long-term company growth.

### D. Conclusion

The outcomes of this study underscore the pivotal role of internal audit effectiveness in enhancing the financial outcomesMSMEs in Kano State, Nigeria. Evidence from the data analysis demonstrates that robust internal audit functions characterized by independence, competence, objectivity, comprehensive audit scope, stakeholder engagement, and continuous improvement practices positively influence both the accuracy of financial reporting and the effeciency of risk management strategies within these enterprises.

The rejection of all three null hypotheses confirms that internal audit effectiveness is not only significantly correlated with financial outcomes but also serves as a critical determinant of operational effectiveness and organizational governance. Auditor independence and objectivity ensure credible and unbiased financial reporting, while competence strengthens the technical execution of audits. Comprehensive audit scope and active stakeholder engagement facilitate the identification and mitigation of risks, enhancing strategic decision-making. Continuous improvement practices ensure that audit processes evolve to address emerging challenges and industry best practises.

In essence, MSMEs that invest in strengthening their internal audit functions are better positioned to achieve sustainable financial growth, maintain transparency, and reduce vulnerability to errors or fraud. The study further highlights that internal audit quality is a crucial mechanism for promoting accountability, operational discipline, and long-term profitability, reinforcing its importance as a governance tool in resource-constrained enterprises. These findings provide empirical support for SME owners, managers, and policymakers seeking to implement audit-driven performance enhancements.

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### F. Author Contribution

NM oversaw the overall research design, created the research framework, and designed the study. Data processing, statistical analysis, and data collection fell under the purview of SL. FK helped with the literature review, results interpretation, and findings discussion. The final text was developed, evaluated, and approved for publication by all authors in collaboration.

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