TO ASSESS THE IMPACT OF EXTERNAL FINANCIAL AUDITING ON CORPORATE GOVERNANCE IN BANKING INSTITUTIONS IN KENYA

BY

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UNITED STATES INTERNATIONAL UNIVERSITY - AFRICA

SPRING 2017
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A Research Project Report Submitted to the School of Business in Partial Fulfillment of the Award of Master’s in Business Administration (MBA) Degree

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

SPRING 2017
DECLARATION

I, the undersigned declare that this is my original work and that it has not been submitted to any other College, Institution or University other than United States International University for academic purposes.

Signed……………………………… Date ………………………………………

Ali Faisal Mohammed  (ID 617086)

This research proposal has been submitted for examination with our approval as university supervisors.

Signed……………………………… Date ………………………………………

Mr. KephaOyaro

Signed……………………………… Date ………………………………………

Dean, Chandaria School of Business
ACKNOWLEDGEMENT

I would like to acknowledge Mr Kepha Oyaro for the guidance that he has accorded me and that has enabled me to complete my research report. I also give special thanks to all the managers in various banks who took part in this research, without them this study would not have been possible.
DEDICATION
This research is dedicated to my lovely family and friends who have been an inspiration to me. God bless you all.
ABSTRACT

The purpose of this study was to analyze the impact of external financial auditors on corporate governance in banking institutions. The research questions of the study are; To what extent have accuracy of financial reporting affected corporate governance in the banking institutions in Kenya?, What impact has Bank’s compliance to international reporting standard had on corporate governance in the banking institutions in Kenya? To what extent has fraud prevention affected corporate governance in the banking institutions in Kenya?

A descriptive research design was used and the study will obtain and described the views of the respondents from banks in Nairobi, in line with establishing the challenges facing auditors in corporate governance. The study will incorporate both quantitative and qualitative research design so as to gain a better knowledge and in-depth understanding of the results. The target population for this study auditors in the 49 bank in Kenya and only 41 responded giving a response rate of 84%

On analysis of the first objective it was established that most respondents agreed that the assessment of internal control is critical in corporate governance and investors place trust on the audited reports before deciding to invest. It was also established that the firm has employed independent experts to audit its statements. However, respondents disagreed that board influence the auditing of the financial statement.

On analysis of the second objective it was revealed that most respondents agreed that the organization has executed auditing according to worldwide auditing requirements, and stakeholders are interested in bank’s compliance to international reporting standard, it was also revealed that the banks have adhered to international reporting standard and external auditor outsourced are objective, unbiased, and competent in verifying materials. However respondents strongly disagreed that have suffered losses due to failures to comply with international reporting standard.

On analysis of the third objective it was revealed most respondents agreed that the all bank accounts are reconciled on regular basis and stakeholders are concerned about fraud cases in the industry. The findings also show that audit committee is appropriately structured to ensure its independence and it issues alert to fraud opportunities within the organization. Majority also agreed that auditors play a role in detecting fraud in the organization and fraud occurrences get reported to the audit committee as a matter of
course. The firms have also taken necessary action to mitigate fraud. However, most respondents disagreed that audit committee involved in allegations of fraud made by employees and third parties.

The study concluded that an assessment of internal control is seen as a critical factor in corporate governance and as such in the banking sector investors place trust on the audited reports before deciding to invest. In addition, the commercial banks in Kenya adhere to auditing practices according to worldwide auditing requirements, this is fostered by the fact that stake holders are interested in bank’s compliance to international reporting standard. The study also concluded that the role of auditors in detecting fraud in the organization is undoubtedly the most important in fraud prevention.

The study recommended that banks need to ensure that they undertake a critical assessment of internal control in order to ensure that ethics in corporate governance is upheld. Commercial banks in Kenya should continuously adhere to auditing practices according to worldwide auditing requirements. The banks need to maintain compliance to international reporting standard and adhere to international reporting standard. There is a need for all bank to undertake a regular accounts reconciliation on regular basis in order to be able to detect crime and fraud cases in the industry. There is also a need for the audit committee to undertake appropriate measures to ensure independence. The institutions also need to involve the audit committee when there is an allegations of fraud made by employees and third parties. For further studies, this research recommends that there is a need to undertake a study to determine the impact of corporate governance on the financial performance of banking institutions.
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ACRONYMS AND ABBREVIATIONS

ANOVA- Analysis of variances

CG- Corporate governance

IFRS- International Financial Reporting Standards

MFI- Micro Finance Institutions

SPSS- Statistical package for social sciences
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

For a society to make any economic decisions it is essential that such vital information based upon the data available during the decision-making time. For a banking institution, the decisions such as offering loan to a firm is grounded upon preceding financial relationships with the corporation, the financial standings of the firm as shown by the financial statements among other factors. For decisions to be consistent with the intention of the bank, such information used decision-making process need to be reliable (Hayes, Wallage, & Gortemaker, 2014). Unreliable information may result into the inefficient use of resources to the disadvantage of the various stakeholders. In the lending decision for instance, assuming decisions are made because of misleading financial and the borrower Company fails to repay back, this would result the financial institution losing both its principal and interest charged on the loan. This therefore implies that another party that could have benefitted from the funds is deprived off such opportunity (Eilifsen, Messier, Glover, & Prawitt, 2013).

According to Furnham and Gunter (2015), as society become more complex, there is an increased likelihood that unreliable information was provided to decision makers. There are several reasons for this: remoteness of information, voluminous data, and the existence of complex exchange transactions as a means of overcoming the problem of unreliable information, the decision-maker must develop a method of assuring him that the information is sufficiently reliable for these decisions. In doing this, he must weigh the cost of obtaining more reliable information against the expected benefits.

As an institution grows, there is a very high probability that inconsistent data was given to the various decision makers because of remoteness of data, voluminous information, and the presence of complex external and internal transactions in the firm (Hayes, Wallage, & Gortemaker, 2014). As a method for defeating the issue of problematic data, the firm must build up a technique for guaranteeing that the data is adequate for such choices. In doing so, the firm should put up measure to acquiring more data that are dependable. A reliable method of a getting access to such reliable information is to through verification (audit) done by independent individuals. The audited data is then applied in the making
decision on the assumption that it is the correct, complete, accurate, and unbiased data (Bachlechner, Thalmann, & Manhart, 2014).

According to Kumar and Mohan (2016), the term audit is gotten from the Latin expression "audile," which is to listen. In early days, an inspector used to listen to the records read over by a bookkeeper keeping in mind the end goal to check them. Auditing is as old as bookkeeping. It has been applied in all antiquated nations, and the first target of reviewing books was to distinguish and counteract blunders and fake entries. According to Furnham and Gunter, (2015), auditing developed and became quickly after the modern upset in the eighteenth century with the development of the business entities the possession and administration have to be independent. The shareholders who were the proprietors required a report from an autonomous master on the records of the organization overall performance by the top management. The target of such review moved and review was required to find out whether the records were valid and reasonable as opposed to just identification of mistakes.

Corporate Governance is a system of regulation, rules, and practices, which an organization is managed and it generally involves looking after the interests of the firm’s stakeholders who include shareholders; management; customers; suppliers; financiers; Government and the community. Corporate governance evolved from the emergence of modern stock organizations, multinational corporations and capitalism during the nineteenth century (Agyemang & Castellini, 2015). Corporate governance acts as a foundation for a firm to attaining its core objectives and entails all the management activities in a responsible and accountable manner. In addition, corporate governance entails the activity used in regulation processes through various agencies either internal or external agencies to resolve any conflicts that arise and to secure both the stakeholder and organizations interest (ACCA, 2012).

Research has demonstrated that organizations that adhere to corporate governance perform better hence underscoring the requirement for good corporate administration (Miring’u & Muoria, 2011). On the other hand, poor corporate administration has demonstrated to prompt breakdown of state organizations and poor governance leads to pilferage of resources and questionable administrations and other operational inefficiencies (Zvavahera & Ndoda, 2014).
Corporate governance in the United Kingdom was first put in the limelight when the Cadbury report was published in 1992, and this was after the collapse of Maxwell Communications and Polly Peck International companies. Adrian Cadbury was the chair of the committee that created the recommendations in regards to the company boards of directors and accounting systems to curb corporate governance risks and failures (Taylor, 2007). According to Ernst & Young (2012), in the United States, the Sarbanes-Oxley Act (SOX) was passed in 2002 due to the collapse of huge corporations like Enron Corporation, Tyco International, Adelphia, and WorldCom. The bill had eleven sections that were enacted as a reaction to these scandals. Investors lost billions of dollars from the affected companies. However, to partake its role effectively, SOX needed the companies furnish the audit committees with relevant resources to carry out their duties. In addition, SOX also demanded the audit committees to create avenues for any confidentiality about any complaints that related to financial auditing and internal control irregularities.

In defining corporate governance in China, Clarke (2006) considers it as the set of rules and practices regulating relationships among participants in post-traditional Chinese business enterprise and that which governs decision making within that enterprise. Corporate governance in China tends to regulate relationships among all parties with interest in the business organization. Although post-traditional enterprises are no longer as tightly controlled by the state as they once were, most Chinese studies pay more attention to the two primary types of firms in China: state-owned enterprises (SOEs) and publicly held companies (PHCs). In defining corporate governance in China, Clarke (2006) considers it as the set of rules and practices regulating relationships among participants in post-traditional Chinese business enterprise and that which governs decision making within that enterprise. Corporate governance in China tends to regulate relationships among all parties with interest in the business organization. Although post-traditional enterprises are no longer as tightly controlled by the state as they once were, most Chinese studies pay more attention to the two primary types of firms in China: state-owned enterprises (SOEs) and publicly held companies (PHCs).

Corporate governance in China is considered as rules and practices that analyses the relationships between the players in post-traditional Chinese business enterprise as well as governing the decision making process within that corporation. Corporate governance in China regulates the relationships by all parties with interest in the firm (Li,
In Sri Lanka, corporate governance reforms were introduced in the 1990s by laws on corporate governance by the Institute of Chartered Accountants of Sri Lanka (ICASL) which was aimed at controlling the financial areas of corporate governance, this was influenced by the Cadbury Code (1992) in the United Kingdom (Senaratne, 2010).

According to the Kenyan company Act (Chapter 486), the board of directors is appointed on behalf of the shareholders to take care of the daily affairs of the firm and it is directly accountable to the shareholders. During the annual general meeting (AGM) held yearly the directors provide a detailed report to shareholders on the company’s performance and future plans. These roles are defined in the Memorandum of Association and well regulated in the Articles of Association. In addition to daily business activities and financial issues experienced in the firm, the board is also tasked with addressing the challenges of and corporate governance, social responsibility and ethics.

1.2 Problem Statement

Financial statements of a company is used by owners of a company to evaluate management’s stewardship, and by investors to make investment decisions. With the rise of new financial scandal and crisis in the banking sector there is an inevitable concern leading to demands for increased transparency and more regulations, for financial audit of the companies but it is largely the auditors’ role to reinforce the confidence in the audit. It is the role and responsibility of the auditors to confirm if management has fairly presented the information in the financial statements. During these audits, the auditor collects evidence to obtain reasonable assurance that the amounts and disclosures in the financial statements are free of any material misstatement (Pandya, 2013).

Corporate governance refers to the whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of its stakeholders (Samanta & Das, 2009). In the UK, corporate governance first came into the spotlight with the publication of the Cadbury Report, shortly after two large companies (Maxwell Communications and Polly Peck International) collapsed (Souster, 2012). Ten years later, in the US, the Sarbanes-Oxley Act was passed as a response to the collapse of Enron Corporation and WorldCom. All of these cases involved companies that had been highly successful and run by a few very
powerful individuals, and all involved some degree of criminal activity on their part (Souster, 2012). Heenetigala (2011) research indicated that corporate governance has significant implications for the growth prospects of an economy. Good corporate governance practices are regarded as important in reducing risk for investors, attracting investment capital, and improving the performance of companies.

From the literature reviewed most studies on corporate governance have focused on the performance of the institutions however no particular one has focused on the role auditing play and in this sense creating a gap in the topic. Each financial scandal that arises in organization does stresses for the need for increased transparency and procedures when it comes to the financial audit of the companies. The recent credit crisis has brought about renewed concern about corporate governance, specifically in the financial sector in the country, and subsequent investigations and reports have called into question the policies, processes and prevailing cultures in many banking and finance-related organizations.

1.3 Purpose of the Study
The purpose of this study isto analyze the impact of external financial auditors on corporate governance in banking institutions.

1.4 Research Question
The research questions of the study are;

1.4.1 To what extent have accuracy of financial reporting affected corporate governance in the banking institutions in Kenya?

1.4.2 What impact has Bank’s compliance to international reporting standard affected corporate governance in the banking institutions in Kenya?

1.4.3 To what extent has fraud prevention affected corporate governance in the banking institutions in Kenya?

1.5 Importance of the Study

1.5.1 Kenyan Banks

The findings of this research will give contribution towards ways increasing understanding about corporate governance practices in the banking industry in Kenya, and ways, which the banks could ensure good corporate governance that aligns with financial auditing. Many financial institutions especially the banks will apply these
findings as a benchmark to decisions making to improve corporate governance in the sector.

1.5.2 Law Makers

The policy makers in the banking industry will use this document as a foundation of improving the existing policies, to effectively implement better regulation of the banking industry.

1.5.3 Scholars and Researchers

Other researchers and scholars will utilize this study as a reference for other related studies on corporate governance in Kenyan banking industry.

1.6 Scope of the study

This study will analyze the impact of external financial auditors in corporate governance in banking institutions. The population of study was financial auditors in the 49 banks in Kenya.

1.7 Definition of Terms

1.7.1 Audit

It is an undependable examination of financial statements of a corporation by an appointed auditor in compliance with any relevant statutory obligations (Eilifsen, Messier, Glover, & Prawitt, 2013).

1.7.2 Corporate Governance

Corporate Governance is a system of regulation, rules, and practices, which an organization is managed and it generally involves looking after the interests of the firm’s stakeholders who include shareholders; management; customers; suppliers; financiers; Government and the community. Corporate governance evolved from the emergence of modern stock organizations, multinational corporations and capitalism during the nineteenth century (Agyemang & Castellini, 2015).
1.7.3 Financial Reporting

Financial reporting is the technique of creating financial statements that disclose an organization's financial performance to the stakeholders who include; management, investors and the government (Souster, 2012).

1.7.4 International Reporting Standard

This is a set of accounting standards, developed by the accounting board with the main aim of ensuring a globally consistency in reporting (Pandya, 2013).

1.8 Chapter Summary

Chapter one is a brief on the analysis of role of external auditors in banking institutions the chapter also identified the problem statement, the research questions, and the purpose of the study. The chapter also mentions the motive of the study and its advantages to the numerous stakeholders. In chapter, two the study will look at the literature evaluate and this will is guided by means of the specific studies questions. Chapter three discusses the technique implemented for the research.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter will look into the information from the available literature on role of external financial auditors in corporate governance. The literature was guided by the specific objectives of the study.

2.2 Accuracy of Financial Statement and Corporate Governance

2.2.1 Independence of internal auditors

Organizational independence allows the audit activity to progress without interference by using the entity it is auditing. The audit process should have enough independence in order for it to be viewed as if it would operate without interference. Coupled with objectivity, organizational independence contributes to the accuracy of the auditors’ work and the potential to depend upon suggested consequences (Boyle, DeZoort, & Hermanson, 2015). Investors place trust on the audited reports before deciding to invest in a corporation, it is the auditor role to establish discrepancies in the financial records, whether they are via fraud or unintended omissions in the statement.

It’s the role of the auditor to search for details that are inconsistent as per the financial info and various specific standards are set and this describe the guide as to what the auditor wants to achieve these expectations. The assessment of internal control is critical to powerfully discharge of the auditor’s position in corporate governance. Such assessment would offer the opportunity of understanding the variables, which in turn will assist him determine on the proper audit method to adopt (Alabede, 2012).

For the shareholders and different stakeholders to trust inside the economic statements, it is imperative to employ independent expert to audit the monetary statements (Coyle, 2010), therefore the role of outside auditors in corporate governance. The role of the external audits in sustaining precise corporate governance is extensively mentioned. Cadbury report of 1992 declared that audit gives an external and objective take a look at on the way in which the economic statements have been prepared and presented. Through the function of outside auditor, the shareholders monitor and manipulate the management and this facilitates issues of transparency in a business enterprise (Solomon, 2010).
Independence is the base of the auditing technique because it helps the auditor to specific his impartial opinion regarding the economic statistics in his record, with no effects of the threats on his judgment. Independence means that the auditor has to do his obligation with honesty, faithfulness, and impartialities (Abdullah, 2010), inside the making plans, checking out of records, evaluating the outcomes, and getting ready his report. It means that the auditor is dedicated in the direction of all customers of his document (Arens, Lvin, & Elder, 2008)

Independence and neutrality of the auditor are the critical factors that cause the reliability and the credibility of the economic declaration. In coming across the financial travesties earlier than they affect the independence, the auditor should take the precise defending methods (Nawaiseh & Alnawaiseh, 2015). The auditor should not undertake any service without consumer order, and if he concurs to try this, he must select a qualified assistant to assist in the process. The auditor’s independence additionally affects the making use of auditing standards, the satisfactory controlling, the management pressure, and providing non-audit services. The independence of the auditor increases by way of his specialty, experience, the performance of the inner auditing (Abdullah, 2010).

2.2.2 Factors Determining External Auditing

It has been recommended in the writing that bigger firms are generally seen as more able of keeping up a sufficient level of autonomy than their littler partners are since they have an authority over administrations thus diminishing their reliance on certain customers (Wilson & Grimlund, 1990). Also, bigger audit firms are for the most part seen as the supplier of high quality audit and appreciate a high notoriety in the business environment and thusly, would endeavor to keep up their autonomy to safeguard their image (Wilson and Chow and Rice, 1982). High reliance on specific clients has been found to influence impression of freedom (Teoh & Lim, 1996). The likelihood of exchanging enormous firms is altogether lower than the likelihood of exchanging littler firms, ceteris paribus. Other than the conceivable impact of the sort of review the firms on the length of position, the decision of review firm can be identified with the span of the auditor and the sort of administrations required. It has been contended that bigger auditors because of the multifaceted nature of their operations and the expansion in the division amongst administration and possession, request exceedingly autonomous review firms to lessen agency problems (Hudaib & Cooke, 2005).
DeFond et al., (2000) reported evidence that showed a correlation between the audit fees charged and the audit client size. The external audit firm is expected to perform more audit work as the client size increases to ensure the performance of an adequate amount of compliance and substantive testing. This increase in audit effort is natural. The relationship between audit fees and client size is unlikely to be linear nonetheless. This conjecture is based on the notion that while the amount of audit work is expected to increase as the client size increases. Very large audit clients represent an opportunity for the audit firm to benefit from certain economies of scale in reducing the amount of audit work performed, and consequently being able to charge lower audit fees.

There are a variety of factors taken before choosing and retaining the external auditors. Especially, one key consideration is the independence of the auditing technique as history and studies has indicated that the fulfillment of the external auditor is predominantly based on the chance that an auditor will find and file a breach in the economic and accounting systems on an agency. However, organizations will regularly remember numerous further traits whilst assessing audit company provider suitability. The significance corporations place on the numerous criteria varies from company to firm and is usually dependent on the particular needs of that agency (Barkley, 2014).

According to Alabede, (2012), the foremost elements taken into consideration in deciding on and retaining an auditor include the size of the audit firm, the popularity of ongoing auditor engagements, the cost of the auditor firm provider and the uniqueness of service the auditing company offers. Compatibility between the organization and auditor, the references received approximately the auditor’s prior work and a written notion provided from the auditor firm outlining how they intend to meet the organizations needs are also factors taken underneath attention while selecting and keeping outside auditors.

Close to the dimensions of the auditor company, studies have indicated that audit fine will increase with audit firm size, that is because of the massive amount of accrued enterprise knowledge and experiences in the field (Eilifsen, Messier, Glover, & Prawitt, 2013). Massive or global businesses can frequently require the expansive assets that large auditor’s offer, which includes large population of employees, knowledge, and availability, that normally larger audit firms are recognized to own. Consecutively, larger companies will require a big audit company to carry out the breadth and range of its significant audit activities. However, for smaller organizations, deciding on and
employing a huge firm might not be vital nor the proper preference all elements considered (Furnham & Gunter, 2015).

Eilifsen, Messier, Glover, and Prawitt (2013) also adds that the reputation of an ongoing auditor engagement should be considered while deciding on and retaining an auditor. A longtime association with selected external auditor may have an effective impact on audit great. The audit firm may also have constructed up an intense understanding, allowing them to fulfil their audit activity comprehensively, but, caution is frequently also exercised in this area as this relationship may pose a danger. According to Agyemang and Castellini (2015), the audit firm can have a bad effect on the excellent of the audit thru a reduced possibility of reporting a located breach within the audit feature. Familiarity may additionally lead to negligence and worse still lack of expertise.

For a few companies minimizing value may be a primary attention and it is far crucial for corporations to balance the cost with the provided. The subcontracting firm usually has a variety of price set in advance and within which the cost and service is maximized while selecting an external auditor. The very last selection should not be the value but as a substitute, this element ought to be incorporated right into a number of things that include price of provider, skill, and expertise rather than the ultimate fee. An external auditor must be selected such that needs and expectancies can be met sufficiently (Barkley, 2014).

It is also widely frequent that industry distinctiveness can lead to the provision of higher quality of the audit task. This is due to a number of motives such as decrease in charges from economies of scale, professional expertise and advanced audit technologies. Additionally, experience in the industry may enhance the detection of fake reporting (Barkley, 2014). The compatibility of the organization with the capability of the audit company is an important issue. For many establishments, choosing an auditor based at the references and recommendation of different enterprise participants can mitigate elements of risk associated with auditor choice and retention (Desai, Gerard, & Tripathy, 2011).

2.2.3 Qualification and Experience of Internal Auditors

Finance departments are being pressed to enhance the near and reporting system. Externally, marketplace and regulatory bodies have improved reporting closing dates. However, speeding up the method is not adequate as there is more call for open and
transparent data. Sarbanes-Oxley requires it, and today’s public markets regularly reward organizations for imparting transparency that is above the regulatory requirements (Skaife, Veenman, & Wangerin, 2013).

Healy and Palepu (2012) highlights that internally, executives and business leaders depend on the finance branch to play a bigger position in supporting business and operational process of making decisions. This larger role includes measuring and handling company overall performance towards strategic goals. Moreover, performance and cost factors also present a challenge to the finance departments seeking to do greater with the very little funds at their disposal. Combined, these pressures are forcing finance departments to search for opportunities to close quicker and smarter.

According to Beaver, Correia and McNichols (2012), financial statements cannot be useful if they are primarily based on unreliable and misguided recordings of transactions. There is no more example of the rubbish in, garbage out principle than economic statement preparation. The hassle is that financial declaration users cannot generally assess the presence of rubbish without a thorough analysis of the statements. The statements might also look exceptional, but in reality be riddled with inaccuracies.

The two important resources of financial announcement inaccuracy are deliberate dishonesty and incompetence. There are principle ways to fight the problems; the primary method is to frequently hire an outside accounting firm to audit the financial statements. In an audit, the external auditor’s verify reported account balances for accuracy. As importantly, the auditor checks to confirm the accounting ideas used in recording transactions are in conformity with Generally Accepted Accounting Principles (GAAP) and applied on a steady basis. Regardless of some infamous audit disasters involving large companies like Enron, the auditing process provides a reasonable insurance against fraudulent and misguided monetary reporting.

The other method used to prevent fraudulent and misguided financial reporting is the adoption of good enough inner controls. Internal controls are the rules and tactics that a commercial enterprise can take to shield its belongings, insure accuracy of monetary reporting, and prevent fraud. Such techniques are not mutually one of a kind however; the firm needs to have accurate internal controls and ordinary audits (Cheng & Green, 2014).
Regrettably, hiring external auditors and having the first-class internal controls comes at a cost particularly for small corporations. The issue of how much of the funding should be spent on auditing and inner controls is an issue of various perspective. For instance, a small commercial enterprise proprietor who uses the economic statements for inner management functions only, has little incentive to rent an outside auditor. However, small commercial enterprise lenders and outside investors a dire need for the audited monetary statements (Elmaleh, 2008).

2.3 Bank’s Compliance to International Reporting Standard and CG
2.3.1 Principles for External Audits

There are set up principles that guide the various stakeholders in the industry. The outside auditor of a financial institution should have banking industry information and competence sufficient to respond accurately to the dangers of cloth misstatement in the bank’s monetary statements and to properly meet any additional regulatory requirements that may be a part of the statutory audit. The external auditor of a financial institution must be objective and unbiased in reality and look with recognize to the bank, regular with the more stringent necessities relevant to public interest entities in the world over ordinary moral standards (Demirgus & Detragiache, 2011).

The outside auditor have to work out expert skepticism when making plans and acting the audit of a bank, having due regard to the particular demanding situations in auditing a bank. In addition, audit corporations challenge financial institution audits ought to comply with the extra stringent requirements on first-rate manipulate relevant to listed entities in the world over widely wide-spread first-class manipulate standards, having due regard to the complexity of a bank audit (Demirgus & Detragiache, 2011). The outside auditor of a bank need to pick out and verify the dangers of material misstatement inside the financial institution’s monetary statements, considering the complexities of banking activities and the need for banks to have a strong manage surroundings (Turlea, Mocanu, & Carmen, 2010).

According to Daniels and Booker (2011), the external auditor of a financial institution ought to respond correctly to the big dangers of cloth misstatement within the financial institution’s financial statements. Demirgus and Detragiache (2011) add that the audit committee have to have a sturdy procedure for approving, or recommending for approval,
the appointment, reappointment, removal, and remuneration of the outside auditor. The audit committee ought to display and assess the independence of the outside auditor. On the other hand, the audit committee should display and verify the effectiveness of the outside audit.

According to Turlea, Mocanu and Carmen (2010), the audit committee ought to have powerful verbal exchange with the outside auditor to permit the audit committee to perform its oversight responsibilities. In addition, it also enhance the best of the audit, and have to require the outside auditor to document to it on all applicable matters to enable the audit committee to perform its oversight duties. There is a need to engage the supervisor and the outside auditor need to have a powerful courting that includes suitable communication channels for the exchange of facts applicable to sporting out their respective statutory responsibilities.

The outside auditor have to record to the supervisor subjects which can be probably to be of fabric importance to the capabilities of the manager. Meanwhile, there ought to be open, timely, and normal conversation between the banking supervisory authority, the audit firm, and the accounting career as a whole on key dangers and systemic issues as well as a non-stop trade of perspectives on suitable accounting techniques and auditing troubles. There also ought to be ordinary and powerful dialogue between the banking supervisory authority and the applicable audit oversight body. Finally, the banking supervisory authority and the audit oversight body ought to study suitable confidentiality necessities while sharing records (Turlea, Mocanu, & Carmen, 2010).

2.3.2 Role of External auditors

Outside audits of economic statements accomplished in accordance with the world over auditing requirements enhance the self-assurance of all users, together with supervisors, inside the reliability of the audited financial statements and the validity of the data furnished. Audits of banks should be executed according with across the world customary auditing requirements. as those requirements aren’t enterprise-unique, for a fine audit supervisors anticipate outside auditors now not handiest to conform with the world over standard auditing standards however also to tailor their audit work in reaction to the massive dangers and problems applicable to banks (Lois & Stewart, 2010).
External auditors are required to conform with applicable jurisdictional and, where relevant, internationally frequent moral standards. However, given the complexity and systemic risks associated with banks, the outside auditor of a financial institution have to observe the most stringent rules for independence beneath these requirements (Desai, Gerard, & Tripathy, 2011). Further, the outside auditor of a bank must also observe the maximum stringent standards on first-rate manipulate at the engagement stage. Given the complexity and diversity of banking sports, and the criminal and regulatory framework wherein banks function, the outside auditor of a bank should have specialized knowledge and competence in auditing banks and need to use experts as appropriate (Lois & Stewart, 2010).

According to Rossouw, Prozesky, du Plessis and Prinsloo (2010), competence is in particular crucial in underpinning an outside auditor's potential to workout expert judgment and carry out key factors of the audit, consisting of figuring out and assessing the risks of fabric misstatement and designing and implementing appropriate responses to those dangers. In some times, which includes the auditing of positive complex accounting estimates, extra specialized know-how may be required to help the audit engagement crew, eg extra information beyond that possessed by the audit engagement team’s individuals in a subject other than accounting or auditing. Examples of such areas are valuation of complicated financial contraptions, business property valuations, and assessment of complicated IT environments, particularly in regions difficulty to significant dangers of cloth misstatement.

Internationally well-known auditing standards set out necessities for the character, timing, and quantity of audit approaches, which the external auditor should carry out to assess the competence, capabilities, and objectivity of the professionals the outside auditor can also use. These are crucial factors in considering the reliability of the records or consequences produced with the aid of the professional (Lois & Stewart, 2010). The outside auditor of a financial institution should comply with the applicable jurisdictional and internationally regularly occurring moral requirements. Moreover, the Committee believes that the outside auditor of a bank have to comply with the greater stringent independence standards for public hobby entities. To the extent that any of the rules within any one of these requirements on ethics is extra restrictive than the corresponding rule inside the different requirements on ethics, the outside auditor ought to comply with the extra restrictive rule (Rossouw, Prozesky, du Plessis, & Prinsloo, 2010).
Professional skepticism is described as an attitude that includes questioning thoughts, being alert to situations, which can also imply possible misstatement due to errors or fraud, and an important assessment of proof (Pandya, 2013). Expert skepticism should take place itself not only thru the auditor obtaining corroborating evidence for control’s assertions, but additionally difficult control’s assertions, actively thinking about whether there are alternative accounting treatments that are most popular to the ones selected via control, and documenting the technique, the evidence obtained, the intent applied and the conclusions reached. Throughout the audit, the auditor have to adopt a wondering approach when thinking about facts and forming conclusions (Desai, Gerard, & Tripathy, 2011).

Daniels and Booker (2011) explain that exercising appropriate professional skepticism is seriously critical in audits of banks due to the variety and importance of accounting estimates and the ability for restrained goal proof helping those estimates. unique areas where professional skepticism need to be exercised through the outside auditor of a bank encompass impairment calculations, truthful price measurements and going problem assessments, which includes tests of solvency and liquidity. Bachlechner, Thalmann, and Manhart (2014) add that different examples may additionally consist of complicated transactions based to achieve a specific accounting treatment and/or regulatory outcome through the control where the audit engagement accomplice has or should have reasonable doubt that the proposed accounting treatment and/or regulatory outcome is steady with the relevant financial reporting framework or regulatory requirements. In this context, the outside auditor have to actively venture management’s assumptions and judgments and shape impartial views. This consists of difficult proof acquired from management that corroborates control’s view.

Where a financial institution always utilizes valuations, which might be on the excessive, or low give up of more than a few acceptable valuations. When there are other indicators of possible management bias, the external auditor must recollect this in the common hazard evaluation of the financial institution and need to inform those charged with governance, where suitable (Cheng & Green, 2014). The evidence of the volume of expert skepticism exercised need to be demonstrable and understandable via audit documentation that describes how, why and what conclusions were reached by the external auditor. On this regard, the world over frequent auditing requirements establish minimum requirements for audit documentation (Elmaleh, 2008).
According to Kumar and Mohan (2016), audit firms should comply with the applicable jurisdictional and the world over well-known standards on satisfactory control. Furthermore, the Committee believes that the external auditor of a financial institution should comply with the extra stringent necessities on quality manage applicable to listed entities in the world over popular high quality management standards. To the volume that any of the regulations inside any one of these first-rate control requirements is greater restrictive than a corresponding rule in the other excellent control standards, the outside auditor ought to observe the more restrictive rule.

The involvement of the engagement first-class control reviewer for the duration of the audit, and the outcome of the fine control assessment, should be obtrusive inside the audit working papers (Shehu & Masunda, 2015). Any big discussions among the engagement excellent manipulate reviewer and the audit engagement crew; mainly in areas wherein perspectives may additionally have differed and as to how conclusions had been reached, need to be fully documented in the audit running papers. Therefore, in jurisdictions wherein the supervisor has admission to the external auditor’s running papers, the great control overview might also be on the manager’s disposal (Rossouw, Prozesky, du Plessis, & Prinsloo, 2010).

### 2.3.3 International Reporting Standard

Globalization has led to each non-public and public area companies to an increasing number of renowned that having a regular economic reporting framework supported via sturdy universally popular accounting standards is the pathway to accessing overseas funding in addition to expanding agencies throughout borders. As such, it is useless to say that internationalization has come to stay. Buyers and customers for decisions rely upon monetary statements and reviews from public agencies. Subsequently the need for the putting in of requirements to manipulate the guidance of such reviews that allows you to decorate their reliability. Unique countries consequently, evolved accounting requirements to the accounting structures appropriate to their surroundings, however, due to multiplied international target market, diverse statistics needs of users from national and international each assets arose and headaches of comparability of economic statements organized the usage of unique requirements also advanced (Shehu & Masunda, 2015).
According to Daske, Hail, and Verdi (2008), corporations that adopt International Financial Reporting Standard (IFRS) and disclosure requirements can gain from improved transparency, and understandability, lower capital expenses to agencies and higher inventory prices, elimination of ambiguities inside the law of securities markets. Similarly, it facilitates simpler global motion of skilled group of workers across countrywide limitations. Additionally, it is going to help multinational groups to fulfill the disclosure requirement for inventory exchanges across the globe.

The method of IFRS adoption and implementation has a variety of challenges that include absence of political suggestion, loss of political motivation, stable rootedness within the domestic subculture and sturdy patriotism, high expenses of imposing IFRS. The complex nature of the requirements, the absence of the directions for the use, the inconsistent interpretation, the continuous changes of IFRSs. Lack of IFRS knowledge by means of adopters, the requirement to alter the attitude of the monetary department, and the financing, taxation and felony systems of a country and the truth that “the country wide accounting traditions tend to preserve counteract the steady and reliable utility of IFRS (Shehu & Masunda, 2015).

2.4 Prevention of Fraud in Banks and Corporate Governance

2.4.1 Bank Fraud

Fraud is defined as an act of deliberate deception with the intention of gaining a few gain, or an act of dishonestly pretending to be something that one is not. According to Akinyomi (2012), fraud is the deliberate falsification, camouflage, or exclusion of the reality for the cause of dishonesty/level control to the financial harm of a character or an organization. It’s far dishonesty or an act of dishonest individual or commercial enterprise to surrender ownership or some lawful proper.

In addition, the association of certified Fraud Examiners (2010) defines fraud as using one’s profession for private enhancement via the conscious misuse, misapplication, or employment of organizational possessions or belongings. Fadipe & Titiloye (2012), refers to fraud as any actions with the aid of which one individual intends to gain deceitful advantage over every other. Fraud is generally taken into consideration to be something calculated to misinform. This consist of all deeds, fake pas, and camouflages regarding a breach of legal or equitable responsibility, believe or evidence justly reposed which end
result in damage to every other or via which gratuitous and conscienceless benefit is taken of any other. Fraud is one-of-a-kind from some other time period that looks like it together with forgery and mistakes in that, it indicates an extra affirmative motion, evil in nature inclusive of purposefully and knowingly intending or performing dishonestly with a depraved motive to cheat or to mislead some other (Owolabi, 2010).

Financial institution frauds significantly threaten the institutional boom of a financial institution because it leads to bank misery, which is because fraud decreases the deposit of depositors and subsequently leads to the erosion of the capital base of banks. The fee of fraud is likewise mostly elaborate to estimate because not all frauds are exposed or maybe reported in view that maximum banks have a proclivity to cover up the frauds originating from their banks all in a bid to maintain to benefit client’s goodwill and stimulate their customers’ confidence all the time. Some of the results of fraud, lack of sales, and lack of customers’ self-assurance top the listing (Akinyomi, 2012).

Fraud outcomes in financial losses to each the banks and their customers. The stop product is insolvency and the lack of public confidence inside the banking enterprise as an entire. The microfinance enterprise is not always proof against the challenges of fraud in banking device. Fraud is possibly the most deadly of all danger confronting MFIs, due to the fact it is miles on this area that a MFIs stands to lose maximum (Okaro, 2009).

2.4.2 Role of Auditors in Prevention of Fraud

The want for external auditors can be visible as a response to the employer problem and the audit functions as a mechanism to attest to the responsibility and stewardship of business enterprise control to reduce the possibility of innocent mistakes and planned misstatements together with fraud and control manipulation. Over time, the role of auditors end up increasingly important specially in a capitalist financial system as the process of wealth introduction and political stability relies heavily on the confidence in processes of accountability and the way nicely the anticipated roles are being fulfilled. This gives rise to analyze hobby on ‘expectations gap’, the variations among what the public expects from an audit and what the auditing profession prefers the audit objectives to be (Știrbu, Moraru, & Farcane, 2009).

A code of behavior effectively implemented represents one of the maximum critical mechanisms of communicating to the personnel the ideal requirements in their pastime,
and to draw interest to the dedication the management undertook which will admire the entity’s integrity. As well, a carefully deliberate program will increase the employees’ expertise of fraud prevention and detection refers to recognizing the early warning symptoms of a likely fraud. The management of an entity should take note of various warning symptoms that emerge: changes in an employee’s behavior, modifications in a single’s lifestyle, drug/alcohol, or gambling addictions, discrepancies about taken depart, and so on. In this sense, the management can set up an exclusive assist system for his personnel that may include circle of counselling (Daniels & Booker, 2011).

Corporate governance has as a main objective to act in the shareholders’ best interest and to maximize shareholder value. Therefore, even though corporate governance is a mechanism in controlling management not to act in their own best interest, the kind of fraud that raises shareholder value may not be caught by strong corporate governance. On the other hand, fraud that is harmful to existing shareholders, since it benefits managers at the expense of shareholder value, for example, should be caught by strong corporate governance, since harmful actions are not in the shareholders’ best interest (Bebchuk & Fried, 2008).

Earnings management has a negative influence on shareholders if they are given false information. The costs of earnings management have a substantial impact on shareholder value and are therefore not merely symbolic. But different incentives drive earnings management. First of all, when the fraudulent activities become public the stock price will crash and shareholders are hurt (Karpoff, Lee, & Martin, 2013). Furthermore, shareholders are hurt when the motivation for earnings management is to benefit the managers themselves, instead of the firm as a whole. For example, when managers receive bonuses according to earnings targets, they may use accruals to boost earnings to make sure they will reach these targets, when in fact they did not, even finds evidence that CEOs manage earnings to get maximal bonuses (Klein, 2012).

This is in line with the organizational theory that argues that companies engage in fraudulent activity when goals and targets are used to determine personal performance. In addition, managers may use undisclosed, private information to engage in insider trading, by selling their personally held shares at a high price, even though they know that this price does not represent true value. When managers manipulate earnings for these reason,
they are benefitting themselves at the expense of shareholder value (Michalowski & Kramer, 2010).

It is management's responsibility to ensure that the correct internal controls are in place. This has been done in response to weak corporate governance, because it makes the managers more accountable to the shareholders. But not all fraud may be because of weak corporate governance. Since earnings may be managed to avoid debt covenants violations or to minimize tax payments, this can be in the best interest of the company and therefore for the shareholders. When the board of directors detects this kind of earnings management, they might look the other way, because this kind of earnings management may benefit the existing shareholders and is therefore not due to a lack of internal control. Managers engage in this kind of earnings management since the end justify the means.

2.4.3 Fraud Detection and Corporate Governance

A lot of research has been conducted to establish a relationship between corporate governance and fraud probability. However, evidence is mixed. Most research has found that it is weak corporate governance to have the CEO as the chairman of the board. Even though most research finds a direct link between more fraud and CEO duality, find no such relation (Xie, Davidson, & DaDalt, 2008). However, prior research has treated all fraud the same, while not all fraud may be due to weak corporate governance, since it may also be beneficial to the existing shareholders. When firms are viewed as better performing firms, not only will the stock price rise, their rating by analysts will increase as well, and the firms are able to get better lending terms. This way firms are able to attract cheaper financing for example. These consequences raises shareholder value, which is desired by the shareholders (Healy, 2007).

According to Dechow, Ge, Larson and Sloan (2010), to prevent debt covenant penalties from being given, managers may use accruals to boost earnings in order to satisfy contractual conditions, when firms raise cash, a high stock price will reduce the cost of raising new equity. When financing is cheaper, the costs for borrowing are lower. Furthermore, firms that meet or beat analysts’ forecasts are rewarded substantially and firms that do not meet the forecast are penalized heavily. According to Jensen, Murphy and Wruck (2009), fewer penalties, lower costs, and better valuations by analysts result in higher shareholder value and are consequently desired by the existing shareholders. When shareholders benefit from earnings management, good corporate governance may
not be able to prevent this, since the main goal of good corporate governance is to act in the shareholders’ best interest. Therefore, it is still not clear whether or not good corporate governance is in the best interest of the shareholders by preventing fraud that is harmful to the existing shareholders.

In order to create insight in this problem, it is important to understand all issues regarding corporate governance and the reasons to commit fraud. It is important to understand the relationships between the managers, the board of directors and the shareholders, and how they create the conditions for fraudulent activity (Hillman & Keim, 2011). According to Blair and Stout (2009) discuss the shareholder primacy perspective, which states that the shareholders are the only residual risk bearers of the corporations and that is why the directors should be accountable to the shareholders only. Since the shareholders are the providers of capital they are the true owners of the firm. Brickley, Coles and Terry (2009) add that most stakeholders, like suppliers, lenders, and employees are protected by contractual obligations to the extent that the managers cannot ignore them. A loan has to be paid off and an employee must receive his or her salary. But shareholders have no such protection and have little possibility to engage in contracts with the firms to protect their rights. They are the recipients of the residual cash flow, meaning that they will receive money after all the other parties have been paid.

Burgstahler and Dichev (2011), add that shareholders have little influence over the daily business and little ability to monitor and this is the reason that shareholders are willing to pay a higher price for control and ownership. They bear additional risk and are therefore the principals of the company to which the directors are solely accountable to. Furthermore, Mallin (2010) view from a rhetoric of property rights point of view, shareholder primacy is justified by arguing that since the shareholders pay, and therefore own, the corporate assets, any project that does not enhance shareholder wealth is theft.

According to Weele (2011), because of diversification purposes, many shareholders own different shares in different companies, making it difficult for them to have full motivation to monitor every manager constantly to make sure he acts in the best interest of the company. Therefore, directors are regarded as agents who only serve the shareholders. These agents are hired since the shareholders do not have the time and skill to run the company themselves argue that the board’s only job is to serve the interest of the shareholders and that their interest are best served when the value of the shares is
maximized. Farrar (2011) adds that the board of directors is a monitoring mechanism for the shareholders, but directors have incentives to go along with the managers, for monetary and social reasons. One way to align the interest of the managers with those of the shareholders, is by introducing a part of their compensation as variable, depending on the stock price of the company. But granting payments due to stock price and earnings increases may cause managers to increase their profits by any means necessary. This may include taking on too risky projects, but also can lead to earnings management and fraud.

Branson (2012), highlights that earnings may be managed in several ways. For example, future profits may be incorporated in current earnings and nonrecurring profit can be accounted for as recurring. Because of this error, financial reporting is wrong, due to incorrect valuations and incorrect and incomplete disclosure. As a result, investors are put on the wrong track. When managers know of these wrong valuations, they can create personal profits by selling their own shares at a too high price. Armstrong, Jagolinzer, and Larcker (2010) state that once earnings are managed to get a higher stock price, a manager can find himself in a vicious circle. When the stock price rises, so do expectations about future performance. Abbott, Park, and Parker, (2006) highlight that a company may not live up to these expectations since they are based on false information, it is important to at least meet the analysts’ forecast. This creates a demand for more earnings manipulations, which can eventually even lead to the collapse of the company.

2.5 Chapter Summary
This chapter deliberated on literature review directed by the objectives of the study. The theoretical framework and conceptual framework are also looked into. In chapter three, the research methodology applied in this study and data collection methods, and analysis was explained.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the general methodology used in this research. This chapter looked at the research design, population, and sample size, data collection methods, research procedures and data analysis and the presentation methods to be utilized in this research.

3.2 Research Design

According to Taylor, Bogdan, and DeVault, (2015), a research design is a design for choosing subjects, research area, and data collection in order to answer specific research questions. A research design is the framework used in research and makes up the blueprint for data collection and the analysis of the data. A descriptive study generally was used in determining the rate with which something occurs or the relationship between variables. According to Blumberg, Cooper, and Schindler (2014), a descriptive study determines, who, what, where, and how of a phenomenon which is the objective of this study. In addition, a descriptive study is concerned with finding out the what, where and how of a phenomenon. This descriptive research design is therefore appropriate for this study.

The study will obtain and described the views of the respondents from banks in Nairobi, in line with establishing the challenges facing auditors in corporate governance. The study will incorporate both quantitative and qualitative research so as to gain a better knowledge and in-depth understanding of the results.. The aim of this study is to provide a clear understanding of role of auditors in corporate governance in Kenya.

3.3 Population and Sampling Design

3.3.1 Population

Population can be defined as the total collection of individuals whom researchers seek to make inference on (Gopalsamy, 2013). The target population for this study auditors in the 49 bank in Kenya this gives a total of respondents 49 respondents as shown (CBK, 2016).
Table 3.1: Population Size

<table>
<thead>
<tr>
<th>Bank Type</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local banks</td>
<td>42</td>
</tr>
<tr>
<td>Representative of foreign</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>49</strong></td>
</tr>
</tbody>
</table>

3.3.2 Sampling Design

3.3.2.1 Sampling Frame

A sampling frame was the source material or device from which a sample is drawn. It represents a list of all those within a population who can be sampled, and may include individuals, households or institution (Zikmund & Babin, 2012). The sample of the study will involve heads of auditors based in the head office of the various banks in Kenya.

3.3.2.2 Sampling Technique

According to Mugenda and Mugenda (2012), sampling is the process of selecting a study subject from a bigger population. It is essential because the methodology applied is used to determine whether or not the sample of the study is a true representative of the whole population from which it is drawn or not. The findings of the study was assumed to be a true representative of the study population.

3.3.2.3 Sample Size

The total population comprised of different groups, and each element in each group is similar to one another in some way. From the initial population of 49 auditors, and since the total population is less than 100, the sample will include all the respondents in the study population. A total census was undertaken through hardcopy and soft copy questionnaire.
3.4 Data Collection Methods

Primary data was collected by administering open and close-ended questionnaire to the respondents. The questionnaire was delivered to the head office of the 49 banks in Nairobi. This instrument was used for cost and time savings for the respondents as well as the researcher. The questionnaire was administered through drop and pick method and was self-administered to reduce interviewer bias. The researcher will obtain a research permit from Chandaria School of Business to help in authorization to collect data from the bank.

3.5 Research Procedures

The study used questionnaires, and the questions were standardized to minimize interference from interpersonal factors. The study will also use a five point Likert scale to ask all respondents to express their opinion on given statements, and they was expected to agree, strongly agree, remain neutral, disagree, or strongly disagree. Before issuing the questionnaire the researcher seek permission from the various supervisors from the various branches in the central business district, and this was done via an official communication by a letter from United States International University. Five questionnaires was developed, pre-tested, and reviewed for precision, completeness, accuracy, and clarity of interview questions. Findings received from the pretest were incorporated into the questionnaire before administering the final copy. Ample time was allowed for respondents to fill in the questionnaires, and the information received was treated confidentially for academic purpose only. The researcher will communicated to the organization about the results of the research findings.

3.6 Data Analysis Methods

Data analysis is the process of analyzing, cleaning, transforming, and modeling data collected in a research. Data analysis methods to be used in the study will include both qualitative and quantitative techniques (Mugenda &Mugenda, 2012). Data was coded according to different variables of the study for ease of data entry and interpretation. The descriptive statistical tool, Statistical Package for Social Sciences (SPSS) and excel will help the researcher to describe the data and determine the extent used.
The quantitative data collected was analyze by the use of descriptive statistics using Statistical Package for Social Sciences (SPSS) and presented through percentages, means, standard deviations and frequencies. This was done by tallying, computing percentages as well as describing and interpreting the data in regard to the study objectives and assumptions through use of SPSS.

The study will use inferential statistics to try to infer from the sample to make judgments of the probability that the observed difference between groups is a dependable one or one that might have happened by chance in this study. The study will also undertake a regression and correlation analysis of the various variables to determine how the various variables relate to each other, the research will also use ANOVA to compare means between the various variables under study. The information was displayed by use of tables and graphs and pie charts where necessary. Tables and other graphical presentations are very appropriate when presenting the data collected for ease of comprehension and analysis.

3.7 Chapter Summary
This chapter clearly describes the methodology that was used to reach the objectives of the study. The research methodology was presented under the following sections; research design, population, sampling frame, sampling technique, Sample size, data collection and data analysis.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
This chapter presents analysis and interprets findings obtained from the field based on the objective of the study. In addition, it has highlighted results from demographics of the respondents such as name of the institution, education level, number of years the organization has been in existence, number of auditors, how often the organization outsources for auditing. The chapter further outlines the impact of external financial auditing on corporate governance in banking institutions in Kenya.

4.1.1 Response Rate
In this study, the researcher distributed 49 questionnaires were distributed and only 41 questionnaires were filled and returned. Hence, a response rate of 84% was represented as shown in table 4.1.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Questionnaires</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filled and collected</td>
<td>41</td>
<td>84</td>
</tr>
<tr>
<td>Non Responded</td>
<td>8</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>49</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.2 Demographics Information

4.2.1 Education
The studies sought to determine the educational levels of the respondent. Majority of the respondents have a bachelor degree 51% followed by graduates with 49%. This indicates that the organization has educated employees who were able to read and understand the questionnaire. Results are shown in figure 4.1.
4.2.2 Existence of the Company

To investigate company’s existence. Majority of the respondents stated that the company has been in existence for 12 years and above this is represented by 26 respondents and 15 respondents stated that the company has been in existence for 1-5 years. Results are shown in the figure 4.2 below

Figure 4.2: Existence of the Company

4.2.3 Number of Auditors

To investigate Number of auditors in the organization 48% of the respondents stated that the organization has below 10, 27% the organization has above 25 auditors and 24% the organization has between 11-25 auditors. Results are represented in the figure below.
4.2.4 Auditing

To investigate how often the organization outsources for auditing 78% of the respondents stated that the organization does it regularly, 12.2% the organization has never outsourced for auditors and 9.8% whenever a crisis occurs in an organization. Results are illustrated in figure 4.4 below. Through outsourcing an organization is able to cut cost, boost operational efficiency and performance and Identify and manage emerging risks more effectively.

Figure 4.4: Number of Auditors
4.3 Accuracy of Financial Statement and Corporate Governance

The first objective of the study sought to establish accuracy of financial statement and corporate governance in the banking institutions. The study used a liker scale and respondents were asked to state their opinion based on the objective.

4.3.1 Descriptive of Financial Statement and Corporate Governance

Most respondents agreed that the assessment of internal control is critical in corporate governance (4.73), investors place trust on the audited reports before deciding to invest (4.61) and the firm has employed independent experts to audit its statements (4.41). However, there was uncertainty on shareholders prefer external auditors to facilitates issues of transparency in the business enterprise (3.83), organization have selected auditor based on references and recommendation from similar enterprises (3.76), have incurred high cost from external audit services (3.12), the firm has experienced omissions in the statements (3.12) and through external auditing we have detected inaccurate reporting (3.10).

Respondents disagreed that board influence the auditing of the financial statement (2.05). On analysis of the means, the variables with the highest means were the shareholders prefer external auditors to facilitates issues of transparency in the business enterprise (1.378), board influence the auditing of the financial statements (1.229), firm has experienced omissions in the statements (1.229), have incurred high cost from external audit services (1.070) and the variable with the least standard deviation was assessment of internal control is critical in corporate governance (.449). This means that respondents do not share the same views as shown in table 4.2.
Table 4.2 Financial Statement

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>MEAN</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence in the organization allows the audit activity to progress without interference</td>
<td>4.54</td>
<td>.674</td>
</tr>
<tr>
<td>Investors place trust on the audited reports before deciding to invest</td>
<td>4.61</td>
<td>.494</td>
</tr>
<tr>
<td>The firm has experienced omissions in the statements</td>
<td>3.12</td>
<td>1.229</td>
</tr>
<tr>
<td>The assessment of internal control is critical in corporate governance</td>
<td>4.73</td>
<td>.449</td>
</tr>
<tr>
<td>The firm has employed independent experts to audit its statements</td>
<td>4.41</td>
<td>.670</td>
</tr>
<tr>
<td>The shareholders prefer external auditors to facilitates issues of transparency in the business enterprise</td>
<td>3.83</td>
<td>1.070</td>
</tr>
<tr>
<td>The board influence the auditing of the financial statements</td>
<td>2.05</td>
<td>1.378</td>
</tr>
<tr>
<td>have selected auditor based on references and recommendation from similar enterprises</td>
<td>3.76</td>
<td>.969</td>
</tr>
<tr>
<td>have incurred high cost from external audit services</td>
<td>3.12</td>
<td>1.229</td>
</tr>
<tr>
<td>Through external auditing we have detected inaccurate reporting</td>
<td>3.10</td>
<td>.831</td>
</tr>
</tbody>
</table>

4.4 Compliance to International Reporting Standard and corporate Governance
The first objective of the study sought to establish compliance to international reporting standard and corporate governance. The study used a liker scale and respondents were asked to state their opinion based on the objective.

4.4.1 Descriptive of Compliance to International Reporting Standard

Most respondents agreed that the organization has execute auditing according to worldwide auditing requirements (4.59), stake holders are interested in bank’s compliance to international reporting standard (4.59), have adhered to international reporting standard (4.49), external auditor outsourced are objective and unbiased (4.37), external auditors are competent in verifying materials (4.24). However respondents were not able to reach an agreement on whether audit committee is in charge of appointing external auditors (3.93), the organization has adopting International Financial Reporting Standard and disclosure requirements has lowered our financial risk (3.83), and compliance to
international reporting standard has facilitated the firms expansion to other regions (3.51). Moreover, respondents strongly disagreed that have suffered losses due to failures to comply to international reporting standard (1.66).

On analysis of the means, the variable with the highest standard deviation were external auditors enable the audit committee to perform its oversight duties 1.034 and compliance to international reporting standard has facilitated the firm’s expansion to other regions (1.247) whereas the variable with the least standard deviation was the bank suffered losses due to failures to comply to international reporting standard (.480).

Table 4.3: Compliance to International Reporting Standard

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>MEAN</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>We have adhered to international reporting standard</td>
<td>4.49</td>
<td>.506</td>
</tr>
<tr>
<td>Audit committee is in charge of appointing external auditors.</td>
<td>3.93</td>
<td>.787</td>
</tr>
<tr>
<td>External auditors enable the audit committee to perform its oversight duties</td>
<td>3.93</td>
<td>1.034</td>
</tr>
<tr>
<td>We execute auditing according to worldwide auditing requirements</td>
<td>4.59</td>
<td>.499</td>
</tr>
<tr>
<td>External auditor outsourced are objective and unbiased</td>
<td>4.37</td>
<td>.698</td>
</tr>
<tr>
<td>External auditors are competent in verifying materials</td>
<td>4.24</td>
<td>.663</td>
</tr>
<tr>
<td>have suffered losses due to failures to comply to international reporting standard</td>
<td>1.66</td>
<td>.480</td>
</tr>
<tr>
<td>Compliance to international reporting standard has facilitated the firms expansion to other regions</td>
<td>3.51</td>
<td>1.247</td>
</tr>
<tr>
<td>Stake holders are interested in bank’s compliance to international reporting standard</td>
<td>4.59</td>
<td>.499</td>
</tr>
<tr>
<td>Adopting International Financial Reporting Standard and disclosure requirements has lowered our financial risk</td>
<td>3.83</td>
<td>.998</td>
</tr>
</tbody>
</table>

4.5 Prevention of Fraud in Banks and Corporate Governance

The first objective of the study sought to establish prevention of fraud in banks and corporate governance. The study used a liker scale and respondents were asked to state their opinion based on the objective.
4.5.1 Descriptive of Prevention of Fraud in Banks

Most respondents agreed that all bank accounts are reconciled on regular basis (4.73), stakeholders are concerned about fraud cases in the industry (4.51), audit committee appropriately structured to ensure its independence (4.49), audit committee alert to fraud opportunities within the organization (4.49), auditors play a role in detecting fraud in the organization (4.37) audit committee alert to fraud opportunities within the organization (4.29), fraud occurrences get reported to the audit committee as a matter of course (4.22) and have taken necessary action to mitigate fraud (4.02). However, there was uncertainty on the bank has recorded cases of fraud (3.37) and respondents disagreed that audit committee involved in allegations of fraud made by employees and third parties (2.27).

On analysis of the means, the variable with the highest standard deviation was audit committee involved in allegations of fraud made by employees and third parties (1.096) and the variable with the least standard deviation was fraud occurrences get reported to the audit committee as a matter of course (.419). This means that there was little variation between those who agreed as indicated in table 4.4

<table>
<thead>
<tr>
<th>VARIABLE</th>
<th>MEAN</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>The bank has recorded cases of fraud</td>
<td>3.37</td>
<td>.698</td>
</tr>
<tr>
<td>We have taken necessary action to mitigate fraud</td>
<td>4.51</td>
<td>.506</td>
</tr>
<tr>
<td>Stakeholders are concerned about fraud cases in the industry</td>
<td>4.37</td>
<td>.488</td>
</tr>
<tr>
<td>Auditors play a role in detecting fraud in the organization</td>
<td>4.73</td>
<td>.449</td>
</tr>
<tr>
<td>All bank accounts are reconciled on regular basis?</td>
<td>4.49</td>
<td>.711</td>
</tr>
<tr>
<td>Audit committee appropriately structured to ensure its independence</td>
<td>4.49</td>
<td>.506</td>
</tr>
<tr>
<td>Audit committee alert to fraud opportunities within the organization</td>
<td>4.29</td>
<td>.642</td>
</tr>
<tr>
<td>Fraud occurrences get reported to the audit committee as a matter of course</td>
<td>4.22</td>
<td>.419</td>
</tr>
<tr>
<td>Audit committee involved in allegations of fraud made by employees and third parties</td>
<td>2.27</td>
<td>1.096</td>
</tr>
<tr>
<td>Audit committee takes responsibility for monitoring fraud opportunities at board and executive level</td>
<td>4.02</td>
<td>.474</td>
</tr>
</tbody>
</table>
4.6 Correlation Analysis between Corporate Governance and Other Variables

The study undertook a correlation analysis to determine the relationship between corporate governance, accuracy, compliance, and Fraud prevention. The findings revealed that there was a strong positive correlation between accuracy of the reports and fraud prevention \((r=.600, p<0.01)\), also a weak positive correlation between fraud prevention and compliance \((r=.392, p<0.01)\). This findings show that with every improvement on accuracy and compliance there is a positive increase in fraud prevention.

**Table 4.5: Correlation Analysis between Corporate Governance and Other Variables**

<table>
<thead>
<tr>
<th></th>
<th>Accuracy</th>
<th>Compliance</th>
<th>Fraud Prevention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accuracy</td>
<td>Pearson Correlation</td>
<td>1</td>
<td>-.064</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.690</td>
</tr>
<tr>
<td>Compliance</td>
<td>Pearson Correlation</td>
<td>-.064</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.690</td>
<td></td>
</tr>
<tr>
<td>Fraud Prevention</td>
<td>Pearson Correlation</td>
<td>.600**</td>
<td>.392*</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
<td>.011</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

4.7 Regression Analysis between Corporate Governance and Other Variables

The study was set to analyze the effects of accuracy, fraud prevention, and compliance on corporate governance. A linear regression was done between corporate governance and the other cofactors table 4.16. The results established that the \(R^2\) was .386 hence 38% of the variation in corporate governance was explained by the variations in the cofactors.
Table 4.6: Model summary Between Corporate Governance and Other Variables

<table>
<thead>
<tr>
<th>Model</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
<th>Change Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>R Square Change</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>F Change</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>df1</td>
</tr>
<tr>
<td>1</td>
<td>.622a</td>
<td>.386</td>
<td>.337</td>
<td>.19080</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.386</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>7.767</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>37</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>.000</td>
</tr>
</tbody>
</table>

a. Predictors: (Corporate Governance), accuracy, fraud prevention, compliance

An ANOVA analysis was done between effects of accuracy, fraud prevention and compliance on corporate governance and at 95% confidence level, the F critical was 7.767 and the P value was (0.000) therefore significant the results are shown in table 4.7

Table 4.7: Anova between Corporate Governance and Other Variables

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regression</td>
<td>.848</td>
<td>3</td>
<td>.283</td>
<td>7.767</td>
<td>.000b</td>
</tr>
<tr>
<td>Residual</td>
<td>1.347</td>
<td>37</td>
<td>.036</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2.195</td>
<td>40</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Corporate Governance
b. Predictors: (Constant), accuracy, fraud prevention, compliance

Table 4.8: Regression Coefficient of accuracy, compliance, fraud Prevention and Corporate Governance

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>(Constant)</td>
<td>4.419</td>
<td>.481</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accuracy</td>
<td>0.111</td>
<td>.094</td>
<td>.208</td>
<td>1.182</td>
</tr>
<tr>
<td>Compliance</td>
<td>0.442</td>
<td>.118</td>
<td>.572</td>
<td>3.735</td>
</tr>
<tr>
<td>Fraud Prevention</td>
<td>.455</td>
<td>.117</td>
<td>.740</td>
<td>3.872</td>
</tr>
</tbody>
</table>

As per Table 4.8, the equation \( Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 \) becomes:

\[ Y = 4.419 + 0.111X_1 - 0.442X_2 + 0.455X_3 \]

Where Y is the dependent variable corporate governance
$X_1$ – Accuracy

$X_2$ – Compliance

$X_3$ – Fraud Prevention

The regression equation illustrated in Table 4.8 above has established that taking all factors into account accuracy, compliance, fraud prevention all other factors held constant corporate governance will be 4.419. The findings presented also showed that with all other variables held at zero, a unit change in accuracy would lead to a 0.111 increase in the corporate governance and a unit change in compliance will lead to a 0.442 change in corporate governance. Further, the findings also showed that a unit increase in fraud prevention would result in a 0.445 change in corporate governance. Only the variables fraud prevention and compliance was significant ($p<0.05$).

4.8 Chapter Summary

This chapter has discussed summary and findings of this study. The first section highlighted - the demographic data of the respondents. The part section gave analyses on the findings on accuracy of financial statement and corporate governance in the banking institutions, the second part highlighted findings on compliance to international reporting standard and corporate governance, and the fourth part discussed findings on prevention of fraud in banks and corporate governance. Chapter five discuses findings conclusions and recommendation of this study.
CHAPTER FIVE

5.0 DISCUSSIONS RECOMMENDATION AND CONCLUSION

5.1 Introduction
This chapter will bring forth and discuss the findings of this study, this will be done by referring to previous studies done on the topic of corporate governance. The study will be guided by the specific research questions.

5.2 Summary of Findings
The purpose of this study was to analyze the impact of external financial auditors on corporate governance in banking institutions. The research questions of the study are; To what extent have accuracy of financial reporting affected corporate governance in the banking institutions in Kenya? What impact has Bank’s compliance to international reporting standard had on corporate governance in the banking institutions in Kenya? To what extent has fraud prevention affected corporate governance in the banking institutions in Kenya?

A descriptive research design was used and the study will obtain and described the views of the respondents from banks in Nairobi, in line with establishing the challenges facing auditors in corporate governance. The study will incorporate both quantitative and qualitative research design so as to gain a better knowledge and in-depth understanding of the results. The target population for this study auditors in the 49 bank in Kenya and only 41 responded giving a response rate of 84%

On analysis of the first objective it was established that most respondents agreed that the assessment of internal control is critical in corporate governance and investors place trust on the audited reports before deciding to invest. It was also established that the firm has employed independent experts to audit its statements. However, respondents disagreed that board influence the auditing of the financial statement.

On analysis of the second objective it was revealed that most respondents agreed that the organization has executed auditing according to worldwide auditing requirements, and stake holders are interested in bank’s compliance to international reporting standard, it was also revealed that the banks have adhered to international reporting standard and
external auditor outsourced are objective, unbiased, and competent in verifying materials. However, respondents strongly disagreed that have suffered losses due to failures to comply with international reporting standard.

On analysis of the third objective it was revealed most respondents agreed that the all bank accounts are reconciled on regular basis and stakeholders are concerned about fraud cases in the industry. The findings also show that audit committee is appropriately structured to ensure its independence and it issues alert to fraud opportunities within the organization. Majority also agreed that auditors play a role in detecting fraud in the organization and fraud occurrences get reported to the audit committee as a matter of course. The firms have also taken necessary action to mitigate fraud. However, most respondents disagreed that audit committee involved in allegations of fraud made by employees and third parties.

5.3 Discussions

5.3.1 Effects of Accuracy of Financial Reporting on Corporate Governance

Most respondents agreed that the assessment of internal control is critical in corporate governance (4.73). This is because organizational independence allows the audit activity to progress without interference by using the entity it is auditing. The audit process should have enough independence in order for it to be viewed as if it would operate without interference. Coupled with objectivity, organizational independence contributes to the accuracy of the auditors’ work and the potential to depend upon suggested consequences (Boyle, DeZoort, & Hermanson, 2015).

The study also established that investors place trust on the audited reports before deciding to invest and Alabede, (2012) highlights that indeed that is a fact and that is why it is the auditor role to establish discrepancies in the financial records, whether they are via fraud or unintended omissions in the statement. For the shareholders and different stakeholders to trust inside the economic statements, it is imperative to employ independent expert to audit the monetary statements (Coyle, 2010), therefore the role of outside auditors in corporate governance. The role of the external audits in sustaining precise corporate governance is extensively mentioned. Cadbury report of 1992 declared that audit gives an external and objective take a look at on the way in which the economic statements have been prepared and presented. Through the function of outside auditor, the shareholders
monitor and manipulate the management and this facilitates issues of transparency in a business enterprise (Solomon, 2010).

The findings also revealed that the firm has employed independent experts to audit its statements (4.41). Independence is the base of the auditing technique because it helps the auditor to specific his impartial opinion regarding the economic statistics in his record, with no effects of the threats on his judgment. Independence means that the auditor has to do his obligation with honesty, faithfulness, and impartialities (Abdullah, 2010), inside the making plans, checking out of records, evaluating the outcomes, and getting ready his report. It means that the auditor is dedicated in the direction of all customers of his document (Arens, Lvin, & Elder, 2008)

However, there was there is uncertainty on organization having selected auditor based on references and recommendation from similar enterprises. Independence and neutrality of the auditor are the critical factors that cause the reliability and the credibility of the economic declaration. In coming across the financial travesties earlier than they affect the independence, the auditor should take the precise defending methods (Nawaiseh & Alnawaiseh, 2015). The auditor should not undertake any service without consumer order, and if he concurs to try this, he must select a qualified assistant to assist in the process. The auditor’s independence additionally affects the making use of auditing standards, the satisfactory controlling, the management pressure, and providing non-audit services. The independence of the auditor increases by way of his specialty, experience, the performance of the inner auditing (Abdullah, 2010).

Regrettably, hiring external auditors and having the first-class internal controls comes at a cost particularly for small corporations. The issue of how much of the funding should be spent on auditing and inner controls is an issue of various perspective. For instance, a small commercial enterprise proprietor who uses the economic statements for inner management functions only, has little incentive to rent an outside auditor. However, small commercial enterprise lenders and outside investors a dire need for the audited monetary statements (Elmaleh, 2008).

5.3.2 Effects of Compliance to International Reporting Standard on CG

Most respondents agreed that the organization has executed auditing according to worldwide auditing requirements and Demirgus & Detragiache (2011) highlight that there
are set up principles that guide the various stakeholders in the industry. The outside auditor of a financial institution should have banking industry information and competence sufficient to respond accurately to the dangers of misstatement in the bank’s monetary statements and to properly meet any additional regulatory requirements that may be a part of the statutory audit.

It was also revealed that stakeholders are interested in bank’s compliance to international reporting standard and a majority of banks have adhered to international reporting standard. According to Daniels and Booker (2011), the external auditor of a financial institution ought to respond correctly to the big dangers of misstatement within the financial institution’s financial statements. Demirgus and Detragiache (2011) add that the audit committee have to have a sturdy procedure for approving, or recommending for approval, the appointment, reappointment, removal, and remuneration of the outside auditor. The audit committee ought to display and assess the independence of the outside auditor. On the other hand, the audit committee should display and verify the effectiveness of the outside audit.

According to Turlea, Mocanu and Carmen (2010), the audit committee ought to have powerful verbal exchange with the external auditor to permit the audit committee to perform its oversight responsibilities. In addition, it also enhance the best of the audit, and have to require the outside auditor to document to it on all applicable matters to enable the audit committee to perform its oversight duties. There is a need to engage the supervisor and the outside auditor need to have a powerful courting that includes suitable communication channels for the exchange of facts applicable to sporting out their respective statutory responsibilities.

It was also revealed that external auditor outsourced are objective and unbiased. Demirgus and Detragiache (2011) noted that external auditor has to work out expert skepticism when making plans and acting the audit of a bank, having due regard to the particular demanding situations in auditing a bank. In addition, audit corporations challenge financial institution audits ought to comply with the extra stringent requirements on first-rate manipulate relevant to listed entities in the world over widely wide-spread first-class manipulate standards, having due regard to the complexity of a bank audit The outside auditor of a bank need to pick out and verify the dangers of material misstatement inside the financial institution’s monetary statements, considering
the complexities of banking activities and the need for banks to have a strong manage
surroundings (Turlea, Mocanu, & Carmen, 2010).

The findings also revealed that external auditors need to be competent in verifying
materials. Desai, Gerard, and Tripathy (2011) noted that external auditors are required to
conform with applicable jurisdictional and, where relevant, internationally frequent moral
standards. However, given the complexity and systemic risks associated with banks, the
outside auditor of a financial institution has to observe the most stringent rules for
independence beneath these requirements. Further, Lois and Stewart (2010) adds that the
auditor of a bank must also observe the maximum stringent standards on first-rate
manipulate at the engagement stage. Given the complexity and diversity of banking
sports, and the criminal and regulatory framework wherein banks function, the outside
auditor of a bank should have specialized knowledge and competence in auditing banks

According to Rossouw, Prozesky, du Plessis and Prinsloo (2010), competence is in
particular crucial in underpinning an outside auditor’s potential to workout expert
judgment and carry out key factors of the audit, consisting of figuring out and assessing
the risks of fabric misstatement and designing and implementing appropriate responses to
those dangers.

5.3.3 Effect of Fraud Prevention on Corporate Governance

Most respondents agreed that the all bank accounts are reconciled on regular basis and
this is done to detect fraud. Akinyomi (2012) established that this was important because
the frauds significantly threaten the institutional boom of a financial institution because it
leads to bank misery, which is because fraud decreases the deposit.

The findings also revealed that stakeholders are concerned about fraud cases in the
industry. Daniels and Booker (2011) notes that this not only apply in the banking sector
and that the management of an entity should take note of various warning symptoms that
emerge: changes in an employee’s behavior, modifications in a single’s lifestyle,
drug/alcohol, or gambling addictions, discrepancies about taken depart, and so on. In this
sense, the management can set up an exclusive assist system for his personnel that may
include circle of counselling. Bebchuk and Fried (2008) notes that a code of behavior
effectively implemented represents one of the maximum critical mechanisms of
communicating to the personnel the ideal requirements in their pastime, and to draw
interest to the dedication the management undertook which will admire the entity’s integrity. As well, a carefully deliberate program will increase the employees’ expertise of fraud prevention and detection refers to recognizing the early warning symptoms of a likely fraud.

The findings also established that the audit committee needs to be appropriately structured to ensure its independence. A lot of research has been conducted to establish a relationship between corporate governance and fraud probability. However, evidence is mixed. Most research has found that it is weak corporate governance to have the CEO as the chairman of the board. Even though most research finds a direct link between more fraud and CEO duality, find no such relation (Xie, Davidson, & DaDalt, 2008). However, prior research has treated all fraud the same, while not all fraud may be due to weak corporate governance, since it may also be beneficial to the existing shareholders. When firms are viewed as better performing firms, not only will the stock price rise, their rating by analysts will increase as well, and the firms are able to get better lending terms. This way firms are able to attract cheaper financing for example. These consequences raises shareholder value, which is desired by the shareholders (Healy, 2007).

Most of the respondents acknowledge that auditors play a role in detecting fraud in the organization. This is in line to a study by Farrar (2011), the board of directors is a monitoring mechanism for the shareholders, but directors have incentives to go along with the managers, for monetary and social reasons. One way to align the interest of the managers with those of the shareholders, is by introducing a part of their compensation as variable, depending on the stock price of the company. But granting payments due to stock price and earnings increases may cause managers to increase their profits by any means necessary. This may include taking on too risky projects, but also can lead to earnings management and fraud.

5.4 Conclusion

5.4.1 Effects of Accuracy of Financial Reporting on Corporate Governance

Assessment of internal control is seen as a critical factor in corporate governance and as such in the banking sector investors place trust on the audited reports before deciding to invest. It is also established that most of the firm have employed independent experts to
audit its statements this could be as a result of the firm having the interest of stake holders at heart.

5.4.2 Effects of Compliance to International Reporting Standard on Corporate Governance

The commercial banks in Kenya adhere to auditing practices according to worldwide auditing requirements, this is fostered by the fact that stake holders are interested in bank’s compliance to international reporting standard. Due to the sensitivity of the sector most of the external auditor outsourced are objective, unbiased and competent in verifying materials and this could explain why many respondents disagreed that have suffered losses due to failures to comply to international reporting standard.

5.4.3 Effect of Fraud Prevention on Corporate Governance

Most of the commercial bank reconcile accounts on regular a basis and issues of fraud cases in the industry are the major concern of stakeholders in the industry and therefore, most of the audit committees are appropriately structured to ensure independence and limitation of fraud opportunities within the organization. The role of auditors in detecting fraud in the organization is undoubtedly the most important in fraud prevention.

5.5 Recommendation

5.5.1 Recommendation for Improvement

5.5.1.1 Effects of Accuracy of Financial Reporting on Corporate Governance

Banks need to ensure that they undertake a critical assessment of internal control in order to ensure that ethics in corporate governance is upheld. There needs to be transparency and this is only possible when the board are note given a chance to influence the auditing of the financial statement.

5.5.1.2 Effects of Compliance to International Reporting Standard on Corporate Governance

The commercial banks in Kenya should continuously adhere to auditing practices according to worldwide auditing requirements. The banks need to maintain compliance to international reporting standard and adhere to international reporting standard. There is
also need for compliance to international reporting standard so as to facilitate the firm’s expansion to other regions.

5.5.1.3 Effect of Fraud Prevention on Corporate Governance

There is a need for all bank to undertake a regular accounts reconciliation on regular basis in order to be able to detect crime and fraud cases in the industry. There is also a need for the audit committee to undertake appropriate measures to ensure independence. The institutions also need to involve the audit committee when there is an allegations of fraud made by employees and third parties.

5.5.2 Recommendation for Further Studies

For further studies, this research recommends that there is a need to undertake a study to determine the impact of corporate governance on the financial performance of banking institutions.


Ernst & Young. (2012). *Sarbanes-Oxley Act at 10: Enhancing the reliability of financial reporting and audit quality.* London, UK: Ernst & Young.


Jensen, M., Murphy, K., & Wruck, E. (2009). ‘Remuneration, Where we’ve been, how we got here, what are the problems, and how to fix them. *ECGI Working paper series in finance*.


APPENDIX I: INTRODUCTION LETTER

Ali Faisal Mohammed
PO BOX 14634-00800
Nairobi.

Dear Sir/Madam,

I am a graduate student from United States International University. Pursuing Masters in Business Administration; Marketing Degree. Am conducting a research focusing on the “Impact of external financial auditing on corporate governance in banking institutions in Kenya” I hereby request your assistance in filling in the provided questionnaire. The questionnaire is a tool used to achieve a research objective. Sensitive information which requires privacy was handled with high confidentiality. Please take note that none of the receive information from the participants was used for a different purpose other than for this study. The data collected from the participants will therefore be handled with high confidentiality. Any assistance accorded to this exercise was highly appreciated.

Yours Faithfully,

Ali Faisal
APPENDIX II: QUESTIONNAIRE
IMPACT OF EXTERNAL FINANCIAL AUDITING ON CORPORATE GOVERNANCE IN BANKING INSTITUTIONS

Please answer every question as in outlined by using either a cross( x ) or (ticking) in the option that applies.

SECTION A: DEMOGRAPHIC FACTORS

1. Name of institution……………………………………………………………………………………………………………………………

2. What is your level of education
   a) Certificate □ b) Diploma □
   c) Bachelor’s degree □ d) Graduate degree □

3. How long has the organization been in existence
   a) 1 to 5 years □
   b) 6 to 11 years □
   c) 12 years and over □

4. How many auditors do you have in the organization
   a) below 10 □ b) 11 to 25 □
   c) above 25 □

5. How many often do you outsource for auditing in the organization
   a) regularly □ b) once in 5 years □
   c) whenever we have a crisis □ d) never □
**SECTION B: ACCURACY OF FINANCIAL REPORTING ON CORPORATE GOVERNANCE**

In a scale of one to five, rate the following statements about accuracy of financial reporting in the table. 1(Strongly disagree), 2(Disagree), 3 (neutral), 4 (agree) and 5(Strongly Agree)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Independence in the organization allows the audit activity to progress without interference</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Investors place trust on the audited reports before deciding to invest</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>The firm has experienced omissions in the statements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>The assessment of internal control is critical in corporate governance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>The firm has employed independent experts to audit its statements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>The shareholders prefer external auditors to facilitates issues of transparency in the business enterprise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>The board influence the auditing of the financial statements</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>We have selected auditor based on references and recommendation from similar enterprises</td>
<td></td>
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<tr>
<td>9</td>
<td>We have incurred high cost from external audit services</td>
<td></td>
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<tr>
<td>10</td>
<td>Through external auditing we have detected inaccurate reporting</td>
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</tr>
</tbody>
</table>

11. What other factors affect accuracy of financial reporting………………………………

.................................................................
SECTION C: BANK’S COMPLIANCE TO INTERNATIONAL REPORTING STANDARD

In a scale of one to five, rate the following statements about bank’s compliance to international reporting standard in the table.

1(Strongly disagree), 2(Disagree), 3 (neutral), 4 (agree) and 5(Strongly Agree)

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 We have adhered to international reporting standard</td>
<td></td>
<td></td>
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<tr>
<td>2 Audit committee is in charge of appointing external auditors.</td>
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<tr>
<td>3 External auditors enable the audit committee to perform its oversight duties</td>
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<tr>
<td>4 We execute auditing according to worldwide auditing requirements</td>
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<tr>
<td>5 External auditor outsourced are objective and unbiased</td>
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<tr>
<td>6 External auditors are competent in verifying materials</td>
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<tr>
<td>7 We have suffered losses due to failures to comply to international reporting standard</td>
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<tr>
<td>8 Compliance to international reporting standard has facilitated the firm’s expansion to other regions</td>
<td></td>
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</tr>
<tr>
<td>9 Stake holders are interested in bank’s compliance to international reporting standard</td>
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</tr>
<tr>
<td>10 Adopting International Financial Reporting Standard and disclosure requirements has lowered our financial risk</td>
<td></td>
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</tr>
</tbody>
</table>

11. What other factors affect bank’s compliance to international reporting standard

...........................................................................................................................................................................
SECTION D: FRAUD PREVENTION AND CORPORATE GOVERNANCE

In a scale of one to five, rate the following statements about fraud prevention in the table.

1(Strongly disagree), 2(Disagree), 3 (neutral), 4 (agree) and 5(Strongly Agree)

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 The bank has recorded cases of fraud</td>
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<tr>
<td>2 We have taken necessary action to mitigate fraud</td>
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<tr>
<td>3 Stakeholders are concerned about fraud cases in the industry</td>
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<tr>
<td>4 Auditors play a role in detecting fraud in the organization</td>
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<tr>
<td>5 all bank accounts are reconciled on regular basis?</td>
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<tr>
<td>6 audit committee appropriately structured to ensure its</td>
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<td></td>
</tr>
<tr>
<td>independence</td>
<td></td>
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<tr>
<td>7 audit committee alert to fraud opportunities within the</td>
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<td></td>
<td></td>
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<tr>
<td>organization</td>
<td></td>
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<tr>
<td>8 Fraud occurrences get reported to the audit</td>
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<tr>
<td>committee as a matter of course</td>
<td></td>
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<tr>
<td>9 Audit committee involved in allegations of fraud made by</td>
<td></td>
<td></td>
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<tr>
<td>employees and third parties</td>
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<tr>
<td>10 audit committee takes responsibility or monitoring fraud</td>
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<tr>
<td>opportunities at board and executive level</td>
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</tbody>
</table>

11. What other factors affect fraud prevention

...................................................................................................................................................
..................................................................................................................................................
APPENDIX III: LIST OF BANKS IN KENYA

<table>
<thead>
<tr>
<th></th>
<th>Bank Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>ABC Bank (Kenya)</td>
</tr>
<tr>
<td>2</td>
<td>Bank of Africa</td>
</tr>
<tr>
<td>3</td>
<td>Bank of Baroda</td>
</tr>
<tr>
<td>4</td>
<td>Bank of India</td>
</tr>
<tr>
<td>5</td>
<td>Barclays Bank of Kenya</td>
</tr>
<tr>
<td>6</td>
<td>CIC Stanbic Holdings</td>
</tr>
<tr>
<td>7</td>
<td>Chase Bank Kenya (In Receivership)</td>
</tr>
<tr>
<td>8</td>
<td>Citibank</td>
</tr>
<tr>
<td>9</td>
<td>Commercial Bank of Africa</td>
</tr>
<tr>
<td>10</td>
<td>Consolidated Bank of Kenya</td>
</tr>
<tr>
<td>11</td>
<td>Cooperative Bank of Kenya</td>
</tr>
<tr>
<td>12</td>
<td>Credit Bank</td>
</tr>
<tr>
<td>13</td>
<td>Development Bank of Kenya</td>
</tr>
<tr>
<td>14</td>
<td>Diamond Trust Bank</td>
</tr>
<tr>
<td>15</td>
<td>Ecobank Kenya</td>
</tr>
<tr>
<td>16</td>
<td>Equity Bank</td>
</tr>
<tr>
<td>17</td>
<td>Family Bank</td>
</tr>
<tr>
<td>18</td>
<td>Fidelity Commercial Bank Limited</td>
</tr>
<tr>
<td>19</td>
<td>First Community Bank</td>
</tr>
<tr>
<td>20</td>
<td>Giro Commercial Bank</td>
</tr>
<tr>
<td>21</td>
<td>Guaranty Trust Bank Kenya</td>
</tr>
<tr>
<td>22</td>
<td>Guardian Bank</td>
</tr>
<tr>
<td>23</td>
<td>Gulf African Bank</td>
</tr>
<tr>
<td>24</td>
<td>Habib Bank</td>
</tr>
<tr>
<td>25</td>
<td>Habib Bank AG Zurich</td>
</tr>
<tr>
<td>26</td>
<td>Housing Finance Company of Kenya</td>
</tr>
<tr>
<td>27</td>
<td>I&amp;M Bank</td>
</tr>
<tr>
<td>28</td>
<td>Imperial Bank Kenya (In receivership)</td>
</tr>
<tr>
<td>29</td>
<td>Jamii Bora Bank</td>
</tr>
<tr>
<td>30</td>
<td>Kenya Commercial Bank</td>
</tr>
<tr>
<td>31</td>
<td>Middle East Bank Kenya</td>
</tr>
<tr>
<td>32</td>
<td>National Bank of Kenya</td>
</tr>
<tr>
<td>33</td>
<td>NIC Bank</td>
</tr>
<tr>
<td>34</td>
<td>Oriental Commercial Bank</td>
</tr>
<tr>
<td>35</td>
<td>Paramount Universal Bank</td>
</tr>
<tr>
<td>36</td>
<td>Prime Bank (Kenya)</td>
</tr>
</tbody>
</table>
37. Sidian Bank
38. Spire Bank
39. Standard Chartered Kenya
40. Trans National Bank Kenya
41. United Bank for Africa
42. Victoria Commercial Bank

**Representative offices of foreign banks**

1. HDFC Bank
2. Nedbank
3. FirstRand Bank
4. Bank of China
5. JP Morgan Chase
6. Bank of Kigali
7. Central Bank of India