ROLE OF INTERNAL AUDIT FUNCTION ON FINANCIAL PERFORMANCE OF THE LISTED COMMERCIAL BANKS IN KENYA IN THE PERIOD 2013 - 2017

BY

NJUNG’E PENINAH WAMBUI

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA

SPRING 2019
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A Research Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirements for the Degree of Masters in Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY- AFRICA

SPRING 2019
STUDENT DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

Signed: ________________________ Date: ______________________
Njung’e Peninah Wambui (ID 653952)

This project has been presented for examination with my approval as the appointed supervisor.

Signed: ________________________ Date: ______________________
Mr. Kepha Oyaro

Signed: ________________________ Date: ______________________
Dean, Chandaria School of Business
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ABSTRACT

The general objective of the study was to determine the role of the internal audit function in the financial performance of listed commercial banks in Kenya. The study had three specific objectives in looking at the internal audit function; the role of the internal auditor’s competencies to the financial performance, the effect of the internal audit independence and the role of the audit committees to the financial performance of the listed commercial banks.

The study adopted a descriptive research design and used research questions to collect data from the respondents. The sample population was 104 people covering the internal audit departments, finance staff, the audit committees and the risk departments of the 11 listed commercial banks in Kenya. Data on the financial performance measure was collected from the bank’s supervisory reports in the Central Bank of Kenya website. The study used quantitative and qualitative techniques to analyze the results obtained from the data collected. The data collected was coded with the use of Statistical Package for Social Sciences (SPSS version 24) and Microsoft Excel. The data was interpreted using frequencies, percentages, mean, standard deviation and presented using tables and figures. Multiple regression was used to establish the relationship between the variables. Correlation analysis was used to establish the significance of the relationship of the variables. The study covered a five-year period 2013-2017.

From the findings, the study concludes internal auditor’s competencies in educational, professional and technical skills contribute to the financial performance of the company. Internal audit is effective in executing its responsibilities with qualified staff who ensure control lapses are timely reported, and corrective action is taken to prevent losses and wastage in the organization. The study emphasizes on the effect of the internal audit independence in reporting as it ensures there is objectivity in reporting control issues noted during their reviews. The role of the audit committees in providing an oversight role to the internal audit function is noted to be critical as it ensures the IAF is effective in the organization. From the study, it is noted the three variables have a significant positive relationship with financial performance of the 11 listed commercial banks in Kenya.

The study recommends that the internal auditors should be properly resourced and continuous training done in workshops and seminars to improve their skills and update themselves with new technology to improve on their audit reviews. The study further
recommends autonomy be given to the IAF in order to promote their independence and objectivity in reporting. The study noted the audit committees have an oversight role on the IAF hence there is a need to ensure the members of the AC are independent and possess the financial skills to understand the financial estimates and assumptions.
TABLE OF CONTENTS

STUDENT DECLARATION ........................................................................................................ ii
COPYRIGHT ............................................................................................................................. iii
ABSTRACT ............................................................................................................................... iv
LIST OF TABLES ................................................................................................................... ix
LIST OF FIGURES .................................................................................................................. x
ABBREVIATIONS .................................................................................................................. xi

CHAPTER ONE ...................................................................................................................... 1
1.0 INTRODUCTION .............................................................................................................. 1
1.1 Background of the Study ................................................................................................. 1
1.2 Statement of the Problem ............................................................................................... 5
1.3 General Objective ........................................................................................................... 6
1.4 Specific Objectives ......................................................................................................... 7
1.5 Significance of the Study ............................................................................................... 7
1.6 Scope of the Study ......................................................................................................... 7
1.7 Definition of terms ......................................................................................................... 8
1.8 Chapter summary ........................................................................................................... 8

CHAPTER TWO ................................................................................................................... 10
2.0 LITERATURE REVIEW .................................................................................................. 10
2.1 Introduction ................................................................................................................... 10
2.2 Internal Auditor Competencies and Financial Performance ....................................... 10
2.3 Internal Audit Independence and Financial Performance .......................................... 15
2.4 Role of Audit Committees and Financial Performance .............................................. 19
2.5 Chapter Summary ......................................................................................................... 23

CHAPTER THREE .............................................................................................................. 24
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.0 RESEARCH METHODOLOGY</td>
<td>24</td>
</tr>
<tr>
<td>3.1 Introduction</td>
<td>24</td>
</tr>
<tr>
<td>3.2 Research Design</td>
<td>24</td>
</tr>
<tr>
<td>3.3 Population and Sampling Design</td>
<td>24</td>
</tr>
<tr>
<td>3.4 Data Collection Methods</td>
<td>26</td>
</tr>
<tr>
<td>3.5 Research Procedures</td>
<td>27</td>
</tr>
<tr>
<td>3.6 Data Analysis Methods</td>
<td>27</td>
</tr>
<tr>
<td>3.7 Chapter Summary</td>
<td>28</td>
</tr>
<tr>
<td>4.0 RESULTS AND FINDINGS</td>
<td>29</td>
</tr>
<tr>
<td>4.1 Introduction</td>
<td>29</td>
</tr>
<tr>
<td>4.2 General Information</td>
<td>29</td>
</tr>
<tr>
<td>4.3 Internal Auditor’s Competence and Financial Performance</td>
<td>32</td>
</tr>
<tr>
<td>4.4 Internal Audit Independence and Financial Performance</td>
<td>37</td>
</tr>
<tr>
<td>4.5 Audit Committees and Financial Performance</td>
<td>42</td>
</tr>
<tr>
<td>4.6 Chapter Summary</td>
<td>48</td>
</tr>
<tr>
<td>5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS</td>
<td>49</td>
</tr>
<tr>
<td>5.1 Introduction</td>
<td>49</td>
</tr>
<tr>
<td>5.2 Summary</td>
<td>49</td>
</tr>
<tr>
<td>5.3 Discussions</td>
<td>50</td>
</tr>
<tr>
<td>5.4 Conclusion</td>
<td>54</td>
</tr>
<tr>
<td>5.5 Recommendations</td>
<td>55</td>
</tr>
<tr>
<td>REFERENCES</td>
<td>57</td>
</tr>
</tbody>
</table>
APPENDICES ........................................................................................................................................... 72
APPENDIX I: INTRODUCTORY LETTER .............................................................................................. 72
APPENDIX II: QUESTIONNAIRE ........................................................................................................... 73
LIST OF TABLES
Table 3.1: Sample Size Distribution ................................................................. 26
Table 4.1 : Role of Internal Auditor's Competencies ........................................... 33
Table 4.2: Internal Auditor’s Competence in Risk Assessment .......................... 33
Table 4.3: Internal Auditor’s Competence in Fraud Detection ............................ 34
Table 4.4: Internal Auditor’s Competence in Evaluation of Controls .................. 35
Table 4.5: Correlation between financial performance and Audit Competencies .......... 35
Table 4.6: Model Summary for Audit Competencies ........................................... 36
Table 4.7: ANOVA for Audit Competencies ....................................................... 36
Table 4.8: Coefficient for Audit Competencies .................................................. 37
Table 4.9: Reporting Structure of Internal Auditor ............................................ 38
Table 4.10: Organizational Independence of the Internal Audit ......................... 39
Table 4.11: Internal Audit Reports ................................................................. 40
Table 4.12: Correlation between Financial Performance and Audit Independence .... 40
Table 4.13: Model Summary for Audit Independence ....................................... 41
Table 4.14: ANOVA for Audit Independence .................................................... 41
Table 4.15: Coefficients for Audit Independence ............................................... 42
Table 4.16: Composition of the Audit Committees ............................................. 43
Table 4.17: Independence of the Audit Committees .......................................... 44
Table 4.18: Financial Expertise of the Audit Committees .................................... 45
Table 4.19: Audit Committee Support to the Internal Audit Function ................... 46
Table 4.20: Correlation between Financial Performance and Audit Committees .... 46
Table 4.21: Model Summary for Audit Committee ............................................ 47
Table 4.22: ANOVA for Audit Committees ....................................................... 47
LIST OF FIGURES

Figure 4.1: Response Rate ................................................................................................................. 29
Figure 4.2: Educational Level ............................................................................................................ 30
Figure 4.3: Professional Certification ............................................................................................... 31
Figure 4.4: Working Experience ........................................................................................................ 31
Figure 4.5: Job Designation ............................................................................................................. 32
#Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC</td>
<td>Audit Committee</td>
</tr>
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<td>CAE</td>
<td>Chief Audit Executive</td>
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<tr>
<td>CIIA</td>
<td>Chartered Institute of Internal Auditors</td>
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<td>CBK</td>
<td>Central Bank of Kenya</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<tr>
<td>CFO</td>
<td>Chief Finance Officer</td>
</tr>
<tr>
<td>GAAPs</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>IIA</td>
<td>Institute of Internal Auditors</td>
</tr>
<tr>
<td>IAF</td>
<td>Internal Audit Function</td>
</tr>
<tr>
<td>ICPAK</td>
<td>Institute of Certified Public Accountants of Kenya</td>
</tr>
<tr>
<td>NSE</td>
<td>Nairobi Stock Exchange</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on Total Assets</td>
</tr>
<tr>
<td>ROE</td>
<td>Return on Equity</td>
</tr>
<tr>
<td>PSIAS</td>
<td>Public Sector Internal Audit Standards</td>
</tr>
</tbody>
</table>
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

Over the years, the role of the internal audit in companies has continued to gain importance. This is because the internal audit adds value to the organization through their evaluation of controls. Harsh economic conditions coupled with complex market conditions, fraud and financial scandals, failed corporate governance policies have made it difficult for organizations to achieve their financial objectives (Mikes & Kaplan, 2013). This has necessitated an effective internal audit role in order to carefully analyze the business risks identified and recommend timely corrective actions. Ruud (2003) noted that internal audit is one of the important support functions for management, the audit committee and all other stakeholders of the business. Ngunyi (2012) in his studies on the effect of audit triangle on financial performance of parastatals in Kenya found internal audit effectively participates in providing an independent review of operational efficiency of firms.

The internal auditor occupies a unique position in the organization. He or she is employed by the management but is also expected to review the conduct of management (Sarens and de Beelde, 2006). When the management is involved in financial impropriety, it can create significant tension between the internal auditor and management. This necessitates the auditor to have a direct reporting to the board audit committee in order to correct the management disregard of company policies (Alzeban & Gwilliam 2014). The listed commercial banks are expected to give value to the investors. Value is given by good financial performance of the listed companies.

The internal auditors’ responsibilities are guided by the chief Audit Executive (CAE) and is in charge of establishing the scope of the audit in the audit charter (IIA, 2004). The internal auditors should have access to records and personnel as necessary and be allowed to employ appropriate probing techniques without impediment. Bett (2014) noted that effective internal audit function is key in improving public confidence in financial reporting and corporate governance. The financial institutions have put in place internal audit function in order to monitor and ensure efficiency in financial performance of the whole organization. Compensation to senior staff is based on the good financial performance and audit reports on their departments are key performance indicators (Maletta, 2013).
Internal audit is a department within a company, which conducts an independent examination of the whole system of controls in the business. According to Chartered Institute of Internal Auditors (2013), the primary role of internal audit should be to assist the board and executive management to protect the assets, reputation and sustainability of the organization. This is achieved by ensuring the whole organization is aware of the controls, the systems in place and they are adhered. An internal auditor examines controls to ensure there is no income leakage, costs are effectively managed, and the assets of the company are safeguarded from waste or misuse. According to CBK, (2013) internal audit risk management, controls and governance practices influence accountability and accuracy of financial statements which in return enhances the financial performance of banks. The internal audit objectivity in carrying out these functions is necessary as it affects the financial performance of the company (Mutua, 2012).

The audit committee support and expertise ensure the reporting is not influenced by the management. CBK Prudential guidelines 2013 (CBK/PG/02) requires that all commercial banks establish an independent board of Audit committee to provide an independent oversight of the institution’s financial reporting and internal control system, ensure checks and balances within the institution are in place and to recommend appropriate remedial action regularly. Mutchler et al. (2001) added that, as the responsibilities of internal auditors grow, so does the demand for greater accountability, independence and objectivity. They suggested that the increased responsibilities of the internal audit function within the environment of a changing business world, coupled with increasing economic competition and globalization, are creating pressure on the internal audit function, which can jeopardize its independence.

International Standards on Auditing (ISA 200) emphasizes the knowledge and the skills required from an internal auditor, which in turn plays a big role in making objective judgements in their duties. An auditor is required to observe the professional code of conduct and should not disclose confidential information to other people. The independence and objectivity of the internal audit function may be undermined if the internal audit staff’s remuneration is linked to the financial performance of the business lines for which they exercise internal audit responsibilities. The remuneration of the head of internal audit or internal audit staff members should be structured to avoid creating conflicts of interest and compromising objectivity (Basel Committee, 2012).
Financial performance is the process of measuring the results of a firm's policies and operations in monetary terms. The overall financial wellness of the company is checked over a given period and is compared to similar firms across the same industry or sectors in aggregation (Cooper et al. 2003). Financial performance of the business is of importance to different stakeholders, for shareholders they are interested in the enhancement of their value and increasing their wealth whereas potential investors are interested in the returns to be realized (Muller, 2014). Financial development of a country is indicated by the growth of its financial institutions. Bashir (2000) examined the financial statements of a sample of Islamic Banks on the relationship between the profitability and the banks' characteristics. He found that profitability had a positive relationship with the capital and loan ratios. In Kenya, there is tremendous growth of the banks, microfinance institutions and the agency banking (Kiambati et al, 2013). To achieve high-level financial performance, it requires effective internal audit function.

The common measures of assessing commercial banks’ performance are the profitability ratios, which are return on total assets (ROA) and return on equity (ROE) (Adam, 2014). Analysts and bank regulators use these measures to check the industry performance and the trends in the markets (Gilbert & Wheelock, 2007). A high ROE is favorable for a bank as it shows its ability to generate cash internally. A high ROA shows the bank is efficiently utilizing its resources. The financial performance of financial institutions has also been measured using a combination of financial ratios analysis, benchmarking, and comparing performance against budget or a mix of these methodologies (Ahmad et al, 2011). Other financial ratios that have been used to measure the financial performance of the banks are net interest margin, the trend in non-performing loans and the liquidity ratios.

According to Agapova and McNulty (2016), the determinants of the financial performance of banks in Central and Eastern Europe are classified into bank-specific factors, industry-specific factors, and macroeconomic factors. They add that the indicators are a departure from the mainstream measures of financial performance, such as return on asset, return on equity, and net interest margin. Alam et al (2011) identified bank specific factors (internal factors) such as size, deposits, business mix and diversification, and operating efficiency to affect performance. They further added external factors include inflation, interest rates and cyclical output among other market variables. The internal factors are within the control of the bank and corporate government policies have been put in place to counter some of them. In Kenya, different government regulations have interfered with the financial performance
of commercial banks, for example the interest capping law, which has marginally reduced commercial banks’ profits.

Internal audit function provides a dependable goal and impartial support to management and review panel while the directors are busy with profitability, rate of return, economic development and financial execution and business routines with regard to the organization (Ljubisavljević & Jovanović, 2011). Mercer (2004) noted that one important factor that affects perceptions of credibility of the financial statements is the degree of external and internal assurance. Disclosure credibility plays an important role for assessing investor perceptions. Suraj (2017) noted the independence of internal audit could enhance financial performance if the auditor is independent of the activities they evaluate and perform their duties objectively to avoid conflict of interest. KPMG (2015) observed that internal audit function would enhance financial performance if there was strict observation of the auditing standards. Beyanga (2011) noted that an effective internal audit function could assist in cost management, identify ways to improve efficiency and minimize losses from inadequate internal controls, which could have a significant impact on the financial performance of an organization. The audit function acts as a watchdog to the firm to protect it from malpractices and irregularities thus enabling the organization to achieve its objectives of profitability and long-term sustainability (Ruto, 2016).

Commercial banks are profit-making organizations and contribute a big percentage in the growth of the economy. Commercial banks act as financial intermediaries in an economy. Financial intermediaries ensure circulation of money in the economy by taking deposits from one customer and lending to another at a fee (Molyneux & Goacher, 2005). They are licensed to take deposits, give credit facilities, custodial services and any other financial service as approved by the regulator. The banks have opened branches across the country to ensure they reach as many people as possible and this enhances their profitability. According to Mutua (2012) commercial banks have been forced to be innovative in their products to remain competitive and increase profitability. In Kenya, all commercial banks are governed by the Companies Act, The Banking Act and the Central Bank of Kenya (CBK) prudential guidelines. CBK is established under the Banking Act. All commercial banks are regulated, registered and supervised by the CBK. It is a requirement of the commercial banks to have an operational independent audit department (CBK Prudential Guidelines, 2013). Commercial banks have been attacked by the globalization, competition (from nonbanking financial institutions) and volatile market dynamic pressures (Casu et al,
2006). Due to the rapid growth in banks and the need to ensure the shareholders’ value is enhanced the internal audit function needs to be competent. When looking at the health of an economy of a country the banking sector play a big role (Haque and Sharman, 2011).

Nairobi Stocks Exchange (NSE) plays a vital role in the growth of Kenya’s economy by encouraging savings and investment, as well as helping local and international companies’ access cost-effective capital. NSE operates under the jurisdiction of the Capital Markets Authority of Kenya. The listed companies are divided according to the industries in which they operate. There are 12 industries, Manufacturing and Allied, Banking, Insurance, Construction and Allied, Agricultural, Automobile and Accessories, Commercial and Services, Energy and Petroleum, Investments, Investment services, Telecommunication and Real Estate. There are eleven listed commercial banks in the NSE (NSE, 2018).

1.2 Statement of the Problem
The recent global financial crisis has led to questioning of how successful internal audit is both in its conventional role of monitoring compliance with internal controls and financial probity and its role as an integral part of the risk management culture within large economic entities, whether in the private or public sector (Alzeban and Gwilliam, 2014). Lumumba (2015) noted that failure in corporate governance in Kenyan companies had led to corporate frauds, improper accounting and incorrect financial reporting, which in return had led to collapse of Chase and Imperial banks in 2015 and insolvency of Uchumi supermarkets.

Christophers and Sarens (2009) in their analysis of the independence of the internal audit function of Australian companies observed that 56% of the respondents admitted there is a culture of internal auditors moving to management functions during their professional careers, which may impede their judgement on areas where they target to grow into. The internal audit department was seen as a stepping-stone and a training ground for other management functions. They observed a potential threat to independence where the internal auditors do not consistently report to the Audit committees functionally. The other threat was observed where the management have the power to hire and fire the CAE. They concluded the three threats have a major effect on the effectiveness of the internal audit function (IAF).

Hernandez and Lema (2012) in their study of internal audit function and financial reporting in 47 Spanish banks observed that in 62% of the banks, the internal auditors
specialize in financial audit and the institutions had higher financial reporting quality. They concluded that higher quality financial reporting occurs when the IAF devotes more time and resources to financial audits. Better reporting also results from taking steps to ensure the accuracy and reliability of accounting records and financial reports.

Ebaid (2011) in their study of the internal audit function of Egyptian listed companies observed there was increasing recognition of the internal audit function by Egyptian listed firms. He found 62% of respondents indicated that Chief Finance Officer (CFO) is responsible for approving the internal audit budget, reviewing and approving the internal audit plan while 38% of respondents indicated the responsibility was with the board of directors or audit committee. This was interpreted to mean internal audit function in Egyptian listed firms does not enjoy a considerable degree of organizational independence in sense that the CFO and the Chief Executive Officer (CEO) have a significant role in internal audit function.

Ondieki (2013) in her research on the effect of internal audit on financial performance in commercial banks observed there is a strong relationship between financial performance and internal audit. She noted that changes in financial performance of commercial banks could be attributed to changes in the internal audit standards, professional competency, and internal audit independence. Wakaba (2014) in his studies on the effect of audit committee characteristics on financial performance of companies listed at the NSE found that audit committee experience, committee gender diversity, audit committee size and number of independent auditors has a significant effect on firm performance.

In this study, the focus shall be on the role of the internal audit function on financial performance of the listed commercial banks in Kenya. The concentration will be on the internal auditor’s competence, the internal auditors’ independence and the role of audit committees on the financial performance of commercial banks in Kenya.

1.3 General Objective
The general objective of the study was to establish the role of the internal audit function on the financial performance of the listed commercial banks in Kenya.
1.4 Specific Objectives

1.4.1 To establish the effect of internal auditors’ competencies on the financial performance of listed commercial banks.

1.4.2 To establish the role of internal audit independence on financial performance of listed commercial banks.

1.4.3 To establish the effect audit committees on financial performance of listed commercial banks

1.5 Significance of the Study

1.5.1 Senior Management of Banks
The research will assist the senior management to appreciate the importance of the internal audit function in enhancing the company value and how they can the support the internal auditors to improve financial performance of the organization.

1.5.2 The policy makers
The study will be useful to the policy makers and the regulators on how best to ensure compliance with the set regulations in the operating guidelines regarding the internal audit function to enhance financial performance of the commercial banks.

1.5.3 Researchers and academicians
The research will provide more ground for further studies on the role of internal auditor’s roles and could assist in development or strengthening the audit standards in place.

1.6 Scope of the Study
The study targets internal auditors, the senior management, the members of the audit committees and the employees from these listed commercial banks. The study will be conducted in Kenya covering the eleven listed commercial banks in the NSE. The analysis will be based on the financial performance of the banks in 2013-2017 in the profitability ratios and will take a period of two months to analyze and report the findings.
1.7 Definition of Terms

1.7.1 Internal Audit

It is an independent, objective assurance and consulting activity intended to add value to an organization's operations through a systematic approach of evaluating the effectiveness of risk management, control, and governance processes. (IIA, 2009)

1.7.2 Audit Committee

A selected number of members of a company’s board of directors who provides an independent review of the financial reporting system, the internal controls and the internal auditors. (Boynton et al, 2001)

1.7.3 Audit Charter

A written document that establishes the responsibilities, purpose and authority of the internal auditors and is approved by the audit committee. Institute of Internal Auditors (IIA, 2016)

1.7.4 Internal control system.

It is the whole system of processes and policies, effected by those charged with governance, management, and other employees, designed to provide reasonable assurance regarding the achievement of the entity’s objectives relating to operations, reporting, and compliance (KPMG, 1999).

1.7.5 Return on Assets

It is the organization’s capacity to create income by using the assets at its disposal (Gilbert and Wheelock, 2007).

1.7.6 Return on Equity

It is the amount that the organization earn relative to the total amount of invested shareholders’ funds (Gilbert and Wheelock, 2007).

1.8 Chapter Summary

This chapter has introduced the study by giving the outline of the research, the objectives and the significance of the study. The details have been covered under the subtitles of the relationship of the variables in the study, the problem statement, the objectives,
significance, scope and the purpose of this study. The next chapter will cover the literature review, chapter three will cover research methodology, chapter four will cover data analysis of the results and chapter five will cover the interpretation of the findings, conclusion and the recommendations.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction
This chapter reviews the existing research literature on the role of internal audit on the financial performance of listed banks in Kenya. It will cover in detail the specific objectives; the competencies of the internal auditors, the internal auditors’ independence and the role of the audit committees

2.2 Internal Auditor Competencies and Financial Performance

2.2.1 Competence
Competence is the sum total of attributes drawn from education and professional qualifications and the guidelines given by the international standards of accounting and auditing in order to perform an audit task. Mutchler et al (2001) defines competence as having the intelligence, education and training to be able to add value through performance. According to IIA (2013) competency is defined as the ability of an individual to perform a job or task properly with a set of defined knowledge, skills, and behavior. The standard defines ten key competencies measure for internal auditors for each job level. Some of the competencies include professional ethics, internal audit management, understanding of governance, risk and control appropriate to the organization, application of International Professional Practices Framework and internal audit delivery. According to Hack (2013) the main challenges facing internal auditors were the widening technical skills gap, corruption and lack of authority. Gramling et al. (2013) suggested that a bigger investment in the internal audit function could result in hiring or training internal auditors with greater competencies and were more likely to have a positive organizational impact. Kibet (2014) found that qualified internal audit personnel improve firm performance because they have a clear insight about how to deal with operations.

One of the core competencies of internal auditors is an understanding of both the financial and operational aspects of the company (Martin & Lavine 2000). Both internal and external auditors concerned with costs and quality work together throughout the year. (Felix et al., 2001). Coordination was noted to maximize the effectiveness of the internal auditors’ contribution and increase their overall efficiency. The standards encourage both the internal and external auditors to coordinate their efforts in completing the financial statements audit
Seol and Sarkis (2005) argued that internal auditor selection could be based on two groups of skills, cognitive skills (technical skills and analytical skills), and behavioral skills (interpersonal skills and organizational skills).

Internal auditors are required to be competent professionals (Kunkel 2014). According to the standards (1200), internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. Zain et al. (2006) identified the level of experience among internal auditors as an indicator of the quality of internal audit. Gramling and Hermanson (2009) argued that skilled and qualified internal auditors are indicative of internal audit quality. Chepngen (2017) in her research on the effect of internal audit function on SACCOs found that lack of adequate understanding coupled with low level of knowledge on auditing operations poses a major threat to the achievement of performance in the IAF and the organization as a whole. Ngunyi (2012) notes that a professional internal audit activity will supplement senior management's actions, by providing independent and objective assurance on the effectiveness of the organization’s governance processes, how well it manages all kinds of risks, and whether internal control processes are operating, as required, to manage risks to an acceptable level.

2.2.2 Internal Audit Competencies in Risk Assessment

Risk assessment involves a dynamic and iterative process for identifying and analyzing risks to achieve the company’s objectives and using that information to decide how to respond to the risks. Internal auditors play an important role in risk assessment (Stewart & Subramaniam, 2010). Risk assessment and internal control monitoring plan should be designed to provide management with reasonable assurance that controls are operating as expected. The plan should also be used to determine internal control modifications needed by considering events that have occurred, processes or procedures that have changed, new projects or programs that are being planned or implemented, and other changes within the company that may have additional risks. According to Gramling (2004), the nature of internal audit activity includes risk assessment, control assurance and compliance work, all of which enhances organization performance. Competency of an internal auditor helps them to evaluate the risk of fraud and the manner in which it is managed by the organization. They are expected to have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work.
Sarens and De Beelde (2006) in their studies of Belgian and US companies observed that the internal auditors play a very important function in enhancing the risk assessment of the organizations and internal control practices. Internal auditor competence is key in evaluation of controls or risk assessment of the organization as this helps in arresting financial problems in the organization. One key area is in the evaluation of the elements of the financial statements. The internal auditor should have the accounting knowledge to interpret and question the entries in different ledgers of the company trial balance. Hutchinson and Zain (2009) in their exploratory study of the internal auditors’ experience and qualifications and firm performance of Malaysian companies found there is a significant relationship between the internal audit quality and organization performance.

Allegrini and D’Onza (2003) found that internal auditors in large Italian firms contribute to the risk management process. Soh and Bennie (2011) in their study on roles and responsibilities of the internal audit function and the factors perceived to be necessary to ensure its effectiveness in Australia CAEs reported that the annual work plan focuses on the examination of a limited number of issues, primarily selected based on risk prioritization. Limited references were made in the interviews to the IAF’s role in the financial statement audit or purely financial auditing. The participants across all organizations heavily emphasized the IAF’s role in compliance and particularly operational audits based on risk. All CAE participants reported that they have full and free access to all areas within the organization to perform the audit activities such as testing of internal controls, compliance work and evaluating risk management processes. CAEs noted that the IAF’s work revolves around IT, business aspects incorporating operational, and compliance issues with a trend towards risk management activities. Mugwe (2012) in her research to establish the relationship between the independence and objectivity of the internal audit function and Earnings per share (EPS) in 26 listed companies in NSE found that when internal auditors are involved in enterprise risk management there is loss of internal auditors perceived objectivity and this could affect profitability.

2.2.3 Internal Auditor’s Competencies in Fraud Detection

Internal auditors play an important role in fraud detection as many frauds are identified by the internal audit function (KPMG, 2003). Coram et al. (2008) found that organizations with competent internal audit staff were more likely than those without to detect and report occurrences of fraud. They further added that the number and magnitude of errors requiring adjustment by the external auditors were substantially lower for entities that had competent
internal audit department. Although it is not the duty of the internal auditor to detect fraud he/she should be knowledgeable enough to understand the operations of the organization which would assist in fraud detection and the audit tests to carry out. Mutua (2012) in her studies of the relationship between risk based auditing and financial performance observed that the internal auditing staffing should be enhanced to allow timely detection of fraud risks and concentrate on high-risk areas, which would increase transparency and accountability, hence enhancing financial performance.

The Treadway Commission’s Report (1987) noted that since internal auditors have in-depth knowledge of most aspects of a company’s operations, they could be highly effective in detecting fraudulent financial reporting. Internal auditors play a vital role in preventing fraudulent financial reporting and reducing the significant costs associated with such activities (Church et al., 1998). Arena and Azzone (2013) found that the effectiveness of internal auditing is influenced by the characteristics of the internal audit team, the audit processes and the organizational structure.

Church et al. (1998) in their studies further showed that internal auditors’ consideration of fraud to explain fluctuations in receivables is affected by firm-specific characteristics, including inherent risk and control risk. A further study by Church et al. (2001) demonstrated that internal auditors were sensitive to factors that may lead to fraudulent financial reporting. When they encounter such factors, internal auditors may be more likely to design tests to search for fraud, which in turn can increase the likelihood of detection. Beasley et al. (2000) found in a study of fraud in companies, that the existence of an internal audit department was less common among fraud companies than non-fraud ones. Kamere (2013) in his studies on challenges faced in professionalizing the internal audit function in listed industrial and Allied companies in Kenya noted where senior management had no regard to the role of the internal audit there was incompetency and lack of performance in the IAF. Kirima (2016) noted an internal auditor’s effectiveness is measured by the ability to gather sufficient and appropriate audit evidence in order to give reasonable opinion regarding the financial statement’s compliance with generally accepted accounting principles.

2.2.4 Internal Audit Competencies in Evaluation of Controls

An effective internal control system is indicated by an adequate assessment of earnings quality and reliable financial results (Costello & Wittenberg-Moerman, 2011). A strong
internal control system is an indication of operational efficiency in the firm, which is key contributor of good financial performance. Internal auditors have a responsibility to provide independent assurance about effectiveness of internal controls to the board and top management and provide advice on internal controls to the board and top management (COSO, 2013). Effective internal controls reduce cases of fraud, embezzlement and cash mismanagement hence supplementing on the level of profits in the company.

Information on the strengths and weaknesses of the control system, recommendations for improvements, are communicated in informal and formal internal audit reports. Any internal control deficiencies deemed to be material weaknesses would result in the company publicly providing an adverse conclusion on the internal control framework (Lin et al., 2011). Adverse conclusions on the strength of the internal control system have significant consequences for companies, including less favorable lending decisions (Schneider and Church, 2008), adverse stock market reactions and increased costs of equity (Hammersley et al., 2008).

In Malaysia, Fadzil et al. (2005) found that internal auditors’ professional proficiency significantly affects the monitoring aspect of the internal control system. Oussii and Taktak, (2018) based on a sample of 59 Tunisian listed companies, found that the internal control quality is significantly and positively associated with IAF competence, internal audit quality control assurance level, follow-up process and audit committee’s involvement in reviewing the internal audit program and results. Professional bodies consider that the IAF attributes and activities tend to enhance the internal control system quality. Pizzini et al. (2015) posited that CAE reporting relationship to the audit committee is associated with reductions in audit report lag by helping senior management maintain a strong system of internal control over financial reporting. They found that the negative relation between IAF quality and audit delay is driven by the competence of internal audit staff. They added that internal auditors’ higher technical competence could enhance IAF effectiveness and reduce the likelihood of severe internal control deficiencies. Nawhera (2012) in his study on internal audit function and financial performance of NSSF in Uganda found that internal audit function had a significant positive effect on performance in relation to control environment evaluation, risk assessment, monitoring and advisory services. Mugo (2013) in her studies to establish the relationship between internal control systems and financial performance in Technical Training Institutions in Kenya found that management is committed to monitoring and supervision of internal controls in the institutions. Top-level
management initiated all the activities of the institutions, the internal audit departments were ineffective, under staffed, and had very few reports to address weaknesses in the system.

2.3 Internal Audit Independence and Financial Performance
The study reviews previous studies based on the internal audit reporting structure, the organizational independence and the internal audit reports and their influence on the financial performance of companies.

2.3.1 Reporting Structure of Internal Auditor
Reporting structure involves the relationship between the senior management and the internal auditor, an internal auditor being an employee of the company. The International Standards for Auditing (IIA, 2004) clearly defines that the CAE should report to a level within the organization that allows the internal audit function to accomplish its activities. The chief audit executive should report administratively to the Chief Executive Officer (CEO) of the company and functionally to the audit committee. From the standard reporting functionally entails that the audit committee should; approve the internal audit charter and the internal audit risk assessment plan; have direct communications with the CAE on the results of internal audit activities; approve decisions regarding the appointment or removal, remuneration and annual performance review of the CAE; make appropriate inquiries of management and the CAE to determine whether scope or budgetary limitations exist that might affect the internal audit responsibilities. Mihret and Yismaw (2007) in their study of internal audit effectiveness in Ethiopian public sector noted effectiveness is affected by quality in the internal audit function and the management support.

Sarens and De Beelde (2006) explored the expectations and perceptions of both senior management and internal auditors found that, when internal audit operates from management support role, there is lack of perceived objectivity and the relationship with the audit committee is weak. Chambers (2014) recommended the primary reporting line for the CAE should be to the chairperson of the audit committee. In exceptional circumstances, the board may wish for internal audit to report directly to the chairperson of the board or delegate responsibility for the reporting line to the chairperson of the board risk committee, provided the chairperson of the board risk committee and all the other committee members are independent non-executive directors. He further suggested in circumstances where the CAE has secondary reporting line, this should be to the CEO in order to preserve
independence from any particular business area or function and to establish the standing of internal audit alongside Executive Committee members.

According to Sarens et al. (2009), reported that the reporting lines of IAF to the audit committee are critical to internal audit effectiveness. Lin et al. (2011) noted that an objective IAF is less likely to be influenced by management in evaluating controls and reporting internal control problems to the audit committee. In a related study, Bedard and Graham (2011) found that an auditor could be better at detecting severe internal control weaknesses when he reports directly to the audit committee rather than to senior management. Hansen (1997) suggests that independent internal audit function, in regard to reporting level, creates an improved control environment and minimizes reporting errors in financial statements.

2.3.2 Organizational Independence

According to Bett (2014), internal auditors are charged with upholding the best interests of their employer, but they may be reluctant to counter management, regardless of the consequences. Organizational independence is more crucial to the effectiveness of internal auditors, as it protects the auditor from pressure or intimidation, and increases the objectivity of the auditing work. Christopher et al (2009), noted that management control structures are put in place to achieve control and compliance requirements. One important component of the management control structure is the internal audit function, which is used by the board and management to fulfil responsibilities in line with social expectations.

Management has a strong influence in setting the overall tone for governance. Senior management influence the operations, board of directors and the internal audit function (Claybrook, 2004). Sarens and De Beelde (2006) found that management requires the internal audit function to take on an extended role to compensate for loss of control resulting from increased organizational complexity. Drent (2002) noted that most senior management expect internal auditors to work for them and reporting to the audit committee is viewed as a formality to satisfy corporate governance requirements. The dilemma comes with the argument that the internal audit function must add value to management, while at the same time not become its servant, and faithfully report on the status to the board (Van Gansberghe, 2005).

Chapman (2001) argued that the main purpose of the internal auditor is objectivity, which could only be achieved if the internal audit function is appropriately positioned in the
organizational structure. He further suggested that the internal audit function should be free to determine its audit scope free from interference. Bariff (2003) affirmed that internal audit function independence is enhanced by positioning in a way that they are able to operate on strategic issues. Alzeban and Gwilliam (2014) observed the interaction and relationship between senior management and internal auditors and the internal audit function is both important and complex. Senior management have an influence on the resources allocated to the internal audit function, which may critically affect the internal audit plan, and the functions (Christopher et al., 2009).

According to Mzenzi and Gaspar (2015), noted that the internal audit function is employed in the organization to ensure accountability and there are no material misstatements in the financial statements. They further suggested that the audit function should remain autonomous in the organization structure. This means there is indirect ability of management to influence the career prospects of internal auditors, as well as the budget and planning of the internal audit function. Van Peursem (2005) observed that internal audits done in a close environment with senior management were at a risk of lack of independence from the management influence. She further suggested that the internal auditors must be careful to avoid conflict of interest of their managers and their profession.

Leung et al. (2004) studied the role of internal audit in corporate governance and management in Australia using both an on-line survey and in-depth interviews of CAEs. They found that the majority of CAEs had reporting responsibilities to the audit committee and 22% of participants reported only to management. Njeru (2013) in his studies on the effect of internal audit independence on corporate governance in commercial banks in Kenya found that there is a threat of internal auditor independence since the CEO’s of some of the banks have a say on the internal audit budget, recruitment, termination and the remuneration of the CAE.

Cohen, Krishnamoorthy and Wright, (2008) found that the management influence on the internal auditors’ work affects their objectivity in reporting and may result in improper revenue recognition, overstated purchase costs of assets and other cash impropriety which affects the organization’s overview. (Mutchler et al., 2001) identified a number of threats to the objectivity of the internal auditors’ one of them being economic interest, resulting from incentive payments or from auditing the work of someone who has the power to affect the internal auditor’s employment or salary. According to Stewart and Subramaniam (2010)
there has been little research that has examined the impact of reporting more to senior management such as the CEO and the effect on independence and objectivity of internal auditors.

2.3.3 Internal Audit Reports

This is a detailed documentation of the internal control lapses and the recommendations by the internal auditors given to management in order to address the control lapses in their area of authority. The reports could be monthly, quarterly or annually depending on the approved internal audit plan. Internal audit report provides recommendations to improve controls and correct deficiencies. According to Dandago and Suleiman (2005), both external and internal auditors are expected to express professional opinion on the financial statement(s) vouched or examined as guided by statutory regulations and professional requirement in discharging their duties. Modibbo (2015) observed that an internal auditor is charged with the responsibility of safeguarding the assets of an organization and provide other duties that will enhance the efficiency and effectiveness of the operations of the organization, through the review of accounting systems, internal control systems and implementation of the corporate policies. Mutai (2011) observed that the internal auditors should be aware of irregularities and report to the management in the audit reports before the external auditor.

In their report, Ernst and Young (2007) noted that the top two measures of IAF effectiveness are the completion of audits in comparison to an internal audit (IA) plan, and the length of time for issuing IA reports. The survey findings suggested that to demonstrate the value and relevance of the IAF, value tracking in terms of cost and revenue benefits should be used as a mechanism to measure the IAF’s support of key business initiatives. Their results indicated that 51 percent of respondents do not perform any value tracking of the IAF, and only 13 percent measure the value of the function based on actual cost savings. Archambeault et al. (2008) noted that an internal audit report has potential to complement existing governance disclosures, increases stakeholders’ confidence in governance quality and financial reporting reliability. Asare et al. (2008) found that internal auditors are sensitive to management’s incentive to misreport financial information and, may be forced to work extra hours when management has a high incentive to misreport.
2.4 Role of Audit Committees and Financial Performance

Audit committees (AC) influence financial performance through its independence, composition and expertise in review of the quality of the financial statements of the company. According to the Chartered Institute of Internal Auditors (CIIA, 2013) Board audit committee, should manage the internal audit function in ways that preserve and enhance internal audit's independence and objectivity. A fully functional audit committee should have a greater likelihood of detecting problems in the organization than a dormant one (Choi et al., 2004). They further added that a board with financial and accounting expertise would unlock the earnings of the company. Financial reporting improprieties and business failures in companies such as the Enron, WorldCom and Adelphia have brought audit committees of corporate boards of directors under increased scrutiny. This was after a collapse of the companies that were built upon weak financial foundations and fraudulent financial reporting, staff and investors losing retirement savings and investments, and resulting bankruptcy (Strategic Direction, 2003).

2.4.1 Composition of the Audit Committees

Best practices suggest that the audit committee should include at least three members to provide the necessary expertise for the oversight function (Cadbury Committee, 1992; BRC, 1999; KPMG, 1999). Persons who are not part of the executive board of the company form audit committees. Al-Thuneibat, (2006) defined the audit committee as a group of persons composed of non-executive directors of the company. CBK Guidelines (2013) indicates audit committee shall comprise only non-executive directors with at least three members chaired by an independent director and one member should at least have accounting expertise or experience in the field of finance and be a member of the Institute of Certified Public Accountants of Kenya (ICPAK). The guidelines further note that the committee is tasked with independent evaluation of the financial reporting, ensure adequate internal controls and to recommend timely appropriate action. The audit committee is expected to continuously review of the corporation’s financial data, ensure appropriate accounting policies, and promote high quality and timely financial statements.

Archambeault and Dezoort (2008) found that companies, who had suspicious switches of external auditors, were the ones who had fewer audit committee members with experience in accounting, auditing or finance than their non-switching counterparts. The size of the audit committee and the resources allocated to the IAF would oversee financial reporting and internal control systems within a firm hence high performance (Anderson et al, 2004.).
They further indicated that firms with smaller board could give the CEO a better-disciplined approach in case of poor performance and was associated with higher market valuation. Sharma et al. (2009) found a negative effect on the AC meetings where the members had multiple directorships, audit committee independence and an independent AC chair. They found a positive association between the higher risk of financial misreporting and AC size, institutional and managerial ownership, financial expertise and independence of the board. This implied then that the number of AC members and meetings had an impact on the performance of the firm.

Gender diversity in the audit committees was associated with financial performance (Carter et al., 2008), reduction in the inherent risk (Ittonen et al., 2007), increased positive reaction from investors (De fond et al., 2005), and the business profitability (Huang et al., 2011). The authors suggested that women were less likely to have attendance problems, and this encouraged the men directors to attend the meetings. Bear et al (2010) further added that increasing membership of female directors in the audit committee positively associated enhanced corporate reputation and therefore high firm performance.

2.4.2 Independence of the Audit Committees

Independence of the audit committees is a key determinant of the effectiveness of the internal audit functions. Zulkamain and Shamsher (2001) noted that the independence of an audit committee is very important in ensuring that the board effectively fulfils its oversight role and holds management accountable to the shareholders. Krishnan (2005) found that there is a positive relationship between audit committee independence and the quality of internal audit reports. Alzeban (2015) in his studies on the expertise of internal audit committees found that quality in financial reporting is influenced by audit committee independence and auditing expertise.

Presence of audit committees creates a perception of enhanced independence of the internal audit function, and more reliable financial reporting among financial statement users. Alzeban and Gwilliam (2014) observed that audit committees may strengthen internal auditors’ status and in turn their ability to remain objective and independent. Turley and Zaman (2007) observed from their studies in the UK financial services company that an audit committee plays a big role on how the internal audit function implements its responsibilities in the organization. Audit committees serve as a potential support of internal audit function. Goodwin (2003) observed that an effective audit committee can
strengthen the internal audit function by acting as an independent forum where internal auditors may report issues affecting management. This independence is further enhanced through accessibility of the audit committee to the internal auditors. James (2003) found that internal audit functions that report to senior management are perceived as less able to prevent financial statements fraud in banks than those reporting only to the audit committee.

Audit committees are viewed as a key safeguard mechanism for internal auditors in managing their professional independence. According to Gramling et al. (2004), a good relationship between the internal auditors and the audit committee gives a good environment and support system to carry out its activities such as risk assessment, control assurance and compliance work. According to Chambers (2014), on the guidance to internal audit, he recommended that the audit committee appoints and removes the CAE and approves the internal audit budget; and that the chairperson of the audit committee sets the CAE’s objectives. Abbott et al. (2004) noted that firms with audit committees, which are composed of independent directors and meet at least twice per year, are less likely to be accused of fraudulent or misleading reporting. They further added that audit committee independence affects companies’ earnings, management and the investors’ perceptions.

2.4.3 Audit Committee Support to the Internal Audit
Abbott et al. (2010) explored the relationship between audit committee involvement and the resources accorded to the IAF through a survey targeting the CAEs of 1,000 companies. The results indicated that audit committees with greater oversight allocated more hours to the IAF than those with less. They also showed substantial variations in IAF budgets and the allocation of those budgets to particular activities, revealing that while the major portion of IAF budgets is directed to internal controls activities, a significant amount is devoted to non-controls activities. Mat Zain et al. (2006) in a study of CAEs of 76 publicly listed Malaysian firms on the relationship between the characteristics of audit committees and IAFs, and the assessment of the internal auditors of their own contribution to audits of financial statements. They found a positive correlation between internal auditors’ assessment of their contribution to financial audits and audit committee characteristics. They identified the characteristics of audit committees as the independence of audit committee members, members’ financial knowledge and experience, the degree of review of the IAF’s work program and budget and characteristics of the IAF itself.
2.4.4 Financial Expertise of the Members of Audit Committee

When preparing financial statements on behalf of companies, certain financial estimates must be made. Consequently, the possession of industry and financial expertise would assist audit committees in their appreciation and evaluation of industry issues (CIFR, 2008). According to the Blue-Ribbon Committee (BRC)'s (1999), recommendations, each audit committee should have at least, one financial expert. It further outlines the importance of the financial knowledge and expertise of audit committee members. According to Carcello and Neal (2000) audit committee plays a big role in monitoring of the quality of financial reporting and corporate governance due to the potential litigation risk they face in executing their duties. To measure quality of the audit committee, there is a need to look at the financial competence of the members. Raghunandan et al. (2001) found that independent committees with at least one member with accounting or finance expertise had longer meetings and more private meetings with the CAE.

De Fond et al (2005) defined the measures of financial competence in two categories; accounting financial expert and non-financial accountant. An accounting expert defined as an experienced certified public accountant, auditor, chief financial officer, controller while non-financial accountant who is chief executive officer, president, or chairman of the board, with experience as the managing director, principal in venture financing, investment banking, or money management. Financial expertise assists in dealing with the complexities of financial reporting and reduces the need for restatement of financial statements (Abbott et al., 2004). De Zoort and Salterio (2001) added that audit committee members with financial reporting and audit knowledge are more likely to understand audit judgments and estimates. They are more likely to arrest material misstatement in the financial accounts. Krishnan (2005) notes that audit committees with financial expertise are less likely to be associated with internal control lapses.

According to De Zoort and Salterio (2001), all audit committee members should have the ability to interpret the financial statements, audit judgements and address material misstatements. Baxter and Cotter (2009) observed that independence of an audit committee is considered important feature in influencing the committee's efficiency in managing the process of financial reporting. They further suggested that audit committee with high level of training in accounts usually has significant impact on returns on equity and return on asset and hence organizational performance. Qin (2007) adds that companies with higher earnings are more associated with audit committee members who have accounts training.
Davidson et al. (2005) found a significant positive stock price reaction when new members of audit committees have financial expertise. Abbott et al. (2004) noted that audit committee financial expertise is significantly and positively associated with audit fees. Zhang et al (2006) observed firms are more likely to be identified with an internal control weakness, if their audit committees have less financial expertise, more specifically, have less accounting financial expertise and non-accounting financial expertise.

Cohen et al. (2014) considered the influence of industry expertise on the audit committee’s ability to monitor the financial reporting. Alzeban (2015) investigated the role played by both industry and audit expertise within the audit committees and how they affect the internal audit function. His studies revealed that audit committees with members who are both industry and auditing experts consistently have more influence on the internal audit function than those with auditing experts alone. Gacheru (2014) studied the effectiveness of the board audit committees’ variables on the financial performance in commercial banks in Kenya. He examined the structural and operational characteristics of the boards in 43 banks and observed a significant positive correlation between percentage of AC members with financial expertise and ROE; changes in the AC membership do not affect ROE and the attendance rate for AC meetings has a significant positive correlation with ROE.

2.5 Chapter Summary

The chapter has reviewed existing literature based on the research objectives. It has covered the competency of the internal auditors, the independence of the internal auditors and the audit committees’ role. The next chapter will look at the research methodologies that shall be used in conducting the research.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter looks at the research design, population and sampling design, sampling frame, sampling technique, sample size, data collection methods, research procedures and data analysis methods. The researcher intends to use the methods in the collection of data for the study. This study will collect information from various members of listed commercial Banks in the NSE that are based in Kenya in an effort to understanding how internal audit function influences the financial performance.

3.2 Research Design
Research design refers to the method used to carry out the research (Mugenda & Mugenda, 2003). The research adopted a descriptive research technique to assess the effect of the internal auditors’ competencies, the independence of the internal audit function and the role of the audit committees on the financial performance of the companies using the questionnaires. A descriptive research attempts to give explanation to phenomena by describing the characteristics and their nature (Mugenda & Mugenda, 2003). The study collected both qualitative and quantitative data. Qualitative data was collected from the questionnaires, which were filled by the respondents from the eleven listed commercial banks. The quantitative data was collected from the supervisory reports in the CBK website. Correlation research approach was adopted to investigate the relationship between the role of the internal audit function and financial performance of the listed commercial banks. The approach assisted in determining whether there is a significant relationship between the two variables or not.

3.3 Population and Sampling Design

3.3.1 Population
Population is the collection of all individuals or items under consideration in a statistical study (Weis, 2012). A population is also defined as a list of objects under a study from which a sample is selected (Mugenda & Mugenda 2003). The study adopted a census survey where all the 11 listed commercial banks operating Kenya were involved. The focus of the study was the Internal Audit Department, the audit committees and the financial department of these companies. The population of the study was 140 respondents who are
internal auditors, senior internal audit managers, Heads of Internal Audit, Finance managers, Risk and Compliance managers and members of the audit committees.

3.3.2 Sampling Design

Sample design refers to the process involved in obtaining or the selection of the correct sample size for the study. According to (Saunders, Lewis & Thornhill, 2016), sampling design is a procedure that ensures the data collected is representative of the population of study. The sampling frame, sampling technique and sample size, all make up the sample design.

3.3.2.1 Sampling Frame

Sampling frame refers to the list of items in which a representative sample is chosen for conducting a study (Kombo & Tromp, 2006). The research was conducted in eleven banks that are listed in the NSE which are licensed by the Central Bank of Kenya. These banks are Kenya Commercial Bank, CFC Stanbic Bank Ltd., Diamond Trust Bank Kenya Ltd., Housing Finance Ltd, Equity Bank Ltd., Co-operative Bank of Kenya Ltd., National Bank of Kenya, I & M Bank, Standard Chartered Bank, Barclays Bank of Kenya and NIC bank.

3.3.2.2 Sampling Technique

Sampling technique is the methodology that is used to pick the sample from a larger population (Kothari, 2004). The research used purposive sampling to pick the sample of the respondents. Purposive sampling is a form of non-probability sampling technique used when one is studying a specific population with defined characteristics (Saunders, Lewis & Thornhill, 2016). It is judgmental in nature and the research will select the chosen respondents based on their knowledge, experience and interaction with the internal audit function.

3.3.2.3 Sample Size

According to Kothari (2004), sample size refers to the number of items selected from a population, which should be neither too large or too small, it should be representative. The sample size is the smaller representation of the main population. Given a margin of error (e) of 5%, at 95% confidence level and a population (N) of 140, the sample size (n) was given by use of the Yamane’s formula;
\[
n = \frac{N}{1 + (Ne)^2}
\]

\[
n = \frac{140}{1 + 140(0.05)^2}
\]

\[
n = 104
\]

Therefore, this implies the data was collected from a sample of 104 respondents which is the sample size obtained from the formulae.

**Table 3.1: Sample Size Distribution**

<table>
<thead>
<tr>
<th>Bank</th>
<th>Sampled population</th>
<th>Sample Proportion</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Bank</td>
<td>14</td>
<td>0.1</td>
<td>10</td>
</tr>
<tr>
<td>Co-operative Bank</td>
<td>14</td>
<td>0.1</td>
<td>10</td>
</tr>
<tr>
<td>Kenya Commercial Bank</td>
<td>14</td>
<td>0.1</td>
<td>10</td>
</tr>
<tr>
<td>NIC Bank</td>
<td>10</td>
<td>0.07</td>
<td>8</td>
</tr>
<tr>
<td>HF Group</td>
<td>11</td>
<td>0.08</td>
<td>10</td>
</tr>
<tr>
<td>National Bank</td>
<td>12</td>
<td>0.09</td>
<td>9</td>
</tr>
<tr>
<td>CFC Stanbic</td>
<td>13</td>
<td>0.09</td>
<td>9</td>
</tr>
<tr>
<td>Standard Chartered Bank</td>
<td>13</td>
<td>0.09</td>
<td>10</td>
</tr>
<tr>
<td>Barclays Bank</td>
<td>13</td>
<td>0.09</td>
<td>10</td>
</tr>
<tr>
<td>Diamond Trust Bank</td>
<td>13</td>
<td>0.09</td>
<td>9</td>
</tr>
<tr>
<td>I &amp; M Bank</td>
<td>13</td>
<td>0.09</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>140</td>
<td>1</td>
<td>104</td>
</tr>
</tbody>
</table>

**3.4 Data Collection Methods**

Questionnaires were used to obtain important information about the population. The questionnaire was divided into four main parts. Section A sought to gather general information of the population. Section B sought to establish the effect of the internal auditors’ competencies financial performance. Section C sought to establish the role of internal audit independence on financial independence. Finally, section D sought the effect of the audit committees on financial performance of the banks. The questionnaires will be structured questionnaires on 5-point Likert scale measurements.
Ngechu (2004) posited that there are many methods used in data collection. The study used both primary and secondary data. Primary data is the information the researcher obtained from the questionnaires. The questionnaires were used because they allow the respondents to give their responses in a free environment as compared to using interviews. Secondary data was collected from the websites of these commercial banks on the published financial information.

3.5 Research Procedures

The research started by developing a research proposal, which was approved by the supervisor. After the approval, the questionnaire was developed for distribution to the respondents. A pilot study was conducted by the researcher taking some questionnaires to some staff in one of the commercial banks. The respondents were selected at random. Pilot testing enables a researcher to tell the areas of weakness that may require corrections and to select the best sample of the respondents (Cooper & Schindler, 2003). From the pilot study, the researcher was able to detect questions that require editing and those that were ambiguous. The final questionnaire was then printed after corrections and used to collect data for analysis. The respondents were sent the questionnaire on email and in four banks; the questionnaire was printed and delivered to the respondents. The questionnaire took 5 minutes to fill and the emails were received immediately after filling. In the four banks it was delivered, it was collected immediately after filling. All the duly filled questionnaires were considered in the study.

3.6 Data Analysis Methods

The study used both qualitative and quantitative methods of data analysis. The data was edited, tabulated and entered in the spreadsheets for analysis. The research used Statistical Package for the Social Science (SPSS Version 24.0) computer application package and Microsoft Excel to analyze data collected from the study. The quantitative techniques used were the descriptive statistics, which include the mean and standard deviation. The data was represented using tables and figures. The study used correlational studies and regression equations for analysis. Correlation analysis was used to investigate the significance of the relationship of the variables. Multiple regression was used to establish the relationship of the variables. The equation was as follows:

\[ Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \varepsilon \]

Where;
Y is the financial performance of the bank measured by Return on Equity (ROE);
β0 is the regression constant;
β1, β2 and β3 are the coefficients of independent variables;
X1 is Internal Auditor’s competencies;
X2 is Internal Auditor’s independence;
X3 is Audit committees; and
ε is the error term.

3.7 Chapter Summary
This chapter covered the research design, the population and sampling design, data collection and research procedures and data analysis that were used in the research. The next chapter will look at the results obtained from the data collected. The results will be interpreted using the descriptive statistics and multiple regression equation will be used to explain the relationship of the variables.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
The chapter presents the data collected from the field on the research problem and the analysis. The study sought to find the role of the internal audit function on the financial performance of the listed commercial banks in Kenya. Data was collected using self-administered questionnaires. The instrument was created in agreement with the objectives of the research.

4.1.1 Response Rate
Questionnaires were prepared and sent to 104 respondents. 77 questionnaires were filled and returned representing 74% response rate. This response rate was sufficient for information analysis and fits in with Mugenda and Mugenda (2003) stipulation that a response rate of 70% and above is viewed as satisfactory.

![Response Rate Pie Chart]

Figure 4.1: Response Rate

4.2 General Information
The data was gathered using questionnaires to the 11 listed commercial banks. The findings are presented in percentages and frequency distributions, mean and standard deviations. Inferential statistics such as correlation and regression analysis was conducted to establish
the relationship of the study variables. The following subsections further discuss the general information of the respondents and how they respondents to the main questionnaire.

4.2.1 Educational Level

The respondents were required to indicate their highest level of education acquired. From the findings 53% of the respondent’s degree as their highest education level, 40% had Masters while 7% had Diplomas. This is an indication that majority of the respondents had a clear understanding of the role of the internal audit function in the organization. The Figure 4.2 shows the findings.

![Educational Level](image)

**Figure 4.2: Educational Level**

4.2.2 Professional Certification

The research sought to understand the respondent’s relevant professional certification they had achieved. From the findings, 55% of the respondents had CPA, 17% had both CPA and CIA, 16% had CPA and CISA, 8% had other qualifications such as AKIB, CCP and ACII while only 1% had CFA. This was an indication that most of the respondents had the basic professional qualifications of auditing. The findings are presented in Figure 4.3.
Figure 4.3: Professional Certification

4.2.3 Working Experience

The study investigated work experience for the respondents in the listed commercial banks in the NSE and the findings obtained are shown in Figure below. It is clear that most the respondents amounting to 43% had worked for the banks a period of between 1-5 years, followed by 23% of those who had worked for less than 5 years, then 14% of between 11-15 years, between 16-20 years was 12% and over 20 years was 7%. This shows that a dominant group of the respondents had worked in commercial banks for 1-5 years. This further implies that a large percentage of employees who have worked for a duration of between years 1-5. The Figure 4.4 indicates the findings of the study on work experience.

Figure 4.4: Working Experience
4.2.4 Job Designation

The researcher sought to understand the job designation of the respondents in the commercial banks. The findings indicate that majority of the respondents were senior managers internal audit with representations of 26%, this was followed by 23% who were finance department staff, 20% were internal auditors, 15% were others and this could be been risk and compliance staff, heads of credit and accounts assistants, 11% were heads of internal audit while on the last one was represented by 5% was from audit committee. The Figure 4.5 shows the summary of the respondent’s job designation.

Figure 4.5: Job Designation

4.3 Internal Auditor’s Competence and Financial Performance

4.3.1 Role of Internal Auditor’s Competencies

The study sought to understand the role of internal auditors’ competencies. The first question was if the educational, professional and technical competence of the internal auditor affects the quality audit department performance where the respondents indicated moderated agreement by 5%, agreed by 49% and strongly agreed with a representation of 46%, a mean of 1.600 and standard deviation of 0.591 was reported. Low education and less competent staff affect knowledge on auditing techniques which impacts on the internal audit function and organization performance in which most of the employees agreed by 38%, strongly agreed by 57% and only 5% moderately agreed, a mean of 1.600 and standard deviation of 0.591 was reported. The respondents also agreed that training of internal auditors enhance their skills in risk assessment, fraud detection and evaluation of
controls which contributes to the performance of the organization where they were represented 3% as moderately agreed, 52% as agreed and 46% as strongly agreed a mean of 1.570 and standard deviation 0.548 was realized. The Table 4.1 indicates the summary of the role of the internal auditors’ competencies.

**Table 4.1: Role of Internal Auditor's Competencies**

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The educational, professional and technical competence of the internal auditor affects the quality audit department performance</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>49%</td>
<td>46%</td>
<td>1.600</td>
<td>0.591</td>
</tr>
<tr>
<td>Low education and less competent staff affect knowledge on auditing techniques which impacts on the internal audit function and organization performance</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>38%</td>
<td>57%</td>
<td>1.600</td>
<td>0.591</td>
</tr>
<tr>
<td>Training of internal auditors enhance their skills in risk assessment, fraud detection and evaluation of controls which contributes to the performance of the organization</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
<td>52%</td>
<td>46%</td>
<td>1.570</td>
<td>0.548</td>
</tr>
</tbody>
</table>

**4.3.2 Internal Auditor’s Competence in Risk Assessment**

The researcher sought to understand the internal auditor's competence in risk assessment where the first question was if the internal audit department contributes to the risk assessment of the company a small percentage of the respondents indicate a moderately agreement by 20% while most agreed by 48% and strongly agreed 33%, a mean 1.480 and standard deviation of 0.598 was reported. On the last question was if risk assessment and planning in the organization contributes to the performance of the company only 13% of the respondents moderately agreed, 47% agreed and 40% strongly agreed a mean of 1.87 and standard deviation of 0.714. The Table 4.2 indicates the summary of the internal auditor’s competence in risk assessment.

**Table 4.2: Internal Auditor’s Competence in Risk Assessment**

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal audit department contributes to the risk assessment of the company</td>
<td>0%</td>
<td>0%</td>
<td>20%</td>
<td>48%</td>
<td>33%</td>
<td>1.480</td>
<td>0.598</td>
</tr>
<tr>
<td>Risk assessment and planning in the organization contributes to the performance of the company</td>
<td>0%</td>
<td>0%</td>
<td>13%</td>
<td>47%</td>
<td>40%</td>
<td>1.87</td>
<td>0.714</td>
</tr>
</tbody>
</table>
4.3.3 Internal Auditor’s Competence in Fraud Detection

The research sought to understand internal auditor’s competence in fraud detection. The respondents agreed that competency of an internal auditor helps them to evaluate the risk of fraud in the organization and how best its managed in which 8% indicated as moderately agreement, 39% as agreed and 53% of the respondents strongly agreed with the statement, a mean of 1.55 and standard deviation of 0.64 was reported. On the question was the competency in auditors helps in detection of fraud 7% of the respondents moderately agreed, 56% agreed, and 38% strongly agreed, a mean of 1.69 and standard deviation was 0.591 was realized. The last statement was if timely detection and reporting of frauds contribute to performance results of the company, 8% of the respondents moderately agreed, 55% agreed, and 38% strongly agreed, a mean of 1.7 and standard deviation of 0.608 was reported. The Table 4.3 indicates the summary of the internal auditor’s competence in fraud detection.

Table 4.3: Internal Auditor’s Competence in Fraud Detection

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competency of an internal auditor helps them to evaluate the risk</td>
<td>0%</td>
<td>0%</td>
<td>8%</td>
<td>39%</td>
<td>53%</td>
<td>1.55</td>
<td>0.64</td>
</tr>
<tr>
<td>of fraud in the organization and how best its managed in which</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8% indicated as moderately agreement, 39% as agreed and 53% of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>the respondents strongly agreed with the statement, a mean of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.55 and standard deviation of 0.64 was reported.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competency in auditors helps in detection of fraud 7% of the</td>
<td>0%</td>
<td>0%</td>
<td>7%</td>
<td>56%</td>
<td>38%</td>
<td>1.69</td>
<td>0.591</td>
</tr>
<tr>
<td>respondents moderately agreed, 56% agreed, and 38% strongly</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>agreed, a mean of 1.69 and standard deviation was 0.591 was</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>realized.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Timely detection and reporting of fraud contribue to performance</td>
<td>0%</td>
<td>0%</td>
<td>8%</td>
<td>55%</td>
<td>38%</td>
<td>1.7</td>
<td>0.608</td>
</tr>
<tr>
<td>results of the company 8% of the respondents moderately agreed,</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>55% agreed, and 38% strongly agreed, a mean of 1.7 and standard</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>deviation of 0.608 was reported.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.3.5 Internal Auditor’s Competence in Evaluation of Controls

The study sought to understand the internal auditor’s competence in evaluation of controls. The question on the internal auditors have the expertise to carry out an evaluation of internal controls of the company in which 3% of the respondents disagreed, 7% moderately agreed, 57% agreed, and 23% strongly agreed, a mean of 1.99 and standard deviation of 0.716. The question on the strong control systems ensure there is operational efficiency and hence profitability in which 8% moderately agree, 44% agreed, and 48% strongly agreed, a mean of 1.600 and standard deviation of 0.634. On the last question internal auditors’ objectivity in reporting control lapses influence the quality of financial statements in which 1% of the respondents disagreed, 17% moderately agreed, 47% agreed and lastly 35% strongly
agreed, a mean of 1.84 and standard deviation of 0.745 was reported. The Table 4.4 indicates the summary of the internal auditor’s competence in evaluation of controls.

Table 4.4: Internal Auditor’s Competence in Evaluation of Controls

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal auditors have the expertise to carry out an evaluation of internal controls of the company</td>
<td>0%</td>
<td>3%</td>
<td>17%</td>
<td>57%</td>
<td>23%</td>
<td>1.99</td>
<td>0.716</td>
</tr>
<tr>
<td>Strong control systems ensure there is operational efficiency and hence profitability</td>
<td>0%</td>
<td>0%</td>
<td>8%</td>
<td>44%</td>
<td>48%</td>
<td>1.6</td>
<td>0.634</td>
</tr>
<tr>
<td>Internal auditors’ objectivity in reporting control lapses influence the quality of financial statements</td>
<td>0%</td>
<td>1%</td>
<td>17%</td>
<td>47%</td>
<td>35%</td>
<td>1.84</td>
<td>0.745</td>
</tr>
</tbody>
</table>

4.3.6 Correlation Analysis

The Pearson Correlation analysis was used to test the strength of the association between variables. The task is one of quantifying the strength of the association and direction of the variables. As shown in Table 4.5, there was a positive relationship between financial performance and audit competencies. This implies that as these variables change either increase or decrease, financial performance changes in a similar direction. The results show that audit competencies had a strong and significant relationship with financial performance (p<0.05). This is indicated in the Table 4.5.

Table 4.5: Correlation between financial performance and Audit Competencies

<table>
<thead>
<tr>
<th></th>
<th>Financial Performance</th>
<th>Audit Competencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.000</td>
</tr>
<tr>
<td>N</td>
<td>77</td>
<td>77</td>
</tr>
<tr>
<td>Audit Competencies</td>
<td>Pearson Correlation</td>
<td>.632**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td>.000</td>
</tr>
<tr>
<td>N</td>
<td>77</td>
<td>77</td>
</tr>
</tbody>
</table>

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

The regression analysis was conducted to reveal the linearity of the relationship between the study dependent and the independent variables. The coefficient of determination R-Squared is 0.400. The value of R-square implies that 40.0 percent of the total variance of financial performance is explained by the model. This means that 60.0 percent of the total variance of financial performance cannot be explained by the model. Hence the results reveal that the audit competencies is one of the key determinant of financial performance among commercial banks listed in the NSE.

Table 4.6: Model Summary for Audit Competencies

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.632&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.400</td>
<td>.392</td>
<td>2.13460</td>
</tr>
</tbody>
</table>

<sup>a</sup>. Predictors: (Constant), Audit Competencies

An ANOVA was conducted at 5% level of significance. A comparison of F-calculated and F-critical is shown in the Table 4.7. From the findings, F-calculated is 49.976 and F (1, 75) is 3.968. Since the value of F Calculated is greater than F Critical, this indicates the overall regression was significant for the study. The p value p=0.00 is less than 0.05 an indication that the audit competencies significantly influence financial performance.

Table 4.7: ANOVA for Audit Competencies

<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>1</td>
<td>Regression</td>
<td>227.716</td>
<td>1</td>
<td>227.716</td>
<td>49.976</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>341.739</td>
<td>75</td>
<td>4.557</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>569.455</td>
<td>76</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup>. Dependent Variable: Financial Performance
<sup>b</sup>. Predictors: (Constant), Audit Competencies

The significance of audit competencies had p value (p=0.000) which is less than 0.05. The beta coefficient 0.623 is positive. Based on this finding, it can be deduced that audit competencies significantly influenced financial performance. It can further be deduced that
audit competencies positively influenced financial performance of the listed commercial banks in the NSE. From the findings the linear regression equation is as follows; Financial Performance = 6.005 + 0.623 Audit Competencies.

Table 4.8: Coefficient for Audit Competencies

<table>
<thead>
<tr>
<th>Coefficients^a</th>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td></td>
<td>6.005</td>
<td>1.132</td>
</tr>
<tr>
<td>Audit Competencies</td>
<td>.623</td>
<td>.088</td>
<td>.632</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance

4.4 Internal Audit Independence and Financial Performance

4.4.1 Reporting Structure of Internal Auditor

The study sought to understand the reporting structure of internal auditor in which most of the respondents agreed that internal auditors reporting to the senior management affect their quality of work and their contribution to the organization. Only 1% disagreed, 23% moderately agreed, 51% agreed who were the majority and lastly 25% strongly agreed a mean of 2.01 and standard deviation of 0.734 realized. The overdependence on management for allocation of resources to the internal audit function affect the audit work in which 13% of the respondents disagreed, 38% moderately agreed 39% agreed and 10% strongly agreed, a mean of 2.53 and standard deviation of 0.852 was reported.

The respondents also agreed that the internal audit operations are positioned strategically in a bid obtain cooperation from both management and staff within the bank where 4% disagreed, 48% moderately agreed, 34% of the respondents agreed, and 14% strongly agreed a mean of 2.42 and standard deviation of 0.784. On the last question the chief executive officer and chief financial officer of the bank have a say on the internal audit budget, recruitment, termination and the remuneration of the internal auditors where 17% of the respondents strongly disagreed, 29% disagreed, 25% moderately agreed, 29% agreed, and only 1% strongly agreed, a mean of 3.31 and standard deviation of 1.103 was reported. The Table 4.9 indicates the summary of the reporting structure of internal auditor.
### Table 4.9: Reporting Structure of Internal Auditor

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal auditors reporting to the senior management affect their quality of work and their contribution to the organization</td>
<td>0%</td>
<td>1%</td>
<td>23%</td>
<td>51%</td>
<td>25%</td>
<td>2.01</td>
<td>0.734</td>
</tr>
<tr>
<td>Overdependence on management for allocation of resources to the internal audit function affect the audit work</td>
<td>0%</td>
<td>13%</td>
<td>38%</td>
<td>39%</td>
<td>10%</td>
<td>2.53</td>
<td>0.852</td>
</tr>
<tr>
<td>The internal audit operations are positioned strategically in a bid obtain cooperation from both management and staff within the bank</td>
<td>0%</td>
<td>4%</td>
<td>48%</td>
<td>34%</td>
<td>14%</td>
<td>2.42</td>
<td>0.784</td>
</tr>
<tr>
<td>CEO and CFO of the bank have a say on the internal audit budget, recruitment, termination and the remuneration of the internal auditors</td>
<td>17%</td>
<td>29%</td>
<td>25%</td>
<td>29%</td>
<td>1%</td>
<td>3.31</td>
<td>1.103</td>
</tr>
</tbody>
</table>

#### 4.4.2 Organizational Independence

The study sought to understand organizational independence. The respondents indicated that organizational independence of the internal audit function is crucial in the effectiveness of the internal audit function. 10% moderately agreed, 35% agreed and 55% strongly agreed, a mean of 1.56 and standard deviation of 0.678 was reported. The management expectations of the duties of internal audit affects their objectivity hence their judgements could be biased where 1% of the respondents strongly disagreed, 17% disagreed, 35% moderately agreed, 36% agreed, 10% strongly agreed with the statement, a mean of 2.62 and standard deviation of 0.932. The last question in the section was if the internal auditors are likely to be influenced by management in evaluating controls and reporting internal control problems to the audit committee only 1% of the respondents strongly disagreed, 18% disagreed, 31% moderately agreed, 34% agreed, and 16% strongly agreed, a mean of 2.56 and standard deviation of 1.006 was reported. The Table 4.10 indicates the summary of the organizational independence of the internal audit.
Table 4.10: Organizational Independence of the Internal Audit

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizational independence of the internal audit function</td>
<td>0%</td>
<td>0%</td>
<td>10%</td>
<td>35%</td>
<td>55%</td>
<td>1.56</td>
<td>0.678</td>
</tr>
<tr>
<td>Management expectations of the duties of internal audit affects their objectivity hence their judgements could be biased</td>
<td>1%</td>
<td>17%</td>
<td>35%</td>
<td>36%</td>
<td>10%</td>
<td>2.62</td>
<td>0.932</td>
</tr>
<tr>
<td>Internal auditors are likely to be influenced by management in evaluating controls and reporting internal control problems to the audit committee</td>
<td>1%</td>
<td>18%</td>
<td>31%</td>
<td>34%</td>
<td>16%</td>
<td>2.56</td>
<td>1.006</td>
</tr>
</tbody>
</table>

4.4.3 Internal Audit Reports

The study sought to understand the internal audit reports. The question on the audit reports are comprehensive, clearly conveyed, reasonable and implementation of the recommendations leads to control improvements and improvements in efficiency where 20% of the respondents moderately agreed 53% agreed, 27% strongly agreed, a mean of 1.92 and standard deviation of 0.684 was reported. The respondents indicated that internal audit reports tracking is cost effective and add value to the organization where 8% disagreed, 25% moderately agreed, 34% agreed and 34% strongly agreed, a mean of 2.06 and standard deviation of 0.951 was realized. The last question in the section respondents indicated that audit reports are timely given, and recommendations are implemented to arrest control lapses where 3% disagreed, 14% moderately agreed, 49% agreed and 34% strongly agree, a mean of 1.86 and standard deviation of 0.756 was reported. The Table 4.11 indicates the summary of the findings on the internal audit reports.
Table 4.11: Internal Audit Reports

<table>
<thead>
<tr>
<th>Audit reports are comprehensive, clearly conveyed, reasonable and implementation of the recommendations leads to control improvements and improvements in efficiency. Internal audit reports tracking is cost effective and add value to the organization. Audit reports are timely given, and recommendations are implemented to arrest control lapses</th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>0% 0% 20% 53% 27%</td>
<td>1.92</td>
<td>0.684</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0% 8% 25% 34% 34%</td>
<td>2.06</td>
<td>0.951</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0% 3% 14% 49% 34%</td>
<td>1.86</td>
<td>0.756</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.4.4 Correlation between Financial Performance and Audit Independence

There was a positive relationship between financial performance and audit independence. This implies that as these variables change either increase or decrease, financial performance changes in a similar direction. The results show that audit independence had a strong and significant relationship with financial performance (p<0.05). This is indicated in the Table 4.12.

Table 4.12: Correlation between Financial Performance and Audit Independence

| Correlations |
|---|---|---|
| Financial Performance | Audit Independence |
| Pearson Correlation | 1 | .560** |
| Sig. (2-tailed) | .000 | 77 |
| N | 77 | 77 |

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

4.4.7 Regression Analysis

The coefficient of determination which is R-Squared is 0.313. The value of R-square implies that 31.3 percent of the total variance of financial performance is explained by the model. This means that 68.7 percent of the total variance of financial performance cannot
be explained by the model. Hence the results reveal that the audit independence is one of
the key determinants of financial performance among commercial banks listed in the NSE.

Table 4.13: Model Summary for Audit Independence

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.560&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.313</td>
<td>.304</td>
<td>2.28334</td>
</tr>
</tbody>
</table>

<sup>a</sup> Predictors: (Constant), Audit Independence

Analysis of variance was conducted at 5% level of significance. A comparison of F-calculated and F-critical is shown in the Table 4.14. From the findings, F-calculated is 34.224 and F (1, 75) is 3.968. Since the value of F-calculated is greater than F-critical, this indicates the overall regression was significant for the study. The p value p=0.00 is less than 0.05 indicating that the audit independence significantly influences financial performance.

Table 4.14: ANOVA for Audit Independence

<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>1</td>
<td>Regression</td>
<td>1</td>
<td>178.432</td>
<td>34.224</td>
<td>.000&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>75</td>
<td>5.214</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>569.455</td>
<td>76</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Financial Performance
<sup>b</sup> Predictors: (Constant), Audit Independence

The significance of audit independence had p value (p=0.000) which is less than 0.05. The beta coefficient 0.397 is positive. Based on this finding, it can be deduced that audit independence significantly influenced financial performance. It can further be deduced that audit independence positively influenced financial performance of the listed commercial banks in the NSE. From the findings the linear regression equation is as follows; Financial Performance=5.669 + 0.397 Audit Independence. If we held the internal audit independence constant, the ROE of the commercial banks would stand at 5.669. This implies a unit increase in the internal independence would lead to an increase in financial performance by a factor 0.397.
Table 4.15: Coefficients for Audit Independence

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>5.669</td>
<td>1.417</td>
</tr>
<tr>
<td>Audit</td>
<td>.397</td>
<td>.068</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance

4.5 Audit Committees and Financial Performance

4.5.1 Composition of the Audit Committees

The study sought to understand the composition of the audit committees. Majority of the respondents agreed that gender diversity in board committees affect their oversight roles to the organization and this could influence investors’ perceptions where 5% of respondents strongly disagreed, 14% disagreed, 26% moderately agreed, 49% agreed, 5% strongly agreed, a mean of 2.650 and standard deviation of 0.970 was reported. The board audit committees should at least have 3 non-executive directors with accounting knowledge to question manipulation of financial records by management in which 10% of the respondents moderately agreed, 68% agreed, 22% strongly agreed, a mean of 1.880 and standard deviation of 0.561 was reported. Lastly there is a high positive association between the risk of financial misreporting and audit committee size which impacts on the performance of the firm where respondents disagreed by 1%, 12% moderately agreed, 60% agreed, and 27% strongly agreed, a mean of 1.870 and standard deviation of 0.656 was realized. The Table 4.16 indicates the summary of composition of the audit committees.
Table 4.16: Composition of the Audit Committees

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender diversity in board committees affect their oversight roles to the organization and this could impact on investors’ perceptions</td>
<td>5%</td>
<td>14%</td>
<td>26%</td>
<td>49%</td>
<td>5%</td>
<td>2.650</td>
<td>0.970</td>
</tr>
<tr>
<td>Board audit committees should at least have 3 non-executive directors with accounting knowledge to question manipulation of financial records by management</td>
<td>0%</td>
<td>0%</td>
<td>10%</td>
<td>68%</td>
<td>22%</td>
<td>1.880</td>
<td>0.561</td>
</tr>
<tr>
<td>There is a high positive association between the risk of financial misreporting and Audit Committee size which impacts on the performance of the firm</td>
<td>0%</td>
<td>1%</td>
<td>12%</td>
<td>60%</td>
<td>27%</td>
<td>1.870</td>
<td>0.656</td>
</tr>
</tbody>
</table>

4.5.2 Independence of the Audit Committees

The study sought to understand the independence of the audit committees. In this a question on the lack of independent audit committees affect the performance of internal audit function 1% of the respondents disagreed, 16% moderately agreed, 39% agreed, and 44% strongly agreed a mean of 1.740 and standard deviation of 0.768 was reported. Majority of the respondents agreed that the independent audit committees oversee financial reporting and disclosures where 16% moderately agreed, 55% agreed, and 30% strongly agreed, a mean of 1.860 and standard deviation of 0.663. On the question that audit committee independence affects companies’ earnings, management and the investors’ perceptions where 13% of respondents moderately agreed, 64% agreed, and 23% strongly agreed, a mean of 1.900 and standard deviation of 0.598 was reported. Lastly the board audit committee is independent from management and the CAE has direct access to the chairperson where 1% of the respondents disagreed, 12% moderately agreed, 55% agreed and 33% strongly agreed, a mean of 1.830 and standard deviation of 0.733 was realized. The Table 4.17 indicates the summary of the independence of the audit committees.
Table 4.17: Independence of the Audit Committees

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of independent audit committees affect the performance of internal audit function</td>
<td>0%</td>
<td>1%</td>
<td>16%</td>
<td>39%</td>
<td>44%</td>
<td>1.740</td>
<td>0.768</td>
</tr>
<tr>
<td>Independent audit committees oversee financial reporting and disclosures. Audit committee independence affects companies’ earnings, management and the investors’ perceptions</td>
<td>0%</td>
<td>0%</td>
<td>16%</td>
<td>55%</td>
<td>30%</td>
<td>1.860</td>
<td>0.663</td>
</tr>
<tr>
<td>The board audit committee is independent from management and the CAE has direct access to the chairperson</td>
<td>0%</td>
<td>1%</td>
<td>12%</td>
<td>55%</td>
<td>33%</td>
<td>1.900</td>
<td>0.598</td>
</tr>
</tbody>
</table>

4.5.3 Financial Expertise of the Audit Committees

The study sought to understand the financial expertise of the audit committees. The first question was if the financial expertise of the audit committees determines the quality in financial statements in which 14% of the respondents disagreed, 34% moderately agreed, 39% agreed and 13% strongly agreed a mean of 2.490 and standard deviation of 0.898 was reported. The question on the audit committees have the ability to interpret financial statements and understand financial estimates where 1% of the respondents strongly disagreed, 10% disagreed, 40% moderately agreed, 38% agreed, 10% strongly disagreed a mean of 2.550 and standard deviation of 0.867. Most of the respondents agreed that audit committee with high level of training in accounts usually has significant impact on returns on equity and return on asset and hence organizational performance where only a few of the respondents moderately agreed with 8%, 56% agreed, and 36% strongly agreed, a mean of 1.710 and standard deviation of 0.604 was reported. The Table 4.18 indicates the summary of the financial expertise of the audit committees.
Table 4.18: Financial Expertise of the Audit Committees

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial expertise of the audit committees determines the quality in financial statements</td>
<td>0%</td>
<td>14%</td>
<td>34%</td>
<td>39%</td>
<td>13%</td>
<td>2.490</td>
<td>0.898</td>
</tr>
<tr>
<td>Audit committees have the ability to interpret financial statements and understand financial estimates</td>
<td>1%</td>
<td>10%</td>
<td>40%</td>
<td>38%</td>
<td>10%</td>
<td>2.550</td>
<td>0.867</td>
</tr>
<tr>
<td>Audit committee with high level of training in accounts usually has significant impact on returns on equity and return on asset and hence organizational performance</td>
<td>0%</td>
<td>0%</td>
<td>8%</td>
<td>56%</td>
<td>36%</td>
<td>1.710</td>
<td>0.604</td>
</tr>
</tbody>
</table>

4.5.4 Audit Committee Support to the Internal Audit Function

The study sought to understand if audit committee support to the internal audit function. The first question was if audit committee is briefed regularly on significant risks facing the company and timely action is taken in which 3% of the respondents disagreed, 30% moderately agreed, 53% agreed, and 14% strongly agreed a mean of 2.210 and standard deviation of 0.713 was reported. Audit committee support to the internal audit department ensures a strong internal control system is maintained in the company in which the respondents indicated 27% as moderately agreed, 69% agreed, 4% strongly agreed, a mean of 2.230 and standard deviation of 0.510. The respondents were in an agreement that the presence of audit committees creates a perception of enhanced independence of the internal audit function which could affect organization’s performance in which 17% moderately agreed, 62% agreed, 21% strongly agreed, a mean of 1.960 and standard deviation of 0.616 was reported. The Table 4.19 indicates the summary of the audit committee and internal audit function.
Table 4.19: Audit Committee Support to the Internal Audit Function

<table>
<thead>
<tr>
<th></th>
<th>SD</th>
<th>D</th>
<th>MA</th>
<th>A</th>
<th>SA</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>The audit committee is briefed regularly on significant risks facing the company and timely action is taken</td>
<td>0%</td>
<td>3%</td>
<td>30%</td>
<td>53%</td>
<td>14%</td>
<td>2.210</td>
<td>0.713</td>
</tr>
<tr>
<td>Audit committee support to the internal audit department ensures a strong internal control system is maintained in the company</td>
<td>0%</td>
<td>0%</td>
<td>27%</td>
<td>69%</td>
<td>4%</td>
<td>2.230</td>
<td>0.510</td>
</tr>
<tr>
<td>Presence of audit committees creates a perception of enhanced independence of the internal audit function which could affect organization’s performance</td>
<td>0%</td>
<td>0%</td>
<td>17%</td>
<td>62%</td>
<td>21%</td>
<td>1.960</td>
<td>0.616</td>
</tr>
</tbody>
</table>

4.5.5 Correlation between Financial Performance and Audit Committees

There was a positive relationship between financial performance and audit committees. This implies that as these variables change either increase or decrease, financial performance changes in a similar direction. The results show that audit committees had a strong and significant relationship with financial performance (p<0.05). This is indicated in the Table 4.20.

Table 4.20: Correlation between Financial Performance and Audit Committees

<table>
<thead>
<tr>
<th>Correlations</th>
<th>Financial Performance</th>
<th>Audit Committees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>77</td>
</tr>
<tr>
<td>Audit Committees</td>
<td>Pearson Correlation</td>
<td>.804**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>77</td>
</tr>
</tbody>
</table>

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

4.5.7 Regression Analysis

The coefficient of determination which is R-Squared is 0.647. The value of R-square implies that 64.7 percent of the total variance of financial performance is explained by the model. This means that 35.3 percent of the total variance of financial performance cannot
be explained by the model. Hence the results reveal that the audit committee is one of the key determinants of financial performance among commercial banks listed in the NSE.

Table 4.21: Model Summary for Audit Committee

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.804&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.647</td>
<td>.642</td>
<td>2.52201</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Audit Committees

Analysis of variance was conducted at 5% level of significance. A comparison of F-calculated and F-critical is shown in the Table 4.22. From the findings, F-calculated is 137.238 and F (1, 75) is 3.968. Since the value of F-calculated is greater than F-critical, this indicates the overall regression was significant for the study. The p value p=0.00 is less than 0.05 an indication that the audit committees significantly influences financial performance.

Table 4.22: ANOVA for Audit Committees

<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>1</td>
<td>Regression</td>
<td>872.908</td>
<td>1</td>
<td>872.908</td>
<td>137.238</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>477.040</td>
<td>75</td>
<td>6.361</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>1349.948</td>
<td>76</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance
b. Predictors: (Constant), Audit Committees

In view of significance of audit committees had p value (p=0.000) which is less than 0.05. The beta coefficient 1.134 is positive. Based on this finding, it can be deduced that audit committees significantly influenced financial performance. It can further be deduced that audit committees positively influenced financial performance of the listed commercial banks in the NSE. From the findings the linear regression equation is as follows; Financial Performance=9.724 + 1.134 Audit Committees.
Table Coefficients for Audit Committees

<table>
<thead>
<tr>
<th>Model</th>
<th>Coefficientsa Unstandardized</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>9.724</td>
</tr>
<tr>
<td>Audit Committees</td>
<td>1.134</td>
<td>.097</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance

4.6 Chapter Summary

From the results and findings of the study, the results revealed that there is a positive and significant relationship between independent variables and dependent variable. For the first objective which showed a positive relationship between financial performance and audit competencies. The results show that audit competencies had a strong and significant relationship with financial performance (p<0.05). For the second objective of the study the results showed that audit independence had a strong and significant relationship with financial performance (p<0.05). on the last objective there was a positive relationship between financial performance and audit committees. The results show that audit committees had a strong and significant relationship with financial performance (p<0.05). The next chapter present the summary of findings, discussion, conclusions, recommendations and suggested areas for further research.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter covers the summary, discussions and conclusions made from the research findings of the study and the research objectives. The recommendations for further studies have been discussed.

5.2 Summary
The main objective of the study was to establish the role of the internal audit function in the financial performance of listed commercial banks in Kenya. Research questions were used for the study and the financial performance measure used was the return on equity (ROE) obtained from the Central Bank supervisory reports. The study had three specific objectives; the effect of internal auditor’s competencies, the role of the internal audit independence and the effect of audit committees on the financial performance of the banks. The study focused on the 11 listed commercial banks in Kenya as at June 2018 in the NSE. The research questions were targeted at the internal audit department, finance department, audit committees and the risk and compliance departments. The staff had sufficient knowledge and experience of the internal audit function and 88% were certified public accountants (CPA) with more than 5 years of experience. From the findings, internal auditor’s competencies had a significant impact on the financial performance. The educational, professional and technical competencies of an auditor have a significant influence on the performance of the audit functions, which has a direct influence on financial performance. Internal auditors’ competencies were noted to play a key role in the risk assessment, evaluation of controls and timely detection of fraud.

The internal audit independence was found to have a significant positive influence on the financial performance of the company at value p=0.00 which is less than 0.05. The independence in reporting of the control lapses and recommendations on how to improve the control environment plays a significant role on performance. The organizational independence of the internal audit function affects the way the audit roles are carried out. The study further found that the internal audit operations need to be strategically positioned in order for the management and staff to co-operate.
From the study, the audit committees play a significant role in supporting and checking the audit function in the commercial banks. Audit committees and financial performance had a positive significant relationship at p=.000 which is less than 0.05. The study found the financial expertise of the audit committee members to contribute to the quality of the financial statements. The errors in the financial statements were minimal where the committee had financial knowledge of interpretation of the estimates. Audit committees ‘independence and financial expertise were found to have a significant impact on the company’s earnings. The composition of the audit committees was noted to have an effect on the audit function and delivery of results.

From the study, the financial performance of the commercial banks had great variation in the period 2013-2017 due to changes in the internal audit competencies, independence of the internal audit department and the effects of the audit committees. We further noted the years 2016 and 2017 the ROE of nine of the commercial banks significantly reduced due to other factors like the interest capping introduced in the country. From the regression analysis, there exists a positive relationship between financial performance and the internal auditor’s competencies, internal audit independence and the audit committees.

5.3 Discussion

5.3.1 Role of the Internal Auditor’s Competencies

The respondents agreed that the internal auditor’s competencies were important features for the internal audit function. Internal audit function contributes to the financial performance through their responsibilities of ensuring strong internal controls of the organization. The study found the educational, professional and the technical knowledge in the internal audit department measure the competencies of an auditor. The respondents agreed that low education and incompetency affects the knowledge of audit techniques and standards, which in return influences the organization’s performance. Bett (2014) in her studies of the relationship between internal audit function effectiveness and financial performance of listed companies in the NSE found that professional proficiency had a significant impact on the financial performance of the companies. She added that the professional proficiency influenced the quality of work delivered in the internal audit department. The respondents agreed on the importance of training of internal auditors to enhance their knowledge in risk assessment, evaluation of controls and fraud detection that contributes to the performance of the organization. The study agreed with Gramling et al
(2013) who found that investing some resources in the IAF could result in hiring and training internal auditors with greater competencies, and thus a positive organizational impact. Oussii and Taktak (2018) found that there was a significant relationship between the internal audit work quality and the internal audit function competencies. The IAF competencies were evaluated based on the educational, professional and work experiences and were noted to contribute to the internal control weaknesses disclosures, which would in turn affect the profitability of the firms. Lin et al (2011) also noted that competence of the internal audit staff was consistently associated with significant reductions of internal control weaknesses occurrence.

The respondents agreed that internal auditors contribute in the risk assessment of the company. Competency was noted to be important in analyzing the risks faced by the banks and the ways to mitigate the risks. Risk assessment and planning was found to be a contributor to the performance of an organization. The respondents agreed that the internal auditors have the skills to carry out and contribute to the risk assessment of the company. Ernst & Young (2007) in their survey noted 75% of the respondents agreed that strong risk management influences the long-term company’s earnings. Most of the respondents in the survey agreed that the internal audit has a role to play in the risk management efforts.

The respondents agreed that the internal auditor’s objectivity was key in reporting internal control lapses. The evaluation and reporting of control lapses was noted to contribute to organization performance in terms of eliminating wastage and creating efficiencies in operations. This is in line with Roth (2004) who observed that good internal controls provide reliable financial reporting for achievement of the company financial objectives. He further found that poor internal controls reduce productivity, increase the complexity of processing transactions, increase the time required to process the transactions and encourage wastage.

The respondents agreed that timely detection and reporting of frauds contributed to the organization’s performance as the losses were discovered before crystalizing. They agreed that the internal auditors were required to be competent enough in order to detect the frauds. This was in line with Johl et al. (2013) who found that a well-resourced internal audit department had greater ability to detect and report fraud. Fraud in a company affects the company’s profitability since the losses incurred have to be compensated. Fraud also affects
the company’s reputation leading to customer flight especially if it affects the customers’ accounts.

5.3.2 Effect of the Internal Audit Independence

The study found that the internal audit independence contributes to the financial performance of the companies. IAFs across respondent organizations were found to report directly to the Audit committees, with administrative reporting to senior executive, the CEO. The Heads of the Internal Audit perceived it necessary for the AC to elevate and protect the status IAF within the organization by providing the appropriate platform for the IAF to present findings at AC meetings. The finding agreed to Soh and Martinov-Bennie (2011) where in the study of Australian companies found that most of the CAEs indicated that reporting to the AC gave a protection to their independence and objectivity, which ensured effectiveness of IAF.

The respondents agreed that organizational independence of the internal audit function helps in the objectivity of reporting of the internal control lapses and effectiveness of the internal audit function. Internal control lapses were noted to affect negatively the performance of an organization by encouraging wastage and inefficiencies. Most respondents disagreed that the senior management interfered with the allocation of resources and the execution of the duties of the internal audit department and there is autonomy of the Internal Audit in the organization structure. This agreed to Kirima (2016) who found that internal auditor were autonomous in the organization and were respected in the government ministries as they provided oversight in operations and the financial audits. He noted that the internal audit function position in the organization determines the independence and the objectivity in reporting and adding financial value to the organization. In most organizations the internal audit budget was approved by the audit committee in the beginning of the year. The CEO had a say in some of the banks on the recruitment and firing of the Head of the Internal Audit. The final decision on the hiring was with the Audit Committee. Nineteen percent of the respondents disagreed that the internal audit function is likely to be influenced by management in reporting the control lapses, 50% agreed while 31% moderately agreed. This implies that in some instances the internal audit may not freely express their opinion on control issues that could be touching on the senior management especially where the career progression depended on them.
The respondents agreed that internal audit reports were comprehensive, clearly conveyed and implementation of the recommendations led to control improvements and improvements in efficiency. The finding agreed to Mihret and Yismaw (2007), where they indicated that the existence of a follow-up process of audit findings and recommendations led to the improvement of IAF effectiveness, which enhanced the efficiencies in the organization. The respondents agreed that the internal audit reports tracking was cost effective and added value to the organization. The reports tracked the implementation time of the audit recommendations to correct the control lapses. Archambeault et al. (2008) concluded that internal audit report has potential to complement existing disclosures, increase stakeholder’s confidence in governance quality and financial reporting reliability.

5.3.3 Role of the Audit Committees

The respondents agreed that audit committees have positive effect on the internal audit function by providing oversight roles to the function, which influences the organization performance. Goodwin and Yeo (2001) found that audit committee’s involvement in the appointment or removal of the CAE encouraged objectivity of the internal audit department leading to greater internal controls quality. Strong internal controls are an indication of organization’s efficiency. Independent audit committees were noted to contribute to financial reporting and disclosures in the financial statements. The respondents agreed that the presence of audit committees create a perception of internal audit quality due to the oversight role they play. The respondents further agreed the independence of the audit committees affected the company’s earnings and the investor’s perceptions.

The independence of the audit committee was influenced by the structure, the balance between executive and non-executive directors, the chairperson of the audit committee and the integrity and objectivity of individual committee members. Wakaba (2014) found that the committee size and the gender diversity in the committees provided a wide range of experiences and better decisions in evaluating the IAF and the organization performance. The Blue-Ribbon Committee Report (1999) stated that independence is critical in ensuring that the AC fulfils its objective oversight role and ensuring shareholders’ value. Lin et al (2011) found that the more the audit committees review the internal audit programs and their field work the better the chances of detecting the internal control weaknesses, which affect the profitability of the organization.
The respondents agreed that the financial expertise of the audit committee was a key element in evaluating the effectiveness of the audit committees and the contribution to financial performance of the company. Committee members with financial expertise were noted to understand the financial estimates and judgements used in the financial audits reports. They would give input to the strategic and financial goals of the organization. This agreed to Abbott et al. (2004) who stated that audit committee financial expertise had a positively significant impact on the firm performance. Gacheru (2014) found a significant positive relationship between the financial performance of banks and the financial expertise of the board audit committee. He noted that financial competency in the audit committees contributed in the duties of arresting financial, accounting and audit issues.

5.4 Conclusions

5.4.1 Internal Audit Competencies

The study concludes that the educational, professional backgrounds and the experience in the audit function determine the internal audit competencies. Continuous training of internal auditors to enhance their skills in risk assessment and fraud detection was happening in the banks which contributed to the performance of the banks. Early detection and reporting of frauds in the organization help prevent losses, which improves profitability. Internal Audit function is actively involved in the risk assessment and management and their professional and technical skills are very relevant.

5.4.2 Internal Audit Independence

The study concludes, internal audit independence could be expressed in the reporting structure, the organizational independence and the internal audit reports. The three elements ensure objectivity in reporting of control lapses in the organization for corrective action. The internal audit reports need to be clearly conveyed, discussed and followed up for implementation in order to improve the control environment. The reporting structure of the CAE to the AC functionally and the CEO administratively ensure the IA responsibilities are fulfilled smoothly.

5.4.3 Role of the Audit Committees

From the study, we can conclude the AC have a critical role of providing oversight to the IAF. This ensures that the IAF remains effective in its contribution to the organization’s performance. The independence of the AC ensures the IAF remains effective in executing their duties and responsibilities. Financial expertise, skills and experience of the members
of the AC enhances committee’s effectiveness by providing a wider range of perspectives and knowledge to oversee company performance, strategy and risk.

5.5 Recommendations

5.5.1 Recommendations for Improvement

5.5.1.1 The Role of Internal Auditor’s Competencies
The commercial banks need to invest resources in the IAD to ensure they recruit and hire qualified internal auditors; periodic training should be included in the Audit plan in order to get value for the organization. The internal auditors should be periodically appraised on the audit standards and be involved in the risk assessment of the organization.

5.5.1.2 The Effect of Internal Audit Independence
The senior management should ensure the IAD is independent of the company’s operations so that they are able to express and independent opinion of the company. Budgeting and recruitment should be overseen by the Audit Committee to ensure the IAF can implement their Audit plan without management’s interference. The CAE should have unlimited access to the Audit Committee so that he is able to timely report control lapses or improprieties by senior management.

5.5.1.3 The Role of Audit Committees
From the study, the audit committee plays a role in influencing the financial performance of the banks. It is therefore important the Audit Committee be independent from management for them to provide the oversight roles on the IAF. The Audit Committee should have a representation of both executive and non-executive directors with financial knowledge as this influences the disclosures made in the financial statements of the companies. They are also able to question the financial judgements made in preparation of the accounting and financial records. The members of the Audit Committees need to be qualified accountants and internal auditors with good standing membership in the professional bodies e.g. ICPAK, CIA among others.

5.5.2 Recommendation for further studies
The study would recommend further studies on other non-listed banks in the NSE to widen the scope of study of the Internal Audit Function in the banking sector in Kenya. This would allow to make a comparison of financial performance of the listed and non-listed commercial banks in relation to the audit function.
The study recommends a further analysis of the independence of the internal audit function in commercial banks and how it can be enhanced to promote the financial performance of the organizations.
REFERENCES


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CIIA (2013), Effective Internal Audit in the Financial Services Sector: Recommendations from the Committee on Internal Audit Guidance for Financial Services, Chartered Institute of Internal Auditors.

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Drent, D. (2002). The duest for increased relevance: internal auditors who successfully communicate and balance their needs and those of their clients can increase their relevance to the organization, Internal Auditor, Vol. 59 No. 1, pp. 49-54.


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APPENDICES

APPENDIX I: INTRODUCTORY LETTER

Peninah Wambui Njung’

United States International University-Africa,

P.O BOX 14634,

Nairobi, Kenya

Dear Respondent,

RE: REQUEST FOR YOUR PARTICIPATION IN MY ACADEMIC RESEARCH PROJECT

I am a student currently pursuing a course towards conferment of Master of Business Administration (MBA) from United States International University – Africa.

In partial fulfilment of the requirements of the award of the degree, I am conducting a research project to determine ‘The role of internal audit function on the financial performance of listed commercial banks. In this regard, you have been selected to participate in this study and your participation will be highly appreciated.

Kindly complete all sections of the questionnaire to enable me complete my research project. The information you provide will be treated as confidential, and will only be used for the purpose of this research.

Yours Sincerely,

Peninah Njung’

Peninah Njung’

72
APPENDIX II: QUESTIONNAIRE

SECTION A: GENERAL INFORMATION

1. LEVEL of EDUCATION:
   Graduate: ☐
   Masters: ☐
   PhD: ☐
   Doctorate: ☐
   Others: ....................................................

2. PROFESSIONAL CERTIFICATION:
   CPA: ☐
   ACCA: ☐
   CFA: ☐
   CIA: ☐
   CISA: ☐
   Others: ....................................................

3. NO. OF YEARS IN THE INSITUTION:
   Less than 5 years: ☐
   5 - 10 years: ☐
   11 - 15 years: ☐
   16 - 20 years: ☐
   Over 20 years: ☐

4. POSITION OF RESPONDENT:
   Head of Internal Audit ☐
   Senior Manager internal audit ☐
   Internal Auditor ☐
   Finance ☐
   Audit committee ☐
   Other __________________________
5. YEARS OF EXPERIENCE

<table>
<thead>
<tr>
<th>Years of Experience</th>
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<tbody>
<tr>
<td>Less than 5 years</td>
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<td>5 - 10 years</td>
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<td>16 - 20 years</td>
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<tr>
<td>Over 20 years</td>
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SECTION B: THE ROLE OF INTERNAL AUDITOR’S COMPETENCIES

On a scale of 1 – 5 state the extent to which you agree with the following statements whereby 1-strongly agree, 2- Agree, 3- Moderately agree, 4- Disagree and 5- strongly disagree.

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
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<tbody>
<tr>
<td>To what extent do you agree internal auditor’s competence influence financial performance</td>
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<tr>
<td>1. The educational, professional and technical competence of the internal auditor affects the quality audit department performance</td>
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<tr>
<td>2. Low education and less competent staff affects knowledge on auditing techniques which impacts on the internal audit function and organization performance</td>
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<td>3. Internal audit department contributes to the risk assessment of the company</td>
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<tr>
<td>4. Risk assessment and planning in the organization contributes to the performance of the company</td>
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<td>5. Competency of an internal auditor helps them to evaluate the risk of fraud in the organization and how best its managed</td>
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<td>6. Internal auditors’ objectivity in reporting control lapses influence the quality of financial statements</td>
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<td>7. Competency in auditors helps in detection of fraud</td>
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<td>8. Timely detection and reporting of frauds contributes to performance results of the company</td>
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<td>9. Internal auditors have the expertise to carry out an evaluation of internal controls of the company</td>
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</tbody>
</table>
10. Strong control systems ensure there is operational efficiency and hence profitability

11. Training of internal auditors enhance their skills in risk assessment, fraud detection and evaluation of controls which contributes to the performance of the organization

SECTION C: THE EFFECT OF INTERNAL AUDIT INDEPENDENCE

On a scale of 1 – 5 state the extent to which you agree with the following statements whereby 1-strongly agree, 2- Agree, 3- Moderately agree, 4- Disagree and 5- strongly disagree.

<table>
<thead>
<tr>
<th>To what extent do you agree to the reporting of internal auditors enhance financial performance</th>
<th>1</th>
<th>2</th>
<th>3</th>
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<tbody>
<tr>
<td>1. Internal auditors reporting to the senior management affect their quality of work and their contribution to the organization</td>
<td></td>
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<tr>
<td>2. Overdependence on management for allocation of resources to the internal audit function affect the audit work</td>
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<tr>
<td>3. Management expectations of the duties of internal audit affects their objectivity hence their judgements could be biased</td>
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<tr>
<td>4. Audit reports are comprehensive, clearly conveyed, reasonable and implementation of the recommendations leads to control improvements and improvements in efficiency.</td>
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<tr>
<td>5. Internal audit reports tracking are cost effective and add value to the organization</td>
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<tr>
<td>6. Organizational independence of the internal audit function is crucial in the effectiveness of the internal audit function</td>
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<td>7. The internal audit operations are positioned strategically in a bid obtain cooperation from both management and staff within the bank</td>
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<td>8. Audit reports are timely given and recommendations are implemented to arrest control lapses</td>
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</tbody>
</table>
9. Internal auditors are likely to be influenced by management in evaluating controls and reporting internal control problems to the audit committee

10. CEO and CFO of the bank have a say on the internal audit budget, recruitment, termination and the remuneration of the internal auditors

SECTION D: THE ROLE OF THE AUDIT COMMITTEES ON FINANCIAL PERFORMANCE

On a scale of 1 – 5 state the extent to which you agree with the following statements whereby 1- strongly agree, 2- Agree, 3- Moderately agree, 4- Disagree and 5- strongly disagree.

<table>
<thead>
<tr>
<th>Statement</th>
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<th>2</th>
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<tbody>
<tr>
<td>To what extent do you agree to the independence of the audit committees enhance financial performance</td>
<td>1</td>
<td>2</td>
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<tr>
<td>1. Lack of independent audit committees affect the performance of internal audit function</td>
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<tr>
<td>2. Independent audit committees oversee financial reporting and disclosures.</td>
<td>1</td>
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<tr>
<td>3. Financial expertise of the audit committees determine the quality in financial statements</td>
<td>1</td>
<td>2</td>
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<td>4. Audit committees have the ability to interpret financial statements and understand financial estimates</td>
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<td>5. Presence of audit committees creates a perception of enhanced independence of the internal audit function which could affect organization’s performance</td>
<td>1</td>
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<td>6. Audit committee independence affects companies’ earnings, management and the investors’ perceptions</td>
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<td>2</td>
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<td>7. Gender diversity in board committees affect their oversight roles to the organization and this could impact on investors’ perceptions</td>
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<td>8.</td>
<td>Board audit committees should at least have 3 non-executive directors with accounting knowledge to question manipulation of financial records by management</td>
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<td>9.</td>
<td>There is a high positive association between the risk of financial misreporting and Audit Committee size which impacts on the performance of the firm</td>
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<td>10.</td>
<td>The audit committee is briefed regularly on significant risks facing the company and timely action is taken</td>
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<td>11.</td>
<td>The board audit committee is independent from management and the CAE has direct access to the chairperson</td>
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<td>12.</td>
<td>Audit committee support to the internal audit department ensures a strong internal control system is maintained in the company</td>
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<td>13.</td>
<td>Audit committee with high level of training in accounts usually has significant impact on returns on equity and return on asset and hence organizational performance</td>
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</table>

**Thank you for completing the survey**