EFFECT OF INTERNAL AUDITING ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN KENYA

JULIUS KAY NTHENGE

A RESEARCH PROJECT SUBMITTTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION, SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

OCTOBER 2022

DECLARATION

This research project is my original work and has not been presented for a degree or any other award in any other University.

Signature: .... Date: 17/11/2022

Julius Kay Nthenge

061/27591/2019)

This research project has been submitted for examination with my approval as the University Supervisor.

Signature: .... Date: 18th 11/2022

Dr. Martin Odipo

Lecturer, Department of Accounting and Finance

School of Business, University of Nairobi

DEDICATION

My loving parents, to whom I dedicate my academic project, have my sincere gratitude for their financial and emotional support. I also would not have been successful without the constant encouragement from my friends and coworkers.

Good luck to everyone.

ACKNOWLEDGEMENT

I convey my gratitude to many invisible hands who worked so hard to complete this project. First and foremost, I convey my gratitude to God for the wonderful favors that He bestowed upon me, allowing me to take in and finish my presentation.

I also convey my sincere gratitude to my supervisor, Dr. Martin Odipo, a lecturer in the University of Nairobi's Department of Accounting and Finance, for his direction, supportive work environment, and sage advice in the course of doing this project.

I also want to thank all of my friends, family, colleagues, and students who supported and helped me as I was drafting the research project.

TABLE OF CONTENT

LIST OF FIGURES

LIST OF TABLES

ABBREVIATIONS AND ACRONYMS

IIA:	INSTITUTE OF INTERNAL AUDITING
ROA:	RETURN ON ASSET
ROE:	RETURN ON EQUITY

ABSTRACT

Goal for the study was to ascertain how internal auditing affect financial performance of commercial banks. The study's main goals was to evaluate the independence of internal auditing, the level of technical proficiency of internal auditing, and the impact of the control environment on internal auditing of commercial banks in Kenya. In order to understand the study's determinants, the study used agency theory, contingency theory, and institutional theory. To create closed-ended questions and determine their applicability, a descriptive research design that was in line with the study's aims was used. Thirty nine commercial banks was the study's target population. Secondary and primary data was gathered for the study. Secondary data was gathered from the yearly financial statements of commercial banks under CBK supervision, while primary data was gathered using a closed-ended questionnaire presented to respondents using the drop-and-pick approach. One management staff member and two representatives from the finance and accounting department made up the study's unit of analysis. The study's data analysis was quantitative. Link between variables in the study was established using multiple-regression analysis. The frequency distribution, percentages, mean, and standard deviation were used to analyze and show the coded data

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Vital tool for management of any organization's authority and procedures is an internal audit (IIA, 2012). According to Dellai, Ali, and Omri (2016) and Allegrini, D'Onza, Paape, Melville, and Sarens (2006), internal audit function gave compliance assurance, financial management, and asset protection top priority. In the recent ages, internal audit has experienced improvements that have increased its value-adding capabilities and broadened its coverage. In according to the Organization of Internal Assessors, internal reviewing is a free, unbiased declaration and advising service intended to advance organizations' processes. A company can realize its purposes by resources of a strict, systematic method to assessing and enlightening the efficiency of damage mitigation, organization, and authority systems (IIA, 2012).

The internal audit department of a corporation is an important division since it is seen to be necessary for the use of the accounting information system, which in the long run aids in the effective assessment of that agency's performance. Internal auditing is mostly seen as crucial in corporate accounting since it is now required to record all industry-related procedures. Because the financial statement illustrates how effectively the internal auditor operates, successful internal audits enable the company to expand. In addition to monitoring procedures carried out by the directors of the company and the audit committees to guarantee the accuracy of the information reporting procedure, an internal audit is an important component of commercial authority in a firm (Public Oversight Board, 1994).

Effective internal systems underpin a corporation's corporate and financial strategy, and internal audit is crucial to enhancing the dependability of these systems, enhancing the risk management procedure, and meeting the requirements of internal users. Accountability of the staff and executive executives to the investors and other shareholders is improved with aid of internal audit (Eighme & Cashell, 2002). The audit board, the company's panel of directors, and administration all profit from internal audit department's unbiased, dependable service. Investor returns, sustainable growth, good leadership, and actual journalism on a corporation's economic performance and corporate behaviour are other issues that stakeholders are concerned with.

1.1.1 Internal auditing

The increased opposition and economic needs in ultra-modern commercial enterprise surroundings has led to the advent of numerous controlling and tracking instruments, including internal auditing systems, through many corporations. Internal auditing is thought of as an impartial, unbiased certification and advisory activity developed to bring value while enhancing an organization's operations. In order to strengthen inspection and control procedures and divorce organizations' management from their departments in order to report on the caliber and steadfastness of financial reports, audits—both internal and external—were principally necessary. Internal operations and financial report quality have a strong correlation, which contributes to competence (Alzoubi, 2019).

Keeping quality under review is essential for protecting organizations from accident risks. Every institution aspires to do that, thus institutions that are audited by qualified auditors are probably at lower risk. (D.H. 2022). The internal auditor’s function is one the important features of providing value to organizations by enlightening the surveillance and continuation procedure to boost outputs (Coram, Ferguson and Moroney 2008).

Additionally, internal auditing is a crucial tool for organizations to use to exploit corporate outcomes Drogalas, G., Karagiorgos, T. & Arampatzis, k (2015). IA's efficacy greatly raises value addition and improves performance (Postula, Irodenko & Dubel 2020). The frequency of audit committees’ meetings, the auditors' accounting expertise, and internal audit independence are all positively connected with efficiency of internal assessment function (Goodwin-Stewait & Kent, 2006). Internal auditing is more effective when it has a number of characteristics, such as independence, conventionality to global ideals, frequent exercise for assessors, and the use of modern regulator systems.

According to Hasaea, S. A., Zhu, J., Alsharabi, N., Khatib, S.F.A., and Yueying (2020), Internal audits evaluate the veracity, accuracy, and authenticity of financial and consists of the analysis gathered from various organizational units and used to support good business decisions at all managerial level. Independence, which means that corporate management cannot be swayed by the audit's research, conclusions, or evaluations, is a requirement for the effective implementation of internal audit activities. With this approach, the internal audit report serves as both a vital handbook for the efficient operation of the company and a communication medium between the audit function and management (Ljubisavljevic & Jovanovi, 2011). Professionals that have a detailed comprehension of the corporate success, organisations, and procedures conduct internal audits to make sure that internal panels are adequate to reduce risk, authority procedures are active and resourceful and the institution's aims and purposes are accomplished.

1.1.2 Financial Performance

Every corporate entity's main goal is to maximize profit (Viresh & Velnampy, 2014). Furthermore, a company can add value to its stakeholders through its financial success. Utilizing a company's resources effectively can improve financial success (Kassim, 2011). The link between the element of the financial situation and the financial statement is frequently used to evaluate the monetary performance of any association (Makkar and Singh, 2013).

The profitability of an association may be evaluated using the stockholders' capacity to create value. Financial performance is frequently assessed using the three accounting measurements investments as discussed below; (Return on Assets) is one type of investment return (ROI) metric that measures a corporation's financial performance in conjunction to the total assets. This proportion assesses a company's performance by associating its return before taxes and interest, or net income, to the assets it has invested in assets.

The phrase "return on equity" (ROE) refers to the profit a firm generates for its shareholders utilizing the money its owners have invested in the business. It is a measure of a corporation's return rate (net income) as a factor of the total of its stakeholders' equity that is based on a percentage. It demonstrates how successfully or unsuccessfully management has maximized stockholder profits on their investment in the firm.

Return on Sales (ROS): By assessing the company's running profit margin and how it employs resources to generate revenue, the ratio gives lenders and potential investors information into how the company operates. Due to the fact that it demonstrates how well management produces revenue from its sales, it is also known as "net profit margin." It shows how successfully the company uses sales to generate a profit.

Market-based performance metrics reflect shareholders' expectations for the company's future performance and are distinguished by their forward-looking elements. They concentration is that in what way does the stock market perceives the company's performance. Share price, profits per share, P/E ratio, and market-to-book value are examples of commonly used performance metrics.

The market's trust in the company's earning potential is gauged by the p/E ratio. P/E ratio = Market rate/Earnings per share is the formula used to compute the ratio.

How a corporation's current market value relates to its book value is determined by a financial valuation metric known as "Market-to-Book Value." The main difference between the book value and market price is the value that would be left over if the firm liquidated all of its goods and paid off all of its obligations.

In this study, ROA was used to gauge the financial success of a commercial bank in Kenya. It measures company's ability to maximize profits. It is determined by dividing the balance sheet's total assets by net income (Khrawish 2011). The capacity of a bank's administration to produce income through the manipulation of available resources is determined by this ratio in financial literature. This demonstrates how efficiently the company's resources are used to produce revenue.

1.1.3 Internal Auditing and Financial Performance

The large percentage of internal audit professionals believe that improved financial performance and a successful internal audit function are related. Beyanga (2011) stated that, a functional internal assessment system may have considerable effect on a firm's financial achievement. Additionally, it could lead to cost savings, the discovery of productivity-boosting opportunities, and the reduction of contact to conceivable losses from improperly protected corporate assets, which all have a substantial impact on an organization's financial profitability.

He also emphasized on the value of an assessment function as a corporate tool for raising performance. Internal auditors contribute to a company's ability to function more profitably and effectively, according to Fadzil, Haron, and Jantan (2005). Lastly but not least, Hermanson and Rittenberg (2005) hypothesized a link between improved organizational performance and the existence of a solid internal assessment function.

According to a survey by KPMG, organizations that have adopted an internal audit function possess performance improvement trends, minimal financial frauds. To realize its purposes of guaranteeing high levels of production and returns, the corporation may use internal audit to safeguard it against crime and other anomalies.

1.2 Research problem

There have been two unconnected but natural repercussions as a result of new commercial accounting disasters and accompanying push for openness and also trustworthiness in reporting. The capacity to decipher the complex accounting procedures that lead to hazy financial accounts has become crucial, to start with. Second, improved reform demands and subsequent regulatory action have changed what constitutes successful management. Directors and company leaders are being held to higher standards of morality and the law. A responsible response to investors' worries about the financial reporting system is the shared objective of both movements. Implementation of internal audit findings and recommendations, however, has been lax. Internal auditing faces obstacles such as corruption, fraud, mistakes and inconsistencies, delayed financial reporting, and discoveries that have not yet produced expected results. There is a common understanding that any organization that does not have an internal audit mechanism in place is vulnerable to a number of dangers that might quickly cause the institution to collapse. Auditors serve a critical role in ensuring efficient financial administration of public resources by preventing the misappropriation of monies. The topic of organizational internal audit and financial performance is, however, understudied, according to relevant research on internal auditing and commercial banks that have be carried out in Kenya.

Mugo (2013) aimed to control the possibility of the function of internal assessment in Kenyan openly registered firms in their study. The results of the investigation exhibited that the core review's purview was not sufficiently broad to include information about other organizational operations in alongside financial information. In terms of objectivity, the degree of autonomy from operations was determined to be rather high, as opposed to the profile group, which was discovered to be somewhat high. The investigation came to the conclusion that the accounting discipline remained a source for hiring personnel for internal audit while giving suggestions for information technology specialists.

In spite of many organizations' lack of appreciation, Kariuki (2014) discovered that the internal independent auditor played a key role in financial regulation. However, to enhance their financial performance, commercial banks must continue to use new strategic strategies. The study addressed the effect of internal auditing on financial performance of commercial bank in Kenya.

1.3 Research Objectives

1.3.1 General objective

I. The overall goal of this research study was to determine the effect of internal auditing on financial performance of commercial banks in Kenya.

1.3.2 Specific objective

I. To evaluate how Kenyan commercial banks' financial performance is impacted by internal auditing's independence.
II. To assess the effect of the level of technical competency of internal auditing on financial performance of commercial banks in Kenya.
III. To assess the effect of control environment of internal auditing on financial performance of commercial bank in Kenya.

1.4 Significance of the study

1.4.1 Government

The governmental sector's governance framework is thought to be supported by internal auditors for the government. Investigations into the problems that impact the performance of the internal assessment role in commercial banks assist in establishing measures to lessen those issues and improve the effectiveness of the assessment role by making sure adequate internal control oversight and assessing whether finances destined for the public facilities are actually being employed wisely with the objective of attaining the anticipated results. Internal reviewing is an essential aspect of managing government finances and a technique for improving departmental efficiency. Internal auditors help the government achieve the highest level of honesty and wise use of public resources. They also bring about changes in operations that foster confidence among people who have a stake in the organization.

1.4.2 Policymakers

Kenyan public policymakers will need the information from this study in order to create policies that will improve internal audit performance and internal auditor efficiency. As a consequence, they will get greater knowledge on how internal audits affect the civic sector's financial returns. This study's assumptions will then also serve as the foundation for the creation of regulations that will enhance internal auditing procedures, make it easier to spot and identify financial management crimes, and halt the theft and loss of public monies.

1.4.3 Scholars and Academicians

The foundation for future studies on the outcome of internal assessment function on commercial bank's monetary performance will be laid by this study, which will be a priceless resource for anybody interested in undertaking research in this field. Further investigation into the internal auditing practices of commercial banks will also be made easier as a result of this. Academics and scholars will value the study since it expands the collection of information previously available on the factors influencing internal auditors' performance in commercial banks.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

It is crucial to conduct thorough examination of literature since it gives a general picture of what is known about the subject under study. In particular, the audit function's influence on banks' financial performance will be examined in this chapter along with various scholarly papers on the subject.

2.2 Theoretical Review

Financial performance and internal audit have given rise to a number of theories. This chapter discussed the following theories which are aligned with objectives of study that's institutional theory, agency theory, and contingency theory.

2.2.1 The Agency Theory

The idea of agency was developed by Jensen and Meckling (1976). An operational agreement is a seal wherein one or more parties (principal(s)) designate another party (agent) to carry out particular tasks on their behalf and provide the agent considerable discretion. They defined it independently but almost simultaneously. Thus, for internal audit to be truly successful, independence and cooperation from high management are required.

The theoretical model of organization is credited to Ross (1973), and the economic principles of agency are assigned to Mitnick (1974). Given that incentives were thought to be the primary difficulty with agency, Ross decided to devote his first analysis of agency to problems with compensation contracts. Mitnick first proposed the current view that organizations arise around power and handle agency as a response to the inherent fault in agency interactions. Since it goes against the principles of creation to make anything perfect, this sort of behavior just never occurs. Nevertheless, culture finds methods to address these defects, whether by accepting them, adjusting to them, or bearing the long-term repercussions of doing so.

Auditors serve as the principals' agents during an audit. The connection between the director and shareholder raises comparable concerns about who is judging the auditor as a result. It may not always be necessary for people to be optimistic and empowered to match goals, monitoring techniques like audit, or better regulation for them to be trustworthy (whether they're directors or auditors). The basic agency model, however, would imply that traders are dishonest. The interests and goals of auditing must be taken into account, just as those of directors. For instance, auditors could be risk-averse and, understanding their potential responsibility, use risk management techniques that limit the scope of their duties and add warnings to their conclusions, which principals may discover.

For shareholders, the auditor's independence from the company's directors is essential since it is thought to be a key component in maintaining the audit's quality. An audit, however, requires close collaboration with the board of directors of a corporation. Due to this close affiliation, investors have doubted the autonomy of auditors—both real and perceived—and have demanded further regulations and standards to protect them. In order to retain their independence and impartiality, audits must be aware of any threats to professional objectivity and take the necessary protective measures as needed. Shareholders heavily weight the independence of the auditors, and credibility is largely fostered by reputation. Auditors have a compelling incentive to maintain their firms.

2.2.2 The Institutional Theory

In accordance with Fogarty, Timothy J.'s (1997) institutional theory, an organization is created and runs in a way that satisfies social expectations insofar as its activities are open to the general public. Therefore, the concern over external legitimacy may take precedence over organizational internal processes, which are sometimes complicated and challenging to define. It is believed that the organization's working procedures and the type of technology it uses may be tangentially related to how it appears on the outside.

Timothy J. Fogarty (1997), who claimed that the insight provided by institutional theory was the realization that an organization's actual accomplishments and those suggested by its structure were sometimes at odds with one another. Other structures that are only visible to outsiders do not significantly improve output, but the organization nevertheless functions with internal procedures that are rarely seen by outsiders. According to Fogarty, companies can avoid external examination provided the appropriate structures are implemented. While allowing for operational process flexibility, loose technical connection helps firms to demonstrate success in solving external problems. Therefore, in order for the core audit sector to operate effectively, the institutions should be prepared to pay the significant costs associated with adopting various technologies and should make sure that the staff is properly trained.

2.2.3 Contingency Theory

According to Woodward (1958), there is no ideal management strategy, and this is the central tenet of contingency theory, a behavioral theory. A number of considerations and the particular conditions at hand were mentioned as reasons why there is no "one size fits all" way to creating a solid management accounting system. The results of this investigation suggest that the best framework for understanding the value of internal audits is the theory of contingency. An audit's purpose is to verify the correctness of a company's reported financial data, as well as the validity of their stated policies, procedures, and processes. Certain financial organizations are mandated by law to undergo independent company audits; other audits, such as those in the IT and safety industries, may be necessary as a result of industry standards. The balanced scorecard considers all of these aspects of a company's operations while conducting an audit. Management and leadership experts agree that there isn't just one ideal way to lead, run, or manage a company. Theory and management of unforeseen events. There are a lot of internal and external factors that might have an impact on a company and its operations. Auditing a company's operations is affected by a wide variety of external variables. This allows the possibility approach to be used for managing reviews, with the caveat that it requires an appreciation of the fluidity and uncertainty of accounting processes and their resulting results.

In most cases, auditors follow a simple process. To successfully handle an audit, auditors need access to data, technology, standards, and processes. They must keep up with the regulations, laws, and standards set out by the government and their field. Audit teams may begin the evaluation process with conversations to learn about the controls and risks before heading out into the field. During an audit, auditors will perform testing and identify any shortcomings in that testing. The next step is to compile reports for management and regulatory bodies. The availability of audit experts, the technologies and systems being analyzed, and the imminence of any deadlines, particularly in the context of planning and fieldwork.

Something that depends on external causes is said to be dependent. The theory of contingencies states, "it relies. The auditing process is task-based and, at times, disorganized. Success in auditing requires meticulous preparation and consideration of many issues. The location and business model of the organization under audit might have a significant impact on the tasks that need to be performed. The makeup of an audit team can also be assessed using the contingency theory. Managers of audit teams are often tasked with leading audits. For each audit assignment, they arranged a backup plan consisting of a mobile ad hoc audit team comprised of assessors chosen for their experience and availability.

Audit teams use structure and contingency to produce results quickly. Auditing studies can look into a variety of topics, such as financial data analysis, manufacturing process evaluation, and compliance with industry standards. Choosing auditors with specific skills or knowledge in the field shortens the learning period and reduces the likelihood of mistakes. Internal auditors ensure the value and outcome of audits by distributing services based on expertise and experience, and then by being adaptable and capable of dealing with changes in procedure. For example, even if the asset classes offered by the company do not conform to the standard model, an auditor with experience evaluating financial instruments may be useful in evaluating a bank or hedge fund (Davoren, 1994).

2.3 Operationalization of the variables

2.3.1 Independence

The professional accountant must be independent in both appearance and thought in order to provide the credibility required in the event of such an audit as well as other assurance services. When someone is in a frame of mind that permits them to express their thoughts without being swayed by things that could cloud their professional judgment, they can act ethically and objectively. A company or a fellow of the compliance function must avoid facts and situations that are material enough to raise questions about their objectivity, independence, or professional skepticism in the eyes of a realistic and competent 3rd party who is informed of all vital information, such as the safeguards used. Therefore, a lack of independence in internal auditing implies that it may have some impact when expressing opinions about internal auditing, which leads to bias. Poor financial performance evaluation, that is, presented in the way that they don't genuinely exist, will result from bias.

2.3.2 Technical competence

to maintain the level of professional expertise essential to guarantee that a customer or owner receives professionally qualified services created on current progresses in practice, law, and technique should use diligence and adhere to the relevant technical and professional requirements. Having at least two years of experience is one prerequisite for becoming an auditor. As a result, the auditor will be able to acquire adequate industry expertise.

2.3.3 Control environment

The management and governance aspects of an organization are part of the control environment. It mainly focuses on the mindset, awareness, and behavior of individuals in charge of creating, putting into place, and overseeing internal controls. The auditing techniques judged essential under the circumstances to accomplish an audit's goal are referred to as the "scope of an audit." The auditor should look at the requirements under ISAs, appropriate professional bodies, legislation, regulations, and, if applicable, the requirements of the audit engagement and reporting obligations when determining the methods necessary to conduct an audit in conformity with ISAs. When the auditor gains an understanding of the workplace, the following factors are important to consider: the sharing and upholding of ethical and moral values; the dedication to competence; the involvement of those responsible for governance; the organization's operating viewpoint and style; the administrative structure; the delegation of authority and responsibility; and the workforce development policies and practices.

2.4 Review of Empirical Studies

2.4.1 Internal Auditors Independence

Chun (1997) argues that objectivity is essential to the auditing process. An internal auditor's impartiality toward the company's employees and operations is critical. Any discrepancies would cast doubt on the auditors' final report and its accompanying recommendations. Because of this, internal audit can't achieve its goal and purpose without a measure of autonomy. The credibility and objectivity of the organization are two of the most important aspects in determining its autonomy.

Given the complexity and importance of banking operations, Dumitrescu (2004) acknowledges in his article on the audit function in financial organizations that every bank should have an internal auditing division. External businesses typically do internal audits for small banks. A bank's internal assessment team needs to be physically and organizationally isolated from the activities they regulate and from the bank's standard internal control processes. As a result, this division's operations are managed in a fair and unbiased fashion. There may be no conflicts of interest between internal auditors and the bank. All financial institutions need to have clear internal auditing policies that spell out the function and authority of the auditing department. All aspects of the internal audit division, including its role in the bank's management and its relationships with other control agencies, should be detailed here.

The concept of independence for internal auditors is crucial since it allows the unit to function autonomously and provide helpful feedback to management on how to continuously develop effective control systems.

Accounting and financial failures, as well as independent audit failures, are common, and this, according to Lawrence (2013), has prompted many who choose an internal auditing career path to push for more independence within their organizations. Institutional top brass in countries that place a premium on internal evaluation now report to specialized commissions that report directly to the executive board of directors. For the auditing services they provide, internal auditors must be independent, and audit committees that lack independence typically fall short of organizational standards (Kadondi, 2012).

The effect of stock ownership and incentive compensation on the independence of internal auditing was studied by Schneider (2014). Experimental research technique utilized in the study requested internal auditors to select what information should be provided in a situation where stock ownership and incentive pay were modified. It was his finding that internal auditors' financial stability and the absence of specified reward structures significantly impacted their capacity to maintain objectivity within the organization. According to the research conducted by Schneider, if internal auditors were not compensated for their efforts, upper management could exert pressure on the internal audit team, leading to skewed results and potentially erroneous conclusions for the company. However, internal auditors were encouraged to report infractions within the company by evident performance-related incentives. Internal auditors fall short of their potential due to weak organizational relationships, a lack of management support, insufficient resources, and a lack of leadership backing.

Fraud, missed deadlines, faulty accvounting, and other shady dealings are all the result of a lack of controls in a company. The need for certified public accountants (CPAs) with industry experience is rising as the number and size of publicly traded companies (FTSs) increase. Some smaller public companies in developing economies struggle to attract and retain experienced accountants, particularly those who are well-versed in generally accepted accounting principles (GAAP) and auditing standards. Therefore, management has a voice in how well internal auditors do their jobs. This increases the likelihood of errors in financial reporting, which can have a devastating effect on a company's bottom line (Cohen, Krishnamoorthy & Wright, 2008).

Most businesses use internal audits and other forms of control to encourage good bookkeeping and keep tabs on how each department is doing in terms of productivity and profitability. Incentive schemes are commonly used to reward top executives, with the goal of encouraging them to maximize profits for stockholders while also maintaining a competitive advantage in the talent war (Maletta, 2013).

For the purpose of ensuring that the board's and stakeholders' expectations are being met, organizations often employ the services of internal auditors (Montondon & Fisher, 2009). The internal audit role exists, but there is little consensus among top executives, board members, and the general public that it is an effective control mechanism that contributes to good governance (Lin, 2013). When assessing the value of internal auditors, it is important to take into account whether or not their work helps the company improve its corporate governance practices, as suggested by the IIA (2012).

2.4.2 Internal Auditors’ Technical Competency

Internal auditors' technical expertise is crucial to effective governance and proper use of taxpayer funds. The internal auditor need to be well-informed, skilled, and competent for the auditing process to be successful. Morgan (2009) contends that internal auditors have the right combination of education and experience. What sets internal auditors apart as technical experts is their ability to maintain independence, competence, honesty, and diligence while carrying out auditing obligations. There is a favorable link between efficiency and efficacy of internal control in firms when internal audit operations have a high level of technical skill.

Inadequate training, specialty, knowledge, and adherence to established auditing procedures all work to dampen the effectiveness of internal audits. According to Kariuki (2014), a company's internal auditors should be qualified experts in their field. There is a significant threat to effective performance from insufficient understanding and an absence of familiarity with auditing techniques. To fulfill their duties effectively, internal auditors need to be highly trained professionals who have earned relevant certifications. Internal auditors need to have a minimal level of education and a solid skilled reputation in evaluating in order to advocate for good governance. It is the primary auditor's duty to find and hire qualified internal auditors who can do the job well. Knowledge, technical skill, and certification of internal auditors all have a role in audit quality, as does the level of professional competency achieved by employees (Mihret & Yismaw, 2011).

There has been a rise in the use of internal auditing as a tool for enhancing the efficiency and effectiveness of government agencies and other public institutions (Diamond, 2002). Traditionally function of the internal auditing department was to verify that the government, its ministries, and the legislature are spending public money responsibly, as defined by the law, and that the budget the public sees accurately reflects the actual situation of the economy (Goodwin, 2014). When properly implemented, an internal audit system can boost productivity, maximize available resources, and prevent unnecessary financial losses. The effectiveness of the government's public spending monitoring systems is greatly enhanced by the presence of active internal organizations, which is core, most importantly, satisfying the needs of internal operators.

It's not easy to spot fraud. Due to factors such as fraudsters' deliberate use of duplicity to hide their conduct and inspectors' possible inexperience in recognizing scams, fraudulent behaviors are very unexpected and challenging to detect (Nieschwietz, 2000). Therefore, the best course of action for the company is to identify and hire people who appear to have distinctively different personality qualities or features and task them with the duty of fraud detection. Uecker (2011) looked at the use of relative hostility assessments between external and internal auditors in the detection of corporate malfeasance. Since most fraud detection comes from the internal auditing department, internal auditors play a crucial role in the process (KPMG, 2013).It is crucial to correctly detect fraud, so any processes that can improve audit effectiveness should be acknowledged. While education and experience are essential for detection, there are a number of personal characteristics that can be utilized as predictions of how suspicious an individual would be (Ashton, 2013). Understanding how auditors are seen and how this impacts presumptions about their detecting capability is a crucial first step in establishing a link between personality features and auditor efficiency.

A review of the relevant literature indicates that five-factor model is widely accepted as an effective tool for summarizing most important aspects of an individual's personality (Judge, 2012). A conscientious person accepts accountability, works hard, stays on task, and does many quality checks. Conscientiousness is the quality that most efficiently organizes and guides one's actions. Wells (2013) conducted interviews with competent fraud assessors and found that they shared several traits. These included the agreeableness attributes of tenacity, attentiveness, and integrity. Only industriousness out of the five factors in the five-factor model has been shown to reliably predict performance on the job (Robertson, 2012). Multiple studies have shown that intellect and conscientiousness are strong indicators of success.

Prior research has connected openness to experience with task performance, and the association has been shown to persist over a period of time (Barrick 2011). Performance in the job can be impacted by conscientiousness in a variety of ways. In general, conscientious workers put in more effort, are more dependable, driven, and reliable. They are also more likely to concentrate on the job at hand and takes fewer hours fantasizing (Viswesvaran, 2012).

Better task-related familiarity is assimilated as a result, increasing productivity .It would be reasonable to assume that conscientious people would pay closer attention to details and benefit more from observation and imitation, increasing their job expertise and productivity (Viswesvaran, 2012). These claims were supported by Colquitt (2010), who indicated a strong correlation between conscientiousness and learning motivation, and by Borman (2011), who showed a favorable association between scrupulousness and job familiarity.

2.4.3 Internal Auditors control Environment

A study was done by Mihret and Yismaw (2011) to evaluate the efficiency of internal audits. The case study method was employed. The intended audience was a sizable public higher education institution in Ethiopia. Using a model created for the analysis, the study looked into the efficiency of the internal review function at a sizable advanced education institution in the civic sector.

Internal assessment quality, organization sustenance, administrative setting, and the auditee characteristics made up the model's four interconnected components.

The study's conclusions show that in order to foster assessment efficiency, the core review department of the organization under investigation must improve the technical expertise of its staff and reduce staff turnover. The internal audit office's institutional structure and internal structure are fairly regarded, but because it lacks budgetary authority, it has less control over the purchase and use of resources. Internal audit services are only available for routine tasks. With the right risk analysis, expanding the service scope by auditing more systems and activities would increase audit effectiveness. It's likely that the internal auditors won't put forth their best effort in their activities if they believe that the management isn't utilizing their reports to the fullest extent. And if management isn't paying attention, the auditee may develop an unfavorable impression of internal audit services, which would have a knock-on effect on auditee excellence.

The research found that the audit process, audit work documentation, audit communications, and advise follow-up of the investigated business all have room for improvement. Adhering to the recordkeeping requirements for the auditing process can increase audit effectiveness by allowing for a more thorough review of the auditing process, appropriate follow-up on the status of recommendations and findings, better distribution of the auditing process, and ongoing improvement of the quality of reporting.

Internal auditing is an important topic for in the past, an internal auditor's job was to aid the business in preserving the confidentiality of its financial records. However, internal auditors now have new duties thanks to the rise of corporate governance. The internal auditor's principal duty is to determine the procedures needed to provide reasonable assurance that all parties may act with full confidence. Internal auditing is a vital resource for audit committees, and as such, they work tirelessly to improve the quality of their relationships with those in the field.

As a result of his wide-ranging duties, the internal auditor is always up-to-date on the company's strategic goals and objectives, as well as all matters pertaining to internal controls, including applicable laws, policies, procedures, opportunities, and threats. Corporate progress, more inquisitive stakeholders, and assurance needs for monetary and non-monetary metrics and reporting all contribute to a rise in auditing efforts. The results of internal audits are therefore "integral" to good corporate governance.

Several participants claim that the internal evaluation feature is crucial to the "oversight" procedure. It is essential to involve auditors in crafting governance processes. The board and upper management can be more effective if they acknowledge the importance of auditing, take steps to strengthen auditor independence and social standing, respond swiftly and effectively to audit findings, and guarantee the CAE's independence .The research highlighted the value of internal auditors in maintaining a company's foundational stability, but also the fact that their primary issue is dealing with subpar working circumstances.

Many variables, says Ramsay (2012), have converged to alter governments in the modern era. Increased accountability and openness in the spending of public funds are among the goals of these reforms, which have led to the introduction of initiatives targeted at expanding government activities and promotion of internal auditing functions to more senior stages. He came up with the idea of internal assessment, which comprises analyzing and enhancing things like management of risks, internal controls, and governance practices. After the Sarbenes Oxley Act was passed, Krishnan and Visvanathan (2013) made an effort to discuss the function of audit committee members and internal audit in communicating to administration about the Act's inherent limitations (SOX). Participants were audit committee representatives from 164 different organizations. The research showed that no defined roles for effective reporting and reporting of fraud in enterprises existed in the regular meetings of internal audit committees.

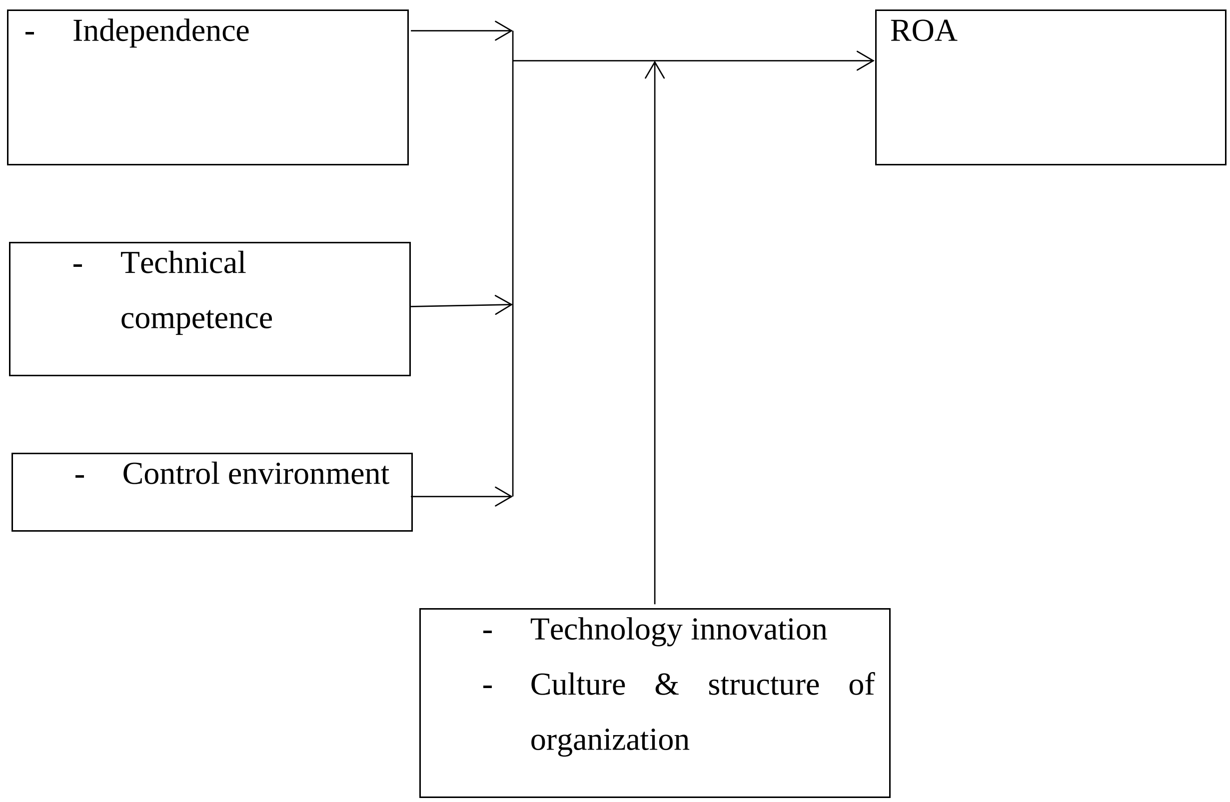
Internal auditors in 24 European nations were surveyed by Hack (2013), who found that the three biggest problems they faced were an increasing demand for hands-on experience, dishonesty, and a dearth of specialists. High maintenance expenses, reluctance to explore, cultural and language differences, not adhering to excellent principles, and unfamiliarity with appropriate accounting standards, rules, and local laws were also noted as barriers to internal auditor efficiency in the study. In fact, only 34% of those polled said that internal auditors actually did stick to established best practices. The study concluded that the organization would benefit from better internal auditing practices.

The internal audit team needs competent people to undertake risk assessments. Almost 90% of respondents in Hack's (2013) survey claimed their organizations routinely conduct risk assessments as part of the process of preparing for internal audits. He also stressed the importance of internal auditor training, saying that only 44% of the participants had the essential auditing abilities and that this hampered the performance of the internal auditor.

2.5 The Conceptual Framework

It is a research instrument made to help some researchers become aware of and comprehend the issue being studied, as well as to communicate this understanding. A theoretical background may be valuable as a tool to help a researcher interpret later findings if it is well-stated (Kombo & Tromp, 2006). Dependent variable and independent variables are connected by the conceptual framework. A dependent variable is one that depends on or results from another variable, even though a regression coefficient is one that arises before a dependent variable (Kothari 2008). In contrast to the dependent variable, which is seen to be the effect, an independent is thought to be the cause. The reliability of independent variables was measured by use of a closed ended questionnaire subjected to a plot test.

Internal Auditing **Financial performance**



Independent variable **Intervening variable** **dependent variable**

Fig 1; The Conceptual framework

Source; Self (2022

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

3.2 Research Design

The investigation was conducted using a descriptive study approach. Structured, formal research and clear, well-worded questions that sought to understand who, what, where, when, or how much were used.

3.3 Target population

In order to draw conclusions about the validity of a study, a researcher must have a certain group as their research target population, according to Kothari (2012). Target population comprised of 39 commercial banks from Kenya. (CBK, 2021).

3.4 The Data collection procedure

Secondary and primary data were used to complete the analysis. Secondary data was collected from the annual supervisory reports of the banking system in Kenya, guaranteeing the data's authenticity, dependability, and greater accuracy. Primary data was gathered by having a closed-ended questionnaire dropped off and picked up from respondents.

3.5 Data analysis and Presentation.

The study used Microsoft excel and SPSS software to analyse data. Quantitative data was analysed for descriptive statistics. Information was presented in figures and tables for simplicity of use, understanding, and appreciation. The model used for the study was Multilinear regression analysis.

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5\varepsilon + \varepsilon$$

Where the letter Y = dependent variable (financial performance);

$B_{0\,=}$ regression constant,

Both β_1, β_2 as well as β_3 = coefficients of independent variables;

X_1 =Auditor’s independence,

X_2 =Auditor’s Technical competencies,

X_3 = Internal Auditor’s control environment,

X_4 =Technology innovation

X_5 = Culture & structure of organization

And ε =error term

3.5.1 Test of Significance

Study analysed the significance of the connection between the independent and dependent variables using an F-test. All of the values of the variables were tested for significance at the 5% level. If the value of the significance coefficient for a given variable is less than 0.05, then that variable was considered significant; otherwise, deemed non-significant if it was higher than 0.05.

CHAPTER FOUR

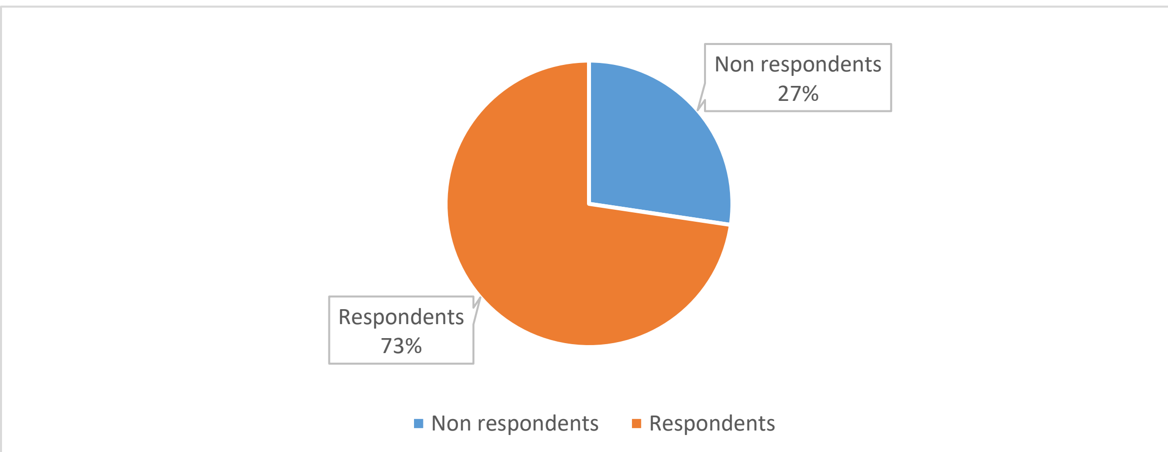
DATA ANALYSIS AND PRESENTATION

4.1 Introduction

The chapter entails demonstration of the data investigation and clarification that was gattered from the field by use of closed ended questionnaire administered to the respondents and also financial data collected from annual financial statements.

4.1.1 Response Rate of Respondents

The unit of analysis comprised of one manager and two staffs from the accounting and finance department from each commercial bank. Therefore, 117 questionnaires were issued to the defendants by means of the drop and pick technique. However, data was collected from 85 respondents who returned their questionnaires hence giving a response rate of 72.65%.



4.2 Presentation of Data

4.2.1 Demographic information

Table 4.1: Respondent gender

Gender	Frequency	Percentage (%)
Male	48	56

Female	37	44
Total	**85**	**100**

Of the total of 85 questionnaires collected, 56 percent were filled out by men and 44 percent by women. This response was representative of the population as a whole, so the gender ratio was not an issue.

Table 4.2: Age group

Age bracket	**Frequency**	**Percentage (%)**
25-34 years	16	19
35-44 years	30	35
45-54 years	28	33
55 years and above	11	13
Total	**85**	**100**

From the findings, the information obtained from the respondents was reliable and relevant because results acquired cut across the age group of the population.

Table 4.3: Education status

Level of education	**Frequency**	**Percentage (%)**
PhD	16	19
Masters	18	21
1st Degree	38	45
Postgraduate diploma	13	15
Total	**85**	**100**

Participants were asked about their highest level of education attained for this study. The results showed that the vast majority of respondents had their first degree.

Table 4.4: Period of Service

Year of service	Frequency	Percentage (%)
1 - 2 years	4	12
2 to 3 years	23	27
3 to 4 years	18	47
4 years and above	40	14
Total	**85**	**100**

4.2.2 Internal Auditing Independence

The aim of this study was to ascertain how long the respondents had spent providing their services on the job. According to the data, the majority of the participants had worked for a considerable amount of time, which suggests that they had a wealth of expertise that this study could rely on.

Table 4.5: Extent which internal auditing independence affect financial performance of commercial banks

	Frequency	Percentage (%)
Very great extent	70	82
Great extent	10	12
Moderate extent	5	6
Total	**85**	**100**

The research was conducted to learn if and how much the autonomy of internal auditing affect the financial performance of commercial banks. The results indicate that the independence of internal auditing has a positive impact on the profitability of financial institutions, with 82% of respondents indicating a very great extent, 12% indicating a great extent, and 6% indicating a moderate extent.

Table 4.6: Effects of Independence of Internal Auditing on financial performance

STATEMENTS	SA	A	N	D	SD	Mean	Standard Dev	
Individuality is crucial to auditing.	70	15	0	0	0	3.75	7.5	
An internal assessor needs to be independent with regard to an organization's employees and operational operations.	63	22	0	0	0	5.5	11	
The opinions, findings, and recommendations of the auditors would be questionable in terms of their integrity.	56	14	15	0	0	7.24	8.38153	
For internal assessment to effectively attain its function and accomplish its goal, independence is required.	80	5	0	0	0	1.25	2.5	
Auditing firm in banking firms recommends that each bank have an internal evaluation department it can rely on regardless of the size and nature of its operations.	82	3	0	0	0	0.75	1.5	
There might not be a conflict of interest between internal auditors and the bank.	23	26	7	29	0	15.5	14.2	
Every bank needs formal internal auditing standards outlining its	78	17	0	0	0	4.25	8.5	

responsibilities and power within the organization.								
Those who are in control of administration and upper management get reports from the internal auditor.	6.75	27	0	0	0	6.75	13.5	
Internal auditor independence and power are well protected.	35	28	1	21	0	12.5	14.15	
All operations, employees, assets, and transaction records are accessible to the internal auditor at no cost and without any limitations.	35	22	3	10	15	12.5	8.02	

In order to determine whether respondents approved or disapproved of maintaining the independence between management and internal auditing, the study included a closed-ended questionnaire with structured statements that were presented to the respondents.

4.2.3 Technical Competency

Table 4.7: Extent to which technical competence affect financial performance.

	Frequency	**Percentage (%)**
Very great extent	70	82
Great extent	13	16
Moderate extent	2	2
Total	**85**	**100**

The research set out to answer the question, "To what extent does the technical proficiency of internal auditing influence the financial profitability of the banks?" It's to a very big extent, the study claims. Internal auditing needs the right set of skills and expertise to have a positive impact on the bottom lines of financial institutions by enhancing their processes and providing new value.

Table 4.8: Effect of technical competency of Internal Auditing on Financial Performance

STATEMENT	SA	A	N	D	SD	Mean	Standard Dev
The performance of banks is impacted by fraud detection since it is fundamentally unexpected and difficult to detect.	47	18	20	0	0	9.5	11
My organization's auditors are qualified to perform audit functions.	56	29	0	0	0	7.5	14.5
Knowledge of the instruments and methods used in financial analysis are available	68	17	0	0	0	4.5	8.5
Internal auditors are proficient in tech-based auditing	73	12	0	0	0	3	6

procedures and IT/ICT.							
Internal assessors are skilled in examining corporate operations.	78	7	0	0	0	1.75	3.5
Internal auditors are knowledgeable about authority, risk, and managerial procedures and tools.	80	5	0	0	0	1.25	2.5
Internal assessors are proficient in continuous/real-time audit	32	16	10	10	17	13.5	3.775
Internal auditors are skilled in using electronic working papers	56	9	10	5	5	7.25	2.6299
Internal auditors are skilled in computer-assisted internal	64	21	0	0	0	5.25	10.5

auditing procedures.							
In commercial banks, the internal audit function identifies frauds.	48	20	7	0	0	6.75	9.43

4.2.4 Internal Auditing Control Environment

Table 4.9, Effects of internal auditing working environment on financial performance

STATEMENTS	SA	A	N	D	SD	Mean	Standard Dev
Formal audit training courses are offered to internal auditors.	60	7	0	8	10	6.25	4.35
There are chances for internal auditors to participate in audit conferences, seminars, and exchange programs.	56	12	10	2	5	7.25	4.57
In an effort to improve their productivity, internal auditors are given training courses in respect to their duties	60	16	9	0	0	6.25	7.76
Internal auditors are given on-the-job training tailored to their duties in the internal assessment unit.	56	29	0	0	0	7.25	0.5
The firm always plans on providing future audit committees training to all of its employees.	50	15	8	4	8	8.75	4.57
Recommendations of internal auditors' are acknowledged and followed	28	14	8	14	11	11.75	2.87

At meetings and conferences, internal auditors are represented.	72	13	0	0	0	3.25	6.5
In audit publications, the internal auditors are lauded and their contribution is acknowledged.	61	24	0	0	0	6	12
There are chances to travel for trainings, audits, conferences, etc.	79	6	0	0	0	1.5	3
The audit committee has carefully thought-out strategies in place to manage significant risks found by internal auditors.	37	30	10	3	5	12	12.35
Clear definitions exist for the work description, division of responsibilities, management, direction, and responsibility.	48	17	10	5	5	9.25	5.68
The controls are adaptable to deal with new hazards, a changing environment, and operational deficiencies.	50	15	13	2	5	8.75	6.23
There is assistance for expert training.	36	28	12	9	0	12.25	11.67

4.3 Financial performance of commercial banks

Financial success served as study's dependent variable. Return on asset ratio was utilized in the study to assess financial performance over a period of 4 years (2018-2021). This ratio shows the profit margin as a percentage of total assets for a commercial bank. The outcomes are shown in table 4.10.

Table 4.10 of Financial Performance

#	Commercial Banks	ROA		#	Commercial Banks	ROA
1	KCB Bank Limited	4.4775		20	Gulf African Bank	1.1975
2	Equity bank ltd	4.3825		21	Mayfair Bank Ltd	-2.2656
3	Cooperative Bank of Kenya Ltd	4.0275		22	Sidian Bank Limited	0.0025
4	NCBA Bank Kenya PLC	2.4025		23	HFC Ltd.	-0.9425
5	Diamond Trust Bank Kenya Limite	2.29		24	Guardian Bank Limited	1.2375
6	Absa Bank Kenya Plc	3		25	Habib Bank AG Zurich	1.715
7	Stanbic Bank Kenya Limited	2.715		26	M- Oriental Commercial Bank	0.5825
8	Standard Chartered Bank (K) Ltd	3.4875		27	Bank of Africa Ltd	-1.7775
9	I &M Bank Limited	3.8825		28	African Banking Corporation	0.4875
10	Bank of Baroda (Kenya) Limited	3.795		29	Development Bank of Kenya Ltd	2.2525
11	Premier Bank Ltd.	2.0725		30	Paramount Bank Ltd	1.0875
12	Bank of India	4.01		31	DIB Bank Kenya Ltd	-8.755
13	Citibank N.A. Kenya	5.5125		32	Credit Bank Ltd	1.035
14	Family Bank Limited	1.64		33	Access Bank Ltd	-6.393
15	National Bank of Kenya Limited.	0.2375		34	Middle East Bank (K)	0.7375
16	SBM Bank Kenya Limited	1.02		35	First Community Bank Ltd	0.7225
17	Victor Commercial Bank Limited	1.5175		36	Kingdom Bank Ltd	0.2975
18	Ecobank Kenya Limited	0.3025		37	UBA Kenya Bank Ltd	-2.25
19	Guaranty Trust Bank	1.77		38	Consolidated Bank of Kenya Ltd	-2.7825
				39	Spire Bank Ltd	-16.173

According to the findings in the table 4.10 commercial banks such as Citibank N.A. Kenya, KCB Bank Ltd, Co-operative bank and Equity bank Ltd registered higher ROA as compared to most commercial banks.

4.4 Regression analysis

To ascertain the relationship between internal auditing, as shown by independence, technical competency, and control environment, and financial performance of banks, multilinear regression analysis was utilized.

Table 4.11 Model summary

Model	R	R^2	Adjusted R^2	Standard Error of Estimate

1	0.856a	0.733	0.693	0.04887

The size of R and R squared exemplifies the significance of the connection between internal audit function and the financial performance of commercial banks. According to the R2 in the model summary table, the quality of the bank's internal auditing can account for as much as 73.3% of the variation in the model's predicted outcome for the bank's financial performance.

Table 4.12 Finding of ANOVA

Model		Sum of Squares	Df	Mean square	F	Sig
1	Regression	214.48	5	42.50	3.22	0.01
	Residual	960.62	72	13.34		
	Total	1175.10	77			

Research using ANOVA to determine the significance of the regression model yielded an f-significance number of 3.22; p0.001. This demonstrates that the regression model has a confidence level of greater than 95% and that the effectiveness of internal auditors is a strong predictor of commercial banks' financial health. Results and significance of the beta coefficients are shown in Table 4.13.

Table 4.13 Coefficients output

	Unstandardized coefficients		**Standardized coefficients**	**T**	**Sig**
	B	**Std. Error**	**Beta**		
Constant	10.88	0.155		2.78	0.534
Independence	0.438	0.041	0.424	2.35	0.03
Technical competence	0.560	0.048	0.532	0.63	0.03
Control environment	0.392	0.058	0.362	1.15	0.04

Technology Innovation	0.241	0.054	0.228	2.12	0.04
Culture & Structure	0.038	0.038	0.028	0.62	0.03

In table 4.13, the coefficient values for Independence, Technical Competence, Control Environment, Technology Innovation, and Culture and Structure of the Organization reveal that there is a positive and significant association between financial performance of commercial banks and these factors. Statistically, the regression equation was

$$Y = 10.88 + 0.438X_1 + 0.560X_2 + 0.392X_3 + 0.241X_4 + 0.038X_5$$

4.5 Interpretation of the findings.

The findings show that commercial bank performance varies significantly due to changes in internal auditor independence, technical competence, and control environment. As a result, the internal auditing determinants studied in the study can be used to explain this variation.

Financial success for commercial banks was found to be related to how well their internal auditing departments performed. Therefore, the effectiveness of the bank's internal audit department boosts the institution's bottom line.

The report suggests that the Internal Auditor profile the Audit Team's competency with respect to the duties assigned to it by the University and the number of persons who should be assigned to those duties. Internal technical expertise and internal auditing staffing, as suggested by Kariuki (2012), can enhance risk-based auditing, allowing businesses to more effectively identify risks in a timely manner and concentrate on high-risk areas, which in turn increases accountability and transparency and boosts financial performance. This connected the dots between the bottom line and the internal auditing

CHAPTER FIVE

DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This unit provides an overview of the study's outcomes, analyses, conclusions, and recommendations in light of its aims. The study set out to determine whether or not internal auditing had any effect on the profitability of Kenya's commercial firms.

5.2 Summary and Discussion

Overall, the study found that internal auditors' performance was highly impacted by the work environment. According to the study's findings, internal auditors must always uphold the highest ethical standards, keep an objective perspective, and adhere to established standards of conduct. The study found that when auditors are allowed to do their jobs in line with the ethics and rules governing the auditing function, audit quality and productivity are both improved. Last but not least, internal auditors at commercial banks take a scientific and systematic approach to analyzing risk management, control, and management, and making contributions to their enhancement.

Evidence suggests that auditor efficiency is significantly impacted by internal auditing integrity. Based on the findings of this study, it was also concluded that the internal auditing role of a financial institution should be kept entirely distinct from the operations it monitors and the regular internal control procedures of the institution. The study concluded that the status and authority of financial institutions within the context of the banking legislation, which guarantees independence, are spelled out in established internal auditing principles. Internal auditors must maintain a level of objectivity and non-bias in carrying out their duties.

According to the findings, internal auditing's effectiveness in relation to commercial banks' financial performance is significantly influenced by auditors' openness to change and their technical competency in internal auditing in many areas.

It was revealed using regression analysis that a commercial bank's financial performance is favourably connected with the quality of its internal auditing, the independence of its auditors from management, and the expertise of its auditors. The studies also demonstrate the importance of accountability within internal audit departments in order to deliver reliable reports on the state of an organization's operations.

5.3 Conclusions

5.3.1 The Internal Auditing Control Environment

Multiple variables, the study concluded, have contributed to the present-day setting. The ability of systems and practices to respond to an ever-changing environment that introduces new risks and operational gaps, the presence of internal auditors at competent annual audit conferences, and the presence of top-level management's encouragement and regulations demonstrating their enthusiasm for cultivating internal auditing are all examples of these.

The research also showed that audit committee members received formal audit training and on-the-job training specific to the tasks they play within the internal audit department through meetings and conferences. The study also found that the company's accomplishments, ethics, human resource policies, and achievement incentive systems all lend support to the company's efforts to cultivate a culture of risk management and achieve its goals while effectively managing risks.

5.3.2 Internal Auditing Independence

The research concluded that commercial banks ensured the independence of auditors by prohibiting internal auditors from performing audits of their own operations and establishing a separate unit for the audit committee. Senior management is accountable for governance, and internal auditors report to them. An internal auditor's role and legal authority are spelled out in an audit charter. The research also concludes that CAE plays a crucial role in hiring of internal auditors and that they are kept separate from management and functional decisions.

5.3.3 Internal Auditing Technical Competence

The findings of this study suggest that the technical competence of internal auditing centres on a number of factors that work together to guarantee that the internal audit department delivers as expected and in line with the organization's goals. An organization's internal audit team needs thorough familiarity with the business sector in which it operates in order to understand the threats it faces and develop effective countermeasures.

The research also concludes that commercial banks' internal auditing technical proficiency has not fully embraced strategies for dealing with risk assessment and analysis, budgetary control, information retrieval, investigation of commercial processes, and the utilization of the IT/ICT and tech-based independent review methods and Panels proof of identity.

5.4 Limitations for the Study

Effective and successful completion of this study was hindered by a few factors. There was a time crunch, which was the first restriction. Only three months were allotted to complete the study. The time and money it took to organize and pay for everything that came up during the research project was another constraint.

5.5 Recommendations

5.5.1 Recommendations for Improvements

5.5.1.1 Internal Auditing Control Environment

Internal auditors at financial institutions should continue to get training from industry professionals through regular seminars. To do their jobs properly, internal auditors need extensive training and experience in the field. It is crucial to keep a close eye on the auditor's progress and provide clear direction and feedback. It is up to the internal auditor's expertise to decide how much supervision is needed.

5.5.1.2 Internal Auditing Independence

To ensure independence, comprehensive audit coverage, thorough study of audited accounts, and adequate action on audit recommendations from commercial banks, directors of the internal auditing function should report to company's management.

5.5.1.3 Internal Auditing Technical Competence

Managers at the affected commercial banks should invest in cutting-edge ICT internal audit software to enhance risk assessment and speed up service delivery in areas like spotting and preventing fraud and other instances of noncompliance with public spending management. Internal auditors also need in-depth instruction in the use of modern internal audit software, which itself should be kept up-to-date to match the rapid pace of technological development.

Organizations that promote better public sector governance, such as the World Bank, the International Monetary Fund, and the United Nations Development Programme, as well as professional bodies, such as the Institute of Certified Public Accountants of Kenya, regularly announce updates to internal audit frameworks.

5.5.2 Recommendations for Further Studies

In light of the findings, the study recommends conducting a similar study, but this time focusing on parastatals and government organizations. As a means of enhancing internal audit in Kenya's commercial banks and, by extension, their overall performance, research into the challenges faced by internal auditors in financial institutions is required.

Internal auditors in Kenya's banking sector need to have their functions and the difficulties they face investigated. The paper suggests investigating commercial banks' internal auditing practices in relation to central bank regulation.

REFERENCES

Allegrini, M., D'Onza, G., Paape, L., Melville, R. and Sarens, G. (2006), "The Europe European literature review on internal auditing". *Managerial Auditing journal*, Vol. 21 No. 8, pp. 845-853

Alzoubi, E.S.S. (2019). Internal audit function, audit committee, and earnings management: evidence from Jordan. *Meditari Accountancy Research,* 27(1), 72-90

Ashton, R.H. (2013). Enriching the ―Expertise Paradigm‖ of Accounting Research: Conscientiousness, General Cognitive Ability and Goal Orientation. Advances in Accounting Behavioral Research, 2, 3-14.

Barrick, M., Mount, M., and J. Strauss. (2011). Conscientiousness and Performance of Sales Representative: Test of the Mediating Effects of Goal Setting. *Journal of Applied Psychology*,78, 715-722

Cai, C. (1997). On the Functions and Objectives of Internal Audit and their Underlying conditions, *Managerial Auditing Journal*, 12(4), 247-250.

Cattrysse, J. (2014). *Reflections on Corporate Governance and the Role of the Internal Auditor*. Roularta Media Group.

Chae, S. J., Nakamo, M., & Fujitani, R. (2020). Evidence from Japan on financial reporting opacity, audit quality, and crash risk, *Journal of Asian Finance, Economics and Busines*s, 7(1), 9-17.

Chartered Institute of Internal Auditors (2017). Internal audit: What is it? From https://na.theiia.org/about-us/about-ia/Pages/frequently-asked-questions.aspx, retrieved on July 18, 2022.

Cohen, J.R., Krishnamoorthy, G. & Wright, A. (2008). Form versus substance: the implications for auditing practice and research of alternative perspectives on corporate governance, Auditing Journal, 27(2):181-98.

Coram, P., Ferguson & Moroney, R. (2008). The extent of asset theft fraud, alternative internal audit frameworks, and internal audit. *Accounting and Finance journal*, 48(4), 543-559

Copper, D.R and Schindler, P.S. (2010) *Business Research Methods*, 8th Edition Mc Growhill irwin, Boston.

Dellai, H., & Omri, M. A. B. (2016). Factors Affecting the Internal Effectiveness in Tunisian organizations. *Research journal of Finance and Accounting*, 7, 208-2011

Diamond, M. J. (2002). The role of internal audit in government financial management: An international perspective. *International Monetary Fund*, Number. 2-94

Drogaslas, G., Karagiorgos T. & Arampatzis K. (2015). Factors associated with Internal Audit Effectiveness: Evidence from Greece. *Journal of Accounting and Taxation*, 7(7), 113-122

Fogarty, Timothy J. (1972) Financial accounting standard setting as an institutionalized action field: Constraints, Opportunities and dilemmas, *journal of Accounting and Public Policy*, Winter, Vol 11, Iss 4, PP331-355

Goodwin, J. (2014). A comparison of internal audit in the private and public sectors, *Managerial Auditing Journal*, 19(2):67-78.

Goodwin, J. (2014). A comparison of internal audit in the private and public sectors. *Managerial Auditing Journal*, 19(5):640-650.

Goodwin-Stewait, J. (2006). Relationship between the audit committee's qualities, external audit fees, and internal audit. *Finance and Accounting journal*, 46(3), 387-404.

Hack, S. (2013). *Higher standards for internal auditors Issue* from March 2008 of CA magazine.

Hazaea, J. Zhu, N. Alsharabi, S. F. A. Khatib, & L. Yueying (2020). Evidence from Yemen regarding the effectiveness of audit committee qualities in commercial banks. 2096–2115 in *Journal of Critical Reviews*, 7(18).

IIA, (2012). The requirements for conducting internal audits professionally. The Institute of Internal Auditors, *Research Foundation*, Altamonte Springs.

Jensen, M. C. and Meckling,W. H. (1976), 'Theory of the firm: Managerial Behavior, agency costs, and ownership Structure', *Journal of Financial Economics*,3,305 -360.

Judge, T.A. (2011) Internal Auditing effectiveness *journal of Accounting & Economics* vol.5

Kelly, T. L. (1927). *Interpretation of educational measurements*. New York, NY: Macmillan.

Kothari, C. R (2008), *Research Methodology and Techniques*. (2nd edition pp. 109-110).

KPMG's Audit Committee Institute (2013). *An Approach to Effective Audit Committee Self-evaluation*

Krishnan, G. V., & Visvanathan, G. (2013). Reporting Internal Control Deficiencies in the Post Sarbanes Oxley Era: The Role of Auditors and Corporate Governance. *International Journal of Auditing*, 11(2), 73-90.

Kariuki (2014). The use of audit committee for monitoring*, journal of Accounting & public policy*

Lawrence, R. (2013). Risky Business Team with Audit Committee to Tackle It Security Needs. *Journal of Accountancy*, www. findarticles.com, Sep 2022

Lin, L. (2013). Corporate Governance, Accountability & Mechanisms of Accountability; an overview, *Accounting, Auditing & Accountability journal committee of Sponsoring Organization* (COSO)

Maletta, M. J. (2013). An examination of auditors' decisions to use internal auditors as assistants: The effect of inherent risk. *Contemporary Accounting Research*, 9(2): 508-525.

Dumitrescu, M. I. –B. (2004). Internal auditing in Banking Organization. *Internal audit function in banking Organizations and on the relation between institutions performing banks*, 16-19

Mihret, D. G., & Yismaw, A. W. (2011). Internal audit effectiveness: An Ethiopian public-sector case study. *Managerial Auditing, Journal*, 22(5), 470-484.

Mitnick, Barry M. (1994). The theory of agency: The policing "paradox" and regulatory behavior. Public Choice Winter, 24: 27-42.

Montondon, L. G., & Fischer, M. (2009). University audit departments in the United States *Financial Accountability & Management*, 15(1): 85-94.

Morgan, W. J. (2009), An assessment of the newly defined internal audit function, *Managerial Auditing Journal*, 17(3):56-83.

Mugenda O, M. and Mugenda, A. G. (2008*) Research Methods*, Quantitative methods and qualitative approaches, 50-52

Robertson, J. C. (2012*). Auditing*. Business Publications, Incorporated.

Ramsay, I. (2012). Independence of Australian Company Auditors: *A Review of Current Australian Requirements and Proposals for Reform*, October 2012.

Schneider, A. (2014). An examination of whether incentive compensation and stock ownership affect internal auditor objectivity. *Journal of Management Issues* 15 (4): 486-497.

Stephen A. Ross (1973) "The Economic Theory of Agency: The Principal Problem," *American Economic. Review* 63,134-139

Uecker, (2011). Auditor size & audit quality; *journal of Accounting & Economics* vol.3

Viswesvaran, C. (2012). Perspectives on models of job performance. *International Journal of Selection and Assessment*, 8(4), 216-226.

Woodward J, (1958): Management & Technology. HM stationery office

APPENDICES

Appendix 1: QUESTIOINNAIRE

This questionnaire aims to learn more about the effect of internal auditing on financial performance of commercial banks in Kenya. The data was handled with confidentiality and used only for academic purpose. The respondents were strongly encouraged and persuaded to provide the most truthful and unbiased responses they can to the questionnaire's questions. Your help in enabling this study effective would be greatly appreciated. Please mark the box next to the effective reaction or, if required, supply the requested information. Make sure to be precise and thorough.

SECTION A. INFORMATION DEMOGRAPHIC

1. What gender are you? Male ( )   Female ( )

2. What age range do you fall into?

25-34 years ( ) 35-44 years ( ) 45-54 years ( ) 55 and above

3. What level of education do you have?

Diploma ( ) Degree ( ) Masters ( ) PhD ( )

4. How long have you been employed by this commercial bank?

1-2 years ( ) 2-3 years ( ) 3-4 years ( ) 4 years and above ( )

SECTION B: INTERNAL AUDITTING INDEPENDENCE

5. How much do internal auditing independence's impact Kenya's commercial banks' financial performance?

Very large extent (5)

To a great extent (4)

Moderate extent (3)

Little extent (2)

No extent (1)

6. How much do you support the following claims on the commercial bank's financial performance in Kenya and the autonomy of internal auditing? (Strongly Agree: 1, Agree: 2, Neutral: 3, Disagree: 4, and Disagree: 5).

STATEMENTS	**1**	**2**	**3**	**4**	**5**
Individuality is crucial to auditing.					
An internal assessor needs to be independent with regard to an organization's employees and operational operations.					
The opinions, findings, and recommendations of the auditors would be questionable in terms of their integrity.					
For internal assessment to effectively attain its function and accomplish its goal, independence is required.					
Auditing firm in banking firms recommends that each bank have an internal evaluation department it can rely on regardless of the size and nature of its operations.					
The internal audit sector should be kept apart from the operations it controls and the standard internal control processes of a banking organization.					
There might not be a conflict of interest between internal auditors and the bank.					
Every bank needs formal internal auditing standards outlining its responsibilities and power within the organization.					
Those who are in control of administration and upper management get reports from the internal auditor.					
Internal auditor independence and power are well protected.					
All operations, employees, assets, and transaction records are accessible to the internal auditor at no cost and without any limitations.					

Section C: TECHNICAL COMPETENCY

7. To what extent does technical competency of internal auditing affect financial performance of commercial banks in Kenya?

Very great extent (5)

Great extent (4)

Moderate extent (3)

Little extent (2)

No extent (1)

8. Which of the following claims about the technical proficiency of internal audits and the financial performance of Kenya's commercial banks do you agree with? (1- Strongly agree: 2- Agree: 3 - neutral: 4- disagree, and 5- strongly disagree)

STATEMENT	1	2	3	4	5
The performance of banks is impacted by fraud detection since it is fundamentally unexpected and difficult to detect.					
Effective fraud detection requires taking steps to increase the effectiveness of auditors.					
My organization's auditors are qualified to perform audit functions.					
Knowledge of the instruments and methods used in financial analysis is there					
Internal auditors are proficient in tech-based auditing procedures and IT/ICT.					
Internal assessors are skilled in examining corporate operations.					
Internal auditors are knowledgeable about authority, risk, and managerial procedures and tools.					
Internal assessors are talented in continuous/real-time audit					
Internal auditors are skilled users of electronic working documents.					
Internal auditors are skilled in computer-assisted internal auditing procedures.					
In commercial banks, the internal audit function identifies frauds.					

SECTION D INTERNAL AUDITORS' CONTROL ENVIRONMENT

9. Mark whether you agree or disagree with the following claims that describe your institution. Use a rating of 5 Where by: 1 = Strongly agree; 2 = Agree 3. Neutral 4 - Disagree 5- strongly disagree

STATEMENTS	**1**	**2**	**3**	**4**	**5**
Formal audit training courses are offered to internal auditors.					
There are chances for internal auditors to participate in audit conferences, seminars, and exchange programs.					
In an effort to improve their productivity, internal auditors are given training chances in employer-specific activities.					
Internal auditors are given on-the-job training tailored to their duties in the internal assessment unit.					
The firm always plans on providing future audit committees training to all of its employees.					
recommendations of internal auditors are acknowledged and followed					
At meetings and conferences, internal auditors are represented.					
In audit publications, the internal auditors are lauded and their contribution is acknowledged.					
There are chances to travel for trainings, audits, conferences, etc.					
The audit committee has carefully thought-out strategies in place to manage significant risks found by internal auditors.					
Clear definitions exist for the work description, division of responsibilities, management, direction, and responsibility.					
The controls are adaptable to deal with new hazards, a changing environment, and operational deficiencies.					
There is assistance for expert training.					

THANK YOU

APPENDIX II: LIST OF COMMERCIALS BANKS IN KENYA

Commercial Banks	ROA		#	Commercial Banks	ROA
KCB Bank Limited	4.4775		20	Gulf African Bank	1.1975
Equity bank ltd	4.3825		21	Mayfair Bank Ltd	-2.2656
Cooperative Bank of Kenya Ltd	4.0275		22	Sidian Bank Limited	0.0025
NCBA Bank Kenya PLC	2.4025		23	HFC Ltd.	-0.9425
Diamond Trust Bank Kenya Limite	2.29		24	Guardian Bank Limited	1.2375
Absa Bank Kenya Plc	3		25	Habib Bank AG Zurich	1.715
Stanbic Bank Kenya Limited	2.715		26	M- Oriental Commercial Bank	0.5825
Standard Chartered Bank (K) Ltd	3.4875		27	Bank of Africa Ltd	-1.7775
I &M Bank Limited	3.8825		28	African Banking Corporation	0.4875
Bank of Baroda (Kenya) Limited	3.795		29	Development Bank of Kenya Ltd	2.2525
Premier Bank Ltd.	2.0725		30	Paramount Bank Ltd	1.0875
Bank of India	4.01		31	DIB Bank Kenya Ltd	-8.755
Citibank N.A. Kenya	5.5125		32	Credit Bank Ltd	1.035
Family Bank Limited	1.64		33	Access Bank Ltd	-6.393
National Bank of Kenya Limited.	0.2375		34	Middle East Bank (K)	0.7375
SBM Bank Kenya Limited	1.02		35	First Community Bank Ltd	0.7225
Victor Commercial Bank Limited	1.5175		36	Kingdom Bank Ltd	0.2975
Ecobank Kenya Limited	0.3025		37	UBA Kenya Bank Ltd	-2.25
Guaranty Trust Bank	1.77		38	Consolidated Bank of Kenya Ltd	-2.7825
			39	Spire Bank Ltd	-16.173