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Drivers of Enhanced Internal Auditor's Performance of NSE Listed Banks in Kenya

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Abstract:

The study evaluated the key driver of enhanced financial performance in the Nairobi Stock Exchange (NSE) listed banks in Kenya. The study posits objectivity, governance and independence have significant effects while the frequency of reporting has no significant effect on the auditor's performance in the NSE listed banks in Kenya. The study used a descriptive research design and a case study to analyze the impact of the variables on auditor's performance using Likert collected responses. The correlation results established that internal auditor's independence, good governance and objectivity positively influenced the performance as they all had positive values. The R squared value being at 75.4% hence showing a good fit. The F statistic was also significant showing that the independent variables were significantly different and that each could contribute differently to the auditor's performance. To enhance performance and mitigate adverse corporate governance issues management requires that the banks offer auditors independence and authority in the management protocols and establish internal audit unit to undertake periodical audits. To facilitate faster delivery of audit services including the detection and prevention of frauds and/or non-compliance with public expenditure, the listed banks should provide a conducive work environment that enables the use of cutting-edge ICT technology to support auditing functions, promote continuous training and develop institutional mechanisms (e.g., enforcement, auditing, or corporate governance structures) to encourage compliance with international standards.

Keywords: Auditor, independence, objectivity, reporting, governance

1. Background of the Study

Internal audit play a critical role in public expenditure management, information communication sharing and provides an assurance on institutional operations that enhance daily organizational performance (Reid & Ashelby, 2002; Diamond, 2002; Institute of Internal Auditors (IIA), 2009). It safeguards organization resources and give an assessment of continuous resource use, feedback to public objectives and expectations, and, helps to reduce the risks inherent in the principal-agent relationship between the executive and the public (Adel, 2011).

The basic roles of internal auditor's activities are directed towards evaluating compliance with the set rules and regulations in a bid to promote preciseness, efficient transactions and corrective actions against deficits for the purposes of transparency and accountability (Stoner, 1994; Owler & Brown, 2009).

Internal auditors must be highly qualified in terms of skills, knowledge, and objectivity. They are guided by institutional approved charters that spell out their authority, independence, and scope of duty during the audit (Paape, 2007; IIA, 2004; Ramsay, 2002). Key factors such as management support, availability of working resources, independence of internal auditors and commitment by management significantly influence the performance (Smith *et al*, 2001).

Lack of objectivity, experience, expertise, knowledge and qualification on auditing practices hinders performance of internal auditors. Kariuki, (2010) posited that internal auditors in a firm should be competent professionals. The chief auditor is required to effectively select and recruit highly trained and skilled internal auditors (Kunkel, 2014).

Internal auditors play a critical role in promoting governance that is critical in the organization for the promotion accountability and transparency in financial management, reduction of risk and minimizing corruption. In this respect, it is important for the internal audit functions and structure to be effective to achieve the intended objectives and internal auditors should be empowered to act with integrity and offer reliable information for action to be undertaken (IIA, 2012).

Lawrence (2013) found that the increased frequency of financial reporting and external audit failures motivated the internal audit profession to seek greater autonomy in the organization structure and in countries where the role of internal audit is highly valued, functional reporting moved from senior officers in the organization to specific committee's set-up under the boards and that report to the board of directors.

Internal audit independence and authority are important concepts that enable the function to operate without interference and provide effective feedback to management on how to continuously enhance effective control policies (Warga, 2014). The auditing services offered by internal auditors are achieved through internal auditor's independence and where internal auditors lack independence, they would normally fail to perform to the expectation of the organization (Kadondi, 2012).

1.1. Statement of the Problem

The application of the various reforms applied in the since the 1990s has sought to enhance and improve performance of various organizations. The steadiness, efficiency and access to finances have been the focus of these reforms. Lumumba (2015), opines that the failure in the financial governance in Kenyan companies had led to corporate frauds, improper accounting and incorrect financial reporting, which in return had led to the collapse of Chase and Imperial banks in 2015 and insolvency of Uchumi supermarkets. A number of studies equally carry similar reports key among them are Otieno (2012), who established that weak internal auditing procedures have increasingly become a major problem in detecting loss of public funds and are an indication of ineffectiveness of internal auditors in the public sector.

On average, banks have been performing well, with Equity bank meeting their expected goals and even surpassing their goals. In the year 2019, Equity improved on its performance with a 14% profit after tax growth to Kshs 22.6 billion from Kshs 19.8 billion in 2018. This is a good trend. However, sustainability of this continued good performance in these banks is the major challenge. The bank's profit for the year ended December 2020 dropped 12 per cent to Sh20.1 billion compared to Sh22.6 billion the previous year. This raises the question as to whether auditor related factors could be the weak link between auditing results and public institution performance. This has led the Kenyan banks to adopt internal audit practices. This is both in its core design of monitoring and adherence to internal controls and its economic integrity (Alzeban and Gwilliam, 2014). Consequently, the study sought to examine the factors that affect internal auditor's performance of NSE listed banks

1.2. Objectives of the Study

1.2.1. General Objective

This objective of the research was to determine the factors that affect internal auditor's performance in NSE-listed commercial banks in Kenya.

1.2.2. Specific Objectives

The specific objectives included the following;

- To determine the objectivity of the internal auditor on the internal auditor's performance of the NSE listed banks in Kenya.
- To evaluate good governance and internal auditor's performance of NSE listed banks in Kenya.
- To review the frequency in reporting and internal auditor's performance of NSE listed banks in Kenya.
- To analyze internal auditor's independence and internal auditor's performance of NSE listed banks in Kenya.

1.3. Hypotheses

The following hypotheses will guide the study:

- Ho1: There is no significant effect between objectivity of the internal auditor and internal auditor's performance of NSE listed banks in Kenya.
- Ho2: There is no significant effect between good governance and internal auditor's performance of NSE listed banks in Kenya.
- Ho3: There is no significant effect between the frequency of reporting and internal auditor's performance of NSE listed banks in Kenya.
- Ho4: There is no significant effect between the independence and internal auditor's performance of NSE listed banks in Kenya

3. Research Methodology

This descriptive case study involved 11 primary NSE listed banks in Kenya. The population of importance in this investigation was the 11 NSE listed banks in Kenya that have transacted between 2013 and 2017. The focus of the study was the Internal Audit Department of these banks. Data collection procedure observed all the necessary ethical consideration like explaining the purpose of the study, assuring the respondents of confidentiality.

Data was analyzed using the following regression model:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon$$

Where:

Y = Internal Auditor performance,

β_0 = Constant Term,

β_1 = Beta coefficients

X₁ = Objectivity

X₂ = Governance

X₃ = Reporting

X₄ = Independence

ϵ = Error Term

3.1. Response Rate

The response rate was high at 94.5%. All of them had post-secondary school level education to which some had done professional courses such as CPA, ACCA, CIFA, CPSPK, and OCP among others. The respondent's length of service in the banks shows that 48% had over 6 years of service in the institution.

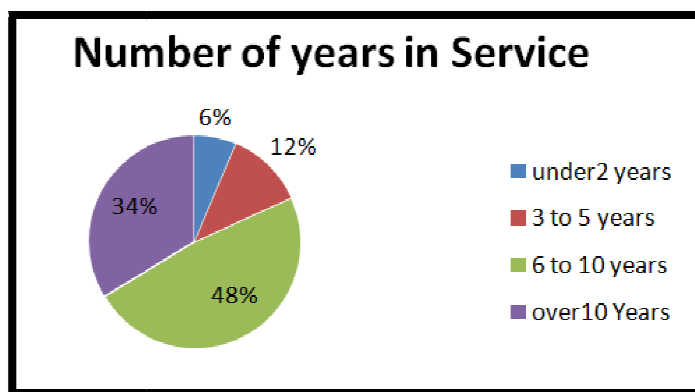


Figure 1: Number of years in Service

3.2. Correlation Analysis

Data on NSE listed banks auditor's performance and independence was analyzed at their means and the subjected to correlation analysis. The results showed that the variable could be used in regression due to the high level correlation with the dependent variable and low correlation among themselves.

	Y	X1	X2	X3
Y	1			
X1	0.761**	1		
X2	0.207	0.80	1	
X3	0.296	0.259	0.393*	1

** . Correlation is significant at the 0.01 level (2-tailed).
 * . Correlation is significant at the 0.05 level (1-tailed).

Table 1: Correlation Table

Source: Field Data (2021)

Y = Internal Auditor Performance, B_0 = Constant Term, B_1 = Beta Coefficients,

X₁ = Objectivity, X₂ = Governance, X₃ = Independence

From the table above, it can be observed that the correlation between the independent variables and the dependent variable was positive at 0.0.761, 0.207 and 0.296 for objectivity, governance and independence. The interpretation was that the level of multi-collinearity between the independent variable was low though significant, which meant that the influence of each variable in the regression model could be identified without challenges. Burns and Burns (2008), note that multi-collinearity is the presence of high correlations between the independent variables and should be avoided or minimized. The variables were found to have a strong positive effect on auditors' performance. The interpretation was that improved objectivity, good governance, frequent reporting and independence would lead to improved performance of the internal Auditor.

R	R ²	Adjusted R Square	Std. Error of the Estimate
0.868	0.754	0.705	0.614

Table 2: Regression Result

Source: Field data (2021)

From table 2 the values of the results were $R=0.868$, $R\text{ Square}=0.754$ and adjusted $R\text{ square}=0.705$. These values clearly suggest that there is a strong relationship between, independence of internal auditor for this model. This implies that independence had a statistically significant effect on performance of internal auditor.

	Sum of Squares	Df	Mean Square	F	Sig.
Regression	34.592	6	5.765	15.306	0.0000
Residual	11.300	30	0.377		
Total	45.892	36			

*Table 3: Analysis of Variance
Source: Field Data (2021)*

The F-statistic was found to be 15.306 and was significant showing that the independent variables were significantly different and that each could contribute differently to the performance of the auditors. The contribution of these variables to the overall performance under interaction is given in the Table 4: Coefficient table below.

Variable	Coefficients	Std. Error	t-statistic	p-value
(Constant)	0.42	0.367	0.115	0.909
Objectivity	0.302	0.138	2.182	0.0
Good governance	0.514	0.148	3.475	0.0
Reporting	0.258	0.07	0.934	0.0
Independence	0.37	0.93	0.401	0.0

*Table 4: Coefficients
Source: Field Data (2021)*

The study model provided useful insight on the relationship between auditor's performance and the four variables namely objectivity, good governance, reporting and independence Table 1, Table 2 and Table 3. The model results also showed a good fit of 75.4% with all the said variables having a significant effect of auditor's performance. This is in line with earlier studies by which accepted similar hypothesis. This high coefficient of determination is comparable with the results from earlier studies that used structural equation modelling. This reveals that goodness of fit for the model and the proxies used for auditor's role imply that audits success is incumbent on internal auditors' objectivity, good governance, frequency in reporting and independence.

This results, Table 4 show that when objectivity is improved by 1%, auditors is enhanced by 0.302 % measure. Similarly, a 1% improvement in governance will lead to a 0.514, reporting and independence will lead to a 0.258 and 0.37 percentage increases respectively. These increases are both significant at 90% confidence interval. Although the coefficient of determination is 75.4%, the regression constant is significant implying that not all relevant variables have been included in the study.

Governance was the most important driver of improved performance. Earlier studies had shown that good governance provides a good working environment that leads to job satisfaction and organization commitment. Job satisfaction and organizational commitment encourage internal auditors to show organizational citizenship behavior in achieving organization goals (Pitaloka and Sofia, 2014). The finding coincides with Morgan (2009) that performance is negatively impacted in organizations where internal auditors work under poor working conditions and where management fails to support their role and despise them as unworthy in the organization and fail to allocate sufficient resources to the internal audit function.

Objectivity were other drivers of auditor's good performance at the NSE listed banks. It encompassed organization management and operation research skills, higher-level objectives link with listed banks operational objectives, the listed banks attitude towards identified risks, the listed banks key related risks and how they impact their high-level objectives, risk, control tools and techniques, project management, electronic work papers, process modelling software and understanding performance and measurement principles verses output targets designed to deliver objectives. Competent auditor's complying with international auditing standards is bound to be successful in their work. Compliance with internal auditing standards contributes significantly to the quality and effectiveness of auditing and finally that internal auditors evaluate and contribute to the improvement of risk management, control and governance using a systematic and disciplined approach in the public sector.

Enhanced auditor's independence and authority requires that the management of every institution give a free hand to auditors to evaluate institutional activities freely (Zayol and Kukeng 2017). This ensures that quality audit reports are prepared just like the systems that prepare them. Therefore, the NSE listed banks must be prepared to provide good governance, reporting frequently and independence that gives independence to auditors and their authority to ensure objectivity in audit reports. Embracing audit's independence significantly impact on their performance in the sector.

Effective auditing standards influence auditor's behavior and improve the quality and effectiveness of audits by substantially adjusting audit practice

4. Conclusion and Policy Recommendation

The study concludes that the auditor's performance of NSE listed banks is positively influenced by internal audit's independence and good governance in that the management policy establishes internal audit units in the banks. To enhance auditor's performance, it is important to mitigate adverse corporate governance issues. The audit's independence and good governance ensure that the management policy does not permit internal auditors to audit operations which they have undertaken. It is also important for the NSE listed banks to facilitate faster delivery of services including the detection and prevention of frauds and or non-compliance with public expenditure management, by providing a conducive work environment that enables the use of cutting edge ICT technology to support auditing functions, promote continuous training and develop institutional mechanisms (e.g., enforcement, auditing, or corporate governance structures) to encourage compliance with international standards.

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Appendix

List of NSE Listed Commercial Banks in Kenya

- Absa PLC Group
- CFC Stanbic Holdings
- Co-operative Bank
- Diamond Trust Bank
- Equity Group
- Housing Finance Group
- I&M Holdings
- Kenya Commercial Bank Group
- NIC Group
- National Bank
- Standard Chartered bank