INTERNAL AUDIT FUNCTIONS AND LEVEL OF FINANCIAL FRAUD AMONG COMMERCIAL BANKS IN KENYA

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION SCHOOL OF BUSINESS, UNIVERSITY NAIROBI

DECEMBER, 2017

DECLARATION

Declaration by Student:

I declare that this research project is my original work and has not been presented for the award of a degree in any Institution of learning.

Signature_______________________________ Date_______________________________

MUIMI MWETI

D61/79121/2015

Declaration by Supervisor

I confirm that the work presented herein was done by the candidate under my supervision.

Signature_____________________________ Date_________________________________

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DEDICATION

This research project is dedicated to my family who have been my key asset to success and supported me both emotionally and financially during preparation of this research project. I sincerely appreciate their support and prayers that led to the completion of this research project within the stipulated timeframe.

ACKNOWLEDGEMENT

First, I thank God for his grace, provision and seeing me through this research project. Second, my special gratitude goes to my supervisor. Mr. Jay Gichana who tirelessly through his effort and initiative guided me through the whole process. Third, I would like to appreciate University of Nairobi administrative staff for their support during the preparation of the final research project. Fourth, I would like to acknowledge all the MBA students, colleagues, friends and my family especially for their moral and material support for the completion of this research project.

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ABBREVIATIONS AND ACRONYMS

ACFE:	Association of Certified Fraud Examiners
AUASB:	Auditing and Assurance Standards Board
IIK:	Insurance Institute of Kenya
IRA:	Insurance Regulatory Authority
IA:	Internal Audit
IAS:	Internal Audit Standards
IC:	Internal Controls
IFIU:	Insurance Fraud Investigation Unit
KPMG:	Klynveld, Peat, Marwick and Goerdeler
NYSE	New York Stock Exchange
SEC	Securities and Exchange Commission
SPSS	Statistical Package of Social Sciences
PAYE	Pay As You Earn
US	United States

ABSTRACT

Financial fraud has become one of the challenges of Commercial Banks operating in the 21st century both in developing and developed countries. Issues of financial fraud have contributed to deteriorating financial performance of Banks in Kenya little has been done to uncover the challenges. This study aimed at establishing the effect of internal audit functions and the level of financial fraud in Commercial Banks in Kenya. The objectives of the study were to establish the effect of Proactive Fraud Audit, Compliance to Policies, Risk Management, Control of Operation and Financial Reporting on level of financial fraud in Commercial Banks in Kenya. The study adopted a descriptive research designs to establish the statistical relationship between variables of the study. The target population of the study comprised on 43 employees of Commercial Banks. Stratified sampling technique was used to select the representative sample. 31 employees were the sample size of the population. The primary data was collected using a structured questionnaire consisting of close-ended and open-ended questions. Qualitative data was analyzed using content analysis method where key themes of published and spoken word were reviewed and conclusions were made. Quantitative regression analysis with the help of Statistical Packages for Social Sciences (SPSS Version21). Data was analyzed using descriptive statistics and presented in form of mean scores, standard deviation and percentages. Regression analysis was conducted at 5% level of significance and at 95% confidence level. The analyzed data was presented in form of tables. The study revealed that there was a statistical relationship between fraud proactive audits, compliance to policies, controls of operations and financial reporting and the level of financial fraud in Commercial Banks in Kenya. The study concludes that Commercial Banks are likely gain competitive edge in the changing business environment if only they developed proactive fraud audit systems, compliance systems, risk management systems, internal control systems and financial reporting systems. The study recommends that by Banks should, train employees on fraud detection in systems, adhere to CBK regulations, develop risk management systems and review internal control systems to promote the spirit of transparency and accountability thus reduced levels of financial fraud.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Internal audit is regarded as an administrative procedure that entails comprehensive review of published documents, counting assets, and reporting to shareholders or directors, managers and external auditors (Kyalo, Kalio & Ngahu, 2016). Many organization around the world recognize internal audit practices as a mechanism of demonstrating accountability in the utilization of financial resources. With increased cases of financial fraud among organizations operating in developed and developing countries, companies have adopted internal mechanisms of controlling the level of financial fraud. Competency and professionalism displayed by internal auditors can enhance organization efficiency and effectiveness (Aderibigbe & Dada, 2007). Internal audit practices adopted by firms around the world are directly correlated to financial performance of organizations despite external influences (Morgan, 2005).

Arens, Elder and Beasley (2010) argue that financial fraud has become a costly vice in the financial performance of organizations around the world. It approximated that collective economic cost of fraud experienced by firms around the world exceeds $650 billion annually (ACFE, 2006). Due to internal and external costs of fraud, identification of approaches to increase firm profitability has become the concern of modern competitive firms. Establishment of financial management systems and engagement of external auditors is the foundation of firm efficiency and effectiveness. It is the ultimate role of firms to adopt internal mechanisms to enhance financial position of a firm (Nila & Viriyanti, 2008).

Bell and Carcello (2000) argue that the internal audit function can significantly add value and minimize cases of financial fraud in the system. Establishment of risk management strategies, improving corporate governance and sourcing services of external auditors can enhance financial performance of the firm in the long run (Nestor, 2004). Internal financial crime behaviour may influence when firms do not conduct internal audit or have weak mechanisms of financial management (Belloli, 2006).

However, despite the fact that organizations can enhance financial position through internal audits, it is noted that the ethical behaviours of workers is key (Auditing and Assurance Standards Board, 2006). A survey conducted by KPMG (2015) observed that majority 71% of the firms were losing more than 30% of their revenues through fraudulent means. It was noted that most of the organizations were losing their revenues through online fraud and falsification of documents by workers (Apostolou *et al.* 2001).

It also emerged that most of the firms' experienced financial losses that exceeded the income generated (Church *et al.* 2001). Therefore, the motivation behind this study will be to investigate internal audit function that can be put in place by banks in order to enhance their financial performance by controlling cases of fraud in the system. The suggested internal audit function that will be investigated by the study comprise of proactive fraud audit, compliance to policies, risk management, controls of operations and financial reporting.

1.1.1 Internal Audit Function

Dixon and Woodhead (2006) ascertain that internal audit is directly correlated with corporate governance of a firm. It consists of various aspects that include reporting, controlling and coordination of activities for the best interest of the firm. External and internal auditing are some of the corporate governance mechanisms that are used during the financial reporting process (Institute of Internal Auditors, 2003). Poor corporate governance can result to corporate failure thus reduced investor confidence. Nila and Viriyanti (2008) argue that internal auditing activity can entail internal control measures taken by firms to enhance financial viability.

By extension, internal control is regarded combined effort of directors, managers and employees to provide reasonable assurance with regard to effectiveness and efficiency of an enterprise. According to IIA (2009), it is noted that compliance to financial and accounting principles, observation of management reporting can promote financial performance of a firm. Furthermore, it is noted that internal audit comprise of environmental control, risk management, communication and evaluation of activities. It is always determined by competence of corporate managers.

The main aim of internal audit is to reinforce the firms' corporate governance thus enhanced efficiency and effectiveness (Schachler *et al.* 2007). Communication between internal and external auditors and management can promote enhanced organization performance (Carcello *et al.* 2005). Institute of Internal Auditors (2009) argues that internal audit can helps firms to achieve their goals in a more efficient using systematic corporate governance and risk management. It provides that opportunity of continuously improving the system in order to minimize financial risk thus identifying deficiencies.

1.1.2 Financial Fraud

Schachler, Juleff and Paton (2007) argue that financial fraud is a deliberate action by individuals to use of deceptive methods during financial transactions with a purpose of satisfying individual needs. Fraud is a social crime that violates civil law and can be conducted by internal and external stakeholders who may include employees and customers. Financial fraud can be a combination of vices that range from cybercrimes, impersonifcation during transaction and falsification of documents with an aim of fraudulently obtaining money illegally. In addition, it consists of a misrepresentation of a substantial facts material fact that are relied by a party when making payments (Schelker, 2008).

Singleton, Bologna and Linguist (2006) suggest that financial crimes committed range from theft of money, making payments to an authorized people or transfer of assets without the knowledge of each party with an aim of selfish gains. The typical crimes can sub-categorized into various forms that range from deceit, subterfuge, impersonification and robbery. Further, it comprises other forms of crime that range from money laundering, forgery, credit card fraud and embezzlement.

Ewa and Udoayang (2012) argue that proactive financial audits like internal auditing, employee training and claiming procedures can be adopted to minimize system fraud. Compliance to policies ranging from tax institutions, central bank and accounting standards can also help firms to minimize financial fraud in their long run. In addition, firms can control financial fraud by using contingency plans, reporting and communication. Furthermore, organizational can minimize financial fraud by embracing internal and external audits and preparation of budgets (Albrecht *et al.*, 2008).

1.1.3 Commercial Banks in Kenya

In the recent past, the Kenyan banking sector has tremendously improved despite internal and external challenges. Based on liquidity ratios and earnings of commercial banks, it is evident that Commercial Banks in Kenya are still experiencing an improvement in profits generated. (Becks *et al*, 2010). Despite technological development among Commercial Banks from developed and developing countries, it is noted that most of the Commercial banks in developing countries and more especially in Kenya are experiencing financial fraud cases which have resulted to deteriorating financial performance.

Profits of Commercial Banks in Kenya rose by a fifth in 2012 and non-performing loans (NPLs) increasing by 13.33 per cent to 61.6 billion shillings. Despite the rise in profit, banks should take precautions when lending money as NPLs could easily lead banks to financial distress leading to failure just like it has in the past (CBK, 2016).Kinyua (2006) posits that Commercial banks in Kenya have recorded a decline in profitability by 36% due to dynamic external business environment, fraudulent means, internal policies of management, competition, globalization, changing consumer demands, influence of technology and high costs of operation.

Costs arising from financial fraud have contributed to poor performance of some of the Commercial Banks and exit from the banking industry. Poor financial performance of banks in Kenya is directly associated with issues related to financial fraud, corporate governance and dynamic business environment characterized by competition, technology and monetary policies formulated by Central Banks of Kenya.

1.2 Statement of the Problem

A survey by World Bank (2016) ascertains that majority (81%) of the Commercial Banks in developing countries including Kenya revealed that they are losing an approximate of 31% of their revenue through fraudulent activities annually. However, it was established that internal audit issues were some of the key determinants of enhancing financial performance of banks despite the challenges of fraud. Central Bank of Kenya survey of (2015) also concurs with the findings of the World Bank Report by establishing that more than 50% of Commercial Banks in Kenya have continued to record losses annually due weaknesses of financial management systems and online fraud. Albrecht *et al.* (2008) aver that better prevention of fraud may help financial institutions to minimize losses and enhance stakeholder values.

However, despite limited studies which have been conducted locally, little has been done to address issues of fraud in Commercial Banks in Kenya. For instance, a study by Kyalo, Kalio and Ngahu (2016) was confined to role of fraud prevention in County Governments in Kenya, a survey conducted by Public Procurement Oversight Authority (2014) was limited to fraud practices in the procurement process among County Governments in Kenya. Further, a study by Otieno, Mugo, Njeje and Kimathi (2015) was confined to firms in the Nairobi Stock Exchange Market. The real issues in Commercial Banks that are of concern from various stakeholders and need to be addressed comprise of increased cases of fraud in the system, questionable integrity of financial management systems, high rate of non-performing loans and drastic decline of profits (CBK, 2016).

From the findings of previous studies such as KPMG (2015); Otieno, Mugo, Njeje and Kimathi (2015); Public Procurement Oversight Authority (2014) & World Bank (2016) it is noted that little attention has been paid by researchers concerning the effect of internal audit function and level of financial fraud among Commercial Banks in Kenya. It is observed that some studies focused on different variables such as financial performance, risk management and control while other studies were confined to different sectors such as manufacturing, Government Ministries, Counties, Sacco's and microfinance institutions. In addition, it was noted that some studies were conducted in different countries such as Uganda, Nigeria, Namibia and South Africa among others. Therefore, it is on this background this sought to answer the question; 'what is the effect of internal audit functions and level of financial fraud in Commercial Banks in Kenya?'

1.3 Objectives of the Study

1.3.1 General Objective

To establish the effect of internal audit functions and level of financial fraud among Commercial Banks in Kenya.

1.3.2 Specific Objective

To determine the effect of internal audit functions and level of financial fraud among Commercial Banks in Kenya in Kenya.

1.4 Value of the Study

The findings of the study would be valuable to the various stakeholders ranging from: regulators, management, policy makers, researchers and scholars. The Central Bank of Kenya as a regulator of the banking sector would find this study to be of value since policies formulated would be implemented based on frameworks of minimizing financial fraud in the among Commercial Banks in Kenya. The study would help Investors to make viable investments decisions with regard to financial risk management.

The management of Commercial Banks in Kenya would be in position to identify how various aspects of financial fraud affect operations of their banks, as well as to determine the extent to which this and other factors affect their financial returns. They would also identify the impediments that face their banks in approaching various financial fraud challenges.

The study would help policy makers to review and develop policies that would safeguard firms from financial fraud. Further, the findings will help shareholders to determine aspects that can contribute to prevention of financial fraud among Commercial Banks in Kenya. Furthermore, the findings would add to the body of existing body of knowledge in financial fraud management thus resulting to new models of fraud prevention. Finally, researchers and academicians would find the study beneficial as it would help them enhance the already existing theories in the area of financial fraud management theory.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter outlines theoretical review of the study, internal audit functions empirical review, summary of knowledge gaps and conceptual framework.

2.2 Theoretical Foundation

The study was anchored on Fraud Triangle Theory and supported by other two theories which include; Agency Theory and Stewardship Theory.

2.2.1 Fraud Triangle Theory

The Theory was established by Cressey (1959) and it argues that fraud offenders can be categorized into independent businessmen, long term violators, and absconders. Independent businessmen are involved in borrowing and they keep the funds for themselves, while long term violators are involved in borrowing to protect family (Ewa, & Udoayang, 2012). Opportunity is affected by performance apprehension because perception of detection is the greatest deterrent (Fish, 2012). Hidden controls do not deter fraud and the controls cannot be predictable. It suggests that to some extent, individuals in organizations can collude with fraudsters to achieve their financial goals using unethical means (Gramling, 2004).

Based on the principles of the Theory, it is argued that organizations that engage workers without background check are likely to suffer more compared to those firms that conduct background checks before engaging workers. Furthermore, weakness of financial systems can provide opportunities to fraudsters to steal and conduct transaction on behalf of other parties illegally (Njeje & Kimathi, 2015). This theory is applicable to this study based on the assumption that Commercial Banks in Kenya can establish internal audit functions like; proactive fraud audits, compliance to policies, risk management and reliability of financial reporting to detect fraudulent activities to enhance efficiency and effectiveness.

2.2.3 Agency Theory

Agency Theory was established by Ross and Stephen (1973). The theory argues that there must be two parties for any contract to be successful (Adams, 1994). In their case, the employer and employee are the two parties who are binding to a contract (Clarke, 1990). The relationship between the principal (employer) and agent (employee) determines the performance of any organization in the dynamic business environment. It suggests that good relations between the employer and employees is likely to enhance financial position of the firm and minimize the level of fraud (Ewa & Udoayang, 2012).

Chen and Pan (2012) ascertain that sound financial management is dependent on the ability of the firm to put appropriate internal audit mechanisms like communication, compliance to financial standards and proactive audits. They further argue that financial performance of the firm is dependent on sound audit practices. Despite the internal and external changes like changes in economic trends, organizations are always striving to minimize levels of financial fraud using internal audit practices (Cole, 2000).

The theory argues that employees (agents) in the finance department need to develop appropriate internal audit practices to help their commercial banks (principal/employer) to mitigate fraudulent activities from internal and external stakeholders. Commercial banks on the other hand should review their compensation policies to enable their employees to meet individual goals using ethical ways rather than fraudulent means. Improving the working conditions and building good relations with employees will contribute to efficiency of the bank.

2.2.4 Stewardship Theory

Davis, Shoormanand and Donaldson (1997) argues that employees of any organization should act as stewards who always seek to protect and maximize shareholders wealth though efficient management practices. It argues that managers should seek to minimize risks and maximize profits though developing appropriate strategies and mechanisms that can increase shareholder wealth. Good stewardship is determined by the ability of managers to forecast and explore alternative means which can help their companies maximize profits. Employee training and investment in new systems that are more efficient and effective is the sole goals of visionary stewards.

Spencer (2007) argues that effective stewardship is driven by individual initiatives of employees to work for the interest of the organization. Mangers should prioritize organizational goals and involve employees in key decisions to minimize resistance to change. However, it is observed that organization structure, employee motivation and efficient and effective monitoring and control mechanisms automatically enhances financial positon of firms. Jain and Narang (2009) assert that in order to protect firm reputation, managers should ensure that they make decisions that integrated with organizational goals.

This theory underpins this study based on the notion that, employees of firms should always seek to develop strategies that will enhance shareholder value. Maximizing stakeholder value in commercial banks is determined by accountability of the banks with resource management. The willingness of employees to make ethical financial decisions and follow the laid down regulations is likely to minimize financial fraud thus performance of commercial banks. Accountability and transparency of the commercial banks to the general public will be an indicator of good stewardship.

2.3 Relationship between Internal Audit Functions and Level of Financial Fraud

Gachoki (2011) assert that proactive fraud audits provide opportunities to auditors in making contributions to the detection of possible fraud. It is noted that a comprehensive audit is designed determine whether financial statement are accurate and reliable for sound financial decisions. By cross checking all the routine transactions which are entered during a given financial year can help to uncover fraud. Norman *et al.* (2010) on the other hand concur that auditors can adopt a number of methods in order to uncover hidden or ignored information in financial statements.

Nila and Viriyanti (2008 revealed that system examination is always conducted in consideration of fundamental consideration principles which include: detection of errors, fraud, distortion of data and chances or reoccurrence of the related fraud cases in the future. After successful completion of the system examination, it is concluded that whether there was fraud or possibility of fraud in the system thus appropriate mechanisms are put in put to minimize such incidences.

Bierstaker *et al.* (2006) noted that despite there not specific techniques applied when conducting systems examination, it is recommendable for organization to engage forensic experts when conducting system examination to detect fraud. Cook and Clements (2009) that majority of the firms did not have the best tools to detect fraud cases. It emerged that to curb system fraud, firms should integrate technology in accounting systems to monitor and tract transactions.

Karuthi (2015) established that majority of the Commercial banks were taking insurance covers as a measure of controlling financial risks. It was further established that most of the commercial banks were financially distressed due to lack of appropriate mechanisms of dealing with fraud cases in the systems. It also emerged that employee knowledge was one of the aspects that contributed to minimal cases of fraud among workers.

Odhiambo (2014) studied the impact of determinants of VAT compliance among Commercial Banks in Kenya and revealed that some Commercial banks failed to submit their VAT on time due to unfavourable economic conditions. Money laundering were common cases financial fraud among financial institutions. It emerged that most of the banks were unable to meet their financial obligations due to high cases of fraud in the system. However, it was noted that the findings of the study were confined to VAT compliance.

Pratolo (2007) ascertains that compliance financial regulations established by financial regulators in the financial sector can enhance the financial position of the firm thus minimized cases of financial fraud. It was further established that financial institutions were not ready to comply to VAT regulations were potential fraudsters indirectly. Inability to comply with industry regulations was an indicator of evading financial obligations of a corporate entity.

Organizations should seek to obtain assurance of compliance from authorities and participate in business forums (Nila and Viriyanti, 2008). Arens, Elder and Beasley

(2010) observe that keeping proper financial records by companies through modern systems can minimize cases of fraud in the system. Organizations should have internal mechanisms of regulating financial transactions.

Mensah, Aboagye, Addo, and Buatsi (2003) found that good governance was correlated with financial performance of the organization. Well managed companies were likely to make informed decisions and minimize unethical practices like fraud in the system. Pratolo (2007) found that the fraudulent activities were minimized but internal control. Consequently, Nila and Viriyanti (2008) also found that fraudulent activities had a correlation with financial distress among firms. However, it was noted that the study was limited to financial performance banks in Nigeria.

Ugrin and Odom (2010) established that antifraud policies and procedures developed companies can add value to organizations that are prone to financial fraud. A combination of tactics like internal control audits and forensic analysis and consultations should be applied whenever conducting system examination. However, the findings of the study were limited internal controls in organizations and not specifically the level of fraud prevention in County Governments in Kenya.

Kilika (2013) revealed that internal audit was one of the practices that enhanced minimized financial fraud among commercial banks. Engagement of external auditors was one way of enhancing internal efficiency. Communication and publication of financial statements was also regarded as practices that enhanced financial position of banks. On the other hand, it was noted that, banks that adopted internal audit practices were experiencing less financial losses compared with banks that did not. System automation was seen as a practice of curbing fraudulent activities. However, the study was confined to internal control practices.

Odhiambo (2014) noted that performing internal audit was dependent on the knowledge and experience of the auditor. Furthermore, it was revealed that to some extent internal auditors may be biased when making critical financial decisions. However, it was noted that internal and external audits are essential sources of information that shareholders need to rely to draw benchmarks on performance of their firms. Firms should assess the level of risk exposure based on corporate governance and operation systems. Safeguarding financial position of the firm is dependent on compliance to laws and the ability to minimize financial risks. It was concluded that internal audit function was largely dependent on organization management and ability to mitigate financial risks

Nila and Viriyanti (2008) suggest that continuous examination of financial records in any organization can enhance financial risk mitigation. Processes adopted by firms to manage financial transaction can result to efficiency and effectiveness of a firm and vice versa. Sackett and DeVore (2006) argue that to a larger extent, companies are prone to financial fraud when they fail to establish corporate governance structures that support and promote accountability and transparence in the management of financial issues. KPMG (2012) revealed that majority (71%) of financial institutions in Kenya were losing their revenue annually through fraudulent means. However, it was noted that survey generalized firms in the United States but not the banking sector in Kenya.

Onyango (2010) also revealed that deteriorating performance of County Governments in Kenya was associated with embezzlement of funds by employees in the system. County Governments did not adhere to internal audits as recommended by the Auditor General' office to improve management of financial resources. The study further revealed that majority of the County Governments were reluctant to automate the systems as a measure of curbing financial fraud. As a result Counties were losing a lot of money through fraudulent methods ranging from forgery, awarding of tenders and inflated pricing of goods and services. However, the findings of the study were confined to general performance of the County but failed to address issues of fraud in Commercial banks.

Mensah, Aboagye, Addo and Buatsi (2003) revealed that controls of operations can contribute to fraud detection among firms. Control activities entail policies and procedures management can implement in order to enhance financial efficiency. ACFE (2014) noted that measures of mitigating systems fraud as proposed was to establish fraud detection systems, implementing internal controls, hire external fraud examiners and institutionalizing ethical culture among workers. It emerged that organizations that sensitized employees on code of ethics were more likely to minimize cases of fraud and vice versa. However, the findings of this study was limited to insurance companies in Kenya but not commercial banks in Kenya

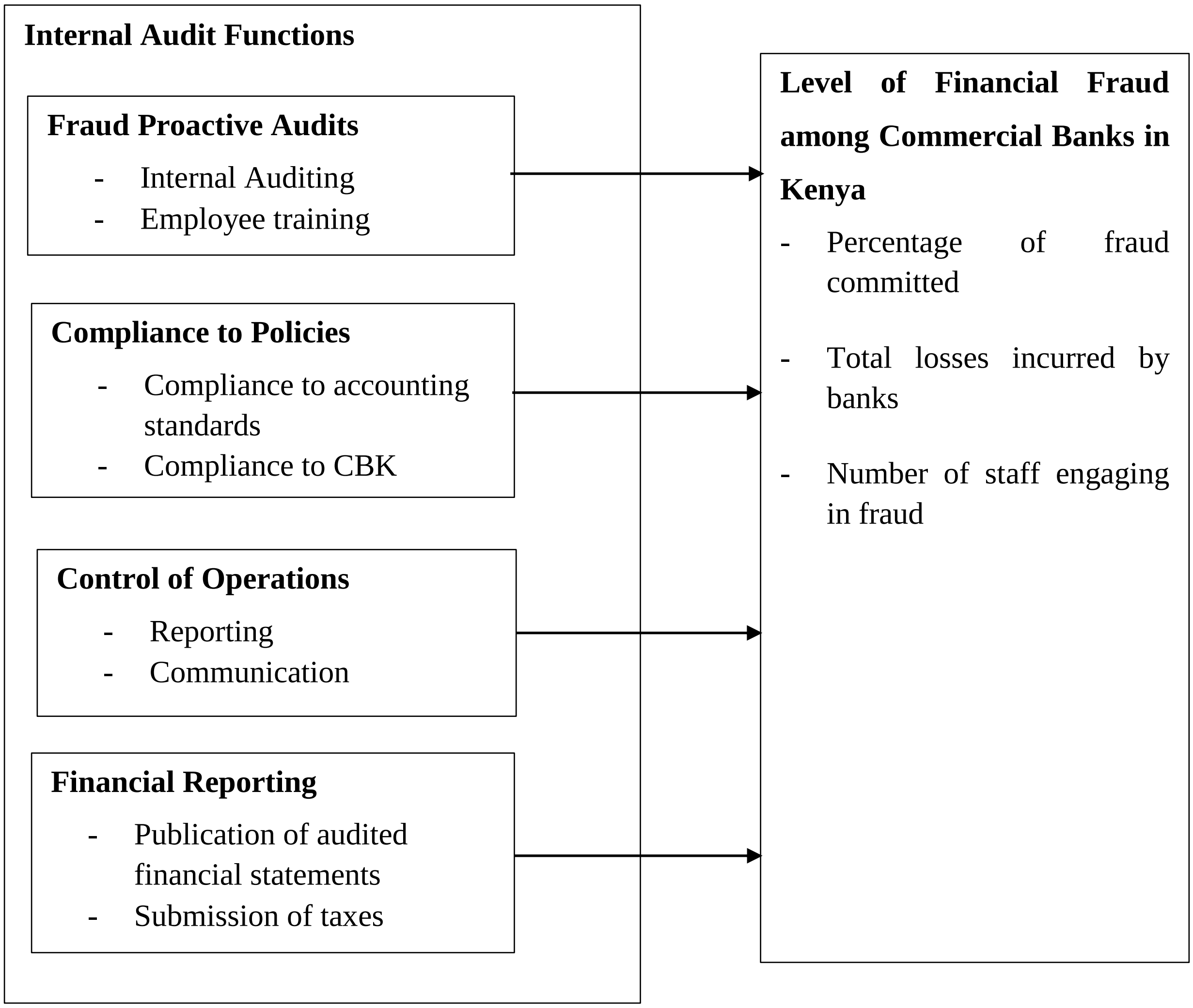
2.4 Summary of Knowledge Gaps

It is evident from previous empirical studies that conceptual, contextual and methodological gaps do exist in this area. For instance, studies by; Karuthi (2015); Odhiambo, (2014); Kilika, (2013); Insurance Regulatory Authority (2015); PWC Global Economic Crime report Survey (2009); Muthama and Gachunga (2014); MaxWorth Associates (2004) among others proved that little has been done with regard to internal audit functions on fraud detection among County Governments. Firstly, some studies focused on different variables like communication, technology, internal audit, financial performance and regulation but did not address variables of this study.

Secondly, some studies focused on different sectors like, Insurance Companies, Higher Institutions Learning and Manufacturing Companies but not Commercial Banks in

Kenya. Thirdly some studies adopted different research methodologies like cross-sectional and longitudinal research designs but not descriptive research design.

2.5 Conceptual Framework



Independent Variables **Dependent Variable**

Figure 2.1: Conceptual Framework

Source: Author (2017)

As illustrated in Figure 2.1, it is revealed that the level of financial fraud among Commercial Banks in Kenya was minimized by embracing fraud proactive audits such as internal audit and employee training. Adherence to polices of Central Bank of Kenya and International Accounting Standards, the level of financial fraud would be minimized. Further, it was identified that control of operation through effective reporting and communication minimized the level of financial fraud. Finally, adherence to financial reporting through publication of audited accounts and compliance to VAT regulations contributed to minimized financial fraud in the among Commercial Banks in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the research design which the study adopted, the target population, sampling procedure and sample size, data collection instruments and procedure, validity and reliability of the instrument and finally data analysis method.

3.2 Research Design

Descriptive research design sought to investigate the effect of internal audit functions and level of financial fraud among Commercial Banks in Kenya. Descriptive research design is considered to be suitable because it provided the opportunity of establishing the interrelationship between variables in their natural setting without manipulating those (Novikov & Novikov, 2013). According to Krishnaswami (2003), the research design is described as a framework used to explore new knowledge in a given area. Furthermore, Cooper and Schindler (2006) regard a research design as a plan of systematic collection, analysis and interpretation of data for strategic decision making.

Lewis and Thornhill (2012) assert that descriptive design is a framework that spells out the overall methodology of conducting a study. It describes the targets population, sample size, instruments and criteria of testing validity and reliability and articulates data analysis techniques. They argue that the major descriptive research designs provides an opportunity of testing the statistical relationship between variables of the study and also gives the ability to collect information and record it without manipulations. They further argue that the concepts of the variables of the study should be based on the deductive arguments of existing theories.

3.3 Target Population

Novikov and Novikov (2013) argue that a population is regarded as the total number of elements, objects or units that display common features and can be used to investigate a particular problem under investigation. Additionally, Kombo and Tromp (2006) concur that it is a set of items that may be sampled to make conclusion about a specific problem under investigation.

Further, they argue that a population a set of elements that can be used to collect, analyze and interpreted information for strategic decision making. This study targeted branch and operations managers of the 43 Commercial Banks in Kenya. The 43 Commercial Banks were selected based on their financial performance for the period between 2014-2016. Therefore, 43 respondents who comprise of branch managers and operations managers of the 43 Commercial Banks were the target population of the study.

3.4 Sampling Technique and Sample Size

A sample is defined by Cooper and Schindler (2006) as the representative of the entire population. Kothari (2006) concurs that a representative sample more than half of the total population is justifiable to make objective conclusions on the problem under investigation. The sample size for this study was half of the total target population that comprised of 43 respondents who constituted of operations and branch managers of the 43 Commercial Banks operating in Kenya. Respondents were selected using purposive sampling techniques.

Lewis and Thornhill (2012) regard purposive sampling method to be suitable in the selection of respondents since it provides an opportunity to select respondents based on the level of information. Furthermore, it provides an opportunity of selecting respondents with adequate information concerning the problem under investigation.

3.5 Data Collection Instrument

Primary data was collected using structured questionnaires as the main instruments while secondary data was obtained from published materials like financial statements and other financial related reports. Questionnaires were preferred in this study because they helped to eliminate subjectivity of the researcher with regard to the problem under investigation. It also gives respondents sufficient time on items that require consultation before responding (Cooper & Schindler, 2006). Sekaran (2011) concurs that questionnaires are preferred instruments of data collection in scientific studies because of their opportunity to capture respondent opinions in a structured manner and in written form for future reference.

3.6 Data Collection Procedure

Drop and pick later method was adopted when administering questionnaires to enhance high response rates. Follow-ups were made by researcher and research assistants through phone calls and face to face interactions with respondents. Clarity on the filled questionnaires was sought from respondents directly before coding, sorting and processing the information. The questionnaire was divided into six section and information collected was measured by subjecting items of the questionnaire to a Likert scale of 1-5.

3.7 Pilot Testing

The researcher conducted a pilot study to address any deficiencies in the research instruments. By conducting a pilot study, the researcher also examined the feasibility of the intended approach of the study. Fisher, (2010) argued that, the accuracy of data to be collected is largely dependent on the data collection instruments in terms of validity and reliability which could only be established through a pilot test. 10% of the main sample size was used to conduct a pilot study.

3.7.1 Validity Test

To test validity, the researcher sought opinions of experts in finance and that of University Lecturers. According to Cooper and Schindler (2006), validity is observed to be measures the extent to which items of the instrument measure what is intended in a more precise and accurate manner. Saunders, Lewis and Thornhill (2009) argue that validity of the instruments is determined by the relevance of the items with existing theories and objectives being sought in a study. Content, criterion, and construct related validity was measured. Content validity was measured using opinions of financial expert. Criterion validity was measured using employees of Commercial Banks and construct validity was measured using theories and variables of the study.

3.7.2 Reliability Test

Kothari (2006) regards reliability as the extent to which an instrument generates similar results after repetitive counts. As suggested by Cooper and Schindler (2006), accuracy in measurement is of great importance due to objectivity goal. In this study, Cronbach’s alpha method was adopted to determine the reliability of variables. Internal consistency was determined based on the principle of similarity of results. The method was used to test reliability of the instrument. Therefore, the critical value of 0.7 was adopted as the acceptable reliability coefficient as proposed by Black (2010).

3.8 Data Analysis

Novikov and Novikov (2013) argue that data analysis is a systematic process that comprise of aspects of editing, coding, classifying information before the analysis process. Black (2010) concurs that it entails categorizing data based on the objectives of the study and summarizing it to provide answers on the research questions. For instance, first order condition was conducted where data was analysed descriptively in form of percentages, means and standard deviation. In addition, qualitative data was analysed using content analysis method. Key themes from published content and spoken word was analysed and conclusions were made. Regression analysis was conducted at 95% confidence level and of 5% significance value to determine the statistical relationship between variables of the study using the model which was of the form: $\mathbf{Y = \beta o + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon}$

Where;

Y=Level of Financial Fraud in Commercial Banks in Kenya

β_0= Y intercept β_1 to β_5 = regression coefficients

X_1 = Fraud Proactive Audits

X_2 = Compliance to policies

X_3 = Controls of operations

X_4 = Financial Reporting

ε= Error term

The analyzed data was tabulated and presented in form of tables for easier interpretation by various stakeholders of the study ranging from employees, the Government, scholars and researchers. Data was interpreted in a manner that will facilitate comprehensive understanding of the problem thus improved policy formulation, decisions and theories in the finance discipline.

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSIONS

4.1 Introduction

This chapter presents the research findings of the study carried out to examine the effect of internal audit functions on the level of financial fraud among Commercial Banks in Kenya. The overall research objective was to determine the effect of internal audit functions and level of financial fraud among Commercial Banks in Kenya in Kenya. The specific research objectives of the study were to; determine the influence of fraud proactive audits, compliance to policies, controls of operations and financial reporting and the level of financial fraud in Commercial Banks in Kenya. In addition, this chapter provides discussions on the statistical relationships between variables of the study and further discusses the findings of the study in relation to existing empirical literature.

4.2 Response Rate

After administration of 43 questionnaires to respondents of Commercial Banks operating in Nairobi, Only 38 questionnaires were returned duly filled. This contributed to 88% response rate. Therefore, this response rate was adequate for data analysis and conforms to Black (2010) who stipulates that a response rate of 30% and above is adequate for analysis and reporting.

4.3 Demographic Characteristics

4.3.1 Gender of Respondents

The respondents of the study were asked to indicate their gender and the following were the findings as shown in Table 4.1:

Table 4.1: Gender of Respondents

Gender	Frequency	Percentage
Female	21	55
Male	17	45
Total	**38**	**100**

Source: Research Data

As shown in Table 4.1, majority (55%) of the respondents were female respondents who worked as operations and branch managers of Commercial Banks in Nairobi region while 45% of them were male respondents. This implies that most of the employees who worked with Commercial Banks were women compared to men. This indicated that most of the Commercial Banks were perceiving women to be more trustworthy compared to men.

4.3.2 Respondent Period of Work

The respondents of the study were asked to indicate the number of years they had worked with their Commercial Banks and the following were the findings as shown in Table 4.2:

Table 4.2: Length of Service

Years	Frequency	Percentage
1- 5 Years	**04**	**11**
6-10Years	**10**	**26**
11-15 Years	**10**	**26**
15 Years and Above	**14**	**37**
Total	**38**	**100**

Source: Research Data

Table 4.2, indicates that majority (37%) of the employees had worked for more than 15 years, 26% had worked for a period between 6-15 years and 11% had worked for a period between 1-5 years. This implies that majority of the respondents had adequate information concerning financial fraud among Commercial Banks based on their experience.

4.3.3 Education Level of Respondents

The respondents of the study were asked to indicate their level of education and the following were the findings as shown in Table 4.3:

Table 4.3: Education Level of Respondents

Level	Frequency	Percentage
Postgraduate	**04**	**11**
Bachelors	**34**	**89**
Diploma	**00**	**00**
Certificate	**00**	**00**
Total	**38**	**100**

Source: Research data

Table 4.3, majority (89%) of the respondents were first degree 20 % while 11% were postgraduate holders. None of them was a certificate or diploma holder. This implies that the majority of the workers joined their banks with the minimum entry requirements of the first degree and a few of them managed to advance their studies after joining. It emerged that most the workers did not have adequate or flexible schedule to advance their careers further.

4.4 Internal Audit Function

4.4.1 Proactive Fraud Audit

The respondents of the study were asked to indicate the effect of proactive fraud audits on the level of financial fraud among Commercial Banks and the following were the findings as shown in Table 4.4:

Table 4.4: Proactive Fraud Audit

Statements	**N**	**Mean**	**S.D**
Legal actions are taken against employees who do not comply with internal accounting standards.	31	4.98	.581
My Bank engages external auditors to analyze financial statements periodically	31	4.88	.444
The Bank train employees on ethical practices during recruitment	31	4.71	.311
Internal Auditors strictly adhere to Accounting Standards	31	4.42	.341
Employees of the Bank have the capacity to verify and approve employee claims, supplier quotations and pay slips	31	3.96	.434
My Bank has effective fraud prevention mechanisms	31	3.77	.383
My Bank has trained internal auditors on ways of curbing fraud	31	2.45	.371
My Bank has effective frameworks of monitoring financial resources allocated to projects	31	2.33	.356
My Bank takes proactive measures in case of fraud in the system	31	2.14	.345
My Bank has developed internal policies that guide utilization of financial reports	31	2.14	.318
Overall mean score=3.665			

Source: Research data

Table 4.4 indicates that majority of the respondents revealed that to a larger extent their Commercial Banks took legal action against employees who failed to adhere to internal accounting standards with a mean of 4.98, engaged external auditors with a mean of 4.88, trained employed on ethical practices with a mean of 4.71, adherence to Accounting Standards by internal auditors with a mean of 4.42, capacity of bank employees to verify supplier quotations with a mean of 3.96, existence of financial fraud preventive mechanisms with a mean of 3.77. Further, it was indicated by some employees that to a small extent their Banks trained internal auditors on fraud prevention with a mean of 2.45, banks had effective frameworks of monitoring financial resources with a mean of 2.33, banks took proactive measures in case of financial fraud and developed internal mechanisms that guided utilization of financial reports with a mean of 2.14.

These findings implies that most of the Commercial Banks were striving to minimize the level of financial fraud in the systems through taking legal action against employees who did not comply with accounting standards, involved external auditors to analyze financial statements, trained employees on ethical values and emphasized on adherence to Accounting standards by Internal auditors. However, on the other hand, it was observed that majority of the Commercial Banks had weak frameworks of preventing financial fraud ranging from system protection, employee training and financial fraud policies.

These findings correspond with that of Norman *et al.,* (2010) who argue banks should have protected financial systems, apply legal penalties and educate employees on ethical values to enhance financial soundness of the system. Both internal and external auditors should be given the opportunity to examine financial statements of an organization in order to reveal gaps that may lead to financial distress among insurance companies. Further Nila and Viriyanti (2008) concurs with these findings by arguing that auditors should use a combination of methods to cross examine financial statements and systems in order to give valid financial reports to insurance companies for strategic decision making.

4.4.2 Compliance to Policies

The respondents of the study were asked to indicate the effect of compliance to policies on the level of financial fraud among Commercial Banks and the following were the findings as shown in Table 4.5:

Table 4.5: Compliance to Policies

Statements	N	Mean	S.D
All employees of the Bank are subjected to Pay As You Earn guidelines	31	4.18	.281
Accountants are always intelligent when making payments	31	4.08	.344
Bank employees ensure that procurement procedures was followed before approving payment for goods and services	31	4.04	.267
Internal auditors always observe high level of ethical standards when scrutinizing financial statements	31	4.02	.411
Internal Auditors observe International Standards of Accounting when calculating the value of client assets	31	4.06	.564
Employees of my Bank perform their duties with high professionalism	31	4.03	.343
Appropriate procedures are followed by the Bank when making any payments	31	3.53	.316
All suppliers of the Bank are VAT compliant	31	3.14	.306
The Bank pays their suppliers promptly after verifying their claim forms	31	3.08	.255
The Bank has Automated Payroll System	31	3.08	.239
Overall mean score=3.998			

Source: Research data

Table 4.5 indicates that to a larger extent, majority of the employees revealed that their Commercial Banks were compliant to various policies as a measure of reducing the level of financial fraud. The results indicates that employees of the Banks were subjected to PAYE guidelines with a mean of 4, 18, accountants were intelligent when making payments with a mean of 4.08, compliance of suppliers before payments were met with a mean of 4.04, high level of ethical standards maintained by internal auditors during scrutiny of documents with a mean of 4.02,

It was also revealed that observation of International Accounting Standards by internal auditors during calculation of value of client assets with a mean of 4.06, employee observation of high level of professionalism when performing their duties with a mean of 4.03, adherence to procedures when making payments with a mean of 3.53, compliance of suppliers to VAT with a mean of 3.14, prompt payment of suppliers and automation of payroll system with a mean of 3.08.

These findings implies that despite challenges of competition and inability to maximize profits, majority of the Commercial Banks strived to minimize the level of financial fraud by complying to various policies such as PAYE, procurement, Accounting Standards, VAT and Financial Accounting Management Systems. These findings are in line with that of Arens, Elder and Beasley (2010); Kyalo, Kalio & Ngahu (2016); Karuthi (2015) & Kilika (2013) who found out that non-compliance of banks to legal obligations such as payment of taxes and adherence to best financial practices equality reflected financial fraud.

4.4.3 Control of Operations

The respondents of the study were asked to indicate the effect of control of operations on the level of financial fraud among Commercial Banks and the following were the findings as shown in Table 4.6:

Table 4.6: Control of Operations

Statements	N	Mean	S.D
The department has an effective and efficient internal reporting systems	31	4.41	.644
The department encourages feedback from various stakeholders on service delivery	31	4.38	.537
Accountants are involved in key financial decisions within the Bank	31	2.21	.544
Accountants are involved in procurement committees	31	2.21	.421
Internal auditors always ensure projects implemented meet the recommend financial budgets submitted	31	2.15	.374
External audit reports and recommendation are considered when formulating financial decisions	31	2.12	.343
Accountants are involved in human resource committees	31	2.11	.487
The department has clear contingency plans that safeguard their assets from fraud activities	31	2.11	.684
The department recruit people with experience and knowledge in financial fraud detection	31	2.07	.473
Forensic audit reports are relied by the Bank to make payment claims	31	2.07	.445
Overall mean score=2.348			

Table 4.6 indicates that to a larger extent, majority of the Commercial Banks did not embrace control of operations despite their influence of reducing the level of financial fraud.

The results reveals that Banks had departments that embraced efficient and effecting reporting mechanisms and provided timely feedback to stakeholders to a larger extent. Further, the results indicate that most the Banks involved accountants in key decisions and in procurement committees with a mean of 2.21, internal auditors emphasized on implementation of projected based on projected budgets with a mean of 2.15, consideration of external auditor reports when formulating financial decisions with a mean of 2.12, involvement of accountants in human resource committees and formulation of contingency plans with a mean of 2.11, recruitment of people with knowledge and experience on fraud detection and reliance on forensic reports to approve payments with a mean of 2.07.

These findings implies that Commercial Banks employed a number of control mechanisms to reduce the level of financial fraud in the system such as provision of information, establishment of reporting systems, involvement of accountants in key decision and procurement committees, consideration of internal financial policies by internal and external auditors when submitting audit reports and finally, recruitment of experienced people and relying on forensic reports to make financial decisions. These findings are corresponds with that of Ewa, & Udoayang(2012) & Fish(2012) who established that the only way banks were to minimize the level of fraud in the system is through participative decision making, establishment of reporting systems, automation of the accounting systems and development of contingency financial plans.

4.4.4 Financial Reporting

The respondents of the study were asked to indicate the effect of financial reporting on the level of financial fraud among Commercial Banks and the following were the findings as shown in Table 4.7:

Table 4.7: Financial Reporting

Statements	N	Mean	S.D
My Bank ensures financial statement are transparent and accessible by members of the public	31	3.88	.487
Finance department always observe frameworks of CBK	31	3.73	.421
My Bank always develops financial budgets based on accounting principles	31	3.56	.374
My Bank prepares annual financial reports	31	3.42	.343
My Bank always encourages transparency and accountability in expenditure	31	3.67	.261
My Bank have a clear financial reporting structure	31	3.21	.189
My Bank engage external auditors to detect financial fraud cases	31	3.21	.184
Overall mean score=3.948			

Source: Research data

Table 4.7 indicates that majority of the employees of Commercial Banks agreed to a larger extent that to minimize financial fraud, their Banks ensured that financial statements were made accessible to members of the public with a mean of 3.88, Banks adhered to CBK regulations, Banks developed financial budgets that that that were compliant to accounting principles with a mean of 3.56, Banks prepared annual financial reports with a mean of 3.42, Banks encouraged transparency and accountability of t expenditure with a mean of 3.67, clarity of the financial reporting structure with a mean of 3.21 and encouraged external auditors to detect financial fraud cases with a mean of 3.21.

These findings implies that Banks emphasized on financial reporting practices to reduce financial fraud such as providing accessibility to financial statements to members of the public, adhering to CBK regulations, developing budgets by observing accounting principles and encouraging transparency and accountability in expenditure. These findings are in line with that of Norman, Rose & Rose (2010); Odhiambo (2014) & Onyango (2010) who noted that financial reporting practices such as adherence to Central Banks regulation and encouraging transparency and accountability were best practices of detecting financial fraud in the system.

4.4.5 Level of Financial Fraud

The respondents of the study were asked to indicate the ways in which they determined the level of financial reporting among Commercial Banks and the following were the findings as shown in Table 4.8:

Table 4.8: Level of Financial Fraud

Statements	N	Mean	S.D
The level of financial fraud in my bank is determined by percentage of cases committed by employees periodically	31	4.48	.487
Total losses incurred by my bank reflects the level of fraud	31	4.23	.421
The number of staff involved in fraudulent activities reflect the level of financial fraud in the system	31	4.16	.374
The ability of the bank to trade securities in the Stock Exchange Market reflects level of fraud in the system	31	4.12	.343
Inability of the bank to diversify reflects the level of fraud in the system	31	4.07	.261
Overall mean score=3.888			

Source: Research data

Table 4.8 indicates that to a larger majority of the respondents indicated that their Banks measured the level of financial fraud using percentages of cases committed by employees periodically with a mean of 4.48, losses incurred with a mean of 4.23, number of staff involved in fraud with a mean of 4.16, ability to trade securities with a mean of 4.12 and inability of the bank to diversify with a mean of 4.07.

The findings implies that Banks were measuring levels of financial fraud by using number of employees involved in fraud, inability to diversify and losses incurred periodically. These findings corresponds with that of Association of Certified Fraud Examiners (ACFE) (2006) & Onyango (2010) who revealed that financial fraud in the system was associated with inability of the bank to meet its financial obligations and venture into new line of business.

4.5 Qualitative Data Analysis

Qualitative information collected from open-ended questions and spoken word of respondents was analyzed using content analysis method where key themes were reviewed and conclusions were made concerning problem that was under investigation

4.5.1 Fraud Proactive Audits

The study revealed that fraud proactive audits such as enforcing legal actions against employees who violated accounting standards, involvement of internal and external auditors in analyzing financial statements and training workers on ethical values of financial matters were attributed to reduced level of financial fraud in among Commercial Banks. However, it was pointed out that to some extent, despite the fact that proactive audits influenced level of financial among Commercial Banks, most of the Banks were losing money due to unethical behaviours among workers and violation of accounting standards or principles.

4.5.2 Compliance to Policies

The study revealed that despite challenges of competition, change of regulations and change of technology, compliance to policies such as Payee as You Earn, Accounting Standards and Value Added Tax influenced the level of financial fraud. However, to some extent it was observed some banks were indulging in money laundering activities that contributed to financial fraud and cybercrimes. Further, it was noted that not all the policies formulated by CBK were embraced by Banks to curb levels of financial crimes.

4.5.3 Controls of Operations

Despite the fact that control of operations contributed to reduced level of financial fraud in the system, it was noted that most of the Commercial had weak internal control mechanisms to reduce financial fraud. It was indicated that some Banks did not provide information to members of the public, others did not have strong internal reporting systems and some did not involve accountants in key decision making and to some extent others did not rely on forensic audit reports to make decision. Further, it was noted that employees of Commercial Banks had little knowledge on financial fraud matters and little was done to enlighten them on changing trends of financial crime.

4.5.5 Financial Reporting

It emerged that financial reporting contributed to reduced financial fraud among Commercial Banks. However, it was observed that some Banks did not embrace some practices such as providing opportunity to members of the public to access financial statements while others did not strictly adhere to CBK regulations and this resulted to lack of transparency and accountability in expenditure.

4.5.6 Level of Financial Fraud

It emerged that Banks were in a position to measure the levels of financial fraud through the number of employees involved in financial crime cases, losses incurred and inability to venture into new line of business such as agency banking or opening new branches within or outside Kenya.

4.6 Inferential Statistics

4.6.1 Correlation Analysis

Pearson’s product moment Correlation Analysis was conducted at 95% confidence interval and 5% confidence level 2-tailed to assess the statistical relationship between the variables while multiple regressions was used to determine the predictive power of the each independent variable and the level of financial fraud of among Commercial Banks.

Table 4.9: Correlations Results Analysis

	Fraud proactive Audits	Compliance to Policies	Controls of Operations	Financial Reporting
	1			
Fraud Proactive Audits	.710			
	.001	1		
Compliance to Policies	.693	.027		
	.001	.799		
Controls of Operations	.434	.539	.356	
	.002	.000	.001	
Financial Reporting	.398	413	389	371
	.001	.000	.001	.002
****p< 0.05**				

Source: Research Data

Table 4.9 indicates that there was statistical correlation between the fraud proactive audits (0.710), compliance to policies (0.693), controls of operations (0.434) and financial reporting (398). The positive relationship indicates that there was a correlation between the four variables of the study on the level of financial fraud among Commercial Banks. service delivery. The significance values of the four independent variables were less than 5% (0.001, 0.001, 002 and 001) which indicates that a unit increase of fraud proactive audits, compliance to policies, controls of operations and financial reporting results to a unit increase in the level of financial fraud of among Commercial Banks in Kenya

4.6.2 Regression Analysis

A multiple regression analysis was conducted to find out the linear relationship between the four independent variables on the dependent variable.

Table 4.10: Regression Results Analysis

Dependent Variable	Independent Variables	Beta Value	T-Value	P-Values
Level of Financial Fraud	Fraud Proactive Audits	0.295	3.277	0.002
Level of Financial Fraud	Compliance to Policies	0.244	3.217	0.000
Level of Financial Fraud	Controls of Operations	0.154	3.446	0.001
Level of Financial Fraud	Financial Reporting	0.148	3.123	0.000

Source: Research Data

Table 4.10 indicates that there was a significant statistical relationship between fraud proactive audits, compliance to policies, controls of operations and financial reporting and level of financial fraud in Commercial Banks in Kenya. The significance values of the five independent variables were; proactive audits (β=0.295, $p < 0.05$), compliance to policies (β=-0.244, $p < 0.05$), controls of operations (β=0.154, $p < 0.05$) and financial reporting (β=0.148, $p < 0.05$)

These results correspond with the view of Norman, Rose & Rose (2010); Odhiambo (2014) & Onyango (2010) who established that Banks are likely to reduce cases of financial crime by adopting proactive audit measures such as internal auditing and compliance to set regulation of Central Banks of Kenya.

Table 4.11: Correlation Coefficient

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	**(Constant)**	1.139	1.2235		0.930	0.000
	Fraud Proactive Audits	0. 787	0.3132	0.152	2.512	0.000
	Compliance to Policies	0. 752	0.3425	0.154	2.195	0.001
	Controls of Operations	0.539	0.1937	0.163	2.782	0.000
	Financial Reporting	0.538	0.1234	0.178	2.518	0.010

Source: Research Data

Table 4.11 indicates coefficient of determination that explains the extent to which changes in the dependent variable can be explained by the change in the independent variables. Multiple regression analysis was conducted to determine the relationship between internal audits functions and level of financial fraud among Commercial Banks in Kenya. After conducting regression analysis, the regression equation ($Y = \beta 0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$)) became: Y= 1.139+ 0.787X1+ 0.752X2+ 0.539X3+ 0.538X4 The results of the regression equation indicates that taking all factors into account (fraud proactive audits , compliance to policies , controls of operations and financial reporting) constant at zero, level of financial fraud in Commercial Banks in Kenya will be 0.0139. Further, the results reflects that taking all other independent variables at zero, a unit increase in fraud proactive audits will lead to a factor of 0.787 level of financial fraud in

Commercial Banks in Kenya; a unit increase in compliance to policies will lead to a factor of 0.752 level of financial fraud in Commercial Banks in Kenya; a unit increase in controls of operations will lead to a factor 0.539 level of financial fraud in Commercial Banks in Kenya and a unit increase in financial reporting will lead to a factor of 0.538 level of financial fraud in Commercial Banks in Kenya.

At 5% level of significance and 95% level of confidence the significance values of the four variables was less than 0.05, indicating that there was a positive statistical relationship between the consolidated variables of internal audit functions and level of financial fraud in Commercial Banks in Kenya.

4.6.3 Summary Model

Table 4.12: Summary Model

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.923	0.852	0.789	0.6273

Table 4.12 indicates that the four independent factors that were studied explain only 85.2% of internal audit functions and level of financial fraud in Commercial Banks in Kenya as represented by the R^2. This therefore means that other factors not studied in this research contribute 14.8% of internal audit functions and level of financial fraud in Commercial Banks in Kenya.

Table 4.13: ANOVA[b]

Model	Sum of Squares	df	Mean Square	F	Sig
Regression	0.003	7	.001	3.867	001[b]
Residual	0.068	22	.021		
Total	0.071	29			

Table 4.13 indicates processed data which is the population parameter that had a significance level of 0.001 and the F value 3.867 which shows that the data is ideal for making a conclusion on the population's parameter as the value of significance (p-value) is less than 5%. The calculated value was greater than the critical value (3.867 >1.701) an indication that fraud proactive audits, compliance to policies, controls of operations and financial reporting had a significantly influence on level of financial fraud in Commercial Banks in Kenya.

The calculated was greater than the critical value an indication that fraud proactive audits, compliance to policies, controls of operations and financial reporting were significantly influencing level of financial fraud in Commercial Banks in Kenya. The significance value of all the four independent variables was less than 0.05 an indication that the model was statistically significant.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents summaries of the study findings as per the study objectives, conclusions based on those findings and recommendations which are based on both the study findings and other relevant literature considered necessary and vital to be used in future to improve the study situation.

5.2 Summary of Findings

5.2.1 Fraud Proactive Audits

The study revealed that fraud proactive audits influenced the level of financial fraud in among Commercial Banks. Neverthless, it was pointed out that to some extent, most of the Banks were losing money due to unethical behaviours among workers and violation of accounting standards or principles.

5.2.2 Compliance to Policies

The study revealed that compliance to policies influenced the level of financial fraud among Commercial Banks despite the influence of competition, technology, change financial regulations. However, it was noted that some Commercial banks were indulging in money laundering activities that contributed to financial fraud and cybercrimes. In addition, it was observed that not all the policies formulated by CBK were embraced by Banks to curb levels of financial crimes.

5.2.3 Controls of Operations

The study revealed that control of operations contributed to reduced level of financial fraud in the system. However, it was noted that most of the Commercial had weak internal control mechanisms to reduce financial fraud. The study identified that some Banks protected information not to be accessed by members of the public, others had ineffective internal reporting systems and some did not involve accountants in key decision making and to some extent others did not rely on forensic audit reports to make decision. Further, it was pointed out that some Banks were doing little in enlighten employees on changing trends of financial crimes.

5.2.4 Financial Reporting

The study established that financial reporting influenced the level of financial fraud among Commercial Banks. However, it was observed that some Banks were putting little effort in shedding more light concerning annual financial statements while others violated CBK regulations and this resulted to lack of transparency and accountability in expenditure.

5.3 Conclusion

It can be concluded that unless Commercial Banks acknowledge the value of fraud proactive audits, compliance to policies, controls of operations and financial reporting, curbing financial fraud would be a difficult task in the changing business environment. Commercial Banks should review their policies ranging from policies that regulate borrowing activities, rsik management and internal audit function. Banks should strive to strictly adhere to Central Bank regulations to maximize profits.

5.4 Recommendation

The study revealed that Commercial Banks were losing money due to unethical behaviours among workers and violation of accounting standards or principles. Therefore, the study recommends that top management of Commercial Banks in Kenya should institutionalize best practices discourage financial fraud cases in the system. Top management should ensure employees recruited have no criminal record and comply with legal regulations such as payment of taxes and previous loans borrowed. Further, management should ensure employees are trained on ethical values and integrity matters as per section six of the new constitution of Kenya.

The study noted that some Commercial Banks were indulging in money laundering activities that contributed to financial fraud and cybercrimes and violated CBK regulation. Therefore, this study recommends that Central Bank of Kenya should impose strict penalties to Banks that violate the set regulations thus minimizing cases of financial crime in the long run. Central Bank of Kenya should subject Commercial Banks to periodical accountability on their financial transaction and ensure compliance to laid down guidelines.

The study revealed that some Banks protected information not to be accessed by members of the public and to some extent did not rely on forensic audit reports to make decision. Therefore, this study recommdnets that Central Bank of Kenya to should reinforce policies that encourage Banks to provide accurate financial information to enhance investor confidence.

The study established some Banks were not willing to publish their audited financial statement to members of the public. Therefore, this study recommends that CBK should take firm legal action against Banks that violated CBK regulations thus improved transparency and accountability in expenditure.

5.5 Limitations of the Study

Obtaining both primary and secondary of data from commercial banks was a great challenge and the management in some commercial banks was not cooperative due to the confidentiality of the information. The researcher managed to obtain the data from most of the commercial banks by seeking permission from top management. Some banks provided data which were expressed in form of foreign currency. This was resolved by converting all the figures into the same currency which is Kenya Shillings. A rate of 1 US$ dollar to 100 Kenyan shillings. This happened with GT Bank, Bank of Africa and Bank of Baroda.

Relying on published information from financial statement was a limitation of the study due to biasness of researchers. The researcher cautiously reviewed the financial statements thus picking pertinent information based validity and reliability. There was an assumption that the financial statements or the annual reports given did not portray a true and fair view of the financial position of the firms. However, this could be misleading because annual accounts are unreliable because banks manipulate their accounts in order to portray a positive image of the bank by maintaining positive earnings.

Limited studies conducted on financial fraud among Commercial Banks were inadequate. This was overcome by extensive literature review on related studies conducted locally and internationally. Due to the high volume data that needed to be collected for this study, there may have been human errors during entry. This may have occurred due to time limit which could not allow for double checking the entries. This can result in errors that ruin statistical results and conclusions by for example affecting the coefficients incorrectly. Data entered incorrectly can change the interpretations and findings of the study. These errors were minimized by having methods for detection and prevention of data errors.

5.6 Suggestion for Further Studies

This study sought to examine the influence of consolidated variables of internal audit functions on the level of financial fraud among Commercial Banks in Kenya, the study suggests that other researchers should seek to investigate other variables in isolation or in a consolidated form and their influence on performance of other financial institutions such as SACCOs and microfinance institutions in Kenya. Other studies should seek to test the moderating, intervening or mediating variables that influence may have an effect between internal audit functions and performance of Commercial Banks.

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APPENDICES

Appendix 1: Introductory Letter

C/O

MUIMI MWETI

D61/79121/2015

UNIVERSITY NAIROBI

TO WHOM IT MAY CONCERN

Dear Respondent,

REF: MBA RESEARCH

I am a student pursuing a postgraduate degree in Business Administration of Kenyatta University. As a requirement of the program, am required to carry out a research study on: ***"Internal Audit Functions and Level of Financial Fraud among Commercial Banks in Kenya"***

I hope that this study will result to findings that would lead to beneficial recommendation on the competitiveness of Commercial Banks in Kenya**.** Information given will be treated with utmost good faith and confidentiality. The final Report will be submitted to your organization for policy making.

Kind Regards

Appendix 2: Questionnaire

SECTION A: DEMOGRAPHIC CHARACTERISTICS

Please supply the required data by filling in the blanks where space is provided or by ticking [√] against the most appropriate answer.

I respondents name……………………………………………………..……………..

[Optional]

1. **What position do you hold in your Department**?..
2. **What is your Gender?**

   a) Male [ ]
   b) Female [ ]

3. **How long have you worked in the Accounting department?**

   a) 1- 5year [ ]
   b) 6-10 year [ ]
   c) 11-15 years [ ]
   d) 15 years and above [ ]

4. **What is your highest Academic level?**

   a) Certificate [ ]
   b) Diploma [ ]
   c) Degree [ ]
   d) Masters [ ]
   e) PhD [ ]

PART B: INTERNAL AUDIT FUNCTION AND LEVEL OF FINANCIAL FRAUD AMONG COMMERCIAL BANSK IN KENYA

Please indicate the following statement on Likert Scale ranging from strongly disagree to strongly agree: Where; **5= (Very Large Extent) 4= (Large Extent) 3= (Small Extent) 2= (Very Small Extent) 1= (Not at All)**

SECTION A: PROACTIVE FRAUD AUDIT AND LEVEL OF FRAUD

5. Indicate the extent to which you agree with the following statements with regard to the level of fraud in your Commercial Bank? **Where; 5= (Very Large Extent) 4= (Large Extent) 3= (Small Extent) 2= (Very Small Extent) 1= (Not at All)**

Proactive Fraud Audit	**1**	**2**	**3**	**4**	**5**
My Bank has effective fraud prevention mechanisms					
My Bank has trained internal auditors on ways of curbing fraud					
My Bank has effective frameworks of monitoring financial resources allocated to projects					
My Bank takes proactive measures in case of fraud in the system					
My Bank has developed internal policies that guide utilization of financial reports					
Legal actions are taken against employees who do not comply with internal accounting standards.					
My Bank engages eternal auditors to analyze financial statements periodically					
The Bank train employees on ethical practices during recruitment					
Internal Auditors strictly adhere to Accounting Standards and Procedures					
Employees of the Bank have the capacity to verify and approve employee claims, supplier quotations and pay slips					

6. **How else does proactive fraud audit influence the level of financial fraud in the Bank?**

____

SECTION B: COMPLIANCE TO POLICIES AND LEVEL OF FRAUD

7. Indicate the extent to which you agree with the following statements with regard to level of fraud in your Bank? **Where; 5= (Very Large Extent) 4= (Large Extent) 3= (Small Extent) 2= (Very Small Extent) 1= (Not at All)**

Compliance to Policies	**1**	**2**	**3**	**4**	**5**
All employees of the Bank are subjected to Pay As You Earn guidelines					
Accountants are always intelligent when making payments					
Bank employees ensure that procurement procedures was followed before approving payment for goods and services					
Internal auditors always observe high level of ethical standards when scrutinizing financial statements					
Internal Auditors observe International Standards of Accounting when calculating the value of client assets					
Employees of my Bank perform their duties with high professionalism					
Appropriate procedures are followed by the Bank when making any payments					
All suppliers of the Bank are VAT compliant					
The Bank pays their suppliers promptly after verifying their claim forms					
The Bank has Automated Payroll System					

8. **How else does compliance policies influence the level of financial fraud in your Bank?**

SECTION C: CONTROL OF OPERATIONS AND LEVEL OF FRAUD

6. Indicate the extent to which you agree with the following statements with regard to the level of fraud in your Bank. **Where; 5= (Very Large Extent) 4= (Large Extent) 3= (Small Extent) 2= (Very Small Extent) 1= (Not at All)**

Control of Operations	**1**	**2**	**3**	**4**	**5**
Accountants are involved in key financial decisions within the Bank					
Accountants are involved in procurement committees					
Internal auditors always ensure projects implemented meet the recommend financial budgets submitted					
External audit reports and recommendation are considered when formulating financial decisions					
Accountants are involved in human resource committees					
The department has clear contingency plans that safeguard their assets from fraud activities					
The department has an effective and efficient internal reporting systems					
The department encourages feedback from various stakeholders on service delivery					
The department recruit people with experience and knowledge in financial fraud detection					
Forensic audit reports are relied by the Bank to make payment claims					

9. How else does control of operations influence the level of financial fraud in the Bank?

____

SECTION D: FINANCIAL REPORTING AND LEVEL OF FRAUD

7. Indicate the extent to which you agree with the following statements with regard to the level of fraud in your Bank? **Where; 5= (Very Large Extent) 4= (Large Extent) 3= (Small Extent) 2= (Very Small Extent) 1= (Not at All)**

Statements	1	2	3	4	5
My Bank ensures financial statement are transparent and accessible by members of the public					
Finance department always observe frameworks of CBK					
My Bank always develops financial budgets based on accounting principles					
My Bank prepares annual financial reports					
My Bank always encourages transparency and accountability in expenditure					
My Bank a clear financial reporting structure					
My Bank engage external auditors to detect financial fraud cases					

8. Suggest measures your Bank can put in place to mitigate financial fraud cases?

....

SECTION F: LEVEL OF FINANCIAL FRAUD

8. Indicate the extent to which you agree with the following statements with regard to the level of financial fraud in your Bank?

Statements	1	2	3	4	5
The level of financial fraud in my bank is determined by percentage of cases committed by employees periodically					
Total losses incurred by my bank reflects the level of fraud in the system					
The number of staff involved in fraudulent activities reflect the level of financial fraud in the system					
The ability of the bank to trade securities in the Stock Exchange Market reflects level of fraud in the system					
Inability of the bank to diversify reflects the level of fraud in the system					

Thank you for your Cooperation

Appendix 3: List of Licensed Commercial Banks in Kenya

1. ABC Bank (Kenya)
2. Bank of Africa
3. Bank of Baroda
4. Bank of India
5. Barclays Bank
6. CFC Stanbic Bank
7. Chase Bank (Kenya)
8. Citibank
9. Commercial Bank of Africa
10. Consolidated Bank of Kenya
11. Cooperative Bank of Kenya
12. Credit Bank
13. Development Bank of Kenya
14. Diamond Trust Bank
15. Dubai Bank Kenya
16. Ecobank
17. Equatorial Commercial Bank
18. Equity Bank
19. Family Bank
20. Fidelity Commercial Bank Limited
21. Fina Bank
22. First Community Bank
23. Giro Commercial Bank
24. Guardian Bank
25. Gulf African Bank
26. Habib Bank
27. Habib Bank AG Zurich
28. I&M Bank
29. Imperial Bank Kenya
30. Jamii Bora Bank
31. Kenya Commercial Bank
32. K-Rep Bank
33. Middle East Bank Kenya
34. National Bank of Kenya
35. NIC Bank
36. Oriental Commercial Bank
37. Paramount Universal Bank
38. Prime Bank (Kenya)
39. Standard Chartered Kenya
40. Trans National Bank Kenya
41. United Bank for Africa
42. Victoria Commercial Bank
43. Housing Finance

Source: Central Bank of Kenya Report (2017)