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

BY:

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DECLARATION

I declare that this research project is my original work and has never been submitted to any other University for assessment or award of a degree.

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This project has been submitted with my authority as the University supervisor.

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DEDICATION

I dedicate this research project to my husband Eric Magutu. I sincerely thank him for his continuous prayers, encouragement and support.
ACKNOWLEDGEMENT

I would like to express my deepest appreciation to all those who provided me the possibility to complete this report in one way or another through their prayers, resources and encouragement.

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ABSTRACT

Financial performance requires appropriate internal audit practices to enhance efficiency. For the purpose of this study the researcher sought to determine the effect of internal audit on financial performance in commercial banks in Kenya. Internal audit was looked at from the perspective of internal audit standards, professional competency, internal controls and independence of internal audit. The study selected one senior manager in the finance department. The researcher administered a survey questionnaire to each member of the target population since it was the most appropriate tool to gather information. Quantitative analysis and regression analysis were used as data analysis technique. Descriptive statistics such as mean, standard deviation and frequency distribution were used in the analysis of data. Data presentation was done by use of tables for ease of understanding and interpretation.

From the findings, the study concludes that internal audit standards, independence of internal audit, professional competency and internal control had a positive relationship with financial performance of commercial banks, the study found that a unit increase in internal audit standards would lead to increase in financial performance of commercial banks, a unit increase in independence of internal audit would lead to increase in financial performance of commercial banks, a unit increase in professional competency would lead to increase in financial performance of commercial banks and further unit increase in internal control would lead to increase in financial performance of commercial banks.

The study recommends that management in commercial banks in Kenya should adopt effective internal audit practices such as internal auditing standards, independence of internal audit, professional competency and internal controls to enhance financial performance of the banks.
LIST OF ABBREVIATIONS

ROA : Return on Assets
ROE : Return on Equity
ROI : Return on Investments
IIA : Institute of Internal Auditors
IA : Internal Audit
PC : Professional Competency
IAS : Internal Audit Standards
IC : Internal Controls
CEO : Chief Executive Officer
1.1 Background of Study

For most of its history internal audit has served as a simple administrative procedure comprised mainly of checking documents, counting assets, and reporting to Board of Directors, Management or External Auditors. In recent times, however, a combination of different forces has led to a quiet revolution of the profession. Organizations have to demonstrate accountability in the use of shareholders money and efficiency in the delivery of services. Organizations now demand great competency and professionalism from internal audit, and scarce resources must be deployed more efficiently to minimize and manage risks. Technological advancement makes it possible to track and analyse data with continually increasing speed thus making it essential for organizations to be well advised by the internal audit department. Internal audit varies from one organization to another, and making change to modern internal audit can be a substantial undertaking. The transition from merely ensuring compliance with rules and regulations to truly delivering added value requires more than just organizational changes. In many bank institutions staff is poorly paid and unmotivated, ethical standards are weak, and governance practices are ineffective leading to asset mismanagement (Ramamoorti, 2003).

All over the world there is a realization that the Internal Audit activity has the potential to provide hitherto unparalleled services to management in the conduct of their duties. This potential has been turned into a challenge and embodied in the new definition of Internal Auditing from the Institute of Internal Auditors (the IIA). Commercial banks have come to the realization that internal audit is essential in improving management of assets in the banks leading improved financial performance of banks (Basel Committee, 2002).
1.1.1 Internal Audit

According to Robertson (1976) Internal Auditing may be defined in several ways depending upon what purpose is to be served. Pickett (1976) stated that “internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”. This definition actually seeks to demonstrate the depth and breadth of the internal audit activity within an institution as against the previous orientation of reviewing payment transactions over the years.

Internal Audit is an objective and independent appraisal service within an organization on risk management, control and governance by measuring and evaluating their effectiveness in achieving the organization’s agreed objectives. In addition, internal audit’s findings are beneficial to the Board of Directors and line management in the audited areas. The service applies the professional skills of internal audit through systematic and disciplined evaluation of the policies, procedures and operations that management put in place to ensure the achievement of the organization’s objectives, and through recommendations for improvement (Dumitrescu, 2004).

The Board of Directors of the Institute of Internal Auditors in June 1999 described internal audit as an independent, material and consultancy activity, which adds value and improves the functioning of an organisation. It helps the organisation achieve its aims by means of a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and the management process.
Internal audit has several aims and principles which it is necessary to adhere to. It is the board of directors of the bank, however which bears final responsibility that the bank’s management applies an appropriate and effective system of internal audit, a system of evaluating banking activity risk and risks concerning bank capital, appropriate methods of monitoring compliance with laws, measures and internal procedures. Likewise, the bank’s management is responsible for drawing up procedures which identify measure, monitor and control the risks that the bank faces.

Internal audit is a part of the repetitive monitoring of the internal control systems of the bank and its procedures for evaluating internal capital. As such, it assists management and the board of directors in the effective performance of their responsibility as outlined above (Gramling, 1997).

Although the need for objectivity and impartiality is of particular importance for the internal audit department in a banking institution, this does not exclude the possibility that this department, too, may contribute to advisory and consultancy activity, if the independence of analyses and evaluations is ensured. Some banks have also introduced a system of evaluating their activities, which does not replace, but supplements the function of the bank’s internal audit. This is a formal and documented process whereby management and employees analyse their activities and evaluate the effectiveness of the related internal control procedures (Hawkes, 1994).

1.1.2 Financial Performance

There are many aspects of the performance of commercial banks that can be analysed. Muga (2012) stated that the importance of bank profitability can be appraised at the micro
and macro levels of the economy. At the micro level, profit is the essential prerequisite of a competitive banking institution and the cheapest source of funds. It is not merely a result, but also a necessity for successful banking in a period of growing competition on financial markets. Hence the basic aim of every bank management is to maximize profit, as an essential requirement for conducting business. At the macro level, a sound and profitable banking sector is better able to withstand negative shocks and contribute to the stability of the financial system. Bank profits provide an important source of equity especially if re-invested into the business. This should lead to safe banks, and as such high profits could promote financial stability.

Schiuma (2003) mentioned accounting-based performance using three indicators: return on assets (ROA), the return on total equity (ROE) and Return on Investment (ROI). These are widely used to assess the performance of firms, including commercial banks. Bank regulators and analysts have used ROA and ROE to assess industry performance and forecast trends in market structure—as inputs in statistical models to predict bank failures and mergers—and for a variety of other purposes where a measure of profitability is desired. The main purpose of this study was to examine if internal audit can actually enhance banks financial performance.

1.1.3 Internal Audit and Financial Performance

Most internal audit professionals argue that an effective internal audit function correlates with improved financial performance. According to Beyanga (2011), an effective internal audit service can, in particular, help reduce overhead, identify ways to improve efficiency and maximize exposure to possible losses from inadequately safeguarded company assets all of which can have a significant effect on the financial performance of an organisation.
He also stated that internal audit is an “invaluable tool of management for improving performance”. Fadzil et al (2005) also noted that internal auditors help run a company more efficiently and effectively to increase shareholders value”. Finally Hermanson and Rittenberg (2005) argued that the existence of an effective internal audit function is associated with superior organizational performance.

At the empirical level, a survey conducted by KPMG (1999) found that the internal audit function in organizations where it exists, contributes substantially to performance improvement and assist in identifying profit evidence in corporate disasters, particularly financial fraud consistently documents an association between weak governance. Thus internal audit by acting as a watchdog could save the organization from malpractices and irregularities thus enabling the organization to achieve its objectives of ensuring high level of productivity and profit.

1.1.4 Commercial Banks in Kenya

The Banking industry in Kenya is governed by the Companies Act, the Banking Act, the Central Bank of Kenya Act and the various prudential guidelines issued by the Central Bank of Kenya (CBK). Commercial Banks are an institution which accept deposits, makes business loans and offers related services. They also allow for a variety of deposits accounts, such as checking, savings and time deposit. These institutions are run to make profits. Commercial banks are licensed and regulated by the central banks of their jurisdiction (countries) in which they operate. In Kenya, the Central Bank of Kenya (CBK) licenses, supervises and regulates commercial banks as mandated under the Banking Act. Over the last few years, the Banking sector in Kenya has continued to growth in assets, deposits, profitability and products offering. The growth has been mainly underpinned by,
an industry wide branch network expansion strategy both in Kenya and in the East African community region and automation of a large number of services and a move towards emphasis on the complex customer needs rather than traditional ‘off-the-shelf’ banking products. This has led to an increased need for internal audit in banks to enhance asset management, control of risks and management controls. Players in this sector have experienced increased competition over the last few years resulting from increased innovations among the players and new entrants into the market. Currently there are 43 licensed commercial banks in Kenya.

1.2 Research Problem
Recent corporate accounting scandals and the resultant outcry for transparency and honesty in reporting have given rise to two disparate yet logical outcomes. First, Internal Auditing skills have become crucial in untangling the complicated accounting manoeuvres that have obfuscated financial statements. Second, public demand for change and subsequent regulatory action has transformed corporate governance. Increasingly, company officers and directors are under ethical and legal scrutiny. Both trends have the common goal of responsibly addressing investors’ concerns about the financial reporting system. However there has been laxity in implementation of internal audit findings and recommendations.

Kenyan banks have not been without crisis, the shortcomings of Kenya's banking sector prior to the banking crisis of the late 1980s, and then the effect of the measures subsequently introduced by Kenya's Central Bank. Banks could be established by any investor almost at will, shareholders and directors escaped any vetting procedure, the role of external auditors was poorly defined and due diligence and banking supervision
inadequate. These shortcomings led to what Karugor Gatamah of the Centre for Corporate Governance based in Nairobi describes as "imprudent lending practices, excessive investment in fixed assets and inadequate systems to measure, identify and control risk".

Various local studies on this topic include: Mutua (2012) researched on impact of risk based audit on financial performance of commercial banks in Kenya. She observed that financial performance requires appropriate risk based audit practices hence effective and efficient internal audit. From the findings, the study concluded that risk based auditing through risk assessment, risk management, annual risk based planning, internal auditing standards and internal auditing staffing should be enhanced.

Otieno (2012) researched on effects of corporate governance on financial performance of commercial banks in Kenya. He concluded that corporate governance plays an important role on bank stability, performance and bank’s ability to provide liquidity in difficult market conditions. From the findings, corporate governance factors account for 22.4 % of the financial performance of commercial banks.

Chepkorir (2010) established that internal audit helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems. The internal auditors are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified.

This research will be different from all the above mentioned as it will specifically look at internal audit as a factor affecting financial performance of commercial banks. The above researchers concentrated on management of risks and corporate governance. This study will have a look at the internal audit function in banks, the role they play in the organisation, internal audit and asset management and how the effect on financial performance.

1.3 Research Objective

The objective of this study will be to establish the effect of internal audit on financial performance of commercial banks in Kenya.

1.4 Value of the Study

This study will help in increasing the role and image of internal audit in commercial banks to make it more effective and professional. It will help the shareholders appreciate the role of the internal audit as one of the most important managerial control systems in an organization required to safeguard their interests.

The management of banks will be able to look for ways of making Internal Audit a completely independent function from the management thus making it more effective. By
implementing recommendations given on the internal audit reports management will be able to enhance performance of the bank.

For scholars it will help them to appreciate and enhance their knowledge of internal audit so as to adhere to the professional ethics as required by the IAS.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

A review of literature is crucial as it shows a picture of the state of knowledge in the area of study. This chapter will review various literatures in the fields of internal audit and impact it has on financial performance of organisations more particularly banks.

2.2 Review of Theories

Various theories have been formulated on internal audit and financial performance. They include Agency theory; contingency theory and Lending credibility theory. These are discussed below:

2.2.1 Agency Theory

Agency theory is concerned with resolving problems that can exist in agency relationships; that is, between principals (such as shareholders) and agents of the principals (for example, company executives). The two problems that agency theory addresses are: the problems that arise when the desires or goals of the principal and agent are in conflict, and the principal is unable to verify what the agent is actually doing and the problems that arise when the principal and agent have different attitudes towards risk. Because of different risk tolerances, the principal and agent may each be inclined to take different actions.

Adams (1994) in his article stated that Agency theory can provide for richer and more meaningful research in the internal audit discipline. Agency theory contends that internal auditing, in common with other intervention mechanisms like financial reporting and
external audit, helps to maintain cost-efficient contracting between owners and managers. Agency theory may not only help to explain the existence of internal audit in organizations but can also help explain some of the characteristics of the internal audit department, for example, its size, and the scope of its activities, such as financial versus operational auditing. Agency theory can be employed to test empirically whether cross-sectional variations between internal auditing practices reflect the different contracting relationships emanating from differences in organizational form.

### 2.2.2 Contingency Theory
The goal of an audit is to test the reliability of a company’s information, policies, practices and procedures. Government regulations require that certain financial institutions undergo independent financial audits, but industry standards can mandate audits in other areas such as safety and technology. Regardless of the audit subject, various factors impact a company’s final results, and the contingency theory takes these factors into account during the audit process.

The contingency theory of leadership and management states that there is no standard method by which organizations can be led, controlled and managed. Organizations and their functions depend on various external and internal factors. The functions of audits are themselves, types of organizations that are affected by various factors in the environment. The presence of such factors is why auditing can be managed by applying the contingency theory, with a recognition that processes and outcomes of audits are dependent on variable and contingent factors.
On a broad level, the audit process is straightforward. Auditors require access to documents, systems, policies and procedures to manage an audit. They must remain compliant with industry standards, government regulations and internal requests. Audit teams may begin the audit process with meetings where they gather risk and control awareness, after which the field work begins. During the audit process, auditors perform substantive procedures and test controls. They then draft reports that they submit to management and regulatory authorities. The audit sub processes, particularly in planning and field work, include contingencies such as business type, employee skill level, applicable laws, available audit workforce, available technology and systems, and deadline.

Daft (2012) in his book writes: “Contingency means: one thing depends on other things” and “Contingency theory means: it depends.” Audit functions are task-oriented and can be loosely structured. The functions also can vary considerably, depending on the area of a company under audit and the type of business model, so auditors must carefully manage their inspections and take variables into account to get the job done. The contingency theory also can be applied to an audit team’s structure. Typically, audit team managers receive audit projects. They then create ad hoc audit teams for the projects, selecting auditors based on expertise and experience in the subject areas, and on auditor availability, all of which add up to contingencies for any given audit project.

Audit teams use a mix of structure and contingency to get the output rolling quickly. The subject of auditing projects can include such diverse areas as evaluation of production processes, inspection of company accounts, and assessment of compliance with industry standards. Selecting auditors with specialized training or those who have a particular skill
set in the subject area minimizes the learning curve and reduces opportunities for errors. The quality and output of audits remain assured when audit teams use resources according to expertise and experience, and when auditors are flexible and can adapt to process fluctuations. For example, an auditor experienced in evaluating financial instruments can be effective in an audit exercise of a bank or hedge fund, even when the financial instruments the institution offers do not fit the typical mould (Davoren, 1994).

2.2.3 Lending Credibility Theory

Volosin, (2007) in his book mentioned that the lending credibility theory is similar to the agency-theory and it states that audited financial statements can enhance stakeholders’ faith in management’s stewardship. The business world consists of different groups that are affected by, or participate in, the financial reporting requirements of the regulatory agencies. They are shareholders, managers, creditors, employees, government and other groups. The major recipients of the annual reports are the shareholders, including individuals with relatively small shareholding and large institutions such as banks or insurance companies. Their decision is usually based on the financial reporting and the performance of the company’s management, who have a responsibility to act in the interests of investors. Thus, the purpose of the financial statements.

The auditor is appointed by the company’s shareholders and reports his results to his clients. The aim of the auditor’s report is to comment on how accurately the company presents its financial situation and how it is performing. This should reassure the shareholders that their investment is secured and also help to reduce the practice of misleading accounting procedures designed to show the company in a more favourable light. Basically, the audit is represented as a process designed to evaluate the credibility of information of a company’s financial statements (Letza, 1996).
2.3 Review of Empirical Studies

Only a few academic studies have examined the effectiveness of internal audit, and even fewer have dealt with the issue empirically. In one of the very few studies that examined the effect of internal auditing on organisational performance, Eden D, (1996) assigned 224 bank branches to experimental conditions (audited or not audited) and monitored their performance for a year. Their findings showed that performance significantly improved during the half year following the audit in the experimental branches, while the control branches experienced a decline due to poor general business conditions. While that study offers a useful jumping-off point for understanding how good auditing can improve a company’s performance, it does not go far enough in explaining when and why internal audit works, and the conditions that facilitate or impede it. Helping to bridge this gap will be one of the main contributions of this study.

According to Cooper and Craig (1983), on his study on the role of internal audit in the Asia Pacific region. This seminal research on internal audit in Australia found a number of issues that were of concern to the profession. It was found that there were a number of misconceptions about what internal auditors were doing and what their chief executive officers (CEO) perceived was being done and in fact there were expectations by the CEO’s that internal audit could do more than the traditional financial auditing work mainly being done at the time. There was nevertheless strong support for internal audit by CEO’s and at the time it was seen as offering long-term career prospects. However, the profession in Australia in the early 1980’s suffered from an image problem, it did not have a strong professional body to represent its interests as it has now, and there were no generally accepted professional qualifications recognized as necessary to practice as an internal auditor. The study was undertaken before the development of modern
internal auditing, as we know it now. It did, however, set the scene for a number of subsequent studies in Australia, Hong Kong and Malaysia.

According to Peursem (2004), a major study was been undertaken in New Zealand on internal auditor’s role and authority. In this study, internal auditors were asked to come to a view on whether functions they perform in connection with audit engagements are essential, and to what degree they feel they enjoy the authority over, and independence from, management that we might expect of a professional. The research constituted a survey of New Zealand auditors, all of whom were members of the New Zealand branch of the IIA. A very high percent (73%) response rate was achieved over the original and follow-up survey. The study found that characteristics of a ‘true’ profession exist but do not dominate. Significantly, and as subgroups, Peursem also observed that public practice and experienced auditors may enjoy greater influence over management, and accountancy-trained auditors may enjoy greater status owing to the ‘mystique’ of the activities emanating from their membership of well-known accountancy professional bodies. The research supports prior studies by Coopers and Craig (1983), Cooper et al. (1966) and Gramling (1997) which all expressed serious reservations about the effectiveness of the internal auditor’s role. In a follow up study in New Zealand, Peursem examined the role of the New Zealand internal auditor and conceptualizes on the auditor’s influence over that role. The fundamental questions how an effective internal auditor can overcome the tension of working with management to improve performance, while also remaining sufficiently distant from management in order to report on their performance. The research found that there are three concepts characteristic of those who best balanced their role: the internal auditor’ external professional status; the presence of a formal and an informal communication network; and the internal auditor’s place in determining their own role.
Informing these concepts is the auditor’s ability to manage ambiguity. This was a qualitative study using a multiple case-based approach in which the researcher made observations, examined documents and interviewed senior internal auditors in six New Zealand organizations. However, it is a very thorough study and offers insights arguably not readily available in more traditional quantitative research.

According to Basel Committee report (2002) each bank should have a permanent internal audit function in order to fulfil its duties and responsibilities. The senior management should take all necessary measures so that the bank can continuously rely on an adequate internal audit function appropriate to its size and to the nature of its operations. These measures include providing the appropriate resources and staffing to internal.

A survey, by Ernst & Young, polled 695 chief audit executives and C-suite executives and found that 80 per cent of them admitted that their organization’s internal audit function has room for improvement. The report found that 75 per cent of the survey respondents believe strong risk management has a positive impact on their long-term earnings performance. An equal percentage of the respondents believe that their internal audit function has a positive impact on their overall risk management efforts. As the role of the internal auditor evolves and stakeholder expectations rise, internal audit functions increasingly require competencies that exceed the more traditional technical skills, such as the ability to team with management and business units on relevant business issues.

Mawanda (2008) conducted a research on effects of internal control systems on financial performance in institution of higher learning Uganda. In his study he investigated and sought to establish the relationship between internal control systems and financial
performance in an Institution of higher learning in Uganda. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls.

The study established a significant relationship between internal control system and financial performance. The investigation recommends competence profiling in the Internal Audit department which should be based on what the University expects the internal audit to do and what appropriate number staff would be required to do this job. The Study therefore acknowledged role of internal audit department to establish internal controls which have an effect on the financial performance of organisations.

Mutua (2012) researched on impact of risk based audit on financial performance of commercial banks in Kenya. Although her study concentrated on risk based audit She acknowledged that financial performance requires appropriate effective and efficient internal audit. From the findings, the study concluded that risk based auditing through internal auditing standards and internal auditing staffing should be enhanced to enable firms to be able to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability, hence enhancing financial performance. This showed that there is indeed a relationship between internal audit and financial performance.
Ndege (2012) researched on Performance and financial ratios of commercial banks in Kenya. The objective of his study was to identify factors, in a ratio form that shape bank performance as measured through return on assets (ROA) and return on equity (ROE). In his study he concluded that ROA and ROE can be used to measure financial performance of banks in Kenya. Internal audit operations and recommendations do not only have short-term effect on the running of an organization but is the backbone of an organization and it dictates the prosperity or the downfall of the particular organization. Its effectiveness and acceptability should be stressed at all levels and especially the management to enhance its viability. However it seems that laxity has crept in and it is in light of this view that we seek to analyse the factors affecting implementation of internal audit reports in Kenyan banks.

2.4 Determinants of Internal Audit

2.4.1 Internal Audit Standards

Glazer and Jaenike (1980) argued that performing auditing work according to internal auditing standards contributes significantly to the effectiveness of auditing. Ridley and D’Silva (1997) found in the UK that complying with professional standards is the most important contributor to IA’s added value.

Standards for audits and audit-related services are published by the IIA (2008) and include attribute, performance and implementation standards. In general, formal auditing standards recognise that internal auditors also provide services regarding information other than financial reports. They require auditors to carry out their role objectively and in compliance with accepted criteria for professional practice, such that internal audit activity will evaluate and contribute to the improvement of risk management, control and
governance using a systematic and disciplined approach. This is important not only for compliance with legal requirements, but because the scope of an auditor’s duties could involve the evaluation of areas in which a high level of judgement is involved, and audit reports may have a direct impact on the decisions or the course of action adopted by management (Bou-Raad 2000). It can thus be argued that greater quality of IA work – understood in terms of compliance with formal standards, as well as a high level of efficiency in the audit's planning and execution – will improve the audit’s effectiveness.

2.4.2 Independence of Internal Audit

According to Cai Chun (1997) Independence is the essence of auditing. An internal auditor must be independent of both the personnel and operational activities of an organization. Otherwise, the integrity of the auditor’s opinions, conclusions and recommendations would be suspect. So, independence is necessary for the effective achievement of the function and objective of internal audit. This independence is obtained mainly from two characteristics – organizational status and objectivity.

Mgr Lon Bogdan Dumitrescu in his article of internal audit in banking organisations (2004) acknowledges that every bank should have an internal audit department on which – with regard to the volume and nature of its activities – it can rely. In smaller banks internal audit is often provided externally. The internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day-to-day internal control processes. In this way it is guaranteed that this department performs its activities objectively and impartially. Internal auditors may not have a conflict of interests with the bank. Every bank should have formalised principles of internal audit providing for its position and powers in the framework of the
bank. There should here be codified the scope of work of internal auditors, the position of the whole department in the bank’s organisational structure, relations with other control departments.

Internal audit must be objective and impartial, meaning that it should perform its activity free of doubts and interference. Members of the internal audit team may not participate in the bank's operations or in the selection and implementation of internal control systems. The professional competence, as well as internal motivation and systematic professional development of each internal auditor are essential factors for the correct functioning of the whole internal audit department of the bank. It is also recommended to rotate individual auditors in the framework of the department, so that the routine performance of work activities is avoided. The internal audit department manager should be responsible that the department performs its activities in accordance with the due principles of internal audit. Especial care should be taken that the audit plan is drawn up formally and procedures for all members of the team are in writing. The professional competence of the department's employees must always be ensured, as must their regular training. The internal audit department is responsible to the bank's management and its board of directors, possibly also to the audit committee, if the bank has one. These bodies of the bank should primarily be informed as to the progress of the audit plan and the attainment of the internal audit department’s objectives.

2.4.3 Professional Competency

Detecting fraud is a challenging task. Perpetrators actively engage in deception in an attempt to conceal their behavior, auditors may have limited experience in fraud detection, and fraudulent activities are inherently unpredictable and difficult to detect (Herz and
Schultz, 1999; Kaplan et al., 2010; Nieschwietz et al., 2000). Hence, the organization would be optimally served by identifying and utilizing those individuals who, because they appear to share certain unique personality traits or characteristics, may be best suited to the fraud detection task. For example, Uecker et al. (1981) used perceptions of relative aggressiveness between internal and external auditors to investigate the detection of corporate irregularities. Internal auditors play an important role in fraud detection with most frauds identified by the internal audit function (KPMG, 2003, Norman et al., 2010). Due to the importance of effective fraud detection, any measures that can enhance the efficacy of auditors should be of value. While experience and ability are undeniably important in the detection process, certain individual characteristics may be predictive of the capacity to detect fraud (Ashton, 1999). Understanding how auditors are perceived, and how these perceptions lead to beliefs regarding their detection abilities, is an important first step in relating personality traits to the efficacy of auditors.

A review of the research reveals a general acknowledgment that the five factor model can be used as a descriptive mechanism for the most salient elements of an individual’s personality (Judge et al., 2002). Conscientiousness is the personality dimension primarily responsible for organizing and directing individual behavior, and conscientious individuals may be characterized as responsible, diligent, persevering and thorough (Digman and Takemoto-Chock, 1981).

Wells (2003) conducted a series of interviews with successful fraud examiners and found that these individuals exhibited a cluster of common traits including perseverance, diligence and integrity – each of which is an attribute of the conscientiousness dimension. Within the context of the five factor model, only conscientiousness has been found to
reliably predict job performance across all occupational groups (Robertson et al., 2000). Indeed, some studies have demonstrated that conscientiousness correlates with task performance just as strongly as cognitive ability (Alonso, 2000). Previous research has demonstrated a linkage between conscientiousness and task performance, and the linkage has been shown to be stable across time (Barrick et al., 1993). Conscientiousness can affect job performance in a number of ways. Conscientious employees are generally more reliable, more motivated, and harder working; they are also likely to devote more energy to the task at hand and spend less time daydreaming (Viswesvaran, 2006).

This results in greater assimilation of task related knowledge, leading to greater productivity (Ones and Viswesvaran, 2006). Conscientious individuals would be expected to pay more attention to detail and profit more from vicarious learning, thus gaining enhanced job knowledge and being more productive (Bandura, 1977; Viswesvaran, 2006). These assertions were confirmed by Colquitt et al. (2000) who showed that conscientiousness was highly correlated with motivation to learn and by Borman et al. (1991) who demonstrated a positive association with job knowledge.

2.4.4 Internal Controls

Controls audits are designed to ensure that appropriate controls over systems and software are in place to ensure that internal controls and internal checks are functioning as designed, (Haylas and Ashton, 1982). Controls audits can have features built into them to ensure that fraudulent truncations are flagged or made difficult, if not impossible, to transact. Controls audits provide assurance that controls are working, but they do not necessarily detect fraud or corruption. Internal controls audit objectives relate to management’s plans, methods, and procedures used to meet the organization’s mission,
goals, and objectives. Internal control includes planning, organizing, directing, and controlling program operations and the systems put in place to measure, report, and monitor program performance, (Esmailjee, 1993).

Haylas and Ashton (1982) in their effort to provide evidence on the effectiveness of particular audit techniques in detecting errors that affect the financial statements suggested that all intentional errors are concentrated in relatively few audits and these are fairly predictable by industry. The great majority of such errors affect income but the direction of effect may either be an understatement or over statement. Regarding the signaling of an error, they found that the large portion of financial statements errors are initially signaled by less rigorous audit procedures such as analytical review and discussions with the client. Client personnel problems such as inexperience, incompetence and insufficient knowledge and inadequate control follow up or reviews were found instrumental in causing the errors.

Salih (1983) evaluated the internal controls of Ethiopian Airlines in Nairobi branch and concluded that the lack of segregation of accounting and custodian functions was the greatest weakness of the branch office. He argued that there is need to centralize cash receipts, establish an audit unit, separate accounting unit from sales section, separate duties of purchase activities and establish a perpetual inventory system for the tickets. He further emphasized that the existence of control is very crucial especially under today’s condition with severe competition which place premium on reliable customers’ services, on consideration of cash, on realization of capital assets and manpower and on other reduction costs.
Esmailjee (1993) studied the internal controls of Nyayo Bus Service Corporation – a state corporation. He observed that cash receipts as well as cash disbursements bear fairly strong controls attributed to the fact that the government accounting system is still in operation. However, the payroll and the stores accounting systems had a lot to be desired. Regarding the Organizational chart, a lot of information was missing. The internal auditor was being underutilized as he was charged with the responsibility of performing routine control checks which were also performed by the examination section. This led to duplication of efforts and down playing of the internal auditor’s effective role.

Keitany (2000) in a study of internal audit control functions and its implications for risk assessment by the internal auditor: A case of quoted companies concluded that even though the extend of reliance on internal control is not sensitive to the strengths of audit departments, companies should not do away with it. This is because as a management tool it should assist management in its day to day operations and not necessarily of any relevance to the external auditor. This may be attributed to the fact that external auditor may have specific considerations which may be beyond the strength of internal controls. However, though the system of internal control was ranked as the most important factor in obtaining audit evidence other indicators followed. It therefore implies that once the auditor establishes the strength of the audit department, other risk indicators come into play notwithstanding the strength of internal control.

In a study investigating the effects of internal control deficiencies on firms risk and cost of equity capital, Ashbaugh, Collins, and Kinney (2006) concluded that firms that disclose an internal control problem experience a significant increase in market-adjusted cost of capital and firms that subsequently improve their internal control systems exhibit a
decrease in their market-adjusted capital. This study provides evidence that internal control risk matters to investors and those firms reporting strong internal controls or firms that correct prior internal control problems benefit from lower costs of equity capital beyond that predicted by other internal control risk factors.

Findings by Schneider and Church (2008) on the effect of auditor’s internal controls opinion on loan decisions suggested that an adverse internal control opinion can underpin the assurance provided by unqualified opinion on financial statements taken as a whole and have a negative effect on lenders assessment. Adverse internal control opinion weakens the importance assigned to the balance sheet and income statement in lending decisions and that it reduces lenders confidence that financial statements are presented fairly in conformance with the generally accepted accounting principles. Khandawalla (1972) carried out a research on the relationship between the degree of competition and control. He concluded that the greater the degree of competition, the greater would be the need to control costs and evaluate whether actual performance meets the target performance expectations.

2.5 Conclusions

From the Literature review, several researchers seem to concur that there is a relationship between internal audit and financial performance of an organization. These conclusions were confirmed after empirical evidence was obtained from the research. However there seems to be very few studies done on effect of internal audit financial performance in organisations.
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction
This chapter sets out various stages and phases that were followed in completing the study. It involved a blueprint for the collection, measurement and analysis of data. Specifically the following sub-sections were included; research design, target population, data collection instruments, data collection procedures and finally data analysis.

3.2 Research Design
Creswell (2003) defines a research design as the scheme, outline or plan that is used to generate answers to research problems. Further Dooley (2007) notes that a research design is the structure of the research, it is the ‘‘glue’’ that holds all the elements in a research project together. The study adopted a descriptive cross-sectional research design, which according to Kothari (2004), is used when the problem has been defined specifically and where the researcher has certain issues to be described by the respondents about the problem. Survey designs were found to be accurate in descriptive studies and generalizations of results (Ngechu, 2004). The study involved the evaluating the effect of Internal Audit in the financial performance of commercial banks in Kenya.

3.3 Target Population
According to Ngechu (2004), a study population is a well-defined or specified set of people, group of things, households, firms, services, elements or events which are being investigated. Thus the population should fit a certain specification, which the researcher was studying and the population should be homogenous. The target population for this study was the 43 registered commercial banks in Kenya.
3.4 Sample Size

Ngechu (2004) underscores the importance of selecting a representative sample through making a sampling frame. From the population frame the required number of subjects, respondents, elements or firms were selected in order to make a sample. The sample included all the 43 commercial bank in Kenya. The study selected 20 commercial banks from a targeted population of 43 Banks in Kenya. Banks were selected in terms of their size as follows: 5 big banking institutions, 10 medium size banks and 5 small banks. The data was treated on the basis of applicability of the study, relevance, and accuracy, sufficient, cost of acquisition of the data and time contribute greatly in supporting the overall data collection. The study purposively selected one senior manager in the finance department thus a sample population of 20 respondents.

3.5 Data Collection Procedures

According to Ngechu (2004), there are many methods of data collection. The choice of a tool and instrument depends mainly on the attributes of the subjects, research topic, problem question, objectives, design, expected data and results. This is because each tool and instrument collects specific data. Donald (2006) notes that there are two major sources of data used by respondents’ primary and secondary data.

The researcher administered a survey questionnaire to each member of the target population. The questionnaire was carefully designed and tested with a few members of the population for further improvements. This was done in order to enhance its validity and accuracy of data to be collected for the study.
The researcher administered the questionnaires individually to selected employees of commercial banks. The researcher exercised care and control to ensure all questionnaires issued to the respondents were received and to achieve this, the researcher maintained a register of questionnaires which were sent and which were received.

3.6 Data Analysis and Presentation

Data will be analyzed using Statistical Package for Social Sciences (SPSS Version 20.0) program. Both quantitative analysis and regression analysis was used as data analysis technique. The data collected was run through various models so as to clearly bring out the effect internal audit on financial performance of commercial banks. Logit model was used to analyze the regression equation. The focus of this study is the link between internal audit and performance of commercial banks. The study measured performance through profitability of the banks. The set of independent variables includes internal audit standards, independence of internal audit, professional competency of internal audit and internal control in the bank.

3.6.1 Conceptual Model

The following conceptual model was adopted in the study where Performance is a function of internal audit standards (IAS), independence of internal audit (IIA), professional competency (PC) and internal control in the bank (IC):

$$\text{PERF}_i = f(\text{IAS}, \text{IIA}, \text{PC}, \text{ICIT})$$

Where

PERF = financial performance of the bank
IAS = Internal Audit Standards
IIA = Independence of Internal Audit
PC = Professional Competency

IC = Internal Controls

### 3.6.2 Analytical Model

The following regression mode was used to perform data analysis

\[
\text{PROF} = \beta_0 + \beta_1 \text{IAS} + \beta_2 \text{IIA} + \beta_3 \text{PC} + \beta_4 \text{IC} + \varepsilon \quad \text{..........................................................(2)}
\]

Performance of the banks was measured using financial performance measures which include the profitability of the bank that is return on assets.

Internal audit standards were measured using various internal audit standards adopted by the commercial banks.

Independence of internal audit was measured using the level of independence of internal auditor in the respective commercial banks.

Professional competency was measured by the level of professional competency of internal auditor in specific commercial banks.

Internal control was measured by the various internal controls in each commercial bank.
CHAPTER FOUR
DATA ANALYSIS AND INTERPRETATIONS

4.1 Introduction

This chapter discusses the interpretation and presentation of the findings obtained from the field. Descriptive and inferential statistics have been used to discuss the findings of the study. The study targeted a sample size of 20 respondents from which 20 filled in and returned the questionnaires making a response rate of 100%. This response rate was satisfactory to make conclusions for the study.

4.2 Data Presentation

4.2.1 Demographic Information

Table 1: Gender of the Respondent

<table>
<thead>
<tr>
<th>Gender</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>15</td>
<td>75</td>
</tr>
<tr>
<td>Female</td>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td>Total</td>
<td>20</td>
<td>100</td>
</tr>
</tbody>
</table>

The study sought to determine the gender of the respondent and therefore requested the respondent to indicate their gender. The study found that majority of the respondent as shown by 75% were males whereas 25% of the respondent were females, this is an indication that both genders were involved in this study and thus the finding of the study did not suffer from gender bias.
### Table 2: Age Distribution

<table>
<thead>
<tr>
<th>Age bracket</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>25 to 34 years</td>
<td>9</td>
<td>45</td>
</tr>
<tr>
<td>35 to 44 years</td>
<td>6</td>
<td>30</td>
</tr>
<tr>
<td>45 to 50 years</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td>51 years and above</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study requested the respondent to indicate their age category, from the findings, 45% of the respondents were aged between 25 to 34 years, 30% of the respondents indicated they were aged between 35 to 44 years, 15% of the respondents indicated they were aged between 45 to 50 years, whereas 10% of the respondents indicated that they were aged above 51 years. This is an indication that respondents were well distributed in terms of their age.

### Table 3: Level of Education

<table>
<thead>
<tr>
<th>Level of Education</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Postgraduate</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>Masters</td>
<td>4</td>
<td>20</td>
</tr>
<tr>
<td>Degree</td>
<td>8</td>
<td>40</td>
</tr>
<tr>
<td>Diploma</td>
<td>6</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study requested the respondent to indicate their highest level of education. From the findings, it was established that 40% of the respondent indicated their highest level as
degree, 30% of the respondent indicated their highest level as college diploma, 20% of the respondents indicated their highest level of education as masters, whereas 10% of the respondents indicated their highest level as post graduate. This is an indication that most of the respondents focused in this study had university degrees as their highest level of education.

Table 4: Period of Service

<table>
<thead>
<tr>
<th>Years of Service</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 2 years</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td>2 to 5 years</td>
<td>6</td>
<td>30</td>
</tr>
<tr>
<td>6 to 10 Years</td>
<td>7</td>
<td>35</td>
</tr>
<tr>
<td>More than 10</td>
<td>5</td>
<td>25</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study requested respondent to indicate the number of years they had served for. From the findings the study established that 35% of the respondents had worked for a period of raging 6 to 10 years, 30% of the respondent indicated that they had worked for a period raging between 2 to 5 years, 25% of the respondents had served for more than 10 years, and finally 10% of the respondents indicated to had worked for a period of less than 2 years, this implies that majority of the respondents had served for a considerable period which indicates that most of the respondents had vast knowledge which could be relied upon by this study.
4.2.2 Professional Competence

Table 5: Extent to which professional competence affect financial performance.

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>4</td>
<td>20</td>
</tr>
<tr>
<td>Great extent</td>
<td>14</td>
<td>70</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study sought to establish the extent to which professional competence of internal auditor affect financial performance of commercial banks in Kenya. From the findings 70% indicated to a great extent, 20% of the respondents indicated to a very great extent whereas 10% of the respondents indicated to a moderate extent. This implies that professional competence of internal auditor affects financial performance of commercial banks in Kenya to a great extent.

Table 6: Effects of Professional Competence of Internal Auditor and Financial Performance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
<th>Strongly disagree</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fraud detection, and fraudulent activities are inherently unpredictable</td>
<td>8</td>
<td>9</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1.40</td>
<td>0.21</td>
</tr>
<tr>
<td>and difficult to detect and they affect the performance of the bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In commercial banks frauds are identified by the</td>
<td>12</td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>0</td>
<td>1.05</td>
<td>0.24</td>
</tr>
</tbody>
</table>
The study sought to establish the level at which respondents agreed or disagreed with the above statements relating to professional competence of internal auditor and performance of commercial banks in Kenya, from the findings the study established that majority of the respondents strongly agreed that measures that can enhance the efficacy of auditors are important for effective fraud detection as shown by mean of 1.00, in commercial banks frauds are identified by the internal audit function as shown by mean of 1.05, fraud detection and fraudulent activities are inherently unpredictable and difficult to detect and they affect the performance of the bank, conscientiousness correlates with task performance just as strongly as cognitive ability as shown by a mean of 1.40 in each case, finally others agreed that the auditors in the organization are qualified to undertake audit function as shown by a mean of 1.60.
4.2.3 Internal Controls

Table 7: Extent to Which Internal Controls Affect Financial Performance of Commercial Banks

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>6</td>
</tr>
<tr>
<td>Great extent</td>
<td>11</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
</tr>
</tbody>
</table>

The study sought to establish the extent to which internal controls affect financial performance of commercial banks in Kenya. From the findings 55% indicated to a great extent, 30% of the respondents indicated to a very great extent whereas 15% of the respondents indicated to a moderate extent. This implies that internal controls affect performance of commercial banks in Kenya to a great extent.

Table 8: Effects of Internal Controls on Financial Performance of Commercial Banks in Kenya

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly agree</th>
<th>agree</th>
<th>Neutral</th>
<th>disagree</th>
<th>Strongly disagree</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Controls audits in the organization have features built into them to ensure that fraudulent transactions are</td>
<td>11</td>
<td>4</td>
<td>5</td>
<td>0</td>
<td>0</td>
<td>1.15</td>
<td>0.23</td>
</tr>
</tbody>
</table>
flagged or made difficult to transact

<table>
<thead>
<tr>
<th></th>
<th>7</th>
<th>10</th>
<th>3</th>
<th>0</th>
<th>0</th>
<th>1.45</th>
<th>0.22</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intentional errors are</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>concentrated in relatively</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>few audits and these are</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>fairly predictable by industry</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The lack of segregation of accounting and Custodian functions hinders fraud detection and reporting

<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>10</th>
<th>2</th>
<th>3</th>
<th>0</th>
<th>1.90</th>
<th>0.19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash receipts bear fairly</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>strong controls</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Firms that disclose an internal control problem experience a significant increase in market-adjusted cost of capital

<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>13</th>
<th>2</th>
<th>0</th>
<th>0</th>
<th>1.60</th>
<th>0.27</th>
</tr>
</thead>
<tbody>
<tr>
<td>The greater the degree of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>competition, the greater</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>would be the need to control</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The study sought to determine the level at which respondents agreed with the statements that relating to internal controls and financial performance of commercial banks in Kenya, from the findings the study established that majority of the respondents strongly agreed that internal Controls audits in the organization have features built into them to ensure that fraudulent truncations are flagged or made difficult to transact as shown by mean of 1.15 ,
that intentional errors are concentrated in relatively few audits and these are fairly predictable by the industry as shown by mean of 1.45, others agreed that cash receipts bear fairly strong controls as shown by mean of 1.55, firms that disclose an internal control problem experience a significant increase in market-adjusted cost of capital as shown by mean of 1.60, the greater the degree of competition, the greater would be the need to control costs as shown by mean of 1.70 and that intentional errors are concentrated in relatively few audits and these are fairly predictable by industry as shown by mean of 1.90.

4.2.4 Internal audit Standards

Table 9: Extent to Which Internal Audit Standards Affect Financial Performance

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>7</td>
<td>35</td>
</tr>
<tr>
<td>Great extent</td>
<td>10</td>
<td>50</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study sought to establish the extent to which internal audit standards affect the financial performance of commercial banks in Kenya. From the findings 50% indicated a great extent, 35% of the respondents indicated to a very great extent whereas 15% of the respondents indicated to a moderate extent. This implies that internal audits standard affect the performance of commercial banks in Kenya to a great extent.
Table 10: Effects of Internal Audit Standards on Financial Performance of Commercial Bank

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
<th>Strongly disagree</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Performing auditing work according to internal auditing standards significantly influences the effectiveness of auditing</td>
<td>7</td>
<td>10</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>1.45</td>
<td>0.22</td>
</tr>
<tr>
<td>Complying with professional standards is the most important contributor to IA’s added value</td>
<td>8</td>
<td>11</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1.25</td>
<td>0.26</td>
</tr>
<tr>
<td>Standards for audits and audit-related services influence the performance of commercial banks</td>
<td>6</td>
<td>13</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1.45</td>
<td>0.28</td>
</tr>
<tr>
<td>Formal auditing standards recognise that internal auditors also provide services regarding information other than financial reports</td>
<td>8</td>
<td>10</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>1.30</td>
<td>0.23</td>
</tr>
<tr>
<td>Auditors to carry out their role objectively and in compliance</td>
<td>6</td>
<td>14</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1.40</td>
<td>0.31</td>
</tr>
</tbody>
</table>
The study sought to determine the level at which respondents agreed with the statements that relating to internal controls and financial performance of commercial banks in Kenya, from the findings the study established that majority of the respondents strongly agreed that complying with professional standards is the most important contributor to IA’s added value formal auditing standards recognise that internal auditors also provide services regarding information other than financial reports formal auditing standards recognise that internal auditors also provide services regarding information other than financial reports as shown by mean of 1.30, auditors to carry out their role objectively and in compliance with accepted criteria for professional practice as shown by mean of 1.40, Standards for audits and audit-related services influence the financial performance of commercial banks, performing auditing work according to internal auditing standards contributes significantly influence the effectiveness of auditing as shown by mean of 1.45 in each case, and finally that internal audit evaluate and contribute to the improvement of risk management, control and governance using a systematic and disciplined approach in the banking as shown by a mean of 1.49.
4.2.5 Independence of Internal Audit

Table 11: Extent to Which Independence of Internal Audit Affects the Performance

<table>
<thead>
<tr>
<th>Independence of Internal Audit</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>4</td>
<td>20</td>
</tr>
<tr>
<td>Great extent</td>
<td>14</td>
<td>70</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>2</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

The study sought to establish the extent to which Independence of Internal Audit affect the performance of commercial banks in Kenya. From the findings, 70% indicated a great extent, 20% of the respondents indicated to a very great extent whereas 10% of the respondents indicated to a moderate extent. This implies that Independence of Internal Audit affect the performance of commercial banks in Kenya to a great extent.

Table 12: Effects of Independence of Internal Audit on financial performance

<table>
<thead>
<tr>
<th>Statement</th>
<th>Strongly agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Strongly disagree</th>
<th>Mean</th>
<th>Std deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence is the essence of auditing</td>
<td>6</td>
<td>12</td>
<td>2</td>
<td>0</td>
<td>1.50</td>
<td>0.25</td>
</tr>
<tr>
<td>An internal auditor must be independent of both the personnel and operational activities of an organization</td>
<td>7</td>
<td>13</td>
<td>0</td>
<td>0</td>
<td>1.30</td>
<td>0.29</td>
</tr>
<tr>
<td>The integrity of the auditor's opinions, conclusions</td>
<td>6</td>
<td>10</td>
<td>4</td>
<td>0</td>
<td>1.60</td>
<td>0.21</td>
</tr>
</tbody>
</table>
and recommendations would be suspect

<table>
<thead>
<tr>
<th>Statement</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence is necessary for the effective achievement of the function and objective of internal audit</td>
<td>4.00</td>
<td>1.95</td>
</tr>
<tr>
<td>Internal audit in banking organisations acknowledges that every bank should have an internal audit department on which with regard to the volume and nature of its activities it can rely</td>
<td>7.00</td>
<td>1.35</td>
</tr>
<tr>
<td>The internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day-to-day internal control processes</td>
<td>8.00</td>
<td>1.30</td>
</tr>
<tr>
<td>Internal auditors may not have a conflict of interests with the bank.</td>
<td>5.00</td>
<td>1.90</td>
</tr>
<tr>
<td>Every bank should have formalised principles of internal audit providing for its position and powers in the framework of the bank</td>
<td>6.00</td>
<td>1.50</td>
</tr>
</tbody>
</table>

The study sought to determine the level at which respondents agreed or disagreed with the above statements relating to Independence of Internal Audit and financial performance of commercial banks in Kenya, from the findings the study established that majority of the respondents’ strongly agreed that An internal auditor must be independent of both the personnel and operational activities of an organization, The internal audit department in a banking institution must be independent from the activities which it controls and must
likewise be independent from the day-to-day internal control processes, as shown by a mean of 1.30 in each case, others agreed that Every bank should have formalised principles of internal audit providing for its position and powers in the framework of the bank, Independence is the essence of auditing as shown by a mean of 1.50 in each case The integrity of the auditor’s opinions, conclusions and recommendations would be suspect as shown by a mean of 1.60, Internal auditors may not have a conflict of interests with the bank, as shown by mean of 1.90 and finally that independence is necessary for the effective achievement of the function and objective of internal audit as shown by mean of 1.95.

4.2.6 Regression Analysis

Table 13: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.919*</td>
<td>.844</td>
<td>.826</td>
<td>.01263</td>
</tr>
</tbody>
</table>

From the findings in the above table the value of adjusted R squared (co-efficient of determination) was 0.826 an indication that there was variation of 82.6% on financial performance of commercial banks due to changes in internal audit standards, independence of internal audit, professional competency and internal control at 95% confidence interval. This shows that 82.6% changes in financial performance of commercial banks could be accounted for by changes in internal audit standards, independence of internal audit, professional competency and internal control. The study also established that there is strong positive relationship between performance of
commercial banks and internal audit standards, independence of internal audit, professional competency and internal control as shown by correlation coefficient of 0.919.

**Table 14: Coefficients**

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>.454</td>
<td>.155</td>
<td></td>
<td>2.939</td>
</tr>
<tr>
<td>Internal audit standards</td>
<td>.560</td>
<td>.148</td>
<td>.554</td>
<td>3.794</td>
</tr>
<tr>
<td>Independence of internal audit</td>
<td>.295</td>
<td>.140</td>
<td>.308</td>
<td>2.109</td>
</tr>
<tr>
<td>Professional competency</td>
<td>.011</td>
<td>.133</td>
<td>.013</td>
<td>.085</td>
</tr>
<tr>
<td>Internal control</td>
<td>.091</td>
<td>.150</td>
<td>.091</td>
<td>.605</td>
</tr>
</tbody>
</table>

The established regression equation was

\[ Y = 0.454 + 0.560 \text{IAS} + 0.295 \text{IIA} + 0.011 \text{PC} + 0.091 \text{IC} \]

From the regression equation, the study revealed that holding internal audit standards, independence of internal audit, professional competency and internal control to a constant zero financial performance of commercial banks would stand at 0.454, a unit increase in internal audit standards would lead to increase in financial performance of commercial banks by a factor of 0.454, a unit increase in independence of internal audit would lead to increase in financial performance of commercial banks by a factor 0.295, a unit increase in professional competency would lead to increase in financial performance of commercial banks by a factors of 0.011 and further unit increase in internal control would lead to increase in financial performance of commercial banks by a factor of 0.091.
4.3 Summary and Interpretation of Findings

From the findings the study revealed that there was greater variation in financial performance of commercial banks due to changes in internal audit standards, independence of internal audit, professional competency and internal control, this clearly shows that changes in financial performance of commercial banks could be accounted for by changes in internal audit standards, independence of internal audit, professional competency and internal control. The study also established that there was a strong positive relationship between financial performance of commercial banks and internal audit standards, independence of internal audit, professional competency and internal control.

The study revealed that internal audit standards, independence of internal audit, professional competency and internal control had a positive relationship with financial performance of commercial banks, the study found that a unit increase in internal audit standards would lead to increase in financial performance of commercial banks, a unit increase in independence of internal audit would lead to increase in financial performance of commercial banks, a unit increase in professional competency would lead to increase in financial performance of commercial banks and further unit increase in internal control would lead to increase in performance of commercial banks.

Eden (1996) showed that performance significantly improved during the half year following the audit in the experimental branches, while the control branches experienced a decline due to poor general business conditions. While that study offers a useful jumping-off point for understanding how good auditing can improve a company’s performance, it
does not go far enough in explaining when and why internal audit works, and the conditions that facilitate or impede it.

Cooper and Craig (1983) found that there were a number of misconceptions about what internal auditors were doing and what their chief executive officers (CEO) perceived was being done and in fact there were expectations by the CEO’s that internal audit could do more than the traditional financial auditing work mainly being done at the time.

Peursem (2004) found that characteristics of a ‘true’ profession exist but do not dominate. Significantly, and as subgroups, Peursem also observed that public practice and experienced auditors may enjoy greater influence over management, and accountancy-trained auditors may enjoy greater status owing to the ‘mystique’ of the activities emanating from their membership of well-known accountancy professional bodies. The research supports prior studies by Coopers and Craig (1983), Cooper et al. (1966) and Gramling (1997) found that there are three concepts characteristic of those who best balanced their role: the internal auditor’ external professional status; the presence of a formal and an informal communication network; and the internal auditor’s place in determining their own role. Informing these concepts is the auditor’s ability to manage ambiguity.

According to Basel Committee report (2002) each bank should have a permanent internal audit function in order to fulfil its duties and responsibilities. The senior management should take all necessary measures so that the bank can continuously rely on an adequate internal audit function appropriate to its size and to the nature of its operations. These measures include providing the appropriate resources and staffing to internal
A survey, by Ernst & Young, found that 75 per cent of the survey respondents believe strong risk management has a positive impact on their long-term earnings performance. An equal percentage of the respondents believe that their internal audit function has a positive impact on their overall risk management efforts. As the role of the internal auditor evolves and stakeholder expectations rise, internal audit functions increasingly require competencies that exceed the more traditional technical skills, such as the ability to team with management and business units on relevant business issues.

Mawanda (2008) in his study established a significant relationship between internal control system and financial performance. The investigation recommends competence profiling in the Internal Audit department which should be based on what the University expects the internal audit to do and what appropriate number staff would be required to do this job.

Mutua (2012) concluded that risk based auditing through internal auditing standards and internal auditing staffing should be enhanced to enable firms to be able to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability, hence enhancing financial performance. This showed that there is indeed a relationship between internal audit and financial performance.
CHAPTER FIVE
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary
The importance of IA is demonstrated in the growing demand for this service in all organisations and in the rapid growth of its professional organisation, the IIA. However researchers have paid little attention to this function and the effect it has on financial performance of organisations.

The aim of this study was to establish if there is a relationship between internal audit and financial performance of commercial banks in Kenya. The source of information was primary data collected from a sample of 20 banks of which one respondent was picked from each bank. Quantitative and regression analysis were used to analyse data collected.

From the analysis the study established that professional competence of internal auditor affects performance of commercial banks in Kenya to a great extent. This established that measures that can enhance the efficiency of auditors are important for effective fraud detection, In commercial banks frauds are identified by the internal audit function ,fraud detection, and fraudulent activities are inherently unpredictable and difficult to detect and they affect the performance of the bank, conscientiousness correlates with task performance just as strongly as cognitive ability, the study established the auditors in the organization are qualified to undertake audit function.

The study established the internal controls affect financial performance of commercial banks in Kenya to a great extent. The study also revealed that internal Controls audits in the organization have features built into them to ensure that fraudulent truncations are
flagged or made difficult to transact, that intentional errors are concentrated in relatively few audits and these are fairly predictable by industry, others agreed that cash receipts bear fairly strong controls, firms that disclose an internal control problem experience a significant increase in market-adjusted cost of capital, the greater the degree of competition, the greater would be the need to control costs as, and that intentional errors are concentrated in relatively few audits and these are fairly predictable by industry.

The study established that internal audits standard affect the financial performance of commercial banks in Kenya to a great extent. The study also revealed that complying with professional standards is the most important contributor to IA’s added value formal auditing standards recognise that internal auditors also provide services regarding information other than financial reports formal auditing standards recognise that internal auditors also provide services regarding information other than financial reports, auditors to carry out their role objectively and in compliance with accepted criteria for professional practice, Standards for audits and audit-related services influence the performance of commercial banks, performing auditing work according to internal auditing standards contributes significantly influence the effectiveness of auditing, and finally that internal audit evaluate and contribute to the improvement of risk management, control and governance using a systematic and disciplined approach in the banking.

The study sought to establish that Independence of Internal Audit affect the financial performance of commercial banks in Kenya to a great extent. The study further revealed that, an internal auditor must be independent of both the personnel and operational activities of an organization, the internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from
the day-to-day internal control processes, each bank should have formalised principles of internal audit providing for its position and powers in the framework of the bank. Independence is the essence of auditing, the integrity of the auditor’s opinions, conclusions and recommendations would be suspect, internal auditors may not have a conflict of interests with the bank and finally that independence is necessary for the effective achievement of the function and objective of internal audit.

5.2 Conclusion

The study revealed that there was greater variation in financial performance of commercial banks due to changes in internal audit standards, independence of internal audit, professional competency and internal control; this shows that changes in financial performance of commercial banks could be accounted for by changes in internal audit standards, independence of internal audit, professional competency and internal control. The study also established that there was a strong positive relationship between financial performance of commercial banks and internal audit standards, independence of internal audit, professional competency and internal control.

The study revealed that internal audit standards, independence of internal audit, professional competency and internal control had a positive relationship with financial performance of commercial banks, the study found that a unit increase in internal audit standards would lead to increase in financial performance of commercial banks, a unit increase in independence of internal audit would lead to increase in financial performance of commercial banks, a unit increase in professional competency would lead to increase in financial performance of commercial banks and further unit increase in internal control would lead to increase in financial performance of commercial banks.
The study found that measures that can enhance the efficiency of auditors are important for effective fraud detection. The study concluded internal Controls audits in the organization have features built into them to ensure that fraudulent transactions are flagged or made difficult to transact. The study further concludes that an internal auditor must be independent of both the personnel and operational activities of an organization.

5.3 Policy Recommendations

There is need for the internal auditors to continuously update themselves with the changing times and technologies and sharpen their skills. By applying skills to the most critical points, building personal and professional credibility and recognising and responding to the needs, internal auditors can become indispensable thus speeding good governance and enhancing efficiency of internal audit.

The management of commercial banks should keep organizing seminars and workshops whereby these internal auditors would be trained frequently by experts either internally or externally. Internal Auditors must have sufficient proficiency and training to carry out the tasks assigned to them. The auditor's work must be carefully directed, supervised and reviewed. The amount of supervision required corresponds to the experience and skill of the auditor.

The head of the internal audit department should be responsible to the management/board in the organisation with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of audit reports, and appropriate action on audit recommendations.
The management of commercial banks should also procure the latest ICT audit software’s. This would enhance fast delivery of services and detection of frauds or any mischief in this field. Internal auditors should be fully trained on how to use the software’s and fresher courses should also be increased in this regard. Frequent upgrading of the software’s should be done to keep abreast with the changing technology.

5.4 Limitations of the Study

In attaining its objective the study was limited to 20 Commercial banks from which only one respondent was picked from each. This is due to the sensitive nature of bank information and respondents were not willing to give information freely.

The study was also limited to the degree of precision of the data obtained from the respective respondents.

The study was also limited to establish effect internal audit on financial performance of commercial banks.

The method used is descriptive research design whereby the variables cannot be controlled by the researcher. The study intended to use questionnaire as the instrument for collecting data. This is because time for the data collection will be limited to two weeks.

5.5 Recommendation for Further Studies

This research recommends a similar study to be done but concentrate on the parastatals and government ministries.

There is need for a study to be conducted to determine the challenges facing internal audit in commercial banks, this will help in enhancing the internal audit in the commercial banks in Kenya and thus positively affecting their performance.
There is need for a study to be conducted on the roles and challenges of internal auditing in the banking industry in Kenya. The study recommends that an in-depth study should be done on effects of central banks regulation on commercial banks on internal audit among commercial banks.
REFERENCES


Kothari, C.R. (2004), Research Methodology: Methods and Techniques (2nd revised edition)


Mugenda O, M and Mugenda, A. G (2003) Research Methods, Quantitative Methods and Qualitative Approaches, 50-52


APPENDICES

Appendix I: Questionnaire

This questionnaire is designed to collect data on to establish effect internal audit on financial performance of commercial banks. The data shall be used for academic purpose only and it will be treated with confidentiality it deserves. The respondents are highly encouraged and persuaded to respond to the statements in this questionnaire in the most truthful and objected way possible. Your participation in facilitating this study will be highly appreciated. Kindly tick in the space provided with the correct answer or supply the required information where, required, please specify and elaborate.

Section A: Demographic Information

1. Gender
   
   Female [ ]                Male [ ]

2. Indicate where you fall among the following age brackets (years)
   
   Below 25 [ ]
   25-34 [ ]
   35-44 [ ]
   45-50 [ ]
   Above 51 [ ]

3. Level of education
   
   Secondary Certificate [ ]          Diploma level [ ]
   Bachelor’s Degree Level [ ]          Masters Level [ ]
   Phd [ ]

4. How long have you worked in the organization?
   
   Less than 2 years [ ]            2-5 years [ ]            6-10 years [ ]
   More than 10 years [ ]

58
Professional competence

5. To what extent does professional competence of internal auditor affect financial performance of commercial banks in Kenya?

- Very great extent [ ]
- Great extent [ ]
- Moderate extent [ ]
- Little extent [ ]
- No extent [ ]

6. What is your level of agreement with the following statements that relate to professional competence of internal auditor and financial performance of commercial banks in Kenya? (1-strongly agree, 2-agree, 3-neutral, 4-disagree, strongly disagree)

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fraud detection, and fraudulent activities are inherently unpredictable and difficult to detect and they affect the performance of the bank</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In commercial banks frauds are identified by the internal audit function</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Measures that can enhance the efficacy of auditors are important for effective fraud detection</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Conscientiousness correlates with task performance just as strongly as cognitive ability</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The auditors in my organization are qualified to undertake audit function</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Internal Controls

7. To what extent do internal controls affect financial performance of commercial banks in Kenya?

- Very great extent [ ]
8. What is your level of agreement with the following statements that relate to internal controls and financial performance of commercial banks in Kenya? (1- strongly agree, 2- agree, 3- neutral, 4- disagree, strongly disagree)

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Controls audits in the organization have features built into them to ensure that fraudulent truncations are flagged or made difficult to transact</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>intentional errors are concentrated in relatively few audits and these are fairly predictable by industry</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The lack of segregation of accounting and custodian functions hinders fraud detection and reporting</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>cash receipts bear fairly strong controls</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>firms that disclose an internal control problem experience a significant increase in market-adjusted cost of capital</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>the greater the degree of competition, the greater would be the need to control costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Internal audit Standards**

9. To what extent does an internal audits standard affect the financial performance of commercial banks in Kenya?

| Very great extent | [ ] |
| Great extent      | [ ] |
10. What is your level of agreement with the following statements that relate to internal audit standards and financial performance of commercial bank in Kenya? (1- strongly agree, 2- agree, 3- neutral, 4- disagree, strongly disagree)

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>performing auditing work according to internal auditing standards</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>contributes significantly influence the effectiveness of auditing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>complying with professional standards is the most important contributor</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>to IA’s added value</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Standards for audits and audit-related services influence the</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>performance of commercial banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>formal auditing standards recognise that internal auditors also provide</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>services regarding information other than financial reports</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>auditors to carry out their role objectively and in compliance with</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>accepted criteria for professional practice</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>internal audit evaluate and contribute to the improvement of risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>management, control and governance using a systematic and disciplined</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>approach in the banking</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Independence of Internal Audit

11. To what extent does Independence of Internal Audit affect the financial performance of commercial banks in Kenya?

<table>
<thead>
<tr>
<th>Extent</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Very great extent</td>
<td>[ ]</td>
</tr>
<tr>
<td>Great extent</td>
<td>[ ]</td>
</tr>
<tr>
<td>Moderate extent</td>
<td>[ ]</td>
</tr>
<tr>
<td>Little extent</td>
<td>[ ]</td>
</tr>
<tr>
<td>No extent</td>
<td>[ ]</td>
</tr>
</tbody>
</table>

12. What is your level of agreement with the following statements that relate to Independence of Internal Audit and financial performance of commercial banks in Kenya? (1- strongly agree, 2- agree, 3-neural, 4-disagree, strongly disagree)

<table>
<thead>
<tr>
<th>Statement</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independence is the essence of auditing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>An internal auditor must be independent of both the personnel and operational activities of an organization</td>
<td></td>
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<td>The integrity of the auditor’s opinions, conclusions and recommendations would be suspect</td>
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<td>independence is necessary for the effective achievement of the function and objective of internal audit</td>
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<td>internal audit in banking organisations acknowledges that every bank should have an internal audit department on which with regard to the volume and nature of its activities it can rely</td>
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<td>The internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day-to-day internal control processes</td>
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<td>Internal auditors may not have a conflict of interests with the bank.</td>
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<td>Every bank should have formalised principles of internal audit providing for its position and powers in the framework of the bank</td>
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Thank you
Appendix II: List of Licensed Commercial Banks in Kenya

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