THE EFFECT OF RISK BASED AUDITING ON FINANCIAL PERFORMANCE IN COMMERCIAL STATE CORPORATIONS IN KENYA

BY

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DECLARATION

This Research Project is my original work and has not been presented to any other institution or university.

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This Research Project has been submitted for examination with my approval as the university supervisor.

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DEDICATION

To my family, for encouragement and support during this course especially my uncle Ndungu. My mother Charity for her wise guidance and upbringing. My loving wife Nancy and my lovely children, Charity, Mark and Peter who have always been on my side despite being away from them for many hours and sometimes coming back home late in the night.
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<td>IIA</td>
<td>Institute of Internal Auditors</td>
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<tr>
<td>INTOSAI</td>
<td>International Organization of Supreme Audit Institutions</td>
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<td>ISA</td>
<td>International Standards on Auditing</td>
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<td>KENAO</td>
<td>Kenya National Audit Office</td>
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<tr>
<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>PCAOB</td>
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ABSTRACT

Recent public interest in the management of resources in the public sector has reignited the need for risk based auditing. A risk based audit approach is designed to be used throughout the audit to efficiently and effectively focus the nature, timing and extent of audit procedures to those areas that have the most potential for causing material misstatements in the financial report (Institute of Chartered Accountants of Australia, 2011). According to Bell et al (2005) the basic premise of RBA is that auditors should devote more resources to accounts that are likely to be misstated and fewer resources to those that are less likely to be misstated thereby improving financial performance. The study sought to establish the effect of risk based audit on the financial performance of the commercial state corporations in Kenya. This research was conducted through a descriptive survey research design. The descriptive survey research design was considered appropriate as it enables description of the characteristics of certain groups, estimation of the proportion of people who have certain characteristics and making of predictions. This study used primary and secondary data. The primary data was obtained from the Chief Internal Auditors of the sampled firms while the secondary data was obtained from the annual financial reports of the sampled state corporations in Kenya over a period of 3 years (2011-2013). The data was collected based on the information about the variables. Quantitative data was analyzed by descriptive analysis while qualitative data was analyzed through content analysis. The study may provide information to policy makers, scholars, academicians and investors on the effect of RBA on the financial performance of public sector in Kenya. From the findings, the study established that risk management, annual risk based audit planning, internal auditing standards and internal auditing capacity significantly affected the financial performance of the state corporations in Kenya over the 3 year period to a great extent. The study concludes that there exists a positive relationship between risk based audit factors and the financial performance of the state corporations in Kenya. The study recommends that the management of the state corporations in Kenya should embrace the ISAs to guide the ethical work of internal auditors, enhance risk management practices and support the internal audit function by providing the necessary resources and fully implementing its recommendations.
CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Audits serve a fundamental purpose in promoting confidence and reinforcing trust in financial information. Risk Based Audit approach is the method the auditor follows to determine the audit procedures to be performed, based on risk; or the indication that the transactions or classes of transactions, accounts or balances and/or disclosures is misstated to enable the auditor to achieve the audit objective. The evaluation and consideration of the risk based audit approach is a normal consequence of striving for improvement and the development of the services that the auditing profession provides (Lutta, 2012).

Risk Based Audit enhances transparency, accountability and responsiveness to public expenditure policy priorities and it virtually covers all aspects of the public financial management (Lutta, 2012). A risk based audit approach is designed to be used throughout the audit to efficiently and effectively focus the nature, timing and extent of audit procedures to those areas that have the most potential for causing material misstatements in the financial report (Institute of Chartered Accountants of Australia, 2011). The risk based audit approach is an essential component in the performance of an audit and part of the audit profession’s defence against legal liability. This improves the standing of the audit profession as the audit was legalised (Rapa and Kauffman, 2005).

Risk Based Audit is superior to traditional audit approaches for two reasons. First, it focuses on risks, the underlying causes of financial surprises, not just the accounting
records. Second, the Risk based Audit shifts the focus from inspecting the quality of the financial information that is recorded in the financial statements to building quality into the financial reporting process and adding value to the Bank’s operations (Gibson, 2003).

The Risk Based Audit, which focuses on both recorded and unrecorded risk, improves financial statement and the financial statement reporting process. The Risk Based Audit focuses on business risk and the process for controlling these risks. The higher the risk area, the more audit time and client controls are required. Besides focussing on the level of risk, the risk based method helps to evaluate and build value into the financial reporting process and the clients business and activities. This knowledge is gained through the way the client operates their business, management, internal and external environments. The knowledge gathered can help to design the audit program that includes the most effective combination of tests responsive to each client’s unique circumstances. For this reason, the risk based approach is then superior to traditional auditing methods (Gibson, 2003).

1.1.1 Risk Based Audit

It is a process, an approach, a methodology and an attitude of mind rolled into one. The simplest way to think about risk based audit conceptually is to audit the things that really matter in an organisation. Risk based audit is developed after considering certain complexities surrounding an audit. Major complexities are, firstly, the expectation gap, secondly, responsibilities of the auditor, thirdly, provision of reasonable assurance, and fourthly, the practical implementation of the standards (Gibson, 2003).
The basic premise of RBA is that auditors should devote more resources to accounts that are likely to be misstated and fewer resources to those that are less likely to be misstated (Bell et al. 2005; Rittenberg & Schweiger, 2005; Knechel, 2007). This approach is expected to lead to more effective and efficient audits (Public Company Accounting Oversight Board, 2007). However, if auditors do not accurately assess misstatements risk at the account level, audit resources will be misallocated, resulting to undetected misstatements (Kinney, 2005; O’Donnell & Schultz, 2005).

Risk based approach requires the auditor to first understand the entity and its environment in order to identify risks that may result in material misstatement of the financial report. Next, the auditor performs an assessment of those risks at both the financial report and assertion levels. The assessment involves considering a number of factors such as the nature of the risks, relevant internal controls and the required level of audit evidence (ICAA, 2011).

The result of the assessment effectively categorises the audit into a) areas of significant risk of material misstatement that require specific responses and b) areas of normal risk that can be addressed by standard audit work program. Having assessed risks, the auditor then designs appropriate audit responses to those risks in order to obtain sufficient audit evidence on which to conclude. Risk assessment continues throughout the audit and the audit plan and procedures are amended where a reassessment is necessary (ICAA, 2011).

1.1.2 Financial Performance

Financial performance is a measure of an organization’s policies and operations in monetary terms. It is a general measure of a firm’s overall financial health over a
given period of time and can be used to compare similar organizations across the same industry or compare industries or sectors in aggregation. There are many different ways of measuring a firm’s financial performance. It may be reflected in the firm’s return on investment, return on assets, value added among others and is subjective measure of how a firm can use assets from its primary mode of business and generate revenues.

There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt (Lutta, 2012).

In public sector, the nature of financial position is a function of the resources and obligations the public sector entity is held accountable for managing and maintaining in order to meet its multiple public interest objectives in both the short and long terms. The financial performance is determined by a comparison of actual versus budgeted annual results. The resultant surplus or deficit provides cumulative information about the financial performance of the public entity (Mutua, 2012).

1.1.3 The Effect of RBA on Financial Performance in Commercial State Corporations

The risk based audit approach provides the auditor with an approach to conduct the audit as efficiently and effectively as possible, benefitting both the audit team and the entity. The basic premise of RBA is that auditors should devote more resources to accounts that are likely to be misstated and fewer resources to those that are less
likely to be misstated thereby improving financial performance (Bell et al. 2005; Rittenberg & Schweiger, 2005; Knechel, 2007). This approach is expected to lead to more effective and efficient audits (Public Company Accounting Oversight Board, 2007).

Focusing on critical risks by auditors align audit priorities with those of the shareholders resulting in adding value to the entity. According to Griffiths (2006) RBA directs scarce audit resources at checking the responses to the risks that present a serious threat to an organization and that regulations are now requiring directors to ensure these risks are properly managed. High quality RBA ensures that critical risks are accurately identified and properly evaluated and reported by the auditors. Good use of RBA results to effectiveness and therefore improving returns to the citizen and investors. As opposed to general audit of business processes in an organization, RBA appeals to an auditor to carefully consider the significant processes in an entity and focus efforts there. Use of RBA ensures that no potentially risky area is left out.

1.1.4 Commercial State Corporations

In the Kenyan context, state corporations operate on a pre-determined set of guidelines that govern recruitment and remuneration of staff, and even their own overall general operations of running the corporations. There is need to give general operating guidelines for state corporations but also a need to give managers of each corporation a free hand to run the same. State corporations were set to empower Kenyans economically and Kenyan institutions that were earlier run by the colonialists (Republic of Kenya, 2007). They were and are the platform in which the government is involved in commercial activities. The state corporations operate on a
pre-determined set of guidelines that govern recruitment and remuneration of staff and even their own overall general operations of running.

According to Richard Bosez and Gaetan Breton (2003) State owned enterprises are arm’s length entities established to pursue public policy and commercial objectives. Unlike other government agencies, SOEs take corporate form and thus constitute a legal entity. Their legal personality is expressed by an Act of Parliament. They operate in many sectors of the economy.

1.2 Research Problem

Auditing is defined as an independent examination and expression of opinion on the financial statements of an entity by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligations. RBA approach is designed to enable the auditor to efficiently and effectively focus the nature, timing and extent of audit procedures to those areas that have the most potential for causing material misstatement(s) in the financial report. Proper use of RBA may result to saving critical audit time and audit resources and coming up with appropriate audit opinion (Masika, 2013).

Recent public interest in the management of resources in the public sector requires us to rethink our approach to public oversight. A cursory glance at local dailies and news channels reveals questionable financial malpractices covering the entire spectrum in the Public Sector. Reading the Constitution reveals various Commissions and state agencies set up to check on these malpractices. Should we continue using the same methods we used yesteryears to fight the war against fraud, corruption, wastage and abuse of public resources? The relevant oversight agencies must be proactive if we
are to sustain the fight against corruption. There is need for continuous auditing if we are to respond to managerial accountability and assessment of service delivery. The Office of the Auditor General must prioritize areas where public resources are at most risk (Edward Ouko-Auditor General of Kenya, 2011).

Lutta (2012) carried out a study titled ‘Determinants of adoption of risk based audit in public sector in Kenya’. The study focussed on five determinants; role of internal audit function, top management commitment, training, policy framework and communication process. The study established that risk based audit enhances transparency, accountability and responsiveness to public expenditure policy priorities and it virtually covered all aspects of public financial management. Despite the recent adoption of Risk Based Audit in the Public Sector audit, no academic research has been carried out to establish the effect of adoption of RBA on financial performance in the public sector thereby creating a knowledge gap. The study sought to answer the following question:-What is the effect of RBA on financial performance in the commercial state corporations in Kenya?

1.3 Objective of the Study

To establish the effect of risk based audit on the financial performance of the commercial state corporations in Kenya.

1.4 Value of the Study

The study would be useful to senior management in state corporations on increasing effectiveness of risk management systems established in their organizations. The study would be a useful tool for formulation of various policies and enhance
accountability and transparency in management of public resources by the state corporations.

The academicians would benefit from the results of this study since they would get to interrogate the concept of RBA and relate it with public audit. The research would make a contribution to the body of knowledge in the field of auditing in Kenya and beyond especially other developing countries. The academicians may want to carry out more studies on this area to increase knowledge.
CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

This chapter provides literature review from related studies by other researchers who have carried out their research in the same field of study. Specific emphasis has been put on the major issues in Risk Based Audit practices on the financial performance of commercial state corporations in Kenya.

2.2 Theoretical Review

The following theories are relevant in the RBA. They include the Auditing theory, the Agency theory and the Risk Based Audit theory. The theories are discussed below;

2.2.1 Theory of Auditing

The audit approach or audit methodology followed by an auditor is a component of the theory of auditing or the axiomatic method of auditing. This is explained by Mautz and Sharaf (1961) as follows: This scheme of auditing knowledge might be pictured in the form of a pie-shaped chart. The entire chart represents knowledge, all knowledge. At the centre is a hard core of the most fundamental types of knowledge, metaphysics, logic and mathematics. Touching this core and drawing strength from it is the groundwork level of auditing knowledge, its philosophical foundation. Included in this level of knowledge is the definition or purpose of the field and the fundamental nature of its knowledge and methodology. It postulates, the basics for inferring concepts, must relate to and be harmonious with this purpose and recognise the possibilities and limitations of its development and evaluation of risk-based audit
approaches methodology. Every field must have just such foundation and it must never permit itself to become separated from the elemental disciplines from which it draws strength. The field of auditing grows outwards from its philosophical foundations; it enters the area of conceptual structure. Then come the precepts (concepts) and the area of practice and practical applications and then showing the adjacent fields of knowledge. This theory indicates the changing role of audit and anticipates more changes going forward.

2.2.2 Agency Theory

A significant body of work has done in this area within the context of the principal-agent framework. The work of Jensen and Meckling (1976) in particular and Fama and Jensen (1983) are important. Agency theory identifies the agency relationship where one party, the principal, delegates work to another party, the agent. According to the agency theory a company consists of contracts between the owners of economic resources (principals) and managers (agents) who are charged with using and controlling those resources (Jensen & Meckling, 1976). Agency theory assumes that agents have more information than principals and that this information asymmetry adversely affects the principal’s ability to monitor whether or not their interests are being properly served by agents. Furthermore, an assumption of agency theory is that principals and agents act rationally and use contracting to maximize their own wealth. The agency relationship can have a number of disadvantages relating to the opportunism or self interest of the agent. For example, the agent may not act in the best interest of the principal. There can be a number of dimensions to this including for example, the agent misusing his power for pecuniary or other advantage and the agent not taking appropriate risks in pursuance of the principal’s interest because he
(the agent) views those risks as not being appropriate and the principal may have
different attitudes to risks. There is also the problem of information asymmetry
whereby the principal and the agent have access to different levels of information; in
practice thus the principal is at a disadvantage because the agent has more
information.

2.2.3 Risk Based Audit Theory

Risk based audit theory argues that clients specific experience increases an auditor’s
ability to assess future client risks accurately (Bell & Solomon, 2002). However, prior
research in Psychology suggests that individuals tend to overweigh experience when
faced with current risk cues that conflict with experience. This design examines the
consequences of prior, positive client-specific experience and efficiency pressure,
represented by costly risk cues, on the ability to generate an effective risk assessment.
The results indicate that individual’s bias toward prior experience. Efficiency results
suggest that higher cue costs result in suboptimal risk cue selection, but do not
negatively influence risk assessment effectiveness. Risk audit theory argues auditor
evaluations during the audit become more effective with client-specific experience
(Bell et al. 1997; Bell et al. 2005). Rather, there is a risk that auditors will rely on
historical client-specific experience, which is backward-looking in nature, in addition
to gaining this increased client-specific knowledge.

RBA is a process, an approach, a methodology and an attitude of mind rolled into one
and it can simply conceptualized as auditing the things(or processes) that really matter
in an organization (IIA, 2004). ISA 315-Identifying and Assessing the Risks of
Material Misstatement through Understanding the Entity and its Environment and ISA
The Auditor’s Responses to Assessed Risks are auditing standards that specifically set out the risk based audit approach, with other auditing standards containing specific risk-related principles and procedures appropriate to their subject matter. Recent public interest in the management of resources in the public sector requires us to rethink our approach to public oversight. A cursory glance at local dailies and news channels reveals questionable financial malpractices covering the entire spectrum in the Public Sector. Reading the Constitution reveals various Commissions and state agencies set up to check on these malpractices. Should we continue using the same methods we used yesteryears to fight the war against fraud, corruption, wastage and abuse of public resources? The relevant oversight agencies must be proactive if we are to sustain the fight against corruption. There is need for continuous auditing if we are to respond to managerial accountability and assessment of service delivery. The Office of the Auditor General must prioritize areas where public resources are at most risk (Edward Ouko-Auditor General of Kenya, 2011).

2.3 Financial Performance Measures

Measurement of financial performance by ratio analysis helps identify organizational strengths and weaknesses by detecting financial anomalies and focusing attention on issues of organizational importance. Turk et al (1995) suggested that the key to analysis and measurement of the financial and operational control and impact is related to the central question. Their model reflects the interrelationship between a series of questions about the mission and the financial resourcing and control of the organization. They suggest that such a framework provides an appropriate analysis for the past performance which will help an organization move towards its future direction.
According to Blair (1996), Return on investment can be used to measure financial performance for many commercial organisations. Return on Investment (ROI) analysis is one of several commonly used financial metrics for evaluating financial consequences of business investments, decisions, or actions. ROI analysis compares the magnitude and timing of investment gains directly with the magnitude and timing of investment costs. A high ROI means that investment gains compare favourably to investment costs (Ball and Shiva Kumar, 2004).

\[
\text{Return on investment} = \frac{\text{Gain} - \text{Investment cost}}{\text{Investment Cost}}
\]

There are many different ways to measure a commercial state corporation’s financial performance. It may be reflected in the firm’s return on investment, return on assets, value added among others and is a subjective measure of how a firm can use assets from its primary mode of business and generate revenues.

Profitability can be measured using Return on sales and return on assets ratios. These ratios are calculated from earnings before interest and taxes. Using earnings before interest provides ratios as independent as possible from the cost of capital. This approach is justified by the difficult of grasping the notion of capital in a state owned corporation. The capital and the debt are often financed by the state (D’souza et al, 2000).

An indicator of how profitable a company is relative to its total assets. ROA gives an idea as to how efficient management is at using its assets to generate earnings. Calculated by dividing a company's annual earnings by its total assets, ROA is displayed as a percentage. Sometimes this is referred to as "return on investment".
The return on assets is calculated as:

\[
\frac{\text{Net Income}}{\text{Total Assets}}
\]

Some investors add interest expense back into net income when performing this calculation because they'd like to use operating returns before cost of borrowing. (Mutua, 2012)

2.4 Risk Based Audit Practices

2.4.1 Risk Management

The separation of ownership and management functions and the presence of information asymmetry introduce the possibility of principal-agent conflicts (Haniffa and Hudaib, 2006). The agency conflicts, agency costs and risks are now managed within the corporate governance framework through accountability mechanisms, such as internal control and audit (Haniffa and Hudaib, 2006).

According to Hay and Knechels’ 2004, demand for auditing is a function of the set of risks faced by individual stakeholders in an organization and the set of control mechanisms available for mitigating those risks. Therefore, internal auditing risk management orientation has given the audit function increased credibility across the enterprise and greater acceptance by management (Beumer, 2006).

Through Risk based audit, sound risk management strategies that are forward looking, can be implemented helping the organizations improve their business decisions (Fatemi & Glaum, 2006). Sound risk management is not just about avoiding or minimising losses, but about dealing positively with opportunities. It is a powerful
tool for the public sector managers (Drzik, 2000). Good risk management is based on a well-planned, logical, comprehensive and documented strategy. This strategy provides policy guidance and plans and procedures that can be used as part of the organization’s everyday work to manage risk (OECD, 2005).

Many risks will be significant to the organization and the discussion of their controls will involve more senior managers and directors than might be involved in traditional finance oriented audits (Al-Tamimi, 2002). Audits will involve more discussions with managers about their risks and their responses to them. Major tasks will include; determining processes and their objectives, identifying risks that hinder the processes with management, controls mitigating the risks, reporting where risks are not sufficiently mitigated by controls and assure management that risks are mitigated to an acceptable level. This has been made easy with adoption of RBA in the public sector (Millichamp, 2002). Through RBA, the audit activity provides useful and relevant information to the organization for managing its risks.

The objective of RBA is to provide independent assurance to the board that there is a sound risk management framework within the organization and risks that may affect the organisation’s business objectives and strategies are being identified, managed and reduced to a level that is acceptable to the board (IIA 2003). One indication of risk management framework is the existence of a separate committee or group, comprised of directors and managers to develop risk management development policy (Goodwin-Stewart & Kent, 2006).
2.4.2 Annual Risk Based Planning

Planning is considered a vital audit activity and it includes preparing a strategic plan, annual plans and programs for individual risk based audit assignments. The operational standard of the internal audit dealing with planning aspects of the internal audit requires the preparation of a strategic plan- usually a five year plan, a periodic (annual) plan and plans for individual audit assignments. It is an exercise by which the head of audit ensures the appropriateness of resources by projecting requirements in a timely fashion thus enhancing good governance (Karapetrovic, 1999).

Proper planning enables accomplishment of a large number of audits in a given period by improving efficiency. In some cases the numbers of the audit engagement are completed in the budgeted time and the number of actual audits performed in a period is usually less than the number of audits stated in the annual audit plan (Sanda, Milkailu & Garba, 2005).

In planning the engagement and determining its scope, the external auditor’s main objective is to gather evidence to support giving an opinion on the financial statements. According to Davidson et al. (2005), an auditor’s duty is to give a fair and truthful view of a client’s set of company’s accounts but auditors cannot guarantee that the company accounts are entirely free from errors and irregularities. In their audit planning, auditors must identify and assess the risk that they need to discover. If an item is discovered, auditors must consider the context and presentation of the item and then decide whether it affects the true and fair view of the company’s accounts.
2.4.3 Internal Auditing Standards

Auditing standards are set on principles of good governance, transparency and accountability, fairness and equity, efficiency and effectiveness, respect for the rule of law and high standards of ethical behaviour. For Risk Based Audit to provide good governance in public sector International Auditing standards must be embraced to guide audit ethics of work and maintain professional auditing standards (Mutua 2012).

The Standards delineate the basic principles that represent the practice of internal auditing and provide a framework for performing and promoting value-added internal auditing. The standards also foster improved organizational processes and operations as well as provide a basis of evaluation of internal audit performance (IIA).

2.4.4 Internal Auditing Capacity

The Foreign Corrupt Practices Act of 1977 mandated public companies to establish and maintain effective internal accounting controls to provide reasonable assurance that assets are safeguarded and that transactions are properly authorised and recorded. To accomplish this, many companies established internal audit functions, increased internal audit staffing and strengthened internal audit independence. Beasley et al. (2000) show that investments in internal auditing have been effective, as companies with internal audit staff are less prone to financial fraud than companies without internal auditing. The number and magnitude of errors requiring adjustment by the external auditors have been found to be substantially lower for the entities that had an internal audit department compared to those that did not have an internal audit function department (Wallace & Kruetzfeldt, 1991).
In 1987, a report by the Treadway Commission recommended that public companies establish an internal audit function that is fully supported by top management and have effective reporting relationships. The report urged that the internal audit function be staffed with an adequate number of qualified personnel appropriate to the size and the nature of the company (Treadway Commission, 1987).

According to Norman Marks (2007), emerging request from boards is that internal auditors review and comments on the organization’s governance policies, processes and practices. The IIA recognizes this in its International Standards for the Professional Practice of Internal Auditing (Standards). Standard 2100 states that internal audit activity should evaluate and contribute to the improvement of risk management, control and governance processes using a systematic and disciplined approach.

According to Ziegenfus (2000), audit quality is a function of the level of staff expertise, the scope of services provided and the extent to which audits are properly planned, executed and communicated. IIA’s standard 1210 on proficiency of the auditor require that the internal auditors possess the knowledge, skills and other competencies needed to perform their responsibilities (IIA, 1999). Since audit work requires knowledge and experience on a wide range of systems and operations, it is imperative to deploy auditors with extensive professional skills and to upgrade their skills through continuing professional training and development.

The audit activity needs professional that collectively has the necessary qualifications and competencies to conduct the full range of audits required by its mandate. In order to ensure good governance, auditors must comply with minimum continuing
education requirements established by their relevant professional organizations and standards. The head of the audit activity must be able to effectively recruit, retain and manage highly skilled staff (Kunkel 2004).

2.5 Empirical Review

The section will provide information from studies of the effect of RBA on financial performance in the public sector. The section will also examine findings of various scholars and authors on the effect of risk based auditing and risk management on the financial performance of commercial state corporations in Kenya and other countries.

2.5.1 International Evidence

Humphrey, et al. (2003) found that business risk approach still faces criticism expressed about their added value, technical methods and the scope and role that the auditor plays. He argued that even though the business risk audit approach became dominant over the last few years, yet their status and identity remains striking. The role of non-executive directors and lack of confidence in the auditors to achieve the objectives which they are supposed to deliver offer a big challenge to the audit profession. The value of audit in society has been has been questioned in recent years. A series of high-profile corporate failures has led to a growing debate on the effective role of audit. Inquiries into the recent banking crisis have sought to understand what role auditors have played in the demise of systemically important financial institutions. The value of audit is once again under the spotlight- this time firmly on an agenda of wider stakeholder interest including banks themselves, businesses, employees, regulators, as well as investors.
According to Davidson et al. (2005), an auditor’s duty is to give a fair and truthful view of a client’s set of company’s accounts, but not to guarantee that the company accounts are entirely free of errors and irregularities. In their audit planning, auditors should identify and assess the risk that they need to discover. If an item is discovered, auditors must consider the context and presentation of the item and then decide whether it affects the true and fair view of the company accounts. The Statements of Auditing Standards, SAS 220 states that ‘Auditors should consider materiality and its relationship with audit risk when conducting an audit’ (O’regan, 2002).

Bowlin (2009) carried out a study titled ‘Risk based auditing, strategic prompts, and auditor sensitivity to the strategic risk of fraud.’ The purpose of the study was to explore the way auditors allocate limited pool of resources among client accounts that differ in non-strategic risk and whether client managers exploit those allocations. Also whether a strategic reasoning prompt enhances auditor sensitivity to the managers potential exploitation of auditors risk based resource allocation and whether such prompts could thereby improve the effectiveness and efficiency of audit resource allocations. The study concluded that RBA is an intuitive approach that focuses more resources on accounts deemed to be riskier and fewer resources on accounts that seem less risky. However, if auditors focus on non-strategic risks and overlook the strategic risks that arise when managers anticipate risk based allocation of audit resources, opportunities for fraud can arise among ostensibly low-risk accounts.

Hironori et al., (2011) carried out a study titled ‘Client risk factors and audit resource allocation decisions.’ The purpose of the study was to examine how individual client risks are categorized into broad risk factors and examining the extent to which such broad risk factors are associated with audit engagement planning decisions. Planned
audit hours was regressed on client risk factors as well as on client size and client status (public or private) and results compared using individual risk assessment. The study found that risk factors are significantly associated with audit planning decisions. That the total audit hours and audit hours by each level of staff are influenced by the risk factors identified from the factor analysis.

Dogui et al., (2013) carried out a study titled ‘ISO auditing and the construction of trust in auditor independence’. The paper analysis focussed on the sense-making strategies used by actors within the network to develop and sustain trust (or doubt) in professional independence. Interviews were conducted on 36 Canadian practitioners including ISO auditors, managers of certification bodies, accreditation inspectors, consultants and corporate environmental managers. The study predicated on a theoretical perspective centred on sense-making processes and the construction of inter-subjective meanings around claims to expertise. The study found that practitioners used a range of sense-making strategies to construct and maintain the belief that ISO audits meet professional requirements of auditor independence. As such the constitution of confidence involves stereotyping, distancing, storytelling and procedural mechanisms that are collectively mobilised in the production of a culture of comfort surrounding the concept of auditor independence.

Vinnari and Skaerbaek (2014) carried out a study titled ‘the uncertainties of risk management: a field study on risk management internal audit practices in a Finnish municipality’. The purpose of the study was to analyse the implementation of risk management as a tool for internal audit activities- focussing on unexpected effects or uncertainties generated during its application. The study found that risk management, rather than reducing uncertainties, itself created unexpected uncertainties that would
otherwise not have emerged. Uncertainties relating to legal aspects of risk management in particular issue of defining and operationalisation of risk management and also issue on resources available for expanding risk management.

2.5.2 Local Evidence

Mutiga (2006) carried out a research on perceived role of the external auditor in corporate governance. The study concluded that while independence of the external auditor enhances the quality of his audit report, and consequently transparency and accountability other evidence indicated that the audit report fails to capture critical issues on corporate governance. After all, audit report is based on historical data and limited to the financial performance and position while corporate governance is administrative in nature and mainly entails corporate issues and board composition. The study concluded that the letter of weakness forms the crux of the weaknesses in the internal control systems of a company, including corporate mechanisms a corporation has put in place. For an auditor to be seen to have discharged his responsibility to the shareholders, he should highlight the contents of the management letter in his audit report or at the annual general meeting where he presents his audit.

Kimwele (2011) notes that in public sector, there is general shortage of skilled labour and efforts to improve skills in government are often frustrated by migration of labour to the private sector for higher pay when workers have acquired sufficient skills. In corporate sector, risk management and risk based audit are considered as important skills in audit and it is an emerging discipline in government organizations in public sector and need sufficient training on this subject.
Lutta (2012) carried out research on determinants of adoption of risk based audit in public sector in Kenya. The study focussed on five determinants; role of internal audit function, top management commitment, training, policy framework and communication process. The study established that risk based audit enhances transparency, accountability and responsiveness to public expenditure policy priorities and it virtually covered all aspects of public financial management. The study found that for RBA to be adopted successfully, all the determinants; top management commitment, training, policy framework and communication are essential and affect the RBA at a level that can averagely be said to be low based on the results provided in the study. There has to be every aspect of each of them put together with other factors not mentioned in the study to ensure an effective and efficient adoption of RBA approach. Overly the regression model was found not suitable for this study meaning that there are other factors that determine the effective implementation of RBA.

Mutua (2012), in the study project for the MBA degree of the University of Nairobi titled, ‘The effect of risk based auditing on financial performance in commercial banks in Kenya’ concluded that risk based auditing through risk assessment, risk management, annual risk based planning, internal auditing standards and internal auditing should be enhanced. The author argued that this would enable the firm be able to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability, hence enhancing financial performance. The author further argued that proper planning improves efficiency, accuracy, completeness, timeliness, convenience and clarity. The study found that credible audit reports, auditor independence, compliance with accepted audit standards, effective internal
audit and independent audit committees influence financial performance in commercial banks in Kenya. From the findings, the study recommended that management in commercial banks in Kenya should adopt effective risk based audit practices such as risk assessment and management, annual risk based planning and internal auditing standards to enhance effective and efficient financial performance.

Masika (2013) carried out a study titled ‘The effect of the quality of risk based internal auditing (RBIA) on the effectiveness of internal audit in regulatory state corporations (RSCs) in Kenya’. The study established that the quality of RBIA is positively related to the effectiveness of internal audit. The study showed that the quality of RBIA and management support for internal audit had a huge influence on the effectiveness of internal audit in regulatory state corporations in Kenya. The study also established that management support for internal audit had considerable influence on the availability of resources to internal audit.

From the study, RSCs in Kenya were strong in risk management. Majority of them had Risk Management Policy Framework in place, risk assessment procedures in place and they carried out regular risk assessment and risk management training. Majority of staff in internal audit were certified members of professional bodies relevant to internal audit. However, the study revealed that internal auditors were not thorough in their work, audit recommendations were not good enough to solve observed problems, internal auditors did not carry out all planned audits and they did not hand in reports on time. It was also revealed that internal audit plans did not address executive management concerns and that quality assessment for internal auditors by third parties was not done regularly.
2.6 Summary of Literature Review

Recent public interest in the management of resources in the public sector requires us to rethink our approach to public oversight. A cursory glance at local dailies and news channels reveals questionable financial malpractices covering the entire spectrum in the Public Sector. Reading the Constitution reveals various Commissions and state agencies set up to check on these malpractices. Should we continue using the same methods we used yesteryears to fight the war against fraud, corruption, wastage and abuse of public resources? The relevant oversight agencies must be proactive if we are to sustain the fight against corruption. There is need for continuous auditing if we are to respond to managerial accountability and assessment of service delivery. The Office of the Auditor General must prioritize areas where public resources are at most risk (Ouko, 2011).

The study sought to establish the effect of RBA on the financial performance in Kenya. Emphasis is made on the role of auditors in good governance practice with little regard on factors that determine successful implementation of risk based audit approach (Rapa & Kauffman, 2005).
CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

The purpose of the study was to examine the effect of RBA on financial performance of commercial state corporations in Kenya. This chapter presents the research design, the target population, data collection and data analysis and presentation methods.

3.2 Research Design

The research design used in this study was a descriptive survey, a design deemed appropriate for investigating the effect of RBA on financial performance of the commercial state corporations in Kenya. Mugenda and Mugenda, (2003) describe descriptive survey as collecting data in order to test hypothesis or to answer questions concerning the current status of the subject of study. The descriptive research design approach has been credited due to the fact that it allows analysis and relations of variables.

3.3 Target Population

Hair (2003) defines population as an identifiable total group or aggregation of elements (people) that are of interest to a researcher and pertinent to the specified information problem. The target population of this study consisted of 10 commercial state corporations in Kenya where RBA was being practised and were listed in Nairobi Securities Exchange. The population of 10 commercial state corporations listed in the Nairobi Securities Exchange is small therefore the study carried out a census survey. The study respondents were the Chief Internal Auditors of the 10
commercial state corporations in Kenya. A census survey was applied for and according to Kombo and Tromp (2006) the method is useful in selecting information rich respondents for in-depth analysis on issues being studied.

3.4 Data Collection

The study used both primary and secondary data. The secondary data was obtained from the annual financial reports of the state corporations that show financial performance. The primary data was collected to obtain information on the effect of risk based audit on financial performance of commercial state corporations in Kenya. The data was collected using a self-administered questionnaire that contained close ended questions. The questionnaire covered RBA practices of Risk management, annual risk based audit planning, auditing standards and internal audit capacity.

3.4.1 Data Validity and Reliability

The study used both secondary and primary data. Financial performance was extracted from the financial statements of state corporations between 2011 and 2013. The primary data on RBA practices which was original in character was collected from the people who had a firsthand experience in the field of study.

3.5 Data Analysis

Mugenda and Mugenda (1999) observe that data analysis is the process of bringing order, structure and meaning of information collected. For collected data to be understood well, it needs to be analysed. Statistical Package for Social Science (SPSS) was used for analysis of data provided by respondents in the questionnaire. It
is preferred because SPSS has an ability to cover a wide range of the most common statistical and graphical data analysis and is very systematic.

3.5.1 Analytical Model

To test relationship between percentages and mean RBA practices and State Corporation’s financial performance a multiple linear regression model was used. A ROA mean for each state corporation was used to indicate the financial performance of each state corporation. The model treated financial performance of State Corporation as the dependent variable while the independent variables were the risk based audit practices namely; risk management, risk based audit planning, internal audit standards and internal audit capacity. The independent variables were obtained by a questionnaire that had likert-scale questions. Prior research has examined impact of RBA on financial performance in commercial banks (Mutua, 2012)

The following multiple linear regression model demonstrates the relationship between the variables.

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon \]

Where;

Y = Return on Assets (ROA), extracted from the financial statements for the years 2011 to 2013 and was derived by dividing the net income by the total assets for each of the state corporation

\[ X_1 = \text{Risk Management} = [(\text{expenditure on risk management/operating income}) \times 100] \]
\[ X_2 = \text{Annual Risk Based Planning} = \frac{\text{expenditure on risk based planning}}{\text{operating income}} \]

\[ X_3 = \text{Internal Auditing Standards} = \frac{\text{expenditure on auditing standards compliance}}{\text{operating income}} \]

\[ X_4 = \text{Internal Auditing Capacity} = \left( \frac{\text{expenditure on internal auditing}}{\text{operating income}} \right) \times 100 \]

\( \alpha \) = Constant term

\( \beta_1, \beta_2, \beta_3, \beta_4 \) = Beta coefficients

\( \epsilon \) = Standard errors (Random error)

Return on Assets (ROA) was extracted from the financial statements for the years 2011 to 2013 and was derived by dividing the net income by the total assets for each of the state corporation. The ROA was the dependent variable. Data on the predictor variables; risk management, annual risk based planning, internal auditing standards and internal auditing capacity was collected by use of a questionnaire.

**3.5.2 Test of Significance**

Test of significance was conducted using regression model and was expected to yield co-efficient of determination (R-square), f-test, t-test and Analysis of variance (ANOVA) at 95% confidence interval. ANOVA was used to determine whether there were any significant differences between the dependent and the independent variables. F-test was used to test the overall significance of the regression model while the t-test was used to test the significance of the independent variables in the
model. The purpose of the regression model was to examine the effect of RBA on financial performance of commercial state corporations in Kenya.
CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data analysis, interpretation and presentation. The objective of the study was to establish the effect of risk based audit on the financial performance of the commercial state corporations in Kenya. Data was collected from 10 commercial state corporations in Kenya where RBA was being practised from 2011 to 2013. The data sources were the annual financial statements of the state corporations spanning three years (2011-2013) for the sampled 10 commercial state corporations in Kenya. Data was collected based on the variables of the study, that is, Return on assets [financial performance] depicted by risk management, Annual Risk Based Planning, Internal Auditing Standards and Internal Auditing Capacity.

4.2 Background Information

The study sought to ascertain the background information about the respondents involved in the study. The background information points at the respondents’ suitability in answering the questions on the effect of risk based audit on the financial performance of the commercial state corporations in Kenya.

4.2.1 Number of employees in the respondent’s corporation

The study sought to establish the number of employees working in the respondent’s corporation. The findings are as shown in Figure 4.1 below.
The findings as shown in Figure 4.1 above indicate the number of employees working in the respondent’s corporation. The study established that majority (60%) of the commercial state corporations in Kenya had 1001 to 3000 employees, 30% had over 3000 employees while 10% of the commercial state corporations in Kenya had 200 to 1000 employees. This implies that majority of the commercial state corporations in Kenya were a major source of employment for many Kenyans. This further depicts the need for RBA to review the risk element associated with the large workforce and its possible effect on the financial performance of the corporations.

**4.2.2 Number of years in operation**

The study sought to find out the number of years the respondent’s corporation had been in operation. The findings are as shown in Figure 4.2 below.
The study found that majority (70%) of the commercial state corporations in Kenya had been in operation for over 10 years, 20% for 6-10 years while 10% of the commercial state corporations in Kenya had been in operation for 1-5 years. This implies that majority of the commercial state corporations in Kenya had been in operation for long enough to appreciate the effect of risk based audit on their financial performance.

### 4.3 Risk based audit and financial performance

The study sought to establish the effect of risk based audit on the financial performance of the commercial state corporations in Kenya and the findings are discussed in subsequent sections.
4.3.1 Effect of inherent risk assessment on financial performance

The study sought to determine whether inherent risk assessment affected the financial performance of the commercial state corporations in Kenya and the findings are as shown in Figure 4.3 below.

**Figure 4.3 Effect of inherent risk assessment on financial performance**

![Pie chart showing 90% Yes and 10% No]

**Source: Research Findings**

The study found that majority (90%) of the respondents indicated that inherent risk assessment affected the financial performance of their corporations while 10% of the respondents indicated that inherent risk assessment did not affect the financial performance of their corporations. This implies that inherent risk assessments affected the financial performance of the commercial state corporations in Kenya. This further shows that inherent risk assessments were a major element of Risk Based Audits.
4.3.2 Extent to which risk assessment factors affect financial performance

In order to further assess the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the respondents were requested to indicate the extent to which various factors on risk assessment affected the financial performance of the commercial state corporations in Kenya. The responses were rated on a five point Likert scale where: 1 – Very low extent 2 – Low extent 3 – Moderate extent 4- Great extent and 5- Very great extent. The findings are as shown in table 4.1.

Table 4.1 Extent to which risk assessment factors affect financial performance

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consideration of risk assessment in the detection of errors.</td>
<td>4.639</td>
<td>0.3559</td>
</tr>
<tr>
<td>The auditors understanding of the corporation’s risk.</td>
<td>4.572</td>
<td>0.9647</td>
</tr>
<tr>
<td>It is difficult and costly to assess risks at the corporation.</td>
<td>3.851</td>
<td>0.4054</td>
</tr>
<tr>
<td>The corporation auditor’s involvement of management in risk evaluation process</td>
<td>4.433</td>
<td>0.6475</td>
</tr>
<tr>
<td>The corporation auditor’s identification of changes that have influence on financial performance at corporation</td>
<td>4.018</td>
<td>0.0159</td>
</tr>
<tr>
<td>Auditors recognition of work environment in risk assessment</td>
<td>3.675</td>
<td>0.8431</td>
</tr>
</tbody>
</table>

Source: Research Findings
From the study findings, the majority of the respondents agreed that; consideration of risk assessment in the detection of errors (Mean=4.639); the auditors understanding of the corporation’s risk (Mean=4.572); the corporation auditor’s involvement of management in risk evaluation process (Mean=4.433) and the corporation auditor’s identification of changes that have influence on financial performance at corporation (4.018) affected the financial performance of the 10 sampled commercial state corporations in Kenya to a great extent. In addition, the majority of the respondents also agreed that; it is difficult and costly to assess risks at the corporation (Mean=3.851) and that auditor’s recognition of work environment in risk assessment (Mean=3.675) affected the financial performance of the 10 sampled commercial state corporations in Kenya to a moderate extent.

This illustrates that various factors on risk assessment such as the auditors understanding of the corporation’s risk, consideration of risk assessment in the detection of errors, auditor’s identification of changes that have influence on the firm’s financial performance and the cost and difficulties in risk assessment significantly affected the financial performance of the commercial state corporations in Kenya.

4.3.3 Significance of various factors in influencing judgments of risk

In order to further assess the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the respondents were requested to indicate the significance level of various factors in influencing judgments of risk in the commercial state corporations in Kenya. The responses were rated on a five point Likert scale where: 1 – Insignificant 2 – Slightly significant 3 – Moderately
significant 4- Significant and 5- Very significant. The findings are as shown in table 4.2.

**Table 4.2 Significance of various factors in influencing judgments of risk**

<table>
<thead>
<tr>
<th>Factor</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective controls</td>
<td>4.926</td>
<td>0.5782</td>
</tr>
<tr>
<td>Lack of adequate funds</td>
<td>4.328</td>
<td>0.2671</td>
</tr>
<tr>
<td>The complexity of operations</td>
<td>4.261</td>
<td>0.8924</td>
</tr>
<tr>
<td>The quality of personnel in internal audit</td>
<td>4.152</td>
<td>1.0135</td>
</tr>
</tbody>
</table>

**Source: Research Findings**

From the study findings, the majority of the respondents were in agreement that; effective controls (Mean=4.926) were a very significant factor that influenced judgments of risk in the commercial state corporations in Kenya while lack of adequate funds (Mean=4.328); the complexity of operations (Mean=4.261) and the quality of personnel in internal audit (4.152) were significant factors that influenced judgments of risk in the commercial state corporations in Kenya.

This implies that judgment of risk in the commercial state corporations in Kenya was significantly influenced by various factors such as existence of effective controls, lack of adequate funds; the complexity of operations and the quality of personnel in internal audit. Further, the findings imply that these factors are critical in the RBA
process and as such have an influence on the financial performance of the commercial state corporations in Kenya.

4.3.4 Influence of risk management on financial performance

The study sought to establish whether management of risk influenced financial performance of the commercial state corporations in Kenya and the findings are as shown in Figure 4.4 below.

Figure 4.4 Influence of risk management on financial performance

Source: Research Findings

The study showed that majority (80%) of the respondents indicated that risk management influenced the financial performance of the commercial state corporations in Kenya while 20% of the respondents indicated that risk management did not influence the financial performance of the commercial state corporations in Kenya. This implies that risk management is critical to the financial performance of the commercial state corporations in Kenya. Thus, risk management significantly influenced the financial performance of the commercial state corporations in Kenya.
4.3.5 Extent to which various risk based audit services affect financial performance

In order to further assess the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the respondents were requested to indicate the extent to which various risk based audit services influenced the financial performance of the commercial state corporations in Kenya. The responses were rated on a five point Likert scale where: 1 – Very low extent 2 – Low extent 3 – Moderate extent 4- Great extent and 5- Very great extent. The findings are as shown in table 4.3.

**Table 4.3 Extent to which various risk based audit services affect financial performance**

<table>
<thead>
<tr>
<th>Service</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Based Audit Reporting time</td>
<td>3.344</td>
<td>0.2685</td>
</tr>
<tr>
<td>Assessment of risks</td>
<td>4.677</td>
<td>0.0598</td>
</tr>
<tr>
<td>Risk Based audit Annual plans with the Management</td>
<td>3.428</td>
<td>1.8924</td>
</tr>
<tr>
<td>Acting on reported audit queries on time</td>
<td>4.475</td>
<td>0.2671</td>
</tr>
<tr>
<td>Implementation of audit recommendations by the Management</td>
<td>4.988</td>
<td>0.8924</td>
</tr>
<tr>
<td>Adequate auditing staff</td>
<td>4.106</td>
<td>1.0135</td>
</tr>
</tbody>
</table>

*Source: Research Findings*
From the study findings, the majority of the respondents were in agreement that;
implementation of audit recommendations by the management (Mean=4.988) influenced the financial performance of the commercial state corporations in Kenya to a very great extent; assessment of risks (4.677), acting on reported audit queries on time (Mean=4.475) and adequate auditing staff (4.106) influenced the financial performance of the commercial state corporations in Kenya to a great extent while risk based audit annual plans with the management (Mean=3.428) and risk based audit reporting time (3.344) influenced the financial performance of the commercial state corporations in Kenya to a moderate extent.

This indicates that various risk based audit services have a significant influence on the financial performance of the commercial state corporations in Kenya.

**4.3.6 Annual audit planning and financial performance**

The study sought to establish whether corporate annual audit planning affected the financial performance of the commercial state corporations in Kenya and the findings are as shown in Figure 4.5 below.
Source: Research Findings

The study showed that majority (70%) of the respondents agreed that corporate annual audit planning affected the financial performance of their corporation while 30% of the respondents disagreed that corporate annual audit planning affected the financial performance of their corporation. This depicts that corporate annual audit planning had a positive influence on the financial performance of the commercial state corporations in Kenya.

4.3.7 Extent to which various risk disclosures affect financial performance

In order to further assess the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the respondents were requested to indicate the extent to which various risk disclosures affected the financial performance of the commercial state corporations in Kenya. The responses were rated on a five point Likert scale where: 1 – No extent at all 2 – Little extent 3 – Moderate
extent 4- Great extent and 5- Very great extent. The findings are as shown in table 4.4.

Table 4.4 Extent to which various risk disclosures affect financial performance

<table>
<thead>
<tr>
<th>Disclosures about financial risk and risk management</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosures about compliance risk and risk management</td>
<td>4.485</td>
<td>0.2793</td>
</tr>
<tr>
<td>Disclosures about environmental and safety risk and risk Management</td>
<td>3.112</td>
<td>0.7621</td>
</tr>
<tr>
<td>Disclosures about technology risk and risk management</td>
<td>2.356</td>
<td>0.2795</td>
</tr>
<tr>
<td>Disclosures about internal process risk and risk management</td>
<td>4.178</td>
<td>0.5346</td>
</tr>
</tbody>
</table>

Source: Research Findings

From the study findings, the majority of the respondents were in agreement that; disclosures about financial risk and risk management (Mean=4.573), disclosures about compliance risk and risk management (4.485) and disclosures about internal process risk and risk management (4.178) influenced the financial performance of the commercial state corporations in Kenya to a great extent. The respondents further indicated that; disclosures about environmental and safety risk and risk management (3.112) influenced the financial performance of the commercial state corporations in Kenya to a moderate extent while disclosures about technology risk and risk management (2.356) influenced the financial performance of the commercial state corporations in Kenya to a little extent.
This indicates that various risk disclosures affected the financial performance of the commercial state corporations in Kenya to varied degrees with the major disclosures being on financial risks, compliance risks and on internal process risks. However, disclosures on environmental and safety risks and on technology risks had lesser impact on the financial performance of the commercial state corporations in Kenya.

4.3.8 Extent to which various auditing standards affect financial performance

In order to further assess the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the respondents were requested to indicate the extent to which various auditing standards affected the financial performance of the commercial state corporations in Kenya. The responses were rated on a five point Likert scale where: 1 – Very low extent 2 – Low extent 3 – Moderate extent 4- Great extent and 5- Very great extent. The findings are as shown in table 4.5.

Table 4.5 Extent to which various auditing standards affect financial performance

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors technical and professional skills</td>
<td>4.463</td>
<td>0.2550</td>
</tr>
<tr>
<td>Auditors readiness to embrace change</td>
<td>4.142</td>
<td>0.2793</td>
</tr>
<tr>
<td>Quality audit reports</td>
<td>4.287</td>
<td>0.7621</td>
</tr>
<tr>
<td>Quality criteria to measure internal auditors Performance</td>
<td>4.075</td>
<td>0.2795</td>
</tr>
</tbody>
</table>

Source: Research Findings
From the study findings, the majority of the respondents agreed that; auditors technical and professional skills (Mean=4.463), quality audit reports (4.287), auditors readiness to embrace change (4.142) and quality criteria to measure internal auditors performance (4.075) are auditing standards that affected the financial performance of the commercial state corporations in Kenya to a great extent.

This shows that the various auditing standards adopted by the commercial state corporations in Kenya had a great effect on their financial performance. There existed a relationship between the adopted auditing standards and the reported financial performance of the commercial state corporations in Kenya.

4.3.9 Extent to which various risk based audit practices affect financial performance

In order to further assess the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the respondents were requested to indicate the extent to which various risk based audit practices affected the financial performance of the commercial state corporations in Kenya. The responses were rated on a five point Likert scale where: 1 – Very low extent 2 – Low extent 3 – Moderate extent 4- Great extent and 5- Very great extent. The findings are as shown in table 4.6.
Table 4.6 Extent to which various risk based audit practices affect financial performance

<table>
<thead>
<tr>
<th>Practice</th>
<th>Mean</th>
<th>Std. Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active and independent audit committee</td>
<td>4.463</td>
<td>0.2550</td>
</tr>
<tr>
<td>Independent directors</td>
<td>3.852</td>
<td>0.7156</td>
</tr>
<tr>
<td>Management's ownership interest</td>
<td>3.658</td>
<td>0.8229</td>
</tr>
<tr>
<td>Financial management and compliance with accepted audit standards</td>
<td>4.075</td>
<td>0.2795</td>
</tr>
<tr>
<td>Limited auditors in the corporation</td>
<td>3.364</td>
<td>0.4522</td>
</tr>
<tr>
<td>Proficiency of the internal auditor</td>
<td>4.129</td>
<td>0.6587</td>
</tr>
<tr>
<td>Effective audit planning</td>
<td>4.184</td>
<td>1.7118</td>
</tr>
<tr>
<td>Effective internal audit department</td>
<td>4.235</td>
<td>0.8675</td>
</tr>
<tr>
<td>Risk assessment</td>
<td>4.321</td>
<td>1.0241</td>
</tr>
<tr>
<td>Risk management</td>
<td>4.356</td>
<td>0.4475</td>
</tr>
</tbody>
</table>

Source: Research Findings

From the study findings, the majority of the respondents were in agreement that existence of; active and independent audit committee (Mean=4.463), risk management (4.356), risk assessment (4.321), effective internal audit department (4.235), effective audit planning (4.184), proficiency of the internal auditor (4.129), financial management and compliance with accepted audit standards (4.075) affected the financial performance of the commercial state corporations in Kenya to a great
extent while independent directors (3.852), management's ownership interest (3.658) and limited auditors in the corporation (3.364) affected the financial performance of the commercial state corporations in Kenya to a moderate extent. Therefore, risk based audit practices significantly affected the financial performance of the commercial state corporations in Kenya.

4.4 Descriptive Statistics

4.4.1 Return on Assets [Financial performance]

Financial performance is a measure of an organization’s policies and operations in monetary terms. The findings on the financial performance for the 10 commercial state corporations in Kenya under study as depicted by return on assets (ROA) are as presented in the table 4.7 below.

Table 4.7 Return on Assets [ROA]

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>10</td>
<td>2.48</td>
<td>0.972</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>3.12</td>
<td>1.372</td>
</tr>
<tr>
<td>2013</td>
<td>10</td>
<td>3.56</td>
<td>0.528</td>
</tr>
</tbody>
</table>

Source: Research Findings

The findings as shown in table 4.7 above indicate the trend of return on assets values over the 3 year period. The ROA mean values were; a mean of 2.48 in year 2011, a mean of 3.12 in year 2012 and a mean of 3.56 in year 2013. This represented a positive change in the ROA mean values of 1.08 over the 3 year period. The steady rise in ROA values over the 3 year period indicates that the financial performance of the 10 commercial state corporations in Kenya under study has been on the increase.
over the last 3 years. On the other hand, the different scores of standard deviation indicate variation in the financial performance for the 10 commercial state corporations in Kenya.

4.4.2 Risk Management

The findings on the risk management percentage values are as presented in the table 4.8 below.

**Table 4.8 Risk Management**

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>10</td>
<td>0.12</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>0.14</td>
</tr>
<tr>
<td>2013</td>
<td>10</td>
<td>0.18</td>
</tr>
</tbody>
</table>

*Source: Research Findings*

The findings as shown in Table 4.8 above indicate the trend of expenditure on risk management of the 10 sampled commercial state corporations in Kenya over the 3 year period. From the findings, expenditure on risk management of the 10 sampled commercial state corporations was 0.12% in year 2011, 0.14% in year 2012 and 0.18% in year 2013. This shows a steady increase in expenditure on risk management among the 10 sampled commercial state corporations in Kenya between 2011 and 2013. Thus, risk management positively affected the financial performance of the commercial state corporations in Kenya over the 3 year period.
4.4.3 Annual Risk Based Planning

The findings on the annual risk based planning mean values are as presented in the table 4.9 below.

Table 4.9 Annual risk based planning

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>10</td>
<td>0.06</td>
<td>1.013</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>0.09</td>
<td>0.625</td>
</tr>
<tr>
<td>2013</td>
<td>10</td>
<td>0.11</td>
<td>0.415</td>
</tr>
</tbody>
</table>

Source: Research Findings

The findings as shown in Table 4.9 above indicate the trend of expenditure on annual risk based planning of the 10 sampled commercial state corporations in Kenya over the 3 year period. From the findings, the expenditure on annual risk based planning mean values for the 10 sampled commercial state corporations was 0.06 in year 2011, 0.09 in year 2012 and 0.11 in year 2013. This shows a steady increase in expenditure on annual risk based planning of the 10 sampled commercial state corporations in Kenya between 2011 and 2013. Thus, annual risk based planning positively affected the financial performance of the commercial state corporations in Kenya over the 3 year period.

4.4.4 Internal Auditing Standards

The findings on the internal auditing standards mean values are as presented in the table 4.10 below.
Table 4.10 Internal auditing standards

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>10</td>
<td>0.09</td>
<td>1.013</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>0.12</td>
<td>0.625</td>
</tr>
<tr>
<td>2013</td>
<td>10</td>
<td>0.16</td>
<td>0.415</td>
</tr>
</tbody>
</table>

Source: Research Findings

The findings as shown in Table 4.10 above indicate the trend of expenditure on internal auditing standards of the 10 sampled commercial state corporations in Kenya over the 3 year period. From the findings, the expenditure on internal auditing standards mean values for the 10 sampled commercial state corporations was 0.09 in year 2011, 0.12 in year 2012 and 0.16 in year 2013. This shows a steady increase in expenditure on internal auditing standards of the 10 sampled commercial state corporations in Kenya between 2011 and 2013. Thus, adherence to the internal auditing standards had a positive influence on the financial performance of the commercial state corporations in Kenya over the 3 year period.

4.4.5 Internal Auditing Capacity

The findings on the internal auditing capacity percentage values are as presented in the table 4.11 below.
### Table 4.11 Internal Auditing Capacity

<table>
<thead>
<tr>
<th>Year</th>
<th>N</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>10</td>
<td>0.20</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>0.25</td>
</tr>
<tr>
<td>2013</td>
<td>10</td>
<td>0.28</td>
</tr>
</tbody>
</table>

**Source: Research Findings**

The findings as shown in Table 4.11 above indicate the trend of expenditure on internal auditing capacity of the 10 sampled commercial state corporations in Kenya over the 3 year period. From the findings, expenditure on internal auditing capacity of the 10 sampled commercial state corporations was 0.20% in year 2011, 0.25% in year 2012 and 0.28% in year 2013. This shows a steady increase in expenditure on internal auditing capacity among the 10 sampled commercial state corporations in Kenya between 2011 and 2013. Thus, internal auditing capacity positively affected the financial performance of the commercial state corporations in Kenya over the 3 year period.

### 4.5 Inferential Statistics

In determining the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the study conducted a multiple regression analysis to determine the nature of relationship between the variables. The regression model specification was as follows;

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon \]

Where; \( Y = \) Financial performance = Return on assets
X\textsubscript{1} = Risk Management, X\textsubscript{2} = Annual Risk Based Planning, X\textsubscript{3} = Internal Auditing Standards, X\textsubscript{4} = Internal Auditing Capacity

\(\alpha=\text{constant},\)

\(\varepsilon=\text{error term},\)

\(\beta=\text{coefficient of the independent variables}.\)

This section presents a discussion of the results of the multiple regression analysis. The study conducted a multiple regression analysis to determine the relative importance of each of the variables with respect to financial performance of the 10 sampled commercial state corporations in Kenya. The study applied the statistical package for social sciences (SPSS) to code, enter and compute the measurements of the multiple regressions for the study. The findings are as presented in the following tables;

**Table 4.12 Model Summary**

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>R Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.877\textsuperscript{a}</td>
<td>.7691</td>
<td>.761</td>
<td>0.0125</td>
</tr>
</tbody>
</table>

**Source: Research Findings**

a. Predictors: (Constant), risk management, annual risk based planning, internal auditing standards, internal auditing capacity
b. Dependent Variable: financial performance [ROA]

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the changes in the independent variables or the percentage of variation in the dependent variable (financial performance) that is explained by all the four independent variables (risk management, annual risk based planning, internal auditing standards and internal auditing capacity).

The four independent variables that were studied, explain 76.91% of variance in financial performance of the 10 sampled commercial state corporations in Kenya firms as represented by the $R^2$. This therefore means that other factors not studied in this research contribute 23.09% of variance in the dependent variable. Therefore, further research should be conducted to investigate the other factors that affect the financial performance of the commercial state corporations in Kenya.

**Table 4.13 Analysis of Variance**

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>31.323</td>
<td>2</td>
<td>.202</td>
<td>9.45</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>5.408</td>
<td>3</td>
<td>.246</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>56.896</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source: Research Findings**

a. Predictors: (Constant), risk management, annual risk based planning, internal auditing standards, internal auditing capacity

b. Dependent Variable: financial performance [ROA]
Analysis of Variance (ANOVA) consists of calculations that provide information about levels of variability within a regression model and form a basis for tests of significance. The "F" column provides a statistic for testing the hypothesis that all $\beta \neq 0$ against the null hypothesis that $\beta = 0$ (Weisberg, 2005). From the findings the significance value is .001 which is less that 0.05 thus the model is statistically significant in predicting how risk management, annual risk based planning, internal auditing standards and internal auditing capacity affect the financial performance of the commercial state corporations in Kenya. The F critical at 5% level of significance was 3.23. Since F calculated (value = 9.45) is greater than the F critical (3.23), this shows that the overall model was significant.
Table 4.14 Multiple Regression Analysis

<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>(Constant)</td>
<td>3.653</td>
<td>.826</td>
<td>3.61</td>
<td>.000</td>
</tr>
<tr>
<td>Risk management</td>
<td>0.752</td>
<td>.0312</td>
<td>0.591</td>
<td>1.81</td>
</tr>
<tr>
<td>Annual risk based planning</td>
<td>0.518</td>
<td>.864</td>
<td>0.802</td>
<td>8.41</td>
</tr>
<tr>
<td>Internal auditing standards</td>
<td>0.424</td>
<td>.68</td>
<td>0.764</td>
<td>4.56</td>
</tr>
<tr>
<td>Internal auditing capacity</td>
<td>0.646</td>
<td>.68</td>
<td>0.451</td>
<td>4.56</td>
</tr>
</tbody>
</table>

Source: Research Findings

From the regression findings, the substitution of the equation

\[ Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \]

becomes:

\[ Y = 3.653 + 0.752 X_1 + 0.518 X_2 + 0.424 X_3 + 0.646 X_4 + \varepsilon \]

Where \( Y \) is the dependent variable (financial performance), \( X_1 \) is the risk management, \( X_2 \) is the annual risk based planning, \( X_3 \) is the internal auditing standards and \( X_4 \) is the internal auditing capacity.
According to the equation, taking all the factors (risk management, annual risk based planning, internal auditing standards and internal auditing capacity) constant at zero, financial performance would be 3.653. The data findings also show that a unit increase in risk management would lead to a 0.752 increase in financial performance; a unit increase in annual risk based planning would lead to a 0.518 increase in financial performance; a unit increase in internal auditing standards would lead to a 0.424 increase in financial performance while a unit increase in internal auditing capacity would lead to a 0.646 increase in financial performance. This means that the most significant factor is risk management followed by internal auditing capacity. At 5% level of significance and 95% level of confidence, risk management had a 0.0012 level of significance; internal auditing capacity had a 0.0015 level of significance; annual risk based planning had a 0.0018 level of significance while internal auditing standards had a 0.0022 level of significance, implying that the most significant factor is risk management followed by internal auditing capacity, annual risk based planning and internal auditing standards, respectively.

4.4 Interpretation of the Findings

From the findings, majority of the respondents indicated that consideration of risk assessment in the detection of errors (Mean=4.639); the auditors understanding of the corporation’s risk (Mean=4.572); the corporation auditor’s involvement of management in risk evaluation process (Mean=4.433) and the corporation auditor’s identification of changes that have influence on financial performance at corporation (4.018) affected the financial performance of the corporations in Kenya. Majority of the respondents further agreed that; it is difficult and costly to assess risks at the
corporation (Mean=3.851) and that auditors recognition of work environment in risk assessment (Mean=3.675) affected the financial performance.

From the findings, majority of the respondents agreed that effective controls (Mean=4.926) was a very significant factor that influenced judgments of risk in the corporations while lack of adequate funds (Mean=4.328); the complexity of operations (Mean=4.261) and the quality of personnel in internal audit (4.152) were significant factors that influenced judgments of risk in the corporations.

The majority (80%) of the respondents were in agreement that risk management influenced the financial performance of the commercial state corporations in Kenya while 20% did not agree. The study findings further revealed that majority of the respondents were in agreement that various risk based audit services have a significant influence on the financial performance of the commercial state corporations in Kenya. From the findings, majority (70%) of the respondents agreed that corporate annual audit planning affected the financial performance of their corporation while 30% of the respondents disagreed. The study findings further found out that majority of the respondents were in agreement that various risk disclosures affected the financial performance of the commercial state corporations in Kenya to varied degrees with the major disclosures being on financial risks, compliance risks and on internal process risks. The study findings indicated that majority of the respondents agreed that various auditing standards adopted by the commercial state corporations in Kenya had a great effect on their financial performance. The findings further showed that majority of the respondents were in agreement that existence of various risk based audit practices significantly affected the financial performance of the commercial state corporations in Kenya.
CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the data findings on the effect of risk based audit on the financial performance of the commercial state corporations in Kenya. The conclusions and recommendations are drawn there to. The study addressed risk based audit practices which included risk management, annual risk based planning, internal auditing standards and internal auditing capacity.

5.2 Summary

From the findings, the study established that inherent risk assessment affected the financial performance of the 10 sampled commercial state corporations in Kenya. The study further indicated that management of risks influenced the financial performance of the commercial state corporations in Kenya.

The study found that risk assessment factors such as the consideration of risk assessment in the detection of errors, auditors understanding of the corporation’s risk, auditor’s involvement of the management in risk evaluation process and auditor’s identification of changes that have influence on corporation’s financial performance affected the financial performance of the 10 sampled commercial state corporations in Kenya to a great extent. The study further established that difficulties and cost associated with assessing risks at the corporation and auditor’s recognition of work environment in risk assessment affected the financial performance of the 10 sampled commercial state corporations in Kenya to a moderate extent.
The study further established that effective controls were a very significant factor that influenced judgments of risk in the commercial state corporations in Kenya. Lack of adequate funds, complexity of operations and the quality of personnel in internal audit were significant in influencing judgment of risks in the banks.

The study revealed that implementation of audit recommendations by the management influenced the financial performance of the commercial state corporations in Kenya to a very great extent while assessment of risks, acting on reported audit queries on time and adequate auditing staff influenced the financial performance of the commercial state corporations in Kenya to a great extent. The study established that corporate annual audit planning affected the financial performance of the commercial state corporations in Kenya. The study also found that disclosures about financial risk and risk management, disclosures about compliance risk and risk management and disclosures about internal process risk and risk management influenced the financial performance of the commercial state corporations in Kenya to a great extent.

The study showed that auditor’s technical and professional skills, quality audit reports and auditors readiness to embrace change are auditing standards that affected the financial performance of the commercial state corporations in Kenya to a great extent. Effective auditing standards influence auditor’s behaviour and improve the quality and effectiveness of audits by substantially adjusting audit practice.

The study indicated that existence of active and independent audit committee, risk management and assessment, effective internal audit department; effective audit
planning and proficiency of the internal auditor affected the financial performance of the commercial state corporations in Kenya to a great extent.

From the regression analysis, the study established that there exists a positive relationship between risk based audit factors and the financial performance of commercial state corporations in Kenya. In addition, the study also established that the most significant risk based audit factor is risk management followed by internal auditing capacity, annual risk based planning and internal auditing standards, respectively.

5.3 Conclusion

The study concluded that effective risk management should enable the management to assess the risks and recommended corrective measures for firm’s improvement. In addition, the study concluded that auditor’s understanding of the corporation’s risk, consideration of risk assessment in detection of errors, auditors recognition of work environment in risk assessment, auditor’s involvement of management in risk evaluation process and auditor’s identification of changes that have influence on performance were key elements of risk management which influenced the financial performance of commercial state corporations in Kenya.

The study concluded that the management of the commercial state corporations in Kenya should be able to embrace proper annual risk based planning so as to improve efficiency, accuracy, completeness, timeliness, convenience and clarity. Proper annual risk based planning leads to transparency and accountability in the commercial state corporations in Kenya hence influencing their financial performance.
The study also concluded that for risk based audit to improve the financial performance of the commercial state corporations in Kenya, the auditors must embrace the International Auditing Standards (ISAs) that guide the internal audit code of conduct and maintain professional auditing standards. Adherence to the ISAs would enhance the independence, confidentiality, integrity and technical skills/competence of the internal auditors which would have a positive effect on a firm’s financial performance.

The study concluded that various internal auditing capacity initiatives such as existence of active and independent audit committee, effective internal audit department, proficiency of the internal auditor and management's ownership interest had a significant positive influence on the financial performance of the commercial state corporations in Kenya.

The study concluded that there exists a positive relationship between risk based audit practices and the financial performance of the commercial state corporations in Kenya. The study further concluded that the most significant risk based audit factor is risk management followed by internal auditing capacity, annual risk based planning and internal auditing standards, respectively.

5.4 Recommendations for Policy

The study recommends that the management of the commercial state corporations in Kenya should emphasize on auditor’s understanding of risk assessment in error detection, work environment in risk assessment, role of management in risk evaluation process and identification of major changes within and outside the
organization that may affect the firm’s financial performance in order to enhance the corporation’s risk management practice and ensure proper financial reporting.

The study recommends that the management of the commercial state corporations in Kenya should bear the responsibility of equipping their firm’s internal audit function with adequate resources to enable it to develop effective annual risk based audit plans that would provide the basis for performance of internal auditing. This would enhance transparency and accountability through improved efficiency, accuracy, completeness, timeliness, convenience and clarity.

The study also recommends that in order to improve the financial reporting of the commercial state corporations in Kenya, the management of the commercial state corporations in Kenya must embrace the International Auditing Standards (ISAs) that guide the ethical guide of internal audit personnel. This would enhance the independence, confidentiality, integrity and technical skills/competence of the internal auditors which would have a positive effect on a firm’s financial performance.

The study recommends that the management of commercial state corporations in Kenya need to develop and retain adequate audit professionals who possess the right technical and professional skills and other competencies needed to perform individual responsibilities in order to ensure quality audit reports and better internal auditor’s performance.

5.5 Limitation of the Study

The main limitation of the study was the inability to include more organisations. This study concentrated only on the commercial state corporations. The study would have
covered more organizations across all sectors so as to provide a more broad based analysis. However resource constraints placed this limitation.

The study also faced challenge of time resources limiting the study from collecting information for the study particularly where the respondents delayed in filing the questionnaire and travelling for collection. The study faced limitation where the management were failing to reveal the financial performance of the organization and sometime delayed in filling the questionnaire. The researcher did follow up to ensure data was collected without further delays.

The study also faced a limitation whereby the respondents were found to be uncooperative because of the sensitivity of the information required for the study. The researcher explained to the respondents that the information they provided was to be held confidentially and was only for academic purpose.

5.6 Recommendation for Areas of Further Research

Since this study explored the effect of risk based audit on the financial performance of the commercial state corporations in Kenya, the study recommends that; similar study should be done in other countries for comparison purposes and to allow for generalization of findings on the effect of risk based audit on the financial performance of the commercial state corporations.

The study recommends that a further research should be carried out to determine other effects of risk based auditing on financial performance of micro finance institutions in Kenya.
The study recommends that a further research should be carried out to determine the challenges affecting implementation of risk based practices in public sector in Kenya and Africa as whole.
REFERENCES


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APPENDICES

APPENDIX I: QUESTIONNAIRE

This questionnaire is prepared for the purpose of collecting data for Research Project in partial fulfilment of the requirement for an award of master of business administration degree and therefore all information will be handled confidentially.

SECTION A: BACKGROUND INFORMATION

1. What is the name of your State Corporation?

………………………………  (Optional)

2. Please indicate the number of employees in your corporation

…………………………………………

3. Kindly indicate the number of years your corporation has been in operation.
   (Tick as applicable)
   i.  1-5 years  [ ]
   ii. 6-10 years  [ ]
   iii. Over 10 years  [ ]

SECTION B: MAIN ISSUES: RISK BASED AUDIT AND FINANCIAL PERFORMANCE

4. Does an inherent risk assessment affect financial performance at your corporation
   Yes [ ]       No [ ]

5. To what extent do the following factors on risk assessment affect financial performance at your corporation?
<table>
<thead>
<tr>
<th>Consideration of risk assessment in the detection of errors.</th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Low extent</th>
<th>Very low extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>The auditors understanding of the corporation’s risk</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Difficult and costly to assess risks at the corporation.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The corporation auditor’s involvement of management in risk evaluation process.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The corporation auditor’s identification of changes that have influence on financial performance at corporation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Auditors recognition of work environment in risk assessment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6. How significant are the following factors in influencing judgments of risk in your corporation?
7. Does management of risk influence financial performance in your corporation?

Yes [ ]    No    [ ]

8. Indicate the extent to which the following risk based audit services influence the financial performance in your corporation?

<table>
<thead>
<tr>
<th>Risk Based Services</th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Average extent</th>
<th>Low extent</th>
<th>Very low extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Based Audit Reporting time</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
9. Does corporation annual audit planning affect financial performance in your corporation?

Yes [ ] No [ ]

10. To what extent do the following disclosures affect corporation financial performance? Use a scale of 1 to 5 where: 1 = No extent at all; 2 = little extent; 3 = Moderate extent; 4 = Great extent; 5 = A very great extent

<table>
<thead>
<tr>
<th>Disclosures</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disclosures about financial risk and risk management</td>
<td></td>
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<tr>
<td>Disclosures about compliance risk and risk management</td>
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<tr>
<td>Disclosures about environmental and safety risk and risk management</td>
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</tbody>
</table>
11. To what extent do the following auditing standards affect the financial performance in your corporation?

<table>
<thead>
<tr>
<th>Standards</th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Moderate extent</th>
<th>Low extent</th>
<th>Very low extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors technical and professional skills</td>
<td></td>
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<tr>
<td>Auditors readiness to embrace change</td>
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<tr>
<td>Quality audit reports</td>
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<tr>
<td>Quality criteria to measure internal auditors performance</td>
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</tbody>
</table>

12. The following is a set of risk based audit practices please indicate to what extent the practices influence financial performance in the corporation where 1
= Very low extent; 2 = Low extent; 3 = Moderate extent; 4 = Great extent; 5 = Very great extent.

<table>
<thead>
<tr>
<th></th>
<th>Very great extent</th>
<th>Great extent</th>
<th>Average extent</th>
<th>Low extent</th>
<th>Very low extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active and independent audit committee</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Independent directors</td>
<td></td>
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<tr>
<td>Management’s ownership interest</td>
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<tr>
<td>Financial management and compliance with accepted audit standards</td>
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<tr>
<td>Limited auditors in the corporation</td>
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<tr>
<td>Proficiency of the internal auditor</td>
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<tr>
<td>Effective audit planning</td>
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<tr>
<td>Effective internal audit department</td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

73
| Risk assessment |   |   |   |   |
| Risk management |   |   |   |   |

Thank you for your Participation
APPENDIX II: FIRMS LISTED IN THE NSE AS AT DECEMBER 2013

1. Eaagads Ltd
2. Kakuzi Ltd
3. Kapchorua Tea Co Ltd
4. Rea Vipingo Plantations Ltd
5. Limuru Tea Co Ltd
6. Sasini Tea and Coffee Ltd
7. Williamson Tea K Ltd
8. Kenya Orchards
9. Access K Ltd
10. Bauman Ltd
11. Car and General K Ltd
12. CMC holdings ltd
13. Express K Ltd
14. Hutchings Biemer Ltd
15. Kenya Airways Ltd
16. Marshall EA Ltd
17. Nation Media Grp Ltd
18. Safaricom Ltd
19. Scangroup ltd
20. Standard Grp Ltd
21. TPS( Tourism Promotion Services ) Serena Ltd
22. Uchumi Supermarkets ltd
23. Barclays Bank of Kenya
24. British American Insurance
25. Carbacid Investments ltd
26. CFC Insurance CFC Stanbic Bank
27. City Trust Ltd
28. Diamond Trust Bank K ltd
29. Equity Bank
30. Housing Finance Co Ltd
31. Centum Investment Co
32. Jubilee Holdings ltd
33. National Bank
34. KCB
35. Kenya Re
36. NIC bank
37. Olympia capital holdings ltd
38. Pan Africa Insurance co ltd
39. Standard Chartered Bank
40. Cooperative Bank
41. Trans-Century
42. Athi River Mining Ltd
43. Bamburi Cement
44. British American Tobacco
45. Crown- Burger K Ltd
46. Eaast African Cables
47. East Africa Portland
48. Eveready EA Ltd
49. BOC K Ltd
50. KPLC
51. Kengen
52. Kenol Kobil
53. Total K
54. Mumias Sugar Co ltd
55. Sameer Africa
56. Unga Group Ltd

APPENDIX III: STATE CORPORATIONS LISTED IN NAIROBI SECURITIES EXCHANGE AS AT DECEMBER 2013

Kenya Airways Ltd

Safaricom Ltd

National Bank

Kenya Commercial Bank

Kenya Re-Insurance

Athi River Mining Ltd

East Africa Portland Ltd

Kenya Power and Lighting

Kenya Electricity Generating Company

Uchumi Supermarkets Ltd