THE EFFECT OF AUDIT SERVICES ON FINANCIAL PERFORMANCE OFBANKING FIRMS IN KENYA

BY

MUTISYA KIMULI

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DECLARATION

I, the undersigned, declare that this research project report is my original work and has not been presented for examination in this or any other university for any award.

Signed: ________________________ Date: _______________________

MUTISYA KIMULI

D61/67806/2013

This research report has been submitted for examination with my approval as the university supervisor.

Signed: ________________________ Date: _____________________

AbdulatifEssajee

Lecturer

Department of Finance and Accounting

School of Business

University of Nairobi

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DEDICATION

I dedicate this research project to my wife Joan Ruth Mutisya.

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LIST OF ABBREVIATIONS

AIG	American International Group Inc.
ASA 700	Auditing and Assurance Standard 700
CEO	Chief Executive Officer
CMA	Capital Markets Authority
CMC	Cooper Motor Corporation
COYA	Company of the Year Awards
EU	European Union
FIRE	Financial Reporting Excellence Awards
GAAP	Generally Accepted Accounting Principles
IA	Internal Auditing
IAS	International Accounting Standards
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
ICPAK	Institute of Certified Accountants of Kenya
IFRS	International Financial Reporting Standards
ISA 700	International Standards on Auditing (UK and Ireland) 700
IASC	International Accounting Standards Committee
IAS-1	International Accounting Standard-1
ISO	International Standards Organization
KNBS	Kenya National Bureau of Statistics
NSE	Nairobi Securities Exchange
PCAOB	Public Company Accounting Oversight Board
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
SAS	Statements on Auditing Standards (United States)
UK	United Kingdom
US	United States

ABSTRACT

In order to secure consistent good financial performance appropriate good management practices and audit services are needed to guarantee sustainable good results through optimal use of resources. For purposes of this study was determining the impact of audit services on financial performance of commercial banks in Kenya. Audit services that were used were international auditing standards, professional competence, internal controls, independence of auditors, various audit services bank liquidity and reported fraud levels. The study used a sample of 20 respondents who were senior managers selected from 20 banks located in Nairobi. The researcher used questionnaires to collect data from the respondents. Secondary datawassourced from the respective banks' websites for periods 2013 through 2017.Methods of analyzing data that were applied were the quantitative and regression analysis. It was established that liquidity and fraud didn't frequently have direct positive association with financial performance. Also it was found that change in audit services results to changes in financial performance of commercial banks. It is recommended that management of commercial banks need to adopt audit practices that are effective based on international auditing standards, advocate the independence of auditors, auditors' professional competence and strengthening of internal controls and other audit services to secure the financial performance of their organizations.

CHAPTER ONE: INTRODUCTION

1.1 Background to the Study

The concepts of "true" and "fair" view as contained in the auditors' report to shareholders have been thesubjectsofdiscussion asto theirmeaning andsignificance (Kirk, 2001)."True and fair view" is closely associated with judgment and is used as a part of the New Zealand, Australia, Singapore, United Kingdom (UK), European Union (EU) and Kenya practices. 'Present fairly 'which is the alternative used in the United States is usually assumed tomean conforms to generally accepted accounting principles. "Present fairly" is the standard applied in US financial reporting environment. According to Hopwood, Page and Turley (1990), "Present fairly "has a tendency to be more rule-based and is the accepted accounting practice of the United States. Both terms, "true and fair view" and "present fairly", have a long history in financial reporting.

A view that is fair and also true regarding to the audit process implies that the financial statements do not have misstatements and its presentation on the financial performance is faithful and conforms to theIASB Conceptual Framework (2010). Despite the fact that the concept of true and fair is clearly explained in topics on accounting; based on its definition it can be concluded that: True implies that statements of finance have been created based on facts and also based on various report frameworks like the IFRSs and are free of any incorrect statements which could be misleading to the users. Fair suggest that financial statements give information that is faithful and isn't biased and also provides a reflection of the substance of the economics of transactions and not just the legal form (Chartered Education, 2015).

Where different stakeholders in the financial accounting arena attach different meanings to the concept of ‘true and fair view' an expectation gap is bound to exist. This may lead to the expectation gap being one of the functions or variables influencing decision making. The expectation gap maybe defined as the distinction of desires that reports on finance reports that are expected by clientsin reports of finances against the degree of the quality of financial reports that are being presented by professionals of accounting (Porter, 1996). Allen (1991) explains the expectation gap as the difference of what the records and statements mean to auditors and accountants and what many of the non-accounting individuals think they imply.

According to Grosu and Chersan (2013), the insurance theory suggests that the information that is provided in the financial audit lowers the risk that the information given by public entities could be incorrect. Limperg's theory of inspired confidence (1932) is an essential hypothesis on the auditor's capacity and focuses on the social obligation of the auditor. The auditor derives his general capacity and confidence in the public eye from his presumed independence and autonomous examination requirement and free assessment in light of that examination.

Various concerns have been raised regarding the idea of true and fair view opinion and the role of the audit function. Mock et al (2009) studied the perception of users in regard to audit report that is unqualified and the effects of audit report on judgment of the individuals using the financial reports. Their conclusion was that when perceiving a company’s performance the audit report is not always considered by all focus groups. Gay and Schelluch (1993) did a studyonimpact of new long form of audit reports on the perception of users in regard to the role of auditors, the state of the audit the process of financial reports in Australia. The conclusion was that audit reports that are revised better the perception of the individuals using it on audit's procedure and purpose.

Porter et al (2009) did a study whose objective was on audit expectations gap in New Zealand and the UK.Users' of the financial reports understanding of the audit report passes a certain message. It concluded that auditor's report content has no effect on clients' comprehension of the duties of executives and the auditor on the concept of financial statement or the concept of the audit procedure.

In Kenya, as is the tradition all over the world, company directors have a responsibility to provide leadership culminating in the production of financial statements providing a view that is true and fair regarding performance financially, financial stand, and adaptability financially of entity in accordance with what is required by IFRS and prerequisites of Kenya Companies Act.

Modern and well managed organizations acknowledge the crucial role played by both external and internal auditors in improving management of company assets to better financial performance. Auditing services facilitate such entities to achieve organizational goals. According to Basel Committee on Banking Supervision Reforms, (2002) improved auditing services improve financial performance in banks.

1.1.1 Auditing Services

The term auditing services refers to both external and internal audit functions. When making decisions the people involved in the process depend on information and financial reports which have already been prepared by the management of the institution. The likelihood of the decision that is reached not being accurate is referred to as 'information risk'. Elder et al. (2010) indicated that the usual procedure applied by individuals in gathering information that is reliable is to perform auditing that is independent.

In order to improve the level of confidence of the individuals who will be using the report it is necessary to conduct external auditing. The individuals responsible for making decisions apply the use of the reports assuming that the reports are accurate, not biased, and are complete.

Internal Audit is appraisal of services that are conducted in the company regarding management of risk, control as well as governance through the measure and evaluation of the level in which they are effective towards the fulfillment of the objectives set by the institution. Additionally, the results that are obtained as a result of audit process will help the board of directors and the entire management in implementing the suggested and plannedimprovements which will increase the efficiency of operations.

The audit service uses professional skills using evaluation policies that are systematic and disciplined and procedures as well as operations that are applied by the management in order to attain their set objectives and also through suggestions that are meant to bring about improvements (Dumitrescu, 2004).

The audit function executes its mandate by applying ISA. In banks it is the role of the directors to ensure that the banks apply appropriate systems of audit which are also effective. A system which evaluates the risks that relate with the activities that are being carried out in the bank, techniques that are appropriate in checking for compliance to regulations, measures as well as internal processes. In addition, it is the responsibility of the management of the banks to come up with the procedures to apply in identifying measures, monitoring and controlling risk that could be faced by the banks.

1.1.2 Financial Performance

The assumption of accountants on those using the financial statements is that they are able to understand and interpret financial statements and make informed decisions based on financial performance.

Those using financial statements, namely: present and potential investors, creditors, suppliers and long term creditors, employees and their representative groups, the government and its agencies, competition, customers and the general public, usually don’t directly access the accounts records from which the financial reports are usually prepared. Clients are essentially “prohibited from auditing" the financial statements themselves and because of this remoteness, there is a need to depend on the services of auditors that help in evaluating financial statements quality.

The auditor is viewed as a safe independent distant outsider not exposed to the pressure and manipulation of management or the board of directors. The general recognition is that autonomous evaluators have little to pick up (and much to lose) from distorting financial statements given to investors and stakeholders.

This study will attempt to establish whether audit services affect the performance of the banks financially. Performance in financial terms is a measure that is subjective on how efficiently the bank applies is assets in its main businesses to generate revenues and present improved measurements of financial performance such as profitability and return on assets.

1.1.3Audit Services and Financial Performance

Most accountants and finance experts do argue that an audit function that is effective has a correlation with improvement in performance financially. Beyanga (2011) indicated that an audit process that is effective assists in reducing overheads, establishes methods that can be applied in improving levels of efficiency, reduces the chances of incurring losses from those assets of the institution that aren't well safeguarded which significantly affects the performance of the company financially.

It is significant to note that audit services whether internal or external have a catalyzing effect in that they keep management perpetually on their toes working on enhancing financial performance and thus institutional operational efficiency. The auditor's report, recommendations, disclosures and the final opinion have an immense impact with regard to financial performance indicators both current and future. Audit services influence short term corrective actions to be taken in order to conform to approved processes, policies and strategic plans.

1.1.4Banking Firms in Kenya

Kenya has the most developed banking industry in East Africa at the moment. Indeed Nairobi is considered the financial capital of the region. With about 43 commercial banks it experiences a highly competitive financial market and thus the motivation to improve financial performance to ensure good results to safeguard stakeholder's interests. The industry supports other sectors that in the economy which are inclusive of: Agriculture and Forestry, Manufacturing, Real Estate, Wholesale and Retail, Education, Transport and Storage, Finance and Insurance.

The banking sector, which is dominated by a mixture of subsidiaries of multi – national corporations and local companies, contributed approximately 6.1% of the

GDP in 2017 according to the KNBS. However, due to the interest capping Finance Act of September 14, 2016, it has experienced a decline to record a contribution of 5.9% to GDP in the 1st Quarter of 2018 (KNBS). This decline has been due to rising levels of poverty which inhibit growth in demand and availability of credit particularly to SMEs.

The Kenyan Vision 2030 Strategy focuses on transforming the country into a middle income country that is industrialized which will provide life that is of high quality for its citizens by the year 2030. The sector is among the key sectors to support the growth strategy and address incidences of high poverty levels of unemployment in the country by facilitating access to credit to youth and small and medium size enterprises. The outcome has been an increasing need to have auditing in the banks to improve the management of resources, controlling of risk as well as government controls. The industry has also been identified by the management as a key player in support of the big 4 agenda. The big 4 agenda of the government are: Universal Affordable Health Care, Achievement of Food Self- sufficiency and nutrition, Affordable Housing for citizens and Manufacturing and Industrialization to a level of 15% of GDP.

1.2Research Problem

According to the Daily Nation of March 27, 2015, a damning forensic audit report showed that Mumias Sugar Company was embroiled in fraudulent accounting and corporate governance contraventions; while only in recent years it stood tall as a model of astute management. The company and its CEO got top honors at the annual COYA awards. MumiasSugar Company won several marketing and public relations awards, enjoyed Super Brand status, was ISO certified, and received an A+ credit rating from the Global Credit Ratings Company and a FIRE award because of their excellent reporting on finances. In the wake of what has happened at the company in the past few years, one would expect that these plaudits would be recalled because, clearly, they were fraudulently obtained. Cases of corporations using creative accounting to cover up fraud are not uncommon. US conglomerates Enron, WorldCom, AIG, and Lehman Brothers did it for years.

Ondieki (2013) did a research on the impact of internal auditing on performance of commercial banks in Kenya financially. The focus of the study was the function of internal audit in the banks, the role it performs in the bank, internal auditing and management of assets and the way it impacts performance financially. The study reached a conclusion that standards of internal audit, independence of internal auditing, competency professionally and internal controls positively relate with performance of commercial banks financially.

Chepkorir (2010) did establish that internal audit assists the company in accomplishing its objectives by having systematic and also disciplined approach in evaluating and improving efficiency in managing risk, controlling and process of governing. The activity of internal auditing does an evaluation of risk exposure that relates to the governance of the organization, information system and operations. It is expected that the internal auditors give suggestions in the areas where they have identified weaknesses or there exist opportunities for improvement.

A number of local companies have found themselves in financial trouble after reporting healthy financial positions and operating results and receiving clean bills of health from their external auditors. These include Uchumi Supermarkets Limited, NBK Limited, Chase Bank Kenya Limited, Kenya Airways Limited, Dubai Bank Kenya Limited and Imperial Bank Kenya Limited. In all these cases, the organizations had been given a clean bill of health with unqualified opinions by their external auditors and had recorded good annual profits coupled with impressive statements of financial position. What the general public did not know is that in all these companies, prior to and during this period, many decisions had been taken by management that were not in shareholders' best interests or those of other financial statement users. For instance, in some of the banks, there were some insider loans that were not only advanced to directors irregularly, but also not reported properly in the financial reports. Why this state of affairs was not flagged out by the auditors begs a lot of questions.

This state of affairs is indicative of an inherent problem which is not being communicated through the audit opinion and hence the need for this research to try to answer the following questions: What is the effect of auditing services on the financial performance of commercial banks in Kenya?

1.3Research Objective

To determine the effect of audit services on the financial performance of commercial banks in Kenya

1.4Value of Study

The findings might be of interest to various shareholders. It will assist the Government of Kenya and policymakers in policy formulation and legislation to regulate and help improve corporate governance with regard to audit services. The study's findings will contribute to the body of knowledge in the area of accounting theory and practice.

To potential investors and other stakeholders including the general public, the study will give some insights into whether audit services influence the performance of banking firms.

To researchers and academicians the study will provide information that can be used for literature review in studies related to audit services. The study will also provide foundation through which further studies on the effect of auditing services on financial performance in the banking industry can be researched.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

The chapter begins with a theoretical review of the theories that underpin the study followed by a review of related empirical studies and concludes with a summary of the literature review.

2.2Theoretical Framework

The Insurance theory, Limperg's Theory of Inspired Confidence and Agency theory are discussed herein below to provide the theoretical framework underlying the area of study.

2.2.1 The Insurance Theory

This theory explains the basis for placing the responsibility of the reported information on the auditors to minimize the expected loss from legal action to directors, managers, creditors and experts associated with the securities markets (Cosserat, 2009). When utilizing audit administrations, managers, supervisors and other senior experts can demonstrate that they exercised due diligence and sensible care. The auditor's opinion expressed in the audited financial statements of an entity is therefore critical to all users of financial statements as exposure is minimized by engaging external auditors in giving opinion regarding the financial reports.

The theory, according to Grosu and Chersan (2013), indicates that making sure financial reports lower the risk that information that is given by the public entities to the users is not incorrect. It indicates that the users of the information both accounting and financial should put into consideration both risk of failure and the risk information it presents in the reports.Lowering risk results to lowering of risk premiums that are requested by the investors which results to lower cost that is assigned to capital.This means that the function of audit has a crucial role in reducing risk information, but justifying that it is a reasonable assurance that affects performance results.

2.2.2Limperg's Theory of Inspired Confidence

This theory (1932) is an essential hypothesis on the auditor's capacity and focuses on the social obligation of the auditor. The auditor derives his general capacity and confidence in the public eye according toLimperg. This is from his presumed independence and autonomous examination requirement and free assessment in light of that examination.

The theory of inspired confidence interfaces the need for usergroups 'questfor quality financial data and the capacity of review methods which address their issues. It also focuses on group necessity for advancement in the strategies of inspection over time. In building up his Hypothesis of Propelled Certainty, Limperg depicts the auditor's practical obligation thus: "The examiner infers his general capacity in the public arena from master requirement and autonomous research". The capacity is established in the certainty that society puts in the review of adequacy and in the auditor's assessment and the perceived trust and expectations that users have in the audit function.

The standardizing center of this theory assumes that the auditor is bound to complete his task in a manner that he does not double-cross the desires which he brings out in the sensible layman; and, on the other hand, may not stir more prominent desires than can be supported by the task done.

As indicated by this reference it could be inferred that this theory does not recommend unmistakable standards concerning the auditors conduct in every specific case; the rule based approach, alluded to by Carmichael (2004). Carmichael postulates that auditor’s touchstone is dependably to play out his task and give the confidence and the perceived confirmation that is needed by society.

2.2.3Agency Theory

In theory of the firm: administrative conduct, ownership structure and agency cost (1976), M.C. Jensen and W.H. Mecklingperceive a firm as a 'black box', worked to generate capital when employed with factors of production, minimizing costs, increasing yields and amplifying benefits whether as an agent or principal despite conflicting interests between owners and managers.

Jensen and Meckling characterize an agency relationship as an agreement under which at least one person (the principal(s)) contracts with someone else (the agent) to do some administration work for their mutual benefit. Both agent and principal seek to maximize their individual personal benefits. Inside this relationship, proprietors have an enthusiasm for increasing the value of their benefits through their actions, while principals are more keen on 'private utilization of firm assets' and firm development. In this regard, the audit opinion expressed in financial statements will to some extent give assurance as to how the managers have executed their mandate with regard to shareholders’ expectations. In this context, the services of the auditor are employed to act as a safeguard and ensure the stewardship of the firm is geared towards optimal financial performance. The audit function therefore supports the achievements of overall organizational goals and objectives. The audit services assist management to review various strategic plans and policies with a view to making recommendations for improvements as necessary.

2.3 Determinants of Financial Performance of Banking Firms in Kenya

2.3.1 International Standards on Auditing

Glazer and Jaenike (1980) did argue that carrying out auditing in line with the auditing standards internationally has a significant contribution to effective auditing process. Ridley and D'Silva (1997) established that sticking with the professional standards in the UK is crucial in contributing to improved quality in the final product.

IAASB is the body that issues ISAstandards. The standards are inclusive of attributes, implementing standards and performance. Generally, the standards on formal auditing recognize that auditors also give services with regard to information and not just consulting and financial statements. The requirement of the standards is for auditors to perform their roles objectively and comply with the professional practice which includes their work evaluating and contributing to improved management of risk, performance financially, control and governing.

2.3.2 Independence of Auditors

Cai Chun (1997) indicated that the essence of auditing is independence. The individual conducting the audit process needs to be independent of the personnel and the operational activities of the company. In cases where the auditor is not independent, then their opinions, conclusions and even recommendations will be suspected. Therefore it is very important to have independence for effectiveness and efficiency of the objective and the function of the audit. Independence can be attained through two traits which are objectivity and status of the organization.

Dumitrescu (2004) does acknowledge in his article concerning internal auditing of the banks that every single banking institution needs to have a department responsible for internal auditing regarding volume as well as the nature of the activity it relies upon. For small banking institutions there is external provision of internal auditing. Auditing departments of the banks should be independent of the control activities and of the daily processes of internal control. Through this, it ensures that the department objectively performs its activities so that the auditors might not have interests that are conflicting with those of the bank. Each bank must ensure that the department dealing with internal auditing is not dependent on other departments and management.

The departmentof internal auditing needs to be responsible to the management of the bank and the directors as well as the audit committee. There is need for these bodies to be primarily updated on the audit plans and the achievement of the objectives of the internal auditing department. Similarly, external auditors, must be independent of the management of the organizations they audit, otherwise their work may be compromised and perceived to be suspect.

2.3.3 Professional Competence

It is not an easy process to detect risk. In trying to cover their behavior, perpetrators do take part in deception. Auditors therefore do not have easy to detect fraud and it is not easy to predict fraudulent activities Herzand Schultz Jr. (1999). Therefore, the company should be optimally served through identification and utilization of those individuals who, since they possess unique characters may best suit the team responsible for detecting fraud.

The role that is played by internal auditors is very important because they detect fraud (KPMG, 2003, Norman et al., 2010). Any measure which improves the level of efficiency of the auditors needs to be of great value. Experience as well as ability is very important in the process of detection, but also the character of an individual could be predictive in detecting fraud (Ashton, 1999). Comprehending the way auditors are perceived and the way the perceptions result to belief in regard to abilities of detection, it is a critical first step in relating character trait of an individual to the level of efficiency of the auditor. It’s crucial noting that experience, on the job training and professional qualifications and continuous interest in literature on current developments in the profession are essential in enhancing related competence.

2.3.4 Internal Controls

Designing of controls audits is done to make sure that there are appropriate controls in place over the systems as well as software to make sure that the internal controls and checks function appropriately according to how they were designed, (Ashton and Haylas1982). These control audits could have inbuilt features to make sure that any fraud is detected or made impossible to complete transacting. Through control audit assurance is provided that controls do work. Internal audits have a relationship with plans on management, techniques and processes applied in meeting the goals of the company as well as their objectives. Plan, organize, direct, and control programs for operations and systems which are created with the aim of measuring, reporting and monitoring the performance of programs are some of the internal controls, (Esmailjee, 1993).

Ashton and Haylas (1982) while trying to provide proof on effectiveness of auditing methods in detection of errors affecting financial reports indicated that all errors that are intentional are concentrated in few audits and they can be predicted with ease in the institution. Most of such errors impact the income but the direction of impacts could either be under or over statement. With regard to the signal of the error, it was established that great portions of the errors on financial reports have an initial signal of audit procedures that are less rigorous like the analytical review and having discussions with the client. The issues of client personnel like lacking experience, lacking competency and lacking sufficient knowledge and control follow ups that aren’t adequate were established to be instrumental in resulting to errors.

2.4Empirical Studies

According to a study by Sayag (2010)onIA, the function in organizations both private and public ones is a mechanism of indispensable control. Despite this, there are few studies that have been carried out on its effectiveness. The aim of his study was building a conceptual comprehension on how effective internal auditing is in companies. He came up with a scale of measuring the level of effectiveness of internal auditing and also a model that comprised of its determinants. The study used a sample of 108 companies that used internal auditing in Israel. The study gathered information from general managers of the companies and also collected information regarding determinants of the internal auditors’ personnel.

Based on the scale that was developed, it was established that the scale had good psychometric properties. From the findings of correlation and regression analysis, it was established that top management are the key determinants in having internal auditing that is effective, other impacts were also established for independence of the company internal auditing. The impact of predictors showed consistency in both private and public institutions. Through the model, a great amount of variation in effectiveness of internal auditing was explained.

Ndege (2012) did a research on financial ratios. The focus of the study was identifying factors in ratio form, shaping performance of the bank whose measurements are obtained using ROA and ROE. The study established that ROA and ROE could be applied in measuring performance (financially) of the Kenyan banking industry. Operations of IA as well as their recommendations have short term impacts on running of the company and also act as the backbone of the company and dictates whether the company will prosper of fail. It is important to stress on its effectiveness and acceptability in all levels more so the management to ensure that it is viable.

Mutua (2012) did a research on effects of audit based on financial performance. Despite the focus of the study being audit, it also acknowledged that to perform financially, there is need to have IA that is efficient, appropriate and effective. The study established that auditing whose basis is risk through standards of internal audit and staffing need to be improved to make sure that companies have the ability of timely detection of risks and concentrating on areas of high risks resulting to more transparency and accountability, therefore increasing performance financially. It was established that IA and performance financially are related.

Mawanda(2008) did a study on the impacts of systems of internal control on performance financially of universities in Uganda. The focus of the study was investigating and establishing the association between systems of internal controls and performance (financially) of Ugandan universities. The perspectives that were applied in looking at Internal controls were control environment, IA, control activities whereas the focus of financial performance was Liquidity, Accountability and Reporting which were used in measuring Financial Performance. The researcher focused on establishing the causes of poor financial performance that is persistent in the perspective of internal controls.

There was a significant association between the systems of internal controls and performance financially. The recommendation was to have profiling that is competent in departments of IA which is based on the expectation of the university on what should be done by IA and the appropriate number of staffs needed for the job. The role played by IA is therefore acknowledged in establishing internal controls which affects financial performance of companies.

Cohn (2012), in a survey by Ernst and Young, selected a total of 695 chief audit executives and C-suite executives and established that 80% IA function of their company could be improved further. It was also established that 75% of the respondents believed that management of risk that is strong positively affects the performance of their long term earnings. The same number of respondents also believed that IA function positively affects their general efforts of managing risk. With the evolvement of IA, the expectations of shareholders increases, IA function increasingly needs competency exceeding more traditional skills, like the ability of teaming with management and business units or other issues of business that are relevant.

Cooper and Craig (1983) studied the role of IA in the region of Asia Pacific. The study established some issues in Australia which were of concern to experts. Some misconceptions were established regarding what internal auditors did and the perception of their CEOs was done and the CEOs expected that more of IA that the traditional work of auditing conducted timely. On the other hand, the CEO’s strongly supported for IA and when it was regarded to have long term prospects for careers. The study formed a base for further researches that were conducted in Australia, Malaysia and Hong Kong.

Some few studies did an examination on how effective IA is and fewer of them did an imperial study. Among the few studies that were conducted, Eden D, (1996) did assign a total of 224 banks to a condition of experiment as either audited or not and did monitoring of how they performed for a duration of one year. It was established that auditing in the experimental banks improved performance while the control banks had lowered business conditions. The study offered a point to jump off to comprehend on importance of auditing in improving the performance of the company, it doesn't further explain when and why IA functions, and conditions facilitating or impeding it. This study will greatly contribute in filling this gap.

2.5 Summary of Literature Review

Based on the above discussions, it is noted that Insurance Theory, the Agency Theory and the Limperg's Theory of inspired confidence offer the theoretical framework on audit services and the resultant financial performance. They have offered some insights in understanding the basis on which auditing services are procured and the benefits to the industry.

Audit services have been discussed in several studies and in general literature. We still have gaps, for instance such the paradox of sudden collapse certain entities soon after obtaining a clean bill of health from external auditors. The area is still being explored by researchers in the context of previous empirical work.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

Methodology of the study is presented in this section. The procedure followed in conducting the study is clearly outlined. The design of the study, population, methods of sampling and the sample, techniques and tools used in collecting data, methods of data analysis and data validity and reliability are presented.

3.2 Research Design

Research design alludes to the technique applied in conducting a research. This study utilizes an exploratory descriptive research design. This outline includes collecting information and after that sorts it, arranges, delineates, and depicts the information. Clear investigations depict the factors by noting who, what, and how?(Babbie, 2002).According to Cohen et al. (2003), descriptive design procedure gathers data that is specific to the goal testing hypothesis of the study. Its favorable position is that, it is utilized widely to depict conduct, demeanor, qualities and characteristics.

3.3 Target Population

The population refers to general group of elements that are being investigated and possess similar attributes (Mugenda and Mugenda 2003).Therefore, there is need for the population to fit some specifics being studied and there is also need for the population to be homogenous. For this study, the targeted population was 43 banks in Kenya that are registered.

3.4 Sampling Procedure and sample size

Ngechu (2004) emphasized on the importance of selecting a sample that is representative from a sampling frame. The sample of elements needed for the study is selected from the sampling frame. The study population includes 43 commercial banks in Kenya. A sample size of 20 commercial banks was selected randomly from the population targeted. The sample of banks is selected in terms of their size as follows: 5 big banking institutions, 10 medium size banks and 5 small banks. The data was considered in terms of accuracy as well as applicability. The process of data collection was greatly supported by the cost of obtaining the data and time used. One senior manager was purposively selected from finance department of the bank and therefore forming a sample of 20 respondents.

3.5 Data Collection Instruments and Method

The research utilized primary data and secondary data. The information was gathered using questionnaires. It incorporated structured and unstructured inquiries.

Mugenda and Mugenda (2003) stated that a survey characterizes the issue and the particular investigation goals of an examination. Questions may be open or closed ended type. With respect to the previous, closed ended inquiry will just permit particular sort of reactions, (for example, Yes or No and Likert scales) whereas for the open ended ones, the respondents will state reactions as they wish in connection to the goals of the investigation. Questionnaires were favored in this investigation since they are exceptionally user friendly regarding time, efficiency and economy.

The structured questions were designed to minimize time used and to encourage a simpler investigation since they're in usable form, while using questionnaires that are unstructured urges the respondents to provide their inside felt responses without feeling that they are restricted from providing information they feel will be helpful.

The selected sample was issued with questionnaires. Designing of the questionnaire was carefully done and was tested with a small group of individuals selected from the population which enabled improvement of the questionnaire. The questionnaires were administered by the researcher to all the individuals in the selected sample. Care and control was exercised by the researcher to make sure that all the questionnaires that were distributed are received back; this was achieved by maintaining a register of questionnaires distributed and those returned.

3.6 Data Analysis and Presentation

Analysis of the collected data was done using SPSS Version 20.0. The methods applied were both descriptive and regression analysis. The gathered data was passed in different models in order to show the effect of audit service on performance (financial) of commercial banks in Kenya. The study applied the use of Logit model in analyzing the regression equation. The aim of the study was linking audit service and financial performance of the banks. Performance of the banks was measured in this study using profitability. The predictor variables were international audit standards, independence of auditors, fraud frequency, professional competence, internal controls and various audit services as factors considered by banks as enhancing attributes to financial performance.

3.6.1 Conceptual Model

The study adopted conceptual model whereby financialperformance is a function of internal controls adopted by the bank. Financial performance was also used as a function of level of fraud, liquidity and audit services. These independent variables were sourced from both primary and secondary data.

$Y = f(X_1, X_2, X_{3,} X_{4,)}$………………………………..…………… (1)

Where:

Y = Financial performance of banks is measured by ROA

X_1 = Internal Controls Reviews

X_2 = Audit Services (various) /no. in a fiscal year

X_3= Liquidity (ratio at end of period)

X_4= No. of frauds reported in a fiscal year

3.6.2 Analytical Model

The following regression model was used to perform data analysis:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

The error term ε is the variability in Y that cannot be explained by the linear association of the response and the predictor variables.

The performance of the banks financially was measured by use of measures of financial performance which are inclusive of ROA,

Internal controls were measured by various internal control reviews done by each commercial bank per year (measured by Yes or No).

Operational audits were measured by frequency and regularity (number) of the audits adopted by the banks per year.

Financial audits were measured by the number of audits per year adopted by each bank.

Compliance audits were measured by the number of audits adopted by the bank per year.

Tax audits were measured by the existence of current tax compliance certificates in the bank.

Information systems audits were measured by the frequency/number of reviews per year.

3.7 Data Validity and Reliability

A pilot study refers to a scale copy and practice of the fundamental investigation. It helps with deciding the reasonableness and simplicity of the utilization of the research instruments and the operational parts of administering the questionnaire. The motivation behind a pilot test is to find conceivable shortcomings, insufficiencies, ambiguities and issues in any part of the study procedure.

Validity is guaranteed by having target questions incorporated into the questionnaire. According to Cooper and Schindler (2003) this is accomplished via instrument pretesting to be utilized to distinguish and adjust any uncertain, clumsy hostile inquiries and methods.

The validity of the study instruments was set up by looking for advice and conclusions of specialists in the field of focus particularly the managers with relevant experience.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

In this chapter the findings of the data gathered from the field is presented and discussed. Discussion of the findings has been done using both inferential and descriptive statistics. The sample size of this study was 20 respondents who were selected from study population. All the questionnaires were filled forming a response rate of100%. It was considered satisfactory and adequate for analyzing and making conclusions.

4.2 Response Rate

Response rates are as tabulated below:

4.2.1 Demographic Information

Table 1: Gender of Respondents

		Bank Classification			Total
		Big	Medium	Small	
Respondent gender	Male	2	8	5	15
	Female	4	0	1	5
Total		**6**	**8**	**6**	**20**

The study covered 20 commercial banks in Kenya all with branches located in Nairobi. The study was conducted in October and November 2018. The respondents were distributed by bank category/size. Six big banks, 8 medium size banks and 6 small size banks were purposively selected for the study.75% of the respondents (a count of 15), are male while 25% is the other gender (a count of 5). There are more female respondents in the big banks at 20% (a count of 4) while only 10% for male (a count of 2). The respondents at the medium level banks are all male at 40%; no female respondents at this level while small banks with 25% are male and 5% female. Both genders participated in the study wasn’t gender biased.

Table 2: Age Distribution

		Age of Respondents				Total
		25-34	35-44	45-50	>50	
Respondent gender	Male	1	11	1	2	15
	Female	4	1	0	0	5
Total		**5**	**12**	**1**	**2**	**20**

Respondents were asked to indicate the age category to which they belonged in. The findings in Table 2 show that 25% of the respondents were aged between 25 to 34 years, 60 % between 35 to 44 years, 5% between 45 to 50 years, whereas 10 % were aged above 50 years. This showed that the respondents were of varied ages.

Table 3: Level of Education

		Respondents’ Educational Level		Total
		Masters	1 st Degree	
Respondents’ gender	Male	1	14	15
	Female	3	2	5
Total		**4**	**16**	**20**

All respondents were 1st Degree and above level of education. 80% (a count of 16) are 1st Degree holders (70% male; 10% female); while 20% (a count of 4) are Masters Level (15% female; 5% male).

Table 4: Length of Service

		Years worked in Organization				Total
		less than 2	2-5	6-10	more than 10	
Respondents gender	Male	1	4	6	4	15
	Female	0	3	1	1	5
Total		**1**	**7**	**7**	**5**	**20**

Respondents were asked to indicate the duration of time in which they have been serving in their bank. The findings established that 35% of respondents had served for between 6 to 10 years, 35% for between 2 to 5 years, 25% for more than 10 years and 5% for a period of less than 2 years. Therefore, most of the respondents had served for long period of time which suggests that the respondents had the information regarding the banks that were needed in this study.

4.3 Data Validity

A pilot survey was carried out to pretest the research instruments. Consultation was also done with the supervisor and experts in the field of study to ensure the research instruments contained all the necessary questions to gather enough data to facilitate successful completion of the study. Analysis of the data was done using SPSS Version 20.0. Methods of analyzing data that were applied in this study was quantitative and regression analysis. The gathered data was passed in various models with the aim of bringing out impact of audit services on performance of commercial banks as the dependent variable against the independent variables: internal controls, audit services, fraud, and liquidity to generate various results which are presented and discussed elsewhere in this study.

4.4 Descriptive Statistics

4.4.1 Fraud Experience in last 2 years

Table 5: Fraud Experience in last 2 years

Classification Table[a,b]

Observed		Predicted: Experienced fraud in the last 2 years		Percentage Correct
		Yes	Can't say	
Experienced fraud in the last 2 years	Yes	19	0	100.0
	Can't say	1	0	.0
Overall Percentage				95.0

a. Constant is included in the model
b. The cut value is .500

Table 6: Fraud Experience by bank size

Bank Size * Experienced fraud in the last 2 years Cross tabulation by bank size

		Experienced fraud in the last 2 years		Total
		Yes	Can't say	
Bank Size*	Big	4	0	4
	Medium	10	1	11
	Small	5	0	5
Total		19	1	20

The cross tabulation above shows that out of the 19 responses of experienced bank fraud; 4 (20%) were from the big banks, 10 (50%) from medium size banks while 5 (25%) was experienced in small banks. Only 5% were not able to respond to the question from the medium banks.95% of the respondents experienced fraud in the last 2 years.

Consider the Binary Model:

Eftiji = fn (Ptiji+ Atiji+ Gtiji+ RoAtiji + Ltiji + Btiji) – [1]

Where:

EftijiBank Experienced fraud in the last 2 years (No = 0, Yes = 1, Can't say = 2). This is a binary model mainly due to the responses Yes or No.

As a function of:

Ptijii is profit at time i for bank j

Atiji is assets accumulated in time i for bank j;

Gtiji is % asset growth in time i for bank j;

RoAtiji is % return on assets in time i for bank j;

Ltiji is % liquidity in time i for bank j;

Btijiis the size of the bank in time i among banks j;

(0, 1) = - 4.408 - 2.944Ptiji – 0.001Atiji – 5.037Gtiji + 15.971ROAtiji – 2.452Ltiji – 2.944Btiji– [2]

The interpretation in this 2nd equation implies that:

The 'constant' -4.408 indicates that holding all factors constant fraud in banking can still be reduced by 4.408. That is for every single banking fraud there is a possibility of it being reduced by 4.408 times.

Bank profits: well recorded, calculated and presented bank profits are likely to reduce possibility of a single banking fraud by 2.944 times significant at 0.004.

Bank Assets: if well and carefully recorded, and disclosed; banking fraud is likely to be reduced by 1%.

% Growth in Assets: if any one % growth in assets is well assessed, documented and recorded and disclosed; then possibility of banking fraud is likely to be reduced by 5.037 times.

Return on Assets (ROA): ROA seems to have a positive correlation with banking fraud. That for every single % increase on ROA; banking fraud seems to also increase by 15.971times.

Bank Liquidity: Bank liquidity seems to have a negative correlation with banking fraud. Thus for every single bank fraud, liquidity reduces banking fraud by 2.452 times.

4.4.2 Effect of Professional Competence

Table7: Effect of Professional Competence on ROALikert Scale Table

Professional CompetenceLikert 1 * % Return on Assets Cross tabulation

		% Return on Assets					Total
		-1.0	1.0	3.0	4.0	5.0	
Professional CompetenceLikert 1	Strongly agree	0	5	3	4	1	13
	Disagree	1	1	1	2	0	5
	Neutral	0	1	1	0	0	2
Total		1	7	5	6	1	20

65% of the respondents (13 in number), strongly agreed that professional competence affects financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year. The above analysis suggests that the bigger the bank the bigger the bank in terms of assets, the bigger the return on assets.

4.4.3 Effect of International Standards on Auditing

Table 8: International Standards on Auditing-Likert 3 * % Return on Assets Cross tabulation

		% Return on Assets					Total
		-1.0	1.0	3.0	4.0	5.0	
International Standards on Auditing-Likert 3	Strongly agree	1	2	0	1	0	4
	agree	0	4	5	5	1	15
	Neutral	0	1	0	0	0	1
Total		1	7	5	6	1	20

75% of the respondents (15 in number), agreed that international standards on auditing affects financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year.

4.4.4 Effect of Independence of Auditors

Table 9:Independence of Auditors-Likert 4 * % Return on Assets Cross tabulation

		% Return on Assets						Total
		-1.0	1.0	2.0	2.0	4.0	5.0	
Independence of Auditors-Likert 4	Strongly agree	0	1	0	1	1	0	3
	agree	0	2	0	2	5	3	12
	Neutral	1	1	1	2	0	0	5
Total		1	4	1	5	6	3	20

60% of the respondents (12 in number), agreed that independence of auditors affects financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year. 25% (5 in number) mainly from small banks were neutral.

4.4.5 Effect of Operational Audits

Table 10:Operational Audits-Likert 5 * % Return on Assets Cross tabulation

		% Return on Assets					Total
		-1.0	1.0	3.0	4.0	5.0	
Operational Audits-Likert 5	Strongly agree	0	0	0	1	0	1
	Agree	1	6	3	5	1	16
	Neutral	0	1	2	0	0	3
Total		**1**	**7**	**5**	**6**	**1**	**20**

80% of the respondents (16 in number), agreed that operational audits affect financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year. Returns on small banks were 1% or less.15% (3 in number) mainly small banks are neutral.

4.4.6 Effect of Compliance Audits

Table 11:Compliance Audits-Likert 6 * % Return on Assets Cross tabulation

		% Return on Assets					Total
		-1.0	1.0	3.0	4.0	5.0	
Compliance Audits-Likert 6	Strongly agree	1	3	4	6	1	15
	Agree	0	3	0	0	0	3
	Neutral	0	1	0	0	0	1
	disagree	0	0	1	0	0	1
Total		**1**	**7**	**5**	**6**	**1**	**20**

75% of the respondents (15 in number), strongly agreed that compliance audits affect financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year. Another15% (3 in number) agreed.

4.4.7 Effect of Financial Audits

Table 12: Financial Audits-Likert 7 * % Return on Assets Cross tabulation

		% Return on Assets					Total
		-1.0	1.0	3.0	4.0	5.0	
Financial Audits-Likert 7	Strongly agree	1	3	1	6	0	11
	Agree	0	2	3	0	1	6
	Neutral	0	2	0	0	0	2
	disagree	0	0	1	0	0	1
Total		**1**	**7**	**5**	**6**	**1**	**20**

55% of the respondents (11 in number), strongly agreed that financial audits affect financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year. Another 30% (6 in number) agreed.

4.4.8 Effect of Tax Audits

Table 13: Commercial Banks Tax Audits-Likert 8 * % Return on Assets Cross tabulation

		% Return on Assets						Total
		-1.0	1.0	2.0	3.0	4.0	5.0	
Commercial Banks Tax Audits-Likert 8	Strongly agree	1	1	0	2	6	1	11
	agree	0	3	0	2	0	0	5
	Neutral	0	1	0	0	0	0	1
	disagree	0	2	0	1	0	0	3
Total		**1**	**7**	**0**	**5**	**6**	**1**	**20**

55% of the respondents (11 in number), strongly agreed that tax audits affect financial performance. Majority of these were from medium and big banks where ROA averaged between 3% and 5% per year. Another 25% (5 in number) agreed.

4.4.9 Effect of Information Systems Audits

Table 14: Info system Audits-Likert 9 * % Return on Assets Cross tabulation

		% Return on Assets							Total
			-1.0	1.0	2.0	3.0	4.0	5.0	
Info system Audits-Likert 9	Strongly agree		0	1	1	1	3	2	8
	agree		1	1	2	3	0	1	8
	Neutral		0	0	0	0	1	0	2
	disagree		1	0	1	0	0	0	2
Total			**2**	**2**	**4**	**4**	**4**	**3**	**20**

40% of the respondents (8 in number), strongly agreed that information system audits affect financial performance. Majority of these were from medium and big banks. Another 40% (8 in number) agreed.

4.4.10 Effect of Frequency of Internal Control Audits

Table 15: Frequency of Audits greater than once per year by bank size * Internal Controls -Likert 2 Cross tabulation

		Internal Controls			Total
		Strongly agree	agree	Neutral	
Frequency of Audits greater than once per year by bank size	1	5	0	0	5
	2	1	9	0	10
	3	0	0	5	5
Total		**6**	**9**	**5**	**20**

Majority of the respondents 75% indicated internal control reviews of more than once per year. The smaller banks respondents were neutral at 25%.

4.4.11Effect of Professional Competence/frauds

Table 16: Professional Competence-Likert 1 * Experienced fraud in the last 2 years Cross tabulation

		Experienced fraud in the last 2 years		Total
		Yes	Can't say	
Professional Competence-Likert 1	Strongly agree	1	0	1
	Agree	2	0	2
	Neutral	14	1	15
Total		**17**	**1**	**18**

Among the study's objectives was establishing the effect of auditing services in reducing fraud in banking companies in Kenya.

Findings: Bank respondents that strongly agree on professional competence experienced one fraud in the last 2 years. While the banks who agree on professional competence experienced 2 frauds in the last 2 years. And those that are neutral on professional competence experienced many banking frauds (14) in the last two years.

4.4.12 Effect of Professional Internal Controls/frauds

Table 17: Internal Controls-Likert 2 * Experienced fraud in the last 2 years Cross tabulation

		Experienced fraud in the last 2 years		Total
		Yes	Can't say	
Internal Controls-Likert 2	Strongly disagree	7	1	8
	Disagree	10	0	10
	Neutral	2	0	2
Total		**19**	**1**	**20**

Findings: 7 Bank respondents that strongly agree that internal controls affect financial performance experienced frauds in the last 2 years. While 10 bank respondents who disagree on Internal Control experienced frauds in the last 2 years. And 2respondents that are neutral on Internal Controls experienced frauds in the last two years. This implies that frauds can occur and such occurrence may not bare a direct relationship with internal controls.

4.5 Correlation Analysis

4.5.1 Professional Competence

Table 18: Effects of Professional Competence of Auditors and Financial Performance of Banks in Kenya

Scores 5= very strong competence; 4= strong competence; 3= averagely competent; 2= not competent; 1= very weak competence

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Professional competence in fraud detection activities	20	2	3	5	4.55	.686
Professional competence of auditors	18	2	3	5	3.22	.548
Professional competence in capacity	20	3	2	5	4.45	.945
Professional competence in integrity	20	2	3	5	4.20	.768
Professional competence in qualifications	19	2	3	5	4.21	.535
Valid N (listwise)	17					

The study aimed at establishing the level of respondents' agreement on statements that relate to impact of professional competence of auditorsonbanks performance. The findings showed that most of the respondents were in strong agreement with all counts as shown by means of over 3.22 on a maximum scale measure of 5 on all the statements.

4.5.2 Internal Controls

Table19: Effects of Internal Controls on Financial Performance of Commercial Banks in Kenya

Scores 5= very strong controls; 4= strong controls; 3= averagely strong; 2= not strong; 1= very weak controls

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for control audit features in banks systems	20	2	3	5	4.30	.657
Likert score for few intentional audit errors	20	2	3	5	4.45	.605
Likert score for lack of segregation of duties	20	3	2	5	4.20	.951
Likert score for cash receipts having strong controls	20	2	3	5	4.15	.813
Likert score for disclosure of internal control effects on shares	20	1	4	5	4.15	.366
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to the impactof Internal Controlsonbanks performance. The findings show that majority of the respondents were in agreement on all counts as shown by means of over 4.15 on a maximum scale measure of 5 on all the statements.

4.5.3International Auditing Standards

Table 20: Effects of International Auditing Standards on Financial Performance of Commercial Banks

Scores 5= very strong standards; 4= strong standards; 3= averagely strong; 2= not strong; 1= very weak standards

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for use of international auditing standards	20	2	3	5	4.10	.641
Likert score for professional standards as most important contributor	20	2	3	5	4.20	.834
Likert score for auditing standards influence on performance	20	2	3	5	4.35	.671
Likert score for recognizing importance of audit reports	20	2	3	5	4.15	.489
Likert score for auditors objectivity and use of accepted criteria on professionalism	20	2	3	5	4.15	.489
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to International Standards on Auditingonbanks performance. The findings showed that majority of the respondents were in strong agreement with all counts as shown by means of over 4.10 on a maximum scale measure of 5 on all the statements.

4.5.4 Independence of Auditors

Table 21: Effects of Independence of Auditors on financial performance of banks

Scores 5= very strong independence; 4= strong independence; 3= averagely independent; 2= not independent; 1= very weak independence

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for auditing independence essence	20	2	3	5	4.25	.786
Likert score for audit independence from operations of other depts.	20	2	3	5	4.15	.587
Likert score for integrity of auditors	20	2	3	5	4.00	.649
Likert score for independence on effective audits	20	4	1	5	3.75	1.118
Likert score for Internal auditors	20	4	1	5	3.95	1.050
Likert score for audit department independence	20	2	3	5	3.90	.641
Likert score for auditors not having conflict of interest	20	1	3	4	3.60	.503
Likert score for independent audit process free from mgt. control	20	2	2	4	3.65	.587
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to Independence of Auditorsonbanks performance. Majority of the respondents were in strong agreement with all counts as shown by means of over 3.60 on a maximum scale measure of 5 on all the statements.

4.5.5OperationalAudits

Table 22: Effects of operational Audits on financial performance of banks in Kenya

Scores 5= very strong standards; 4= strong standards; 3= averagely strong; 2= not strong; 1= very weak standards

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for operational manuals and procedures	20	3	2	5	3.90	.641
Likert score for Quality control manuals and standards	20	2	3	5	4.00	.459
Likert score for top management support	20	2	3	5	3.95	.510
Likert scale for regularity of operational audits	20	2	3	5	3.90	.447
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate with Financial Auditsonbanks performance. Respondents were in strong agreement with all counts as shown by mean of over 3.90 on a maximum scale measure of 5 on all the statements.

4.5.6Compliance Audits

Table 23: Effects of Compliance Audits on financial performance of banks

Scores 5= very strong standards; 4= strong standards; 3= averagely strong; 2= not strong; 1= very weak standards

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for compliance on environment and safety	20	2	3	5	4.00	.562
Likert score for tax compliance certificate	20	2	3	5	4.40	.681
Likert score for regularity	20	3	2	5	4.60	.821
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to Compliance Auditson banks performance. Majority of the respondents were in strong agreement with all counts as shown by mean of over 4.00 on a maximum scale measure of 5 on all the statements.

4.5.7Financial Audits

Table 24: Effects of Financial Audits on financial performance of banks

Scores 5= very strong standards; 4= strong standards; 3= averagely strong; 2= not strong; 1= very weak standards

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for regularity	20	3	2	5	4.50	.889
Likert score for consistency	20	2	3	5	4.50	.761
Likert score for fraud reports	20	3	2	5	4.30	.865
Likert score for reputation of external auditors	20	3	2	5	4.35	.875
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to Financial Audits onbanks performance. Majority of the respondents were in strong agreement with all counts as shown by mean of over 4.30 on a maximum scale measure of 5 on all the statements.

4.5.8Tax Audits

Table 25: Effects of Tax Audits on financial performance of banks

Scores 5= very strong standards; 4= strong standards; 3= averagely strong; 2= not strong; 1= very weak standards

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for tax issues in last 2 years	20	3	2	5	4.60	.883
Likert scale for tax compliance	20	3	2	5	4.40	.995
Likert score for tax consultancy engagement	19	3	2	5	4.11	1.049
Likert score for tax audit regularity	20	3	2	5	4.20	1.105
Valid N (listwise)	19					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to Tax Audits on banks performance. Majority of respondents were in strong agreement with all counts as shown by mean of over 4.11 on a maximum scale measure of 5 on all the statements.

4.5.9Information Systems Audits

Table 26: Effects of Information Systems Audits on financial performance of banks

Scores 5= very strong standards; 4= strong standards; 3= averagely strong; 2= not strong; 1= very weak standards

	N	Range	Minimum	Maximum	Mean	Std. Deviation
Likert score for keeping pace with current audit innovations	20	3	2	5	4.40	.995
Likert score for information system auditors	20	3	2	5	4.05	1.099
Likert score for External information audit regularity	20	3	2	5	3.95	1.050
Likert score for Information system audit regularity	20	3	2	5	4.10	.968
Valid N (listwise)	20					

The study aimed at establishing the level to which respondents are in agreement of disagreement with statements that relate to impacts of Information System Auditson. Majority of the respondents were in strong agreement with all counts as shown by mean of over 4.05 on a maximum scale measure of 5 on all the statements.

4.6 Regression Analysis and Hypotheses Testing

Table 27: Model Summary

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		
					R Square Change	F Change	df1
1	.812[a]	.660	.490	1.05655	.660	3.879	6

The findings in Table 27 above show that the value of adjusted R^2 which is also referred to the coefficient of determination is 0.490which suggests that there is 49.00% variation on financial performance of commercial banks as a result of change in audit standards, independence of auditors, professional competence, other types of audits listed above and internal controls at 95% confidence interval. This shows that a 49.00% change in banks performance can be explained by changes audit services. It was also established that performance of commercial banks and audit services were strongly and positively relatedas shown by correlation coefficient of 0.812.

Table 28: Coefficients

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.044	3.978		.262	.797
	Mean score for tax audit	1.744	.915	.964	1.906	.081
	Means score for Information system audit	.994	.580	.629	1.714	.112
	Mean professional competence score	2.094	.755	.582	2.774	.014

The established regression equation is:

$Y = 1.044 + 1.744X_1 + 0.944X_2 + 2.094X_3$

From the regression equation, the study revealed that holding international audit standards, independence of auditors, professional competence, internal controls and various types of audit services to a constant zero, financial performance of commercial banks would stand at 1.044. A unit increase in various audit service categories would lead to increasesin banks performance bythe factors indicated in the above equation for each category. The independent variables of tax audits, information systems audit and professional competence are significant as shown on the table of coefficients.

4.7 Discussion of Research of Findings

The study findings reveal that changes in audit services, internal controls, bank size and liquidity result to variations that are witnessed in banks performance. This suggests that changes in those factors could account for change in performance of the banks.

Eden (1996) established that there was significant improvement in performance for the experimental banks while the control banks had lowered business conditions. The study offered a point to jump off to comprehend on importance of auditing in improving the performance of the company, it doesn't further explain when and why IA functions, and conditions facilitating or impeding it. This study will greatly contribute in filling this gap.

Cooper and Craig (1983) established some misconceptions regarding what internal auditors did and the perception of them by their CEOs.The CEOs expected more of IA than the traditional work of auditing conducted previously.

Basel Committee report (2002) indicated that every single bank needs to have a permanent IA function for the purpose of fulfilling its responsibility as well as mandate. It is the duty of senior management to take all measures needed to ensure that the bank can continuously rely on reliable IA function which is appropriate based on the size and nature of operations. Normal measures are inclusive of provision of appropriate resources as well as staffing to IA and selection of external audit in an appropriate manner. ErnstandYoungestablished that 75% of the respondents believed that management of risk that is strong positively affects the performance of their long term earnings. The same number of respondents also believed that IA function positively affects their general efforts of managing risk. With the evolvement of IA, the expectations of shareholders increases, IA function increasingly needs competency exceeding more traditional skills, like the ability of teaming with management and business units on issues of business that are relevant.

Mawanda (2008) found significant relationship systems of internal controls and performance financially. The recommendation was to have profiling that is competent in departments of IA which is based on the expectation of the university on what should be done by IA and the appropriate number of staffs needed for the job.

Mutua (2012) established that auditing whose basis is risk through standards of internal audit and staffing need to be improved to make sure that companies have the ability of timely detecting risks and concentrating on areas of high risks resulting to more transparency and accountability, therefore increasing performance financially. It was established that IA and performance financially are related.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter summarizes the findings, conclusions, recommendations, limitations of the study and suggestions for further research.

5.2 Summary of Findings

The study aimed to establish the association between audit services and the financial performance of commercial banks in Kenya. The source of information was primary data that was gathered from 20 respondents which were one senior staff respondent from the finance department was picked from each bank and secondary data. Quantitative and regression analysis were applied in analyzing data collected.

It was established that audit services, internal controls, fraud and liquidity affect banks performance.

It was found that most of the respondents associate decline or increase in assets and profitability to the level of execution of strategic plans, market intelligence and adaptation to the operating environment.

The study established that bank liquidity seems to have a negative correlation with bank fraud.

The study also established that regardless of bank size, the more a bank shifts upwards in size there is a likelihood of reducing fraud.

The study found that bad management practices such as large insider loans without proper security, creative or false accounting or collusion with external and internal auditors, conflict of interest and other governance issues were cited as some of the reasons why some banks suddenly collapse after reporting healthy financial performances. To remedy this anomaly majority of respondents suggested mandatory change of auditors say, after every 3 years. In addition, legislation leading to heavy sanctions such as fines and long jail terms for violators involved in illegal practices.

5.3 Conclusion

The study established that variation in banks performance existed as a result of changes in levels of audit services, internal controls and bank size. There was however no direct correlation between liquidity, bank size and financial performance. It was further concluded that there is need for auditors to be independent in personnel and activities of operation of the banks in order be effective.

5.4 Recommendations

There is need for auditors, both external and internal to continuously update themselves with the changing times in terms of professional developments, standards and technologies to be effective. This is because applying their skills to crucial areas and building personal and professional competence increases their credibility and recognition when responding to client needs. This approach will make auditors become more valuable to stakeholders as they will have potential to enhance good governance and operational efficiency in the organizations they work for.

5.5 Limitations of the Study

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

Another limitation of the study was level of precision of the collected information collected from the respective respondents. The source of secondary data was each bank’s websites. The figures so obtained were presumed to be an accurate representation.

The study was also limited to establishing the impact of audit services on banks performance in terms of finances.

The design that was used was descriptive research design whereby the researcher could control the variables. Questionnaire was used as tool for collecting data; because the duration for data collection was limited to a span of 2 weeks.

5.6 Suggestions for Further Research

A similar study should be done on Manufacturing Companies in Kenya and other sectors of the economy including government Ministries and Departments.

A study should be carried out to establish the challenges that face audit profession especially regarding ethics and its association to top management and the professional and legal framework in which it operates. This will help in enhancing knowledge in this area which can give some insights into how it impacts governance, financial performance and overall operational efficiency.

There is need for a study to be carried out to determine why some companies suddenly collapse after consistently reporting good financial performances in immediate preceding years.

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Appendix I: List of Licensed Commercial Banks in Kenya

1. Bank of Africa
2. ABC Bank (Kenya)
3. Bank of Baroda
4. Bank of India
5. Barclays Bank
6. Brighton Bank
7. CFC Stanbic Bank
8. Chase Bank (Kenya)
9. Citibank
10. Commercial Bank of Africa
11. Consolidated Bank of Kenya
12. Cooperative Bank of Kenya
13. Credit Bank
14. Development Bank of Kenya
15. Diamond Trust Bank
16. Dubai Bank Kenya
17. Ecobank
18. Equatorial Commercial Bank
19. Equity Bank
20. Family Bank
21. Fidelity Commercial Bank Limited
22. Fina Bank
23. First Community Bank
24. Giro Commercial Bank
25. Guardian Bank
26. Gulf African Bank
27. Habib Bank
28. Habib Bank AG Zurich
29. I&M Bank
30. Imperial Bank Kenya

31. Jamii Bora Bank
32. Kenya Commercial Bank
33. Sidian Bank
34. Middle East Bank Kenya
35. National Bank of Kenya
36. NIC Bank
37. Oriental Commercial Bank
38. Paramount Universal Bank
39. Prime Bank (Kenya)
40. Standard Chartered Kenya
41. Trans National Bank Kenya
42. United Bank for Africa
43. Victoria Commercial Bank

Appendix II: Questionnaire

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

SECTION: A –Institutional memory

1.How long have you worked in the organization?

Less than 2 years [ ] 2-5 years [ ] 6-10 years [ ]

More than 10 years [ ]

2.How would you classify your bankrelative to other banks in Kenya?

Small size [ ] Medium [ ] Large size [ ]

3. Has your bank experienced fraud problems in the last two years?

Yes [ ] No [ ] can't say [ ]

4. How many frauds?...

SECTION B - Professional competence

5. How many financial audits have you done in the last 2 years? …………….

6. What is your level of agreement with the following statements that relate to professional competence of auditors and financial performance of commercial banks in Kenya? (1-strongly agree, 2- agree, 3-neutral, 4-disagree, 5-strongly disagree)

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

SECTION C - Internal Controls

7. What is your level of agreement with the following statements that relate to internal controls and financial performance of commercial banks in Kenya? (1-strongly agree, 2- agree, 3-neutral, 4-disagree, 5-strongly disagree)

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

8. What was the closing bank balance sheet Assets value in millions of Kshs:

2014…………., 2015. 2016……………..,2017…………………….

9. What was the profit posted by the bank in the last 4 years in mill? Kshs? 2014…………., 2015.…………, 2016……………..,2017……………………

10. What is the growth % in assets posted by the bank in the last 4 years? 2014…………., 2015. 2016…………….., 2017…………………….

11. What is the amount of bank capital base growth % in the last 4 years?2014…………., 2015. 2016…………….., 2017…………………….

12. What factors do you associate with either growth or decline of items 9-12 above? List factors by what area of financial performance they do affect

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SECTION D - International Standards on Auditing

12. What is your level of agreement with the following statements that relate to international auditing standards and financial performance of commercial banks in Kenya?

(5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	**5**	**4**	**3**	**2**	**1**
Performing auditing work according to international auditing standards contributes significantly to influence the effectiveness of auditing					
Complying with professional standards is the most important contributor to audit's added value					
Standards for audits and audit-related services influence the performance of commercial banks					
Formal auditing standards recognize that auditors also provide services regarding information other than financial reports					
Auditors carry out their role objectively and in compliance with accepted criteria for professional practice					
Audits evaluate and contribute to the improvement of risk management, control and governance using a systematic and disciplined approach in the banking					

SECTION E - Independence of Auditors

13. What is your level of agreement with the following statements that relate to Independence of Internal Audit and financial performance of commercial banks in Kenya? (5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	**5**	**4**	**3**	**2**	**1**
Independence is the essence of auditing					
An internal auditor must be independent of both the personnel and operational activities of an organization					
The integrity of the auditor's opinions, conclusions and recommendations would be suspect					
Independence is necessary for the effective achievement of the function and objective of an audit					
Banking organizations acknowledge that every bank should have an internal audit department on which with regard to the volume and nature of its activities it can rely					

The internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day-to-day internal control processes					
Internal auditors may not have a conflict of interests with the bank					
Every bank should have formalized principles of internal audit providing for its position and powers in the framework of the bank					

SECTION F - Operational audits

14. What is your level of agreement with the following statements that relate to Operational Audits and financial performance of commercial banks in Kenya?

(5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	**5**	**4**	**3**	**2**	**1**
Each department in the bank has operations manuals detailing procedures and processes guiding various business activities and setting standards of performance					
Quality control manuals are in place and are revised regularly to match current industry standards and trends					
Top Management has ensured the existence of an audit committee with a working framework and processes to support the audit function and follow up on implementation of audit recommendations					
Operational audits are done regularly in the bank by qualified auditors					

15. In the last two years, did operational audits confirm good bank practices/procedures? Yes/ No ………….. (Tick appropriately)

16. If yes, in which areas? (Explain)…………………………………

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17. If No, explain………………………………………………………….

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SECTION G - Compliance audits

18. What is your level of agreement with the following statements that relate to compliance audits and financial performance of commercial banks in Kenya?

(5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	**5**	**4**	**3**	**2**	**1**
My organization has compliance certificates pertaining to environmental and safety issues					
My organization has tax compliance certificate					
Compliance audits are done regularly in the bank to meet statutory and legal requirements					

SECTION H - Financial audits

19. What is your level of agreement with the following statements that relate to financial audits and financial performance of commercial banks in Kenya?

(5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	**5**	**4**	**3**	**2**	**1**
Financial audits are done regularly at least twice per year					
My organization has consistently obtained a clean bill of health after each financial audit					
There have not been major reports of fraud in our organization in the last two years					
Our external auditors are among the big four in the country and have a good reputation					

SECTION I –Tax Audits

20. What is your level of agreement with the following statements that relate to tax audits and financial performance of commercial banks in Kenya?

(5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	5	4	3	2	1
My organization has not had tax issues in the last two years					
My organization is tax compliant					
My organization engages a tax consultant					
Tax audits are done regularly in the bank					

SECTION J - Information System Audits

21. What is your level of agreement with the following statements that relate to information systems audits and financial performance of commercial banks in Kenya?

(5-strongly agree, 4- agree, 3-neutral, 2-disagree, 1-strongly disagree)

Statement	5	4	3	2	1
My organization keeps pace with new developments and innovations in information systems and adopts as necessary					
My organization has information system auditors					
External information system auditors regularly review the adequacy of the banks information systems					
Information systems audits are done regularly in the bank					

22.Inyour opinion:

(a) Why do some banks collapse soon after reporting impressive financial performance figures and obtaining a clean bill of health from their auditors?

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(b) Briefly suggest how the above anomaly may be resolved:

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23.Indicate whether yourbankperforms these types of audits:

Financial Yes [ ] No [ ]

Compliance Yes [ ] No [ ]

Information Systems Yes [ ] No [ ]

OperationalYes [ ] No [ ]

Internal Control Yes [ ] No [ ]

Tax Yes [ ] No [ ]

24. If the answer to any of the above type of audits is yes, please indicate frequency per year:

Financial	once	[ ]	twice	[ ]	>twice	[ ]
Compliance	once	[ ]	twice	[ ]	>twice	[ ]
Information Systems	once	[ ]	twice	[ ]	>twice	[ ]
Operational	once	[ ]	twice	[ ]	>twice	[ ]
Internal Control	once [ ]twice		[ ]	> twice	[ ]	
Tax	once	[ ]	twice	[ ]	> twice	[ ]

25. Howoften does your bank do Internal Control Reviews per year?
<Once [] Once [ ] twice [ ]> twice [ ]

SECTION K: Demographic Information

26.Gender

Female [ ] Male [ ]

27. Indicate where you fall among the following age brackets (years)

Below 25 [ ]

25-34 [ ]

35-44 [ ]

45-50 [ ]

Above 51 [ ]

28. Level of education

Bachelor’s Degree Level [ ] Masters Level [ ]

PhD [ ] Diploma [ ]

Others [ ]