

**FACTORS INFLUENCING EFFECTIVENESS OF INTERNAL AUDIT IN
THE BANKING SECTOR IN KENYA**

BY

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DECLARATION

I declare that this thesis is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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ABSTRACT

Internal audit aids organization to achieve its objectives by systematic evaluation of its risk management, governance processes and control activities. The execution of IA in the banking sector is envisioned to lessen organizational risks emanating from administration of financial resources and also increase the financial sectors' performance hence safeguarding against bank failure. However Kenya has not been left out in bank failures in 2015/2016, three banks failed or placed under receivership including Dubai Bank, Imperial Bank and Chase bank. This study sought to determine factors influencing Internal Audit effectiveness in the banking sector in Kenya with special focus on the commercial banks in Nairobi. The study adopted a cross sectional descriptive research design involving administration of questionnaires to a sample of internal auditors from all the 40 commercial banks in Nairobi. Data analysis was carried out using SPSS version 20. The results indicated that IA in commercial banks was relatively effective and thus acted as value added service to the banks. The bank management should ensure IA has enough staff as well as ensure presence of sufficient certified IA.

Key words: Internal audit, Internal control systems, Audit inputs, Audit environment, Audit processes, internal audit effectiveness, Audit output and Commercial banks.

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DEDICATION

I purely dedicate this achievement to my brother George Morara who all through has been instrumental, my beloved wife Gladys Kwamboka for the support and not forgetting my beloved children who at times would bear with my situation Samuel, Job, Joshua and Amos God bless you.

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ACRONYMS AND ABBREVIATIONS

CBK	Central Bank of Kenya
IA	Internal Audit
IIA	Institute of Internal Auditors
ICS	Internal Control System
KCA	Kenya College of Accountancy
SPSS	Statistical Package for Social Sciences
OCC	Office of the Comptroller of the Currency

DEFINITION OF TERMS

Internal Audit - Is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations (IIA, 2016).

Internal Audit Effectiveness – Ability of internal audit to contribute to an organizational governance processes, its control activities as well as how they manage risks by encouraging suitable ethics and values, safeguarding organizational performance management and answerability, collaborating risk control information and coordination of governance-related undertakings (IIA, 2016).

Audit Environment: These are general outlook of the relationship of personnel involved in auditing process and the general outlook of the organization at large (Pungas, 2003).

Audit Inputs: These are things that are used during the audit process including personnel and other resources required for functionality of the internal audit.

Audit Outputs: These are the end products of an audit process which include policies, plans, proposals, reports, recommendations and regulations (Pungas, 2003).

Audit Processes: These are the steps followed by an internal audit to ensure a successful audit which include requesting for documents, preparing an audit plan, scheduling an opening meeting, conducting fieldwork, drafting an audit report and setting up a closing meeting (Pungas, 2003).

Internal Control System: The entire network of systems setup within an entity to deliver realistic assurance that the entity goals will be accomplished (IIA, 2016).

CHAPTER ONE

INTRODUCTION

Background to the Study

According to Institute of Internal Auditors, Internal Audit (IA) is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. These are activities carried out by an organization's management and other staff members intended to offer realistic assurance concerning effectiveness and efficiency of processes, consistency of financial reporting, compliance with appropriate laws and regulations and preserve organizational assets (Gamage, Lock & Fernando, 2014). Internal auditing is an autonomous and objective evaluation of the organizational processes and consulting actions intended for value addition to the organization and enhance the operations of the organization (Cohen, Krishnamoorthy & Wright, 2002; GoodwinStewart & Pamela Kent, 2006).

IA helps an entity to meet its objective and goals by bringing a systematic and a disciplined approach to evaluate and improve effectiveness of risk management, control and governance processes. It is part of Internal control systems (ICS) which consists of the entire network of systems setup within an entity to deliver realistic assurance that the entity goals will be accomplished (Wainaina, 2011; Nyakundi, Nyamita & Tinega, 2014). IA is part of organizational risk assessment which is the determination and examination of pertinent risks attendant to accomplishing the entities' objectives (Karagiorgos,Drogalas, Eleftheriadis & Christodoulou, 2009). According to Douglas (2011), IA encompasses an organizational plan and as well synchronized measures and methods embraced by an entity geared towards ensuring

safety of its assets, checking the accurateness and consistency of its accounting information, uphold efficiency in operations, and buoy up observance of the laid down managerial policies.

Therefore internal audit aids organization to achieve its objectives by a systematic evaluation of its risk management, governance processes and control activities hence promoting good governance (Cohen, Krishnamoorthy & Wright, 2008). This implies that IA is critical to addressing threats that are likely to affect the organization such as fraud and corruption. In addition the ultimate goal of IA is to advance organizational efficiency and effectiveness by offering the management constructive criticism thereby imploring further opportunities through which the management can strengthen ICS hence good corporate governance (Cohen & Sayag, 2010).

A well-functioning IA is key to monitoring and promotion of good governance system in an organization (Cohen, Krishnamoorthy & Wright, 2002). According to Giriunas (2009), IA might support an entity's competitive advantage within the prevailing economic circumstances, unravel problems stumble upon effectively, encourage prudent utilization of accessible organizational resources, curb organizational expenditure, prevent pilferage of resources and therefore attract more investors. This implies that IA is an important component of good corporate governance not only in private sectors but also the public sectors (Lemi, 2015). Particularly, the execution of IA in the banking sector is envisioned to lessen organizational risks emanating from administration of financial resources and also increase the financial sectors' performance (Douglas, 2011; Ondieki, 2013; Waweru & Kalani, 2009).

Being cognizant of the critical role of IA in an organization, it is therefore

imperative that IA delivers timely and detailed reports (Bota-Avram, 2011; Bota-Avram & Rachisan, 2013). This implies that IA has to function effectively if it has to achieve the objectives set. To effectively execute its function the IA has to have: independence to make decisions regarding processes, prescribed mandate (existence of approved audit charter), unrestricted access, enough funding, knowledgeable and experienced leadership and staff, presence of audit committee, stakeholder backing, adoption of prescribed professional audit standards and unconstrained scope within organization (Belay, 2007; De Smet & Mention, 2011)

Banks consider IA as a backbone of managing risks; it forms the cushion against bank failure (Gup, 1998). This is because majority of bank failures is attributable to excessive uptake of risky banking services with significant effects on bank's liquidity (Karrberg & Sellman, 2012). Globally it is estimated that about 500 banks failed during the Great Recession of between 2005 and 2013 (Barton, Hodder, & Shepardson, 2014). Kenya has not been left out in bank failures, in 2015/2016, three banks failed (Waweru & Kalani, 2009; Juma, 2016). Bank failures is considered to have disastrous effects on a country's economy as there will be depositors fear and flight making hence limiting the country ability to mobilize savings and deepen financial accessibility.

1.1.1 Effectiveness of internal audit

Internal audit is said to be effective if it achieves that which it is intended to or the capacity to obtain results that are consistent with targets (Sawyer, 1995; Arena and Azzone, 2009) Effective IA undertakes an independent evaluation of financial and operating information systems and procedures, to provide useful recommendations for appropriate improvements. The effectiveness of internal audit greatly contributes to the effectiveness of the organization at large both individually and as a corporate

(Dittenhofer, 2001; Spraakman (1997), applying the theory of transaction cost economics, it demonstrates how internal audit recommendations are important to the management of government organizations. Internal audit effectiveness can either focus on the internal audit's ability to plan, execute and objectively communicate useful findings (Xiangdong, 1997; Spraakman, 1997; Dittenhofer, 2001) or taken a broader perspective and include factors that transcend the boundary of a single organization (Van Gansberghe, 2005) Since, audit effectiveness fosters the achievement of a common goal, there would be a natural incentive in an organization to improve it.

1.1.2 Factors influencing effectiveness of IA

In this study I focused on three potential factors; internal audit inputs brought in due to experience, technical and soft skills of audit staff, another factor is internal audit processes which include management support, independence of IA and relationship with external auditors. Internal audit environment is one of the factors in focus which also touches on organizational setting and attributes to explain audit effectiveness (Pungas, 2003). Internal audit quality, which is determined by the internal audit department's capability to provide useful findings and recommendations, is central to audit effectiveness. Internal audit has to prove that it is of value to the organization and earn a reputation in the organization (Sawyer, 1995). Internal audit has to evaluate its performance and continually improve its service (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.

Audit findings and recommendations would not serve much purpose unless

management is committed to implement them. Adams (1994) argues that Implementation of audit recommendations is highly relevant to audit effectiveness (Van Gansberghe, 2005) and the management of an organization is viewed as the customer receiving internal audit services. As a result, management's commitment to use audit recommendations and its support in strengthening internal audit is vital to audit effectiveness (Sawyer, 1995). Management retains the authority to improve the organizational setting and influence the auditee towards a positive effect on audit effectiveness, which in turn, benefits audit quality. Governance framework, organizational perceptions and ownership, organizational setting, legislation, improved professionalism, conceptual framework and adequate resources are among the factors that influencing internal audit effectiveness (Cohen & Sayag, 2010; Van Peurseem, 2005).

1.1.3 Banking sector in Kenya

Banks in Kenya are established under the Banking Act Cap 488 and regulated under the provisions of the Central Bank of Kenya Act Cap 491 of the Laws of Kenya. The Banking Act Part II Sec 4(1) & (2) gives the Minister of Finance powers to license any institution intending to carry out banking business in Kenya on recommendations from the Central Bank Of Kenya exclusive inspection powers on any licensed banking institutions to ensure that they conform with the rules and guidelines issued by the Central Bank of Kenya from the time to time.

The number of financial institutions currently operating in Kenyan market is 42 commercial banks according to the Central Bank of Kenya listing (2016). CBK is mandated to regulate, monitor and protect the banking system including all commercial banks as a supervisory body; this is meant to ensure order, efficiency and

effectiveness as well as ensuring welfare and public policy growth. One problem is that it is almost impossible to find a banking system where there is no intervention (Nicholl, 1996).

What then is the role of the CBK as a supervisor? The supervisor's primary role is damage control. The form of the damage control in banking begins with diagnosis, assessments and evaluation of problems or risks on a timely basis (Sheng, 1996). Minimize moral hazard behaviour, connected lending, conflicts of interest, fraud and mismanagement through effective regulation backed by a good legal regulation framework. Financial sector liberalization is going through a phase of re-regulation with a broader coverage extending not only to the banking sector but also to non-banking financial intermediaries (Sheng, 1996). Banks are particularly subject to market failures arising from asymmetries of information. On the asset side, they take on the risk of valuing projects and funding borrowers whose ability to repay is uncertain (Kithinji & Waweru, 2007). On the liability side, the confidence of creditors and deposits who have imperfect information on the bank's actual position is essential to a bank's ability to provide deposits and payments services. High leverage and the illiquidity and in transparency of bank assets render banks particularly vulnerable to losses of creditors' confidence.

Section 107 of the Banking Act prohibits banks from lending to any individual or group of companies more than 25 percent of Capital and Reserves (Central Bank, 2013). This section has been a contentious issue and has been blamed for the collapse of many banks in Kenya. Banks continue to lend more than this percentage to people, especially directors. Therefore Central Bank supervisory department has to be stricter to ensure total compliance to avoid such a practice in the future. Another area is insider lending which involves giving loans to bank officers without abiding to the

rules and regulations of Central bank. The regulation of the banking system is important not only for purposes of the reduction of possibility of bank failure or minimizing depositors' possible loss, but because banking sector collapse is a systemic risk which may impact heavily and negatively in other areas of macro economy (Nicholl, 1996).

1.1 Statement of the Problem

The Kenyan Vision 2030 seeks to attain vibrant and competitive financial sector which will not only deepen financial inclusion among the citizens but also ensure efficient and effective delivery of financial services (Mwega, 2014). This will result in protection of depositors and fair return on investment to the shareholders of the commercial banks thus contributing to general stability of the banking industry within the country. However, there have been cases of financial misappropriation and non-adherence to Central Bank of Kenya (CBK) set policies (Akelola, 2014). Over the recent past this has seen commercial banks being winded up with some being placed under receivership. Some of these cases include Dubai Bank, Imperial Bank and Chase Bank. In addition Family Bank has been touted to have not adhered to anti-fraud regulations and thus facilitated the siphoning of money meant for the National Youth Service while there have been cases of insider trading in Co-operative Bank. Being cognizant of this, CBK has been championing to entrench a culture of good corporate governance in financial sector in Kenya.

It has been recognized that good corporate governance will curtail pilferage of banks' resources hence boosting its financial performance (Okibo & Kamau, 2012; Al-Shetwi, et al., 2011; Ondieki, 2013). A well-functioning IA enables early fraud

detection and reduction (Unegbu & Kida, 2011) therefore reducing reporting errors (Gordon & Smith, 1992; Rahmatika, 2014) hence increased investor confidence (Holt & DeZoort, 2009). The numerous scandals therefore witnessed could be an indication of failure of the IA in advocating for enforcement of good governance (D'Silva & Ridley, 2007). Despite these inadequacies in corporate governance indicated in glaring lack of accountability there has been no study which has been carried out to evaluate the factors affecting functionality of IA among commercial banks in Kenya. Therefore this study sought to fill this gap by exploring the factors affecting effectiveness of Internal Audit in Kenyan commercial banks.

1.2 Objective of the Study

The general objective of the study was to determine factors influencing effectiveness of Internal Audit in the banking sector in Kenya with special focus on the commercial banks in Nairobi.

Specific Objectives

1. To determine the influence of audit inputs on Internal Audit effectiveness in commercial banks in Nairobi.
2. To assess the contribution of audit process on Internal Audit effectiveness in commercial banks in Nairobi.
3. To evaluate the influence of audit environment on Internal Audit effectiveness in commercial banks in Nairobi.

1.3 Research Questions

The researcher sought to answer the following questions in the course of the study.

1. How do audit inputs influence Internal Audit effectiveness in commercial banks in Nairobi?
2. What is the contribution of audit processes on Internal Audit effectiveness in commercial banks in Nairobi?
3. What is the influence of audit environment on Internal Audit effectiveness in commercial banks in Nairobi?

1.4 Justification of the Study

According to Al-Shetwi, et al., (2011), effectiveness IA is associated with financial performance. This is attributed to the fact that a well-functioning IA is able to detect fraud early enough thus enabling design of measures to prevent it from happening. Furthermore an effective IA was to enable the design of measures on risk mitigation hence minimizes the possibility of occurrence of organizational risks (Unegbu & Kida, 2011). In addition an effective IA is expected to reduce chances of occurrence of error reporting hence driving further improvement not only in quality of financial report but also quality of audit reports (Gordon & Smith, 1992; Rahmatika, 2014). With reliable financial reports and actionable audit reports, the corporate governance within the financial sector is expected to improve hence increased investor confidence thus better chances of economic growth (Holt & DeZoort, 2009). However, the banking sector in Kenya has been plagued with significant financial misappropriation and non-adherence to regulations set by CBK hence casting doubts in to performance of IA and subsequent corporate governance within the commercial banks. It was therefore imperative that this study evaluated what factors affected the effectiveness of IA in an attempt to bolster good corporate governance within the Banking sector.

1.5 Significance of the Study

This study sought to fill the current literature gap on factors influencing effectiveness of IA in its attempt to provide assurance of internal controls, risk management and compliance with applicable rules and regulations. As such the regulator, that is the CBK, will expectantly use the information generated in the formulation and implementation better internal control processes while also effectively seeking for ways to address challenges hindering effective and efficient IA to enable the commercial banks better its corporate governance.

The study provided critical information that was going to help management to appreciate the challenges faced by internal audit function to effectively play its role in the organization and help solve them. This will thus enable the management to be better stewards in safeguarding not only the shareholders' interests but also protecting deposits made by customers. The findings will be of value also to the shareholders as it will enable them to know whether their investment are properly safeguarded and enable them seek further ways of safeguarding their investments. The study is also expected to have significant contribution to empirical and theoretical literature on effectiveness of IA. This is of importance to researchers in the area of internal audit and banking. The study also formed a basis for future researchers who may want to explore how financial resources are managed within commercial banks.

1.6 Scope of the Study

The study focused on factors influencing effectiveness of IA in the banking sector. This study covered all commercial banks within Nairobi County which were fully functional at the time of the study. The study only involved 40 internal auditors while

investigating on IA inputs, IA processes and IA environment in relation to IA effectiveness.

1.7 Limitations of the Study

The researcher anticipated that there could have been lack of cooperation from the interviewees, especially being senior managers of internal audit who may not be too willing to spend time answering questionnaires. Some respondents might have not appreciated the importance or significance of the study and hence could ignore the questionnaires altogether. To control such possibilities the researcher took time explaining to the respondents on the importance of the research, design an anonymous questionnaires and give assurance that information was only meant for study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the review of the theoretical review underpinning the study variables, the conceptual framework showing the relationship among the study variables in review of other similar studies.

2.2 Theoretical Framework

This part covers major theories underpinning various aspects of the phenomena under investigation in this study.

2.2.1 *Agency Theory*

Agency theory is of the opinion that corporate governance being a contractual mechanism positioned to monitor administration on behalf of the shareholders in an attempt to address the split-up in control and ownership in an organization (Cohen, Krishnamoorthy & Wright 2008; Hermanson, Tompkins, Veliyath & Ye, 2012). According to this theory, the management is observed to be opportunistic self-centered actors, who mostly favour their own wellbeing over the wellbeing of those they represent without being cognizant of the effect of their act to those they represent. Therefore to counter this behaviour, the contractual contrivances tend to bring into line management objectives with the objectives of the principal as well as establishment of systems to diminish asymmetry of information between management and owners thus reducing the unscrupulous behaviour of the management who now appreciate that they cannot mislead the monitors (Cohen et al., 2008).

In this case internal audit serves as a link between the owners and the management because the management accepts to guarantee against malpractices by execution of checks in the operations of the company by engaging identified persons to execute the checks (Deegan, 2009). Thus internal audit in the organization serves as an oversight the corporate governance hence underscoring the need of an effective internal audit. Therefore as an agent the management of an organization reveals its societal and environmental engagements in their annual reports and educates the public of the undertakings and state of the organization (Taylor, Sulaiman & Sheahan, 2001). Thus agency theory may possibly elucidate the reason why organizations carry out internal audits as safeguard of the shareholders' interests (Abdullah, 2014). Agency theory can be used to explain that it is in the interest of management to maintain a strong internal audit department. Using agency theory, Xiangdong (1997) explained the role that internal audit plays in an economy and points out that internal audit has an advantage over external audit in obtaining information quickly and finding problems at an earlier stage, hence this theory is of great value to this study to enable the researcher to understand any conflicting interests amongst the management and shareholders of an entity.

2.2.2 Role Theory

Role theory indicates that individual actions contained by situations, situations that govern individuals' acts are directed on a social basis which determines the roles of an individual (Ebimobowei & Kereotu, 2011). The person in context therefore must embrace roles determined by the situation for them to accomplish their assigned duties successfully within the situation. In this theory, individuals role within an

organization encompasses particular behavioral forms that are essential in executing a specific tasks assigned to a position within an institution.

The notion of a role in this theory accentuates the element that staff at work continually make personal analysis of the way they are expected to behave within the setting in where they work being cognizant of other employees whose actions might affect. These other employees have anticipations of what role an individual is expected to play and therefore if the individual fulfils the expectations laid he would be considered to have effectively played the role. Therefore there can be incompatibility in what other stakeholders within organization expect the internal auditor to perform and what the internal auditor actually performs.

Within the organization the management expects the internal auditor to act as a consultant as well as provides assurance of procedures within the institution (Stewart & Subramaniam, 2010; Vu & Segura, 2015). This creates role ambiguity for the internal auditor. In addition the internal auditors do not consider their role as acting as a deterrent to financial embezzlement while on the other hand the management expects the internal auditor to avert, discover and report misappropriation this conflict in expectation therefore impedes the performance of an internal auditor as well as assurance of the internal control systems within the organization (Ahmad & Taylor, 2009).

2.2.3 Communication Theory

Lewis and Graham (1988) mentioned that, communication comes from the Latin word “communicare” which means to make common. Thus, to communicate is the process of creating a common meaning with an individual, a group or an entity. Communication is the transfer of meaning or mutual understanding among at least

two parties to share information about a subject or issue and arrive at an agreed upon meaning (Guo, 2009). In accordance with the needs of the IIA as the professional body that takes care of internal auditing, several studies such as by (Davidson 1991; Quinn & Hargie 2004, Golen 2008), confirm the importance of and the need for effective communication skills in all organization functions. Lewis & Graham (1988), Smith (2005) in their studies they suggest some of the ways of improving communication skills.

Studies by Hahn & Golen (2008) have discussed communication barriers and how they can be eliminated. All these studies are in agreement that effective communication and interpersonal relationships between managers and staff have a strong contribution to improve profitability and productivity hence, higher quality of services and products, cost reduction and high level of efficiency and effectiveness (Clampitt & Downs, 1993). According to both IIA Standards and previous studies, the study of effective communication in internal auditing is very crucial.

Davidson (1991) confirms that, all auditors can benefit from knowledge of current communication concepts and even those who believe they are good communicators need to work consciously on assessing, improving, and applying their skills. Inability to communicate effectively could be related to inappropriate information or communication complexity. Hahn (2008) confirmed that much information is as bad as little information because it reduces the receiver's ability to concentrate effectively on the most significant messages. In such an environment, internal audit users may have new concerns about their trust for internal auditors' performance thus, the essence of effective communication as a solution to this problem. To overcome such communication problems, Hahn (2008) recommends parties of the communication process to focus and offer only the necessary

information by easy ways to provide meaning to the information rather than just pass on the message, and keep the information clear and simple to understand and finally ask for feedback.

The existence of effective communication between internal auditors themselves, internal auditors and auditees, internal auditors and organization members, without any doubt, is needed to strengthen the internal audit effectiveness. Importance of effective communication extends to include the relationship between internal auditors and auditees, which can be explained under the communication theory. In this study, effective communication is one of the main factors for the effectiveness, which is measured by examining the relationship with auditees. However, there are several factors, which could contribute to the weakness of this relationship such as, internal auditors' perceptions or just looking for the auditees' weaknesses and on the other hand auditees view internal auditors as fault finders. Such environment leads to lack of trust among internal auditors and auditees and creates one of the main communication barriers, which is a lack of trust among the parties involved in communication processes (Hahn, 2008). To prevent such threats, it is necessary to improve auditees' collaboration with internal auditors. Thus employment of communication theory in this study becomes necessary to establish the need for such skills towards achieving effective internal audit.

2.3 Empirical Review

Empirical review is a way of gaining knowledge by analyzing qualitatively or quantitatively previously conducted researches (Goodwin, 2005). This part then covers previous studies undertaken on dependent and independent variables as they appear in the conceptual framework.

2.3.1 Effectiveness of internal audit

An effective internal audit aids the firm to establish how the firm can be able to improve its governance processes, its control activities as well as how they manage risks by encouraging suitable ethics and values, safeguarding organizational performance management and answerability, collaborating risk control information and coordination of governance-related undertakings (Feizizadeh, 2012). On the other hand an ineffective IA especially in the public sector can lead to resurgence of fraud, emergence of non-compliance with standard operating procedures thus non-factual financial decision making (Unegbu & Kida, 2011).

Several measures have been proposed to assess IA effectiveness. Pungas, (2003), Aguolu, (2009) and Karagiorgos, Drogalas and Giovanis (2011) observed that IA effectiveness can be charged if it meets its primary objectives. Cassandra (2008) contended that IA for it to be effective must be objective, independent and meet the organizational status. Feizizadeh (2012) observed that IA to be effective must meet the needs of the stakeholders, perform to the best of the internal auditors, compliant with established professional standards and meets its own IA performance indicators. Beckmerhagen, Berg, Karapetrovic & Willborn (2004) on the other hand reasoned that the IA effectiveness should not only assess how it meets its objectives as well as the number of audit reports it produces but also should include how executable the report produced is. In this study IA effectiveness was considered as its ability to meet its primary objectives that is ability to generate useful recommendations and effectively communicate these recommendations for action.

Trivially written IA findings add no value to the organization or lead to

inappropriate decisions and conclusions. Without recognizing the need for IA, the tone of management can just use IA to comply with the CBK requirements as opposed to using IA reports and recommendations to add value to the banks services. However, IA recommendations can only be useful as a value add service if the IA reports are precisely written hence contributing to better corporate governance which improves the financial performance of the banks. Studies in among Tanzania and Luthanian commercial banks found that IA were minimally involved in risk management at the banks and therefore were perceived to serve little functions other than aiding the banks to comply with statutory requirements (Ramachandran, Subramanian, & Kisoka, 2012; Karmanova, 2013). On the other hand, a study among commercial banks in Ghana found that IA reports produced by in-house IA departments were not strong enough to provide significant value to the respective banks (Ndamenenu, 2011). On the contrary a study among commercial banks in Nigeria found that IA not only helped in compliance with statutory requirements but also enhanced management effectiveness and efficiency of banking operations well above costs incurred in maintaining an IA department (Etuk, 2011).

Timely communication of IA report and its recommendations enable the management to react to the issues raised in a timely manner thus effectively mitigating organizational risks identified. Delay in presenting IA reports and recommendations would inhibit the ability of the IA to contribute as a value addition to the banks. IA reports should be clearly communicated to the management for appropriate follow up on identified organizational risks and safeguard against loss of impetus of the IA recommendations made in previous reports (Mihret & Yismaw, 2007). A study among Jordanian commercial banks found that the management had consistent follow-up of the IA recommendations which improved IA performance in

the subsequent reports (Awdat, 2015). A study among Ghanaian commercial banks by Ayagre, Appiah-Gyamerah and Nartey (2014) found that the management had established a communication system to follow-up the implementation status of recommendations from IA reports.

IA department needs to establish good communication lines with IA primary stakeholders including senior management and the audit committee in order for IA to effectively understand their expectations and needs to reduce chances of occurrence of role conflict and ambiguity resulting from expectations gap. A study among commercial banks in Rwanda found that IA had established effective communication lines with not only the management, audit committees and board of management but also with the auditees (Nyirabigirimana, 2015). Similarly a study among Tanzanian commercial banks found that IA had proper interaction with members of the audit committee that give rise to better functionality of IA department (Ramachandran, Subramanian, & Kisoka, 2012).

Involvement of auditees during preparation of IA reports is particularly necessary since the auditees are the implementers of the subsequent IA recommendations and hence it is wise for their opinions to be reflected in IA reports so as to make recommendations as practical as possible. This implies that IA have to establish continuous communication line with the auditees from IA evaluation and report preparation. A study among Albanian and Greek commercial banks found that there was inadequate participation of auditees in drawing audit reports which resulted in impractical recommendations from IA (Karagiorgos, Drogalas, & Dimou, 2011; Kristo, 2013). On the contrary studies done by Ramachandran, Subramanian, and Kisoka (2012) and Drogalas, Karagiorgos and Arampatzis (2015) in Tanzanian and

Athens Stock Exchange's listed commercial banks found that communication between IA and auditees was effective thus better functionality of internal auditing.

2.3.2 Internal Audit Input and Effectiveness of Internal Audit

Financial institutions are engaged in complex financial operations which require competent internal auditors to help in management of organizational risk (Delloite, 2011). These large risks can only be managed by sufficient and competent internal auditors (Zain, Subramaniam & Stewart, 2006). This is true because having appropriate capacity in IA enable the auditors to effectively evaluate risks within the organization hence deterring occurrence of opportunistic behaviors when necessary (Prawitt, Smith & Wood, 2009; Staden & Barac, 2014). As organizational risks increase to be more complex, there is need for more competent auditors (Ondieki, 2013). On the other hand lack of sufficient capacity in IA leads to triviality in findings which adds no value to the organization or lead to inappropriate decisions and conclusions (Harding & Trotman, 2009; Barasa, 2015). In a study in Malaysia it was observed that there was lack of knowledge of the role of IA and therefore the clients could not appreciate the value of IA (Ali, 2009). In some cases commercial banks in Kenya have resorted to hiring incompetent IA to enable the managers continued non-disclosure of the true state of the bank hence contributing to failure of some banks (Otieno, 2012).

Being cognizant of the importance of IA capacity, the management can control their functionality by restricting availability of training opportunities for auditors, restricting number of staff to IA or making internal audit as training ground for novice employees (Stewart & Subramaniam, 2010). Studies by Al-Twajjry (2004); Staden and Barac (2014) and Ejoh and Ejom (2014), found that there were insufficient staff

in many internal audit departments and the auditors mostly lacked knowledge in executing IA. A study in Tanzanian, Ethiopian and Libyan commercial banks found that auditors' competencies affected effectiveness of internal audit (Ramachandran, Subramanian & Kisoka, 2012; Deribe & Regasa, 2014; Ashour, Sukoharsono & Ghofar, 2015). Contrarily a study among commercial banks in Jordan found that auditors' competence and proficiency did not affect IA quality (Al-Khaddash, Al-Nawas & Ramadan, 2013). A study among commercial banks in Kigali found that although most of the internal auditors had not been certified, they were found to be competent enough to perform their functions (Nyarabigirimana, 2015). Similarly also in Libyan commercial banks there was limited use of career IAs hence limited professionalism in the audit reports (Abu-Azza, 2012).

2.3.3 Internal audit Process and effectiveness of internal audit

Organizational context regulates the effectiveness of IA activities and how IA will add value to the organizational performance (Okike, 2004; Ahmad, Othman & Jusoff, 2009). Organizational context is the tone set up by the management. If the management depicts IA as a serious undertaking and equally treats its findings as such, the internal auditors will be treated as such and vice versa hence determining its functionality (Cohen & Sayag, 2010). Since the top management determines the tone of the organization it thus contributes to not only the performance of IA but also the organizational performance in general (Schwartz, Dunfee & Kline, 2005).

Top management support to IA can be seen as a function of availing funds pool for IA, providing training opportunities for the auditors and proper execution of findings made by the IA (Mihret & Yismaw, 2007; Cohen & Sayag, 2010). Management support ensures that IA is effectively protected from external or internal

interference. In a study in Kogi State in Nigeria, it was observed that there were political interferences in the audit departments and the auditors did not have sufficient auditing knowledge (Emmanuel, Ajanya & Audu, 2013). A study in Kigali found that internal auditors had been accorded support by their respective managers at commercial banks (Nyirabigirimana, 2015). Contrarily a study in Libya found that IA departments were dissatisfied with the support accorded by the management (Abu-Azza, 2012).

Internal auditor's independence is the ability of the internal auditor to carry out audits devoid of interference within or without the organization's interference while giving room for auditors to come up with accurate conclusions without any bias (Usang & Salim, 2015). Independence of IA is critical for attainment of organizational objectives as well as ensuring reliability of financial reports (Christopher, Sarens & Leung, 2009; Cohen & Sayag, 2010). However, when IA can be interfered with by the management it compromises its reliability providing the managers with opportunity to engage in opportunistic behaviours (Ege, 2014; Usang & Salim, 2015). This situation arises when there is impaired auditor's task description, job insecurity and when IAs are perceived as faultfinders (Barasa, 2015). In a study in Indonesia, it was observed that IA lacked independence leading to loss of transparency and accountability in management (Rahmatika, 2014). According to a study in Malaysia, it was observed that the IA were placed in locker heads with the management and were forced to produce results favouring the parent ministries (Shamsuddin & Bharathii, 2014). Furthermore, numerous studies have highlighted the progressive impact of independent and effective IA on championing good corporate governance (Carcello, Hermanson & Raghunandan, 2005; Asare, 2009) and reporting quality (Prawitt, Sharp & Wood, 2012). A study among Jordanian banks found that IA

independence did not affect the quality of audit reports (Al-Khaddash, Al-Nawas & Ramadan, 2013).

A study by Lutta (2012) found that adoption of risk assessment was dependent on roles played by internal auditors and their capacity, support from the management, organizational policies and communication within the organization. In most organization internal audit department acts as a training ground for developing future employees whereby new recruits are seconded to the audit department thereafter they are deployed to various other departments (Stewart & Subramaniam, 2010). According to Christopher, (2009), this method of staff development presents an independence and objectivity threat to the role of internal auditors within an organization. This is specifically so because the internal auditors may be hesitant to make strong propositions on issues that come up and poses a threat to the organization if they are aware that they might be posted back to the same constituent part of the organization they are presently auditing. A study by Shamsuddin and Johari (2014) found that the effectiveness of internal auditor is enhanced if there is robust business risk environment and the auditor has good working relationship with members of the audit committee.

A study in Saudi Arabia among internal auditors revealed that internal auditors had constrained relationship with external auditors since the former perceived the latter as fault finders who did not appreciate good sides of internal audit but only acted as police detectives' (Alzeban & Sawan, 2013). Furthermore there is need for good working relationship between internal auditors and the audit committee since audit committees enables the IA to be independent and objective (Karmanova, 2013). However a study among commercial banks in Libya found that the relationship

between audit committees and internal auditors affected IA effectiveness (Ashour, Sukoharsono & Ghofar, 2015).

2.3.4 Audit environment and effectiveness of internal audit

Firms with integrity are described as being more constructive, cooperative, transparent, pioneering with higher levels of employee motivation as well as a culture of valuing customer loyalty (Duggar, 2009). Therefore employees tend to develop shared values and easily reach consensus as they will be able to live up to the values they advocate for. This implies that employees will be able to develop interpersonal relationships which create a positive work environment essential. However, it is generally argued that staff will copy the actions of the management as well as what the management accepts or encourages, and as a result the management will determine the ethical behaviour of the other staff (Chartered Institute of Internal Auditors, 2014). For instance if the management are merely keen about profits, the employees will tend to take bigger risks to satisfy this demand without consideration the views of customers.

According to social power theory, the management can not only influence the other staff judgments by expressing specific values (San, Moorthy& Lung, 2012). Therefore internal auditors being management advocates tend to be more likely to be affected by the set management values thus their conclusions will tend to be more doubtful if management sets a poor tone (Wang, 2015). On the other hand, if the management sets a good tone the internal auditors will be more likely to stick to their professional ethics in their judgment (Wang & Fargher, 2014). Furthermore it has been argued that a well-functioning IA can strengthen the management's tone and offer direction in decision making by checking not only the other internal control

components but also the actions of the management (Hansen, Stephens & Wood, 2009).

In addition internal auditors are charged with the responsibility of ensuring that ethical behaviour trickle down to lowest cadres of employees therefore a poor management tone hinders the ability of the internal auditor to advocate for ethical behaviour (Stewart & O'Leary, 2006). A study by Wang (2015) found that internal auditors' effectiveness are lower if the management tone is poor as compared to when the management tone is good. Similarly Asare, Davidson & Gramling, (2008) and Hansen, et al (2009) observed that internal auditors normally alter their audit plans to reflect management's tone. Contradicting results were however found by Stewart and O'Leary (2006) and O'Leary and Stewart, (2007) who found that governance mechanisms and management integrity regarding accounting policies in an organization did not affect ethical decision making by internal auditors.

Managerial competencies are underlying characteristics including traits, motives, skills, self-concept and knowledge that enable the managers to attain superior and effective performance within their roles. The management in public should apply a specific set of competencies sets to attain excellence in performance as well as support strategic objectives of the organization (Jarvalt & Veisson, 2006). This means that competencies expresses not only things that are valued within the organization but also defines the characteristics that have been deemed to result to attainment of excellent performance. Competent based management allows adoption of systematic approach to utilization of full capacities of employees and links the individual capacity development goals with the strategy of the organization (Bosch & Cardona, 2011). Managerial competency is necessary in the effective functioning of IA and ICS because it provides the management understanding of ways of improving

ICS and the management's enthusiasm in taking necessary actions to improve ICS. In ICS, the manager has a role in preventing failures in ICS by creating robust ICS. However, for the managers to execute this critical role effectively, the manager needs to be cognizant of probability of occurrence of the failure, nature of failure and be willing to deter the failure from occurring (Maksymov, 2014). A study by Birabwa (2012) found that there was positive correlation between managerial competence and internal control system at National Social Security Fund. According to Abdullah, (2015) managerial competencies enable better implementation of good governance, hence enabling the internal auditor to function effectively. A study by Wolfe, Mauldin and Diaz (2009) found that functionality of IA is affected by the management's intent to mitigate against risks identified.

Functionality of internal audit is also determined by the organizational structure (Patterson & Smith, 2012). Centralized decision-making leads to diminished adoption innovation (Van der Voet, 2013). In addition an organization with high degree of formalized job description impedes organizational learning from prior audit reports since the formalized job description tends to cause poor communication within and without the organization hence administrative delays (Martinez-Leon & Martinez-Garcia, 2011). Management allocation of responsibility and values determines the tone and functionality of ICS components to be strong. This is so because it is the management of an entity that sets the risk tone and determines the strategies that mitigate against these risks (Rae, Subramaniam & Sands, 2008). In addition, it is the management to resolve or determine the level of adherence to established standards within an institution. This in turn enables the employees to be cognizant of what they are expected to do and the associated management support for the laid down values even if it has negative consequences on the entity (Lightle,

Castellano & Cutting, 2007). On the other had a weak control environment will also weaken the other ICS components, therefore auditors should explore existence of an ethical environment created by the management among the employees. The internal auditor is better placed to appraise the existing organizational environment since the internal auditor is cognizant of changes within the organization throughout the year thus helping them have an upper hand in detecting fraud. Mohamud (2013) observes that majority of internal audit departments lacked audit charter which meant that the auditors did not clearly know their set objectives and the scope of their work in undertaking internal audit in most organizations. A study in Nigeria observed that the financial transactions were being regularly reviewed by the management to establish if they were conforming to the laid down budgets and duties in transactions were adequately segregated but the internal auditors were not properly trained on implementation of the existing financial and accounting system (Ejoh & Ejom, 2014). A study in Greece observed that control activities in ICS were largely implemented (Karagiorgos, et al., 2011).

Within an organization the auditor can play the role of a consultant to the management or be independent which means that there can be a role conflict hence impeding IA effectiveness (Stewart & Subramaniam, 2010). A study by Roussy (2013) among internal auditors in public sectors in Quebec observed that the internal auditors were more leaned towards helping the management by acting as a consultant which impedes the auditors work as the management in the long run saw the auditors as part of the management thus compromising independence of IA. Additionally internal auditors are not cushioned against internal politics within the organization hence reduced independence (Vu & Segura, 2015).

2.4 Conceptual Framework

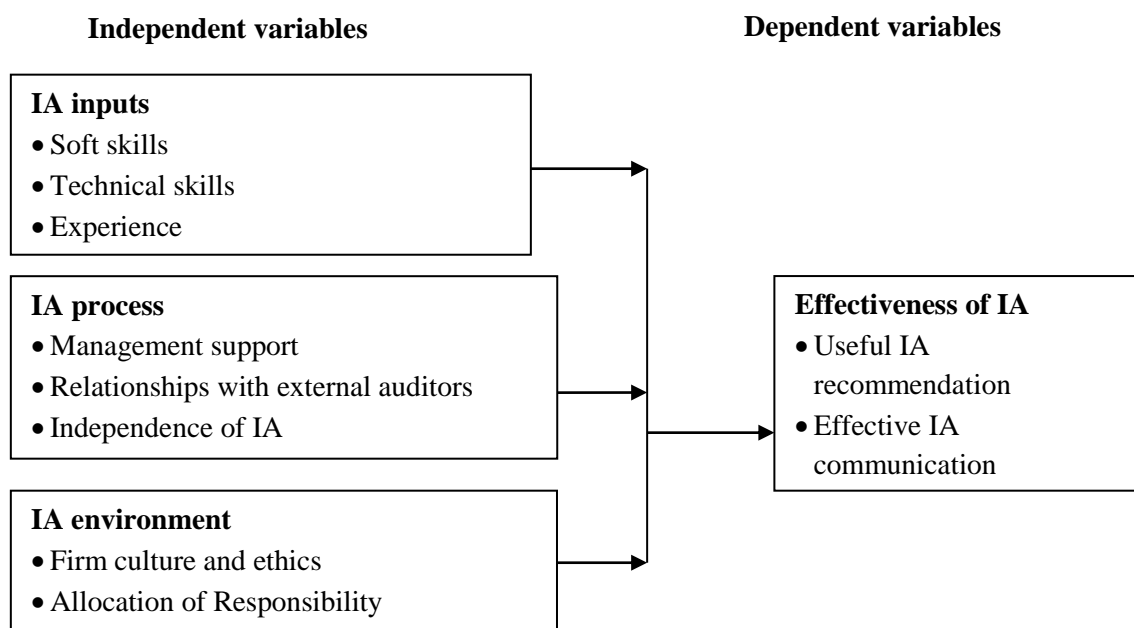
This study sought to investigate factors influencing effectiveness of Internal Audit in the banking sector in Kenya with special focus on the commercial banks in Nairobi. The factors that were considered included IA inputs, IA process and IA environment. IA inputs were considered to be a function of IA soft and technical skills as well as the IA experience. It was hypothesized that lack of sufficient capacity in IA leads to triviality in findings which adds no value to the organization or lead to inappropriate decisions and conclusions. On the other hand shortage of staff in the IA department leads to role overload among the existing IA which hinders their ability to generate quality IA recommendations.

IA process in this study was composed of management support for IA department, the relationship between IA and external auditors as well as the level of IA independence. Top management support to IA consists of availing sufficient budgetary allocation for IA, providing training opportunities for the auditors to build their capacities and protecting IA from external or internal interference. Without sufficient management support, the IA will lack sufficient resources and capacity needed to execute quality IA reporting. Poor relationship with external auditors reduces the chances that IA will not benefit from critique offered by the former on how to improve IA reporting hence non-improvement in IA quality. Independence of IA ensures objectivity in IA evaluation and reporting hence when IA is interfered with by the management or other external parties; it compromises its reliability hence resulting in IA reports that do not add value to the bank.

In this study, IA environment was assessed based on the precincts of management ethics and culture as well as how resources are allocated within the organization. An entrenched culture of organizational dishonesty and information

manipulation by the management is likely to hinder functionality of the IA department who are at the monitors of the implementation of organizational code of ethics. According to social power theory, top management has the power to influence followers' decision making and internal auditors being part of employees of an organization normally make assessment under the ethical climate in the context of working environment and the tone at the top. If the management sets a good tone the internal auditors will be more likely to stick to their professional ethics in their judgment while poor ethics among top management will create IA sceptism.

Figure 1:
Conceptual Framework



Source: Author (2016)

2.5 Operationalization of variables

The variables of the study were operationalized as per the table below

Table 1:
Operationalization of Variables

Variable	Indicators	Scale
IA inputs	Soft skills	4-point Likert Scale
	Technical skills	4-point Likert Scale
	Experience	4-point Likert Scale
IA process	Management support	4-point Likert Scale
	Relationships with external auditors	4-point Likert Scale
	Independence of IA	4-point Likert Scale
IA environment	Firm culture and ethics	4-point Likert Scale
	Allocation of responsibility	4-point Likert Scale
Effectiveness of IA	Useful IA recommendation	4-point Likert Scale
	Effective IA communication	4-point Likert Scale

Source: Author (2016)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Suitable research methodology enables the researcher to collect suitable data which will result in useful findings enabling appropriate conclusions and recommendations to be made. The research methodology points out on the nature of the instruments, sampling plan and type of data to be collected vis-à-vis type of analysis to be drawn. This section will include research design to be adopted, target population, sample size and sampling procedure, data collection instruments and data analysis techniques.

3.2 Research Design

The study utilized a cross-sectional descriptive research design. This was due to lack of scholarly studies done to explore on the subject in Nairobi County. It described the effectiveness of IA at a specific point in time within the commercial banks. It also explored the factors contributing to this effectiveness of IA.

3.3 Target Population

Target population was the group or the individuals to whom the survey applies. In other words, you seek those groups or individuals who are in a position to answer the questions and to whom the results of the survey apply (Kitchenham & Pfleeger 2002). The study was conducted among commercial banks in Nairobi. The target population in this study comprised of 40 fully operational banks as shown in Table 3.1 below. Auditors were well positioned to provide the required information to answer

the questions posed in this research. The unit of analysis was individual commercial bank.

Table 2
Target Population

Ownership	Number of Commercial Banks
Locally controlled	23
Foreign owned	14
Public owned	3
Total	40

Source: (CBK)

3.4 Sampling and Sampling Procedure

A sample is a representative group that is to be studied on behalf of the entire target population. A sample size is a portion of the target population gotten from the available population (Mugenda & Mugenda, 2003). In research there are two major ways of determining sample size, the first based on proportion of the target population with target characteristics and the second based on the finite number of target population (usually less than 10, 000). Due to the small number of unit of analysis this study was conducted among all commercial banks in Nairobi County. Therefore a census approach was used to select the banks to be included in this study. Within each bank head of internal audit department or assistant head of internal audit department was purposively selected to be involved in the study.

3.5 Research Instrument

The study relied on primary data which was collected using self-administered questionnaire. The questionnaire was constructed to contain structured closed-ended questions and was used to gather quantitative data. The questionnaires collected data

in three sections including; demographic characteristics of respondents, factors influencing effectiveness of IA and internal audit effectiveness.

3.6 Validity and Reliability of the Instrument

3.6.1 Reliability of Research Instruments

Reliability is the degree to which measures can be repeated over time in dissimilar settings (Golafshani, 2003). Reliability is grouped in to external reliability (replicability of results in different sites) or internal reliability (agreement of results from different members of data collection team) (Bryman & Bell, 2015). This study ensured both external and internal reliability by making adjustments to the study instruments after the pre-testing so as to resolve issues of ambiguity which might be a threat to both internal and external validity. Reliability of the research instrument was assessed from the pre-test analysis where a Cronbach Alpha Coefficient of more than 0.8 was considered reliable. As indicated in Table 3.3 below, all the study variables had Cronbach Alpha score greater than 0.8 hence the study instrument was reliable.

Table 3

Reliability of the research instrument

Variables	Number of Items	Cronbach Alpha score
Internal Audit Effectiveness	6	0.828
Internal Audit Input	4	0.847
Internal audit Process	8	0.863
Internal Audit Environment	7	0.875

Source: Author (2016)

3.6.2 *Validity of Research Instruments*

Validity examines whether the research instrument accurately measures that which it was envisioned to assess (Golafshani, 2003). Validity is the exactness and relevance of extrapolations derived from research results. The researcher assured external validity through extensive literature review and through adopting the questionnaires that were designed to answer the intended research question.

3.7 Data Collection Procedure

The data collection was pretested to ensure they collected accurate information as well as to correct any ambiguity in the questions which were administered in the main study. The data generated during the pretested was used to assess the instrument validity and reliability. This pretesting was done among two heads of internal auditors at two of the banks which were part of the study. After the pre-testing, necessary modifications were done on the study instruments before undertaking the main study.

After pretest the study instruments were modified and thereafter ethical approval was sought from the KCA Ethical Committee before the actual study commenced. Permission was sought from each of the banks to conduct research within the institutions. The respondents were provided with information on the research and its intended purpose and informed consent was obtained from them. All the responses got from respondents were treated as confidential. The study was flexible to allow any respondent to withdraw if she/he felt uncomfortable to continue with the study. The interviews were based on voluntary participation and only respondents who were willing to answer questions honestly were recruited. The respondents were paid or compensated for their participation.

3.8 Data Processing and Analysis Data

At the end of each data collection administration, the filled questionnaire was cross checked for completeness and any missing entries. Qualitative data form was subjected to content and thematic analysis where the responses were transcribed and themes developed with these themes presented together with verbatim. Emerging patterns and themes were compared against the survey data and the study objectives and were used to complete and supplement quantitative data. The quantitative data obtained from the questionnaires were then entered, cleaned and analyzed using the Statistical Package for Social Sciences (SPSS) version 20. Descriptive statistics such as frequency and percentages were used to present quantitative findings using tables and charts. Relationship between the independent variables and the dependent variable were established using linear regression models. To determine this model, factor analysis were carried out among corresponding questions so as to allow formation of factors with the highest Eigen values which accounts for the highest variation in the variables. The factors derived were regressed to determine the relationships of the variables as stated in the model below:

$$Y = b_0 + b_1X_1 + + b_2X_2 + b_3X_3 + \varepsilon$$

Where Y is the dependent variable, which in this case is the internal audit effectiveness, and b_i are the regression coefficients while X_i are the independent variables (IA inputs, IA process and IA environment respectively) and ε is the error term.

CHAPTER FOUR

FINDINGS AND DISCUSSION

4.1 Introduction

This study sought to determine factors influencing effectiveness of Internal Audit in the banking sector in Kenya with special focus on the commercial banks in Nairobi. It was carried out among 40 head of internal audit department drawn from 40 fully operational commercial banks in Nairobi.

4.2 Response Rate

From a target of 40 internal audit departments drawn from 40 fully operational commercial banks in Nairobi, 35 heads of internal audit department and 15 assistant heads (in the absence of head two questionnaires were left) of internal audit department responded to the study which represented a satisfactory 87.5% (for head of internal audit department) response rate. The response rate was highest among foreign owned commercial banks and least for public owned commercial banks.

TABLE 4
Response Rate

Bank Ownership	Target Internal Auditors	Respondents	Response Rate
Locally controlled	23	20	87.0%
Foreign owned	14	13	92.9%
Public owned	3	2	66.7%
Total	40	35	87.5%

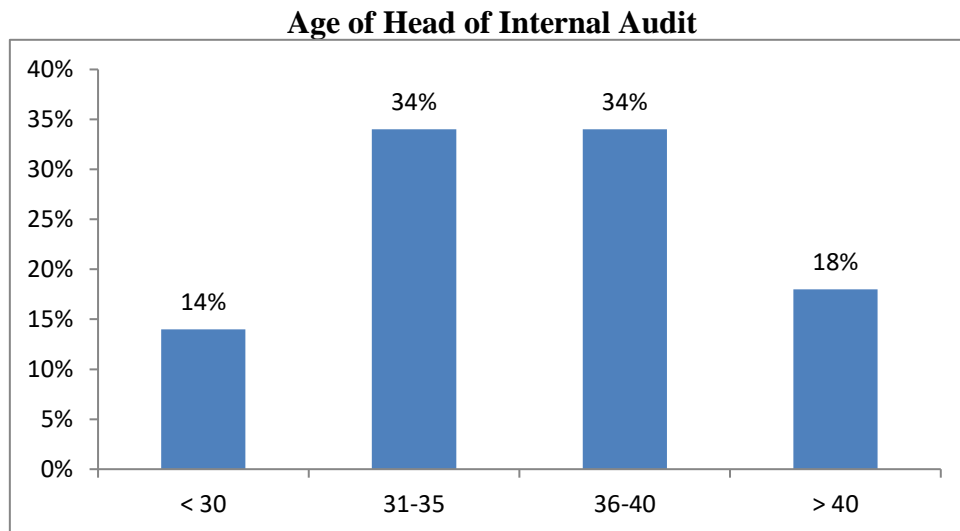
Source: Author (2016)

4.3 Socio-Demographic Characteristics

4.3.1 Age of Head of Internal Audit

Majority of the respondents were aged between 31 and 40 years while 48% were aged below 35 years. Only 18% were aged 40 years and above. This showed that the head of internal auditors were in their mid-career life hence an indication of significant experience in the industry.

FIGURE 2



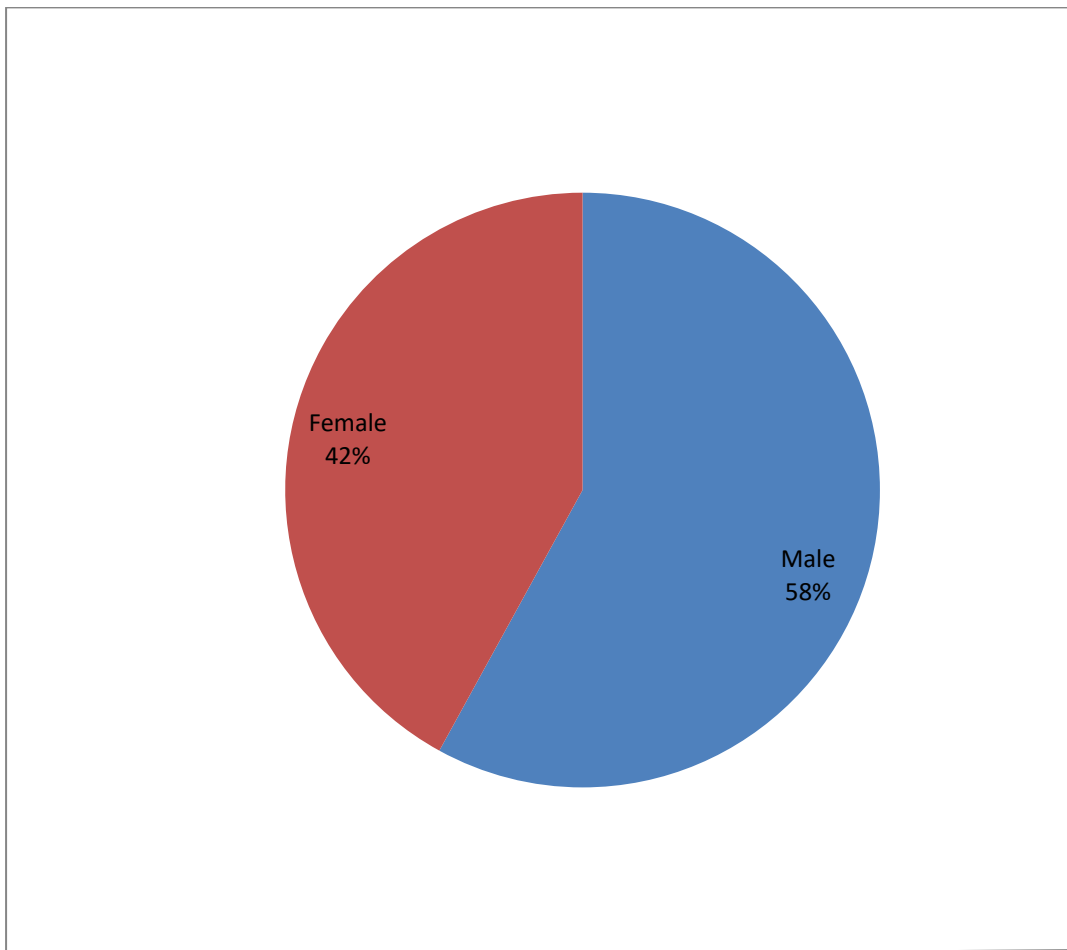
Source: Author (2016)

4.3.2 Gender of Head of Internal Audit

Male respondents composed 58% while female respondents composed 42%.

FIGURE 3

Gender of Head of Internal Audit



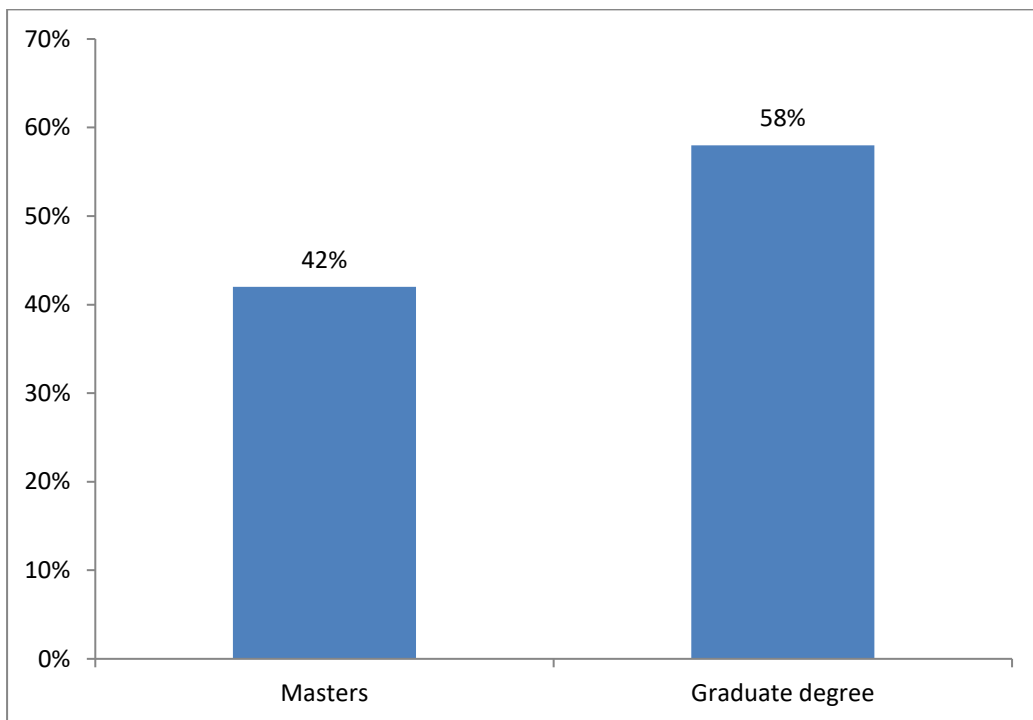
Source: Author (2016)

4.3.3 Education Level of Head of Internal Audit

Majority (58%) of the head of internal audit departments in commercial banks had graduate degrees while 42% had master's degree. This showed that the internal audit departments had sufficient educational grounding to effectively manage IA within their respective banks.

FIGURE 4

Education Level of Head of Internal Audit



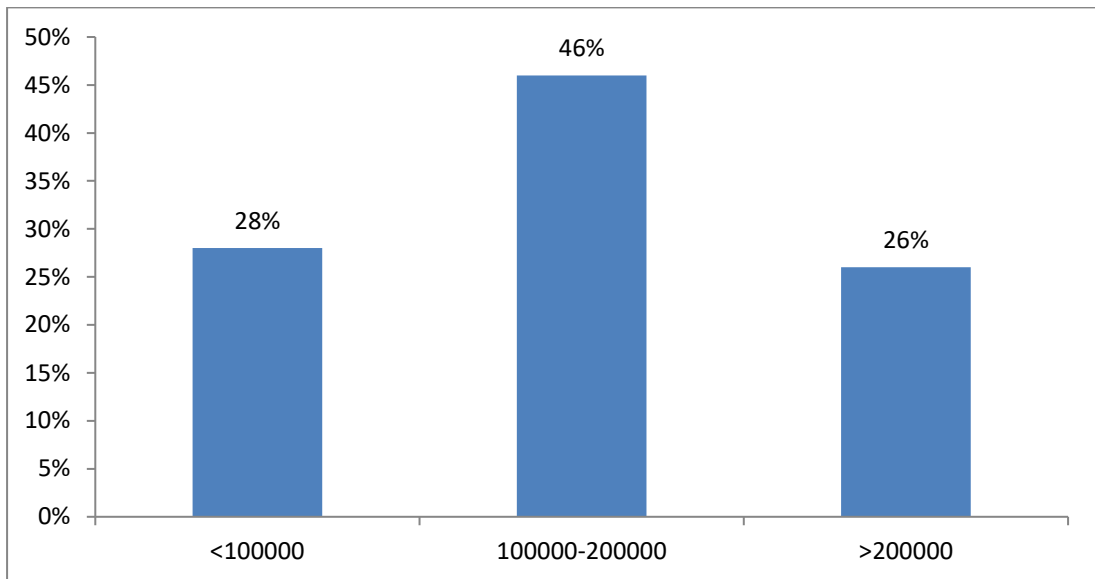
Source: Author (2016)

4.3.4 Monthly Income of Head of Internal Audit

Majority (46%) of the respondents earned more than Kshs. 100,000 per month. These indicated that majority of head of internal audit department were adequately remunerated.

FIGURE 5

Monthly Income of Head of Internal Audit



Source: Author (2016)

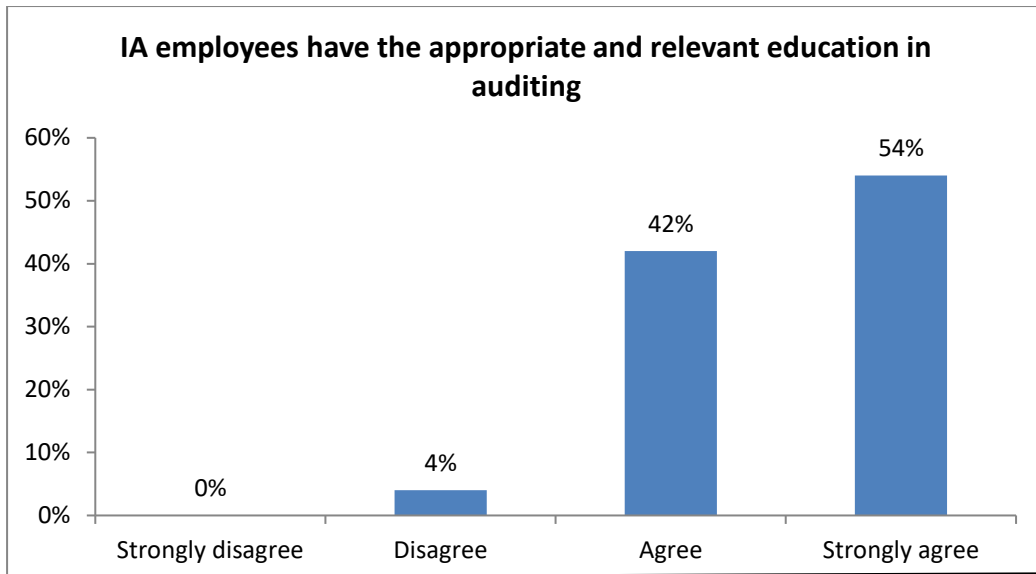
4.4 Internal Audit Input and Effectiveness of Internal Audit

4.4.1 IA employees' education in auditing

Auditors use professional judgment in performing their works which underscores the need to have professionally qualified internal auditors. According an overwhelming 96% of the respondents, the IA employees within the banks had appropriate and relevant auditing education. This was depicted in their education level as majority either had graduate degrees or master's degree. Contrarily studies by Al-Twaijry (2004); Staden and Barac (2014) and Ejoh and Ejom (2014), found that the auditors mostly lacked knowledge in executing IA.

FIGURE 6

IA employees' education in auditing

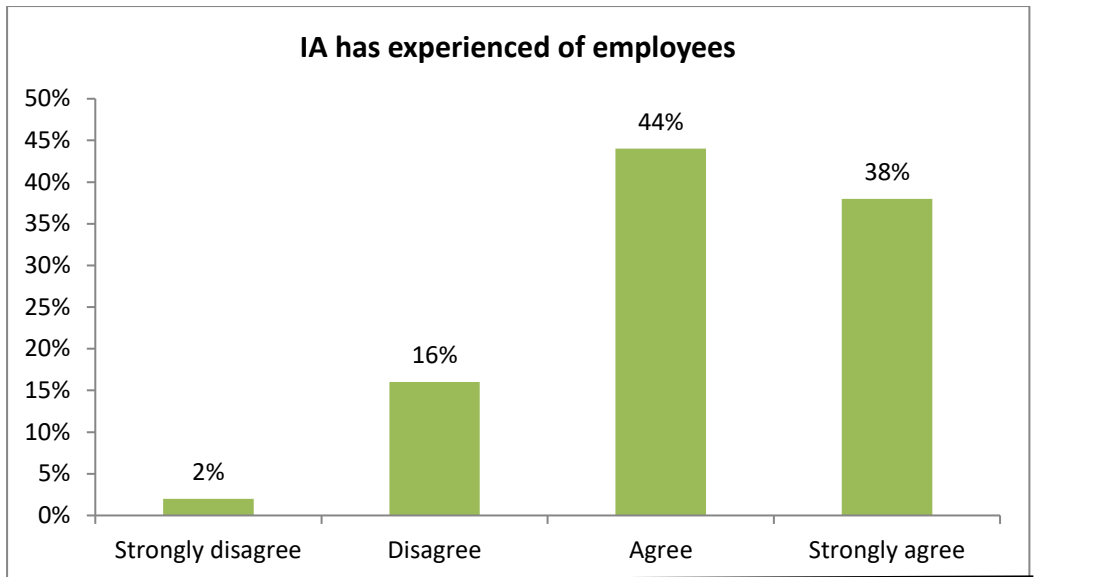


Source: Author (2016)

4.4.2 IA employees' experience

Financial institutions are engaged in complex financial operations which require experienced internal auditors to help in management of organizational risk. Appropriate experience in IA enables the auditors to effectively evaluate risks within the organization hence deterring occurrence of opportunistic behaviors when necessary. Majority (82%) of the respondents were of the opinion that IA staff had sufficient experience. This was indicated in their ages as up to 52% were aged above 35 years which shows that they had spent significant amount of time in the industry hence higher work experience.

FIGURE 7
IA employees' experience



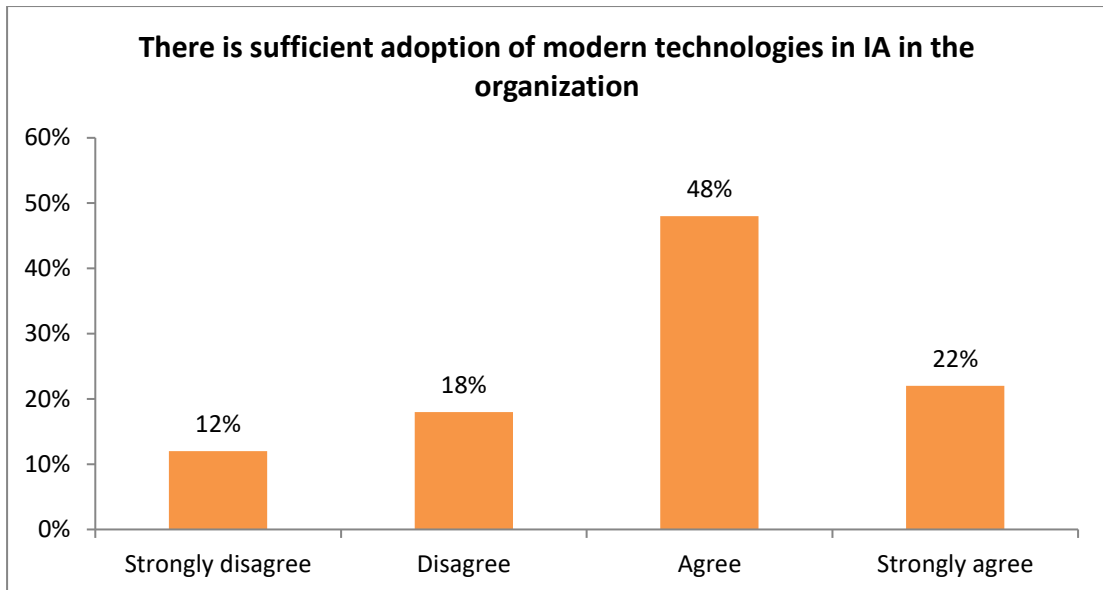
Source: Author (2016)

4.4.3 Adoption of modern technology in IA

Adoption of technology in IA helps ease and fasten the work of internal auditors considering that they have to continuously evaluate organizational risks and provide an assurance of organizational processes. According to 30% of the respondents the banks had low adoption rate of modern technology in IA although the banks had adopted international best practice in the auditing industry.

FIGURE 8

Adoption of modern technology in IA



Source: Author (2016)

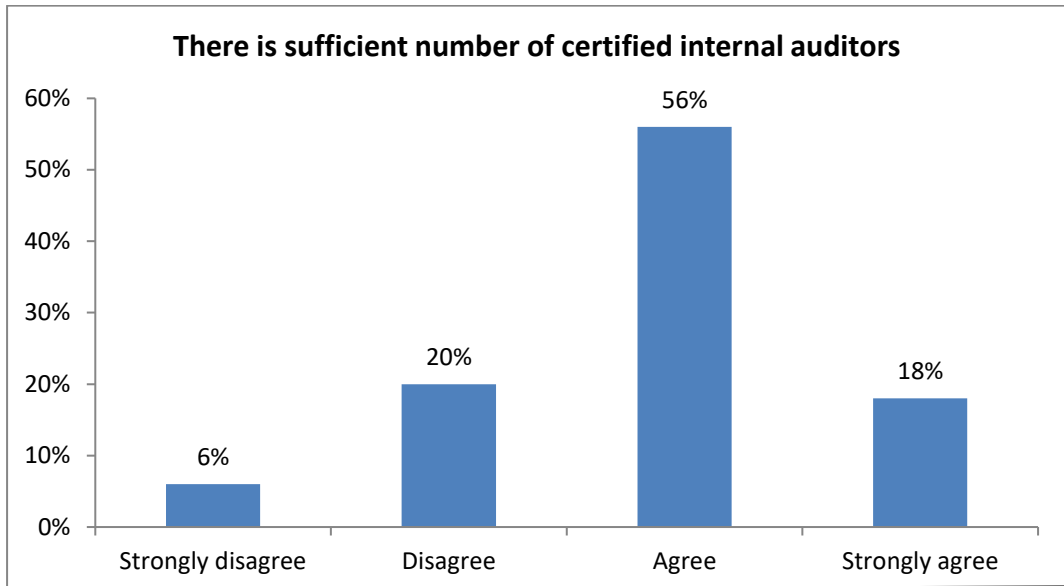
4.4.4 Number of certified internal auditors

The low certification of IA staff implies that IA do not have sufficient capacity which can lead to triviality in findings that adds no value to the organization or lead to inappropriate decisions and conclusions. According to 26% of the respondents there were relatively few certified internal auditors within the bank. This was similar to a study among commercial banks in Kenya in which Otieno (2012) noted that some banks have resorted to hiring incompetent IA to enable the managers continued non-disclosure of the true state of the bank hence contributing to failure of some banks. Similar findings were however made in a study among commercial banks in Kigali (Nyirabigirimana, 2015) and Libya (Abu-Azza, 2012) which found that there was limited use of certified IAs hence limited professionalism in the audit reports. Similarly also studies by Al-Twaijry (2004); Staden and Barac (2014) and Ejoh and

Ejom (2014), found that there were insufficient staff in many internal audit departments.

FIGURE 9

Number of certified internal auditors



Source: Author (2016)

4.5 Internal Audit Process and Effectiveness of Internal Audit

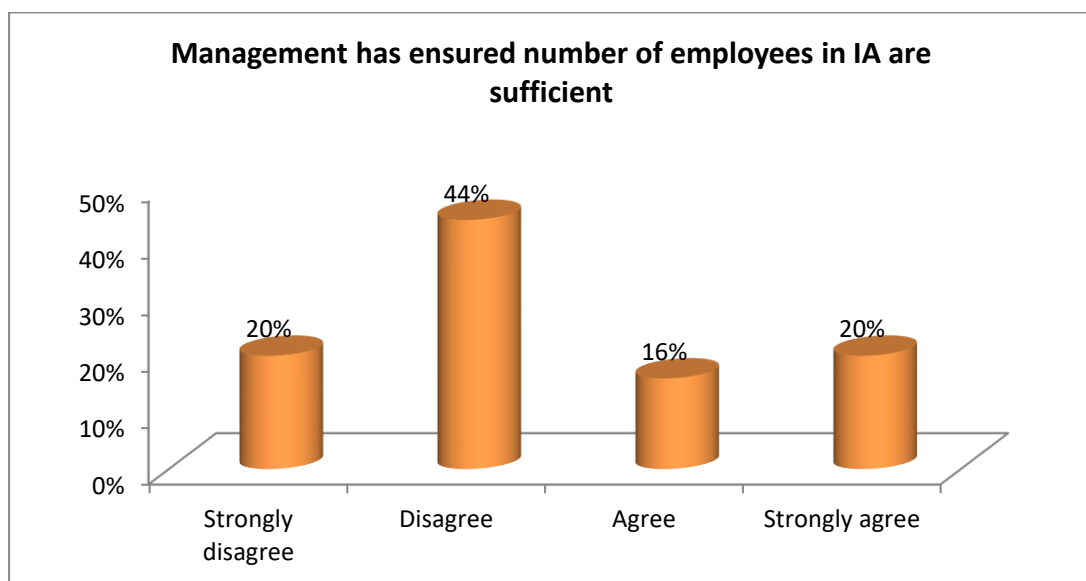
4.5.1 Management support

Provision of adequate number of IA staff. According to only 36% of the respondents, there was an average support from the top management on issues regarding the functionality of IA departments. This shows that top management did not attach requisite seriousness to the needs of IA department to enable them function effectively in safeguarding organizational risks and assets. The respondents noted that there was just average efforts from the top management to ensure that the number of staff in IA department were sufficient with respect to the auditing workload. Shortage in number of staff in IA department relative to the amount of work needed to generate

an IA report will hinder the ability of the internal auditors to generate adequate and timely IA reports to be communicated to the management or board of directors. Similar findings were also documented among firms listed in Athens Stock Exchange in Greece which found that the support which the management offered IA was not adequate to enable IA to effectively execute its mandate (Drogalas, Karagiorgos, & Arampatzis, 2015). Similar findings were noted by Al-Twaijry (2004), Staden and Barac (2014) and Ejoh and Ejom (2014) who found that there were insufficient staff in many IA departments.

FIGURE 10

Provision of Adequate Number of IA Staff



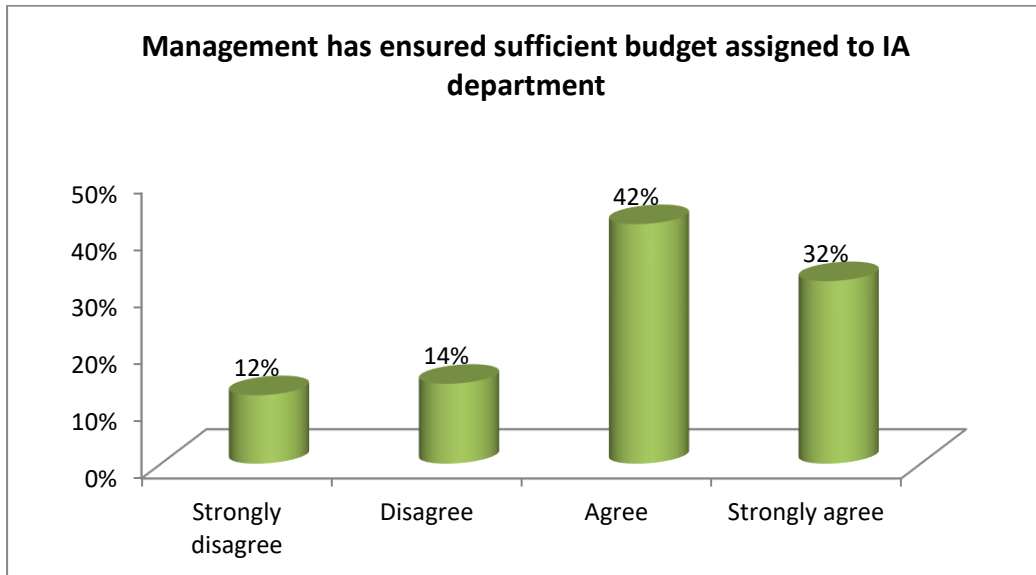
Source: Author (2016)

Provision of adequate IA funds. Being cognizant of the importance of IA capacity, the management can control their functionality by restricting availability of funds to enable IA operations run smoothly. Availing sufficient funds not only facilitate smooth running of IA activities but also acts as a motivating factor for the internal auditors who might consider availing the funds as a mirror of the tone of the top management regarding the importance of IA. Majority (74%) of the respondents noted

that management were aware of IA needs hence did provided sufficient funds to the IA department through annual bank budgets.

FIGURE 11

Provision of Adequate IA Funds

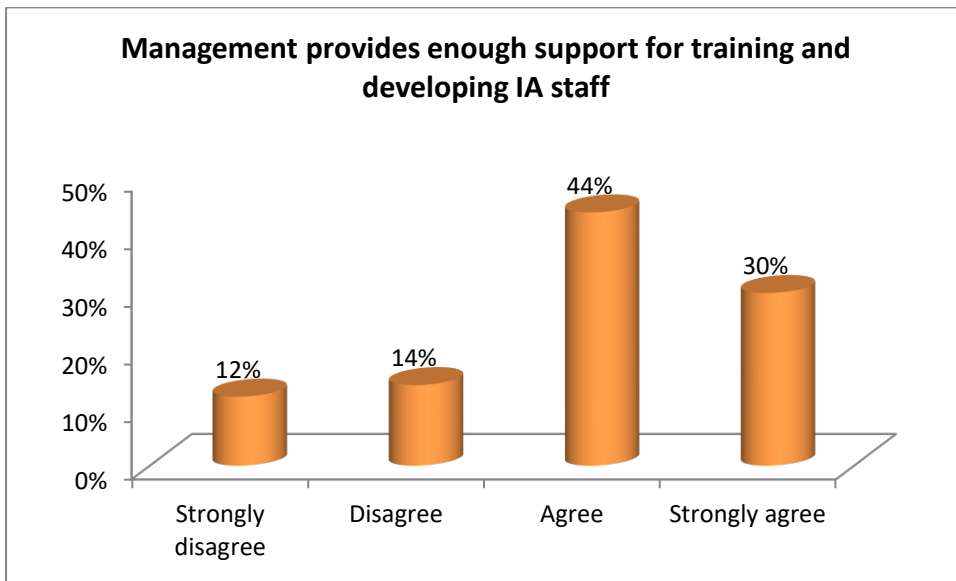


Source: Author (2016)

Provision of IA capacity building programs. Furthermore the management also averagely provided capacity building programs for the IA staff. Similar findings were made among commercial banks in Libya which found that IA departments were dissatisfied with the support accorded by the management (Abu-Azza, 2012). Similar findings were made among commercial banks in Nigeria which found that although IA played a significant role in enhancing efficiency of the bank management, the staffs in IA department were not provided with adequate capacity building opportunities (Etuk, 2011). Contrary findings were made in Kigali which found that internal auditors had been accorded support by their respective managers at commercial banks by offering them training opportunities to advance their capacities (Nyirabigirimana, 2015).

FIGURE 12

Provision of IA Capacity Building Programs



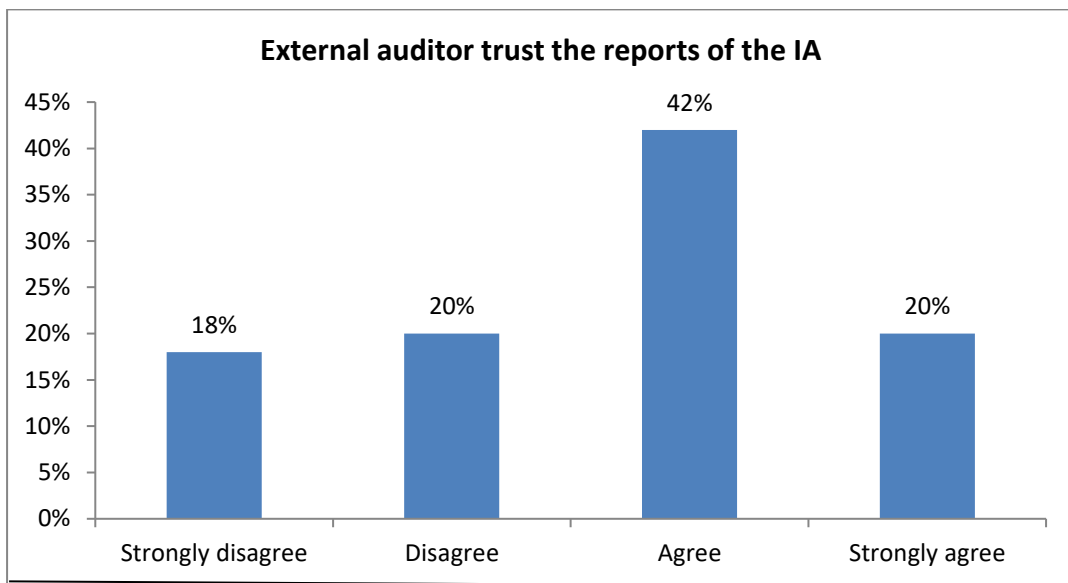
Source: Author (2016)

4.5.2 Relationships with external auditors

External auditors trust of IA reports. According to 62% of the respondents external auditors trusted the reports of the internal audit department. There were some cases (38%) in which external did not trust reports from the IAs as they might have deemed IA reports were incomprehensive. Some of the respondents positively perceived external auditors. However, in some cases IAs perceived external auditors to be functioning as police investigators whose role was focused on mistakes within the IA reports. This was similar to a study in Saudi Arabia among internal auditors which revealed that internal auditors had constrained relationship with external auditors since the former perceived the later as fault finders who did not appreciate good sides of internal audit but only acted as police detectives' (Alzeban & Sawan, 2013).

FIGURE 13

External Auditors Trust of IA Reports

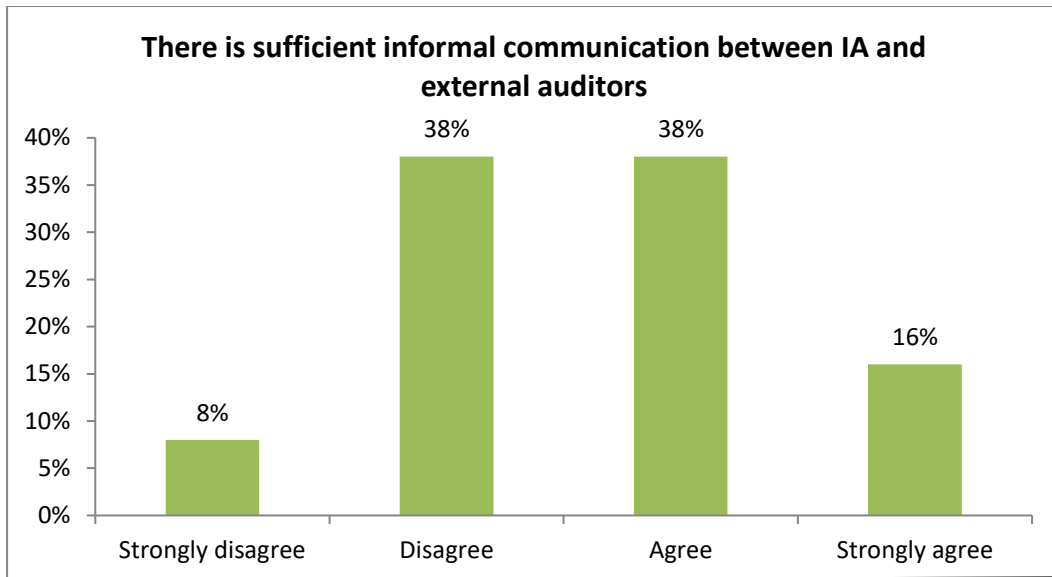


Source: Author (2016)

Communication between internal and external auditors. Poor communication between internal and external auditors implies that the bank's external auditors will lack a basis of their audit work hence having to take a long time in auditing the bank systems which may be costly to the banks. Informal communication between internal and external auditors enable the external auditors communicate the internal auditors to develop their capacity which ensures that they generate reports that can be relied upon by external auditors in their reporting. On the other hand too much informal communication and relationship between internal and external auditors could imply that they can collude to hide organizational risks which could be detrimental to the organizational performance of the banks. The communication also between IA and external auditors was averagely rated. According to 64% of the respondents internal and external auditors had sufficient informal communication.

FIGURE 14

Communication between Internal and External Auditors



Source: Author (2016)

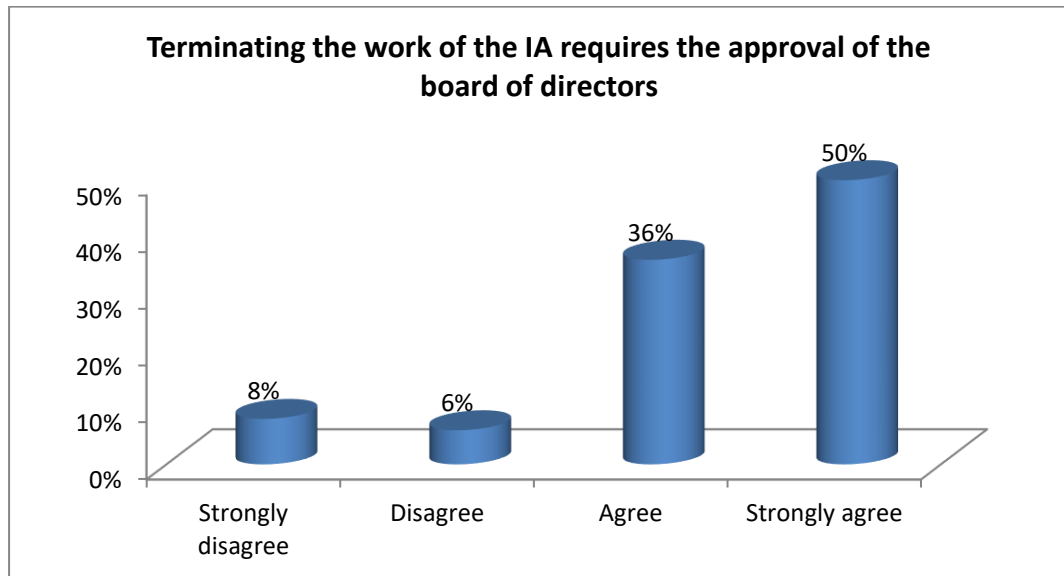
4.5.3 Independence of IA

IA reporting authority. Without independence, IA loses its role of offering objective perspective of what is happening within an organization resulting in IA being viewed as part of management. If IA is dependent on management, it will lead to compromised judgement on fraud risk assessments as IA will tend to play management advocate role (Wang & Fargher, 2014). To safeguard IA independence and objectivity internal auditors should be answerable to authorities outside management this ensures that auditors do not necessarily have to dance to the music of the management as a way of attaining job security. IA staff can also have conflict of interest during assessment and reporting of high levels of risk. According to 86% respondents work undertaken by IA department is sanctioned and terminated by board of directors hence not under direct control of the management of the bank. Presence of a direct communication line between the IA and board of directors or members of

audit committee enables the IA to report any occurring deficiency independently thus reducing the influence of the management in IA reports (Shamsuddin, & Johari, 2014).

FIGURE 15

IA Reporting Authority



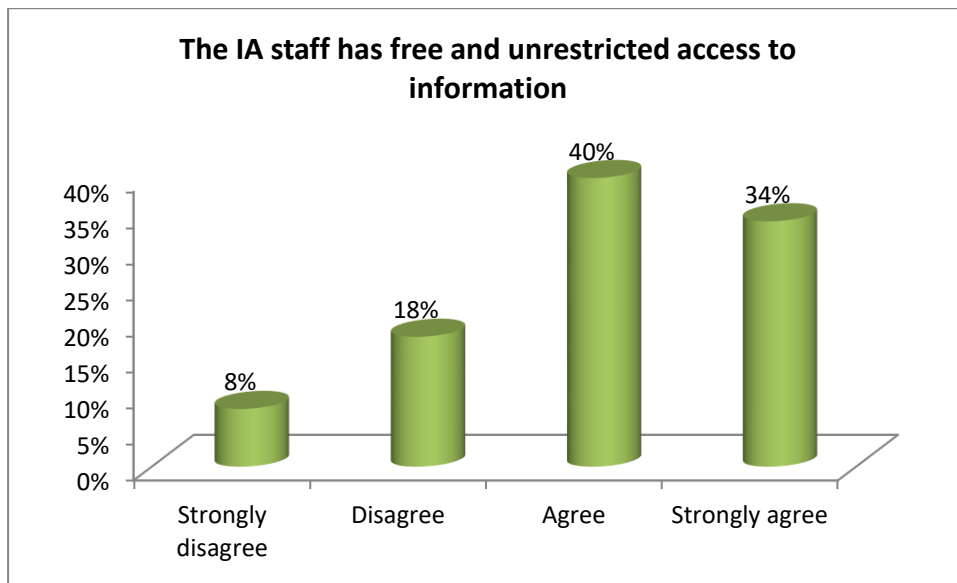
Source: Author (2016)

Access to information. According to 84% respondents, the IA staff reported that they had free and unrestricted access to the information they required within the bank however there were some cases in which the IA staff were restricted access to organizational information. Constraining access to information by IA could reflect the tone of top management by encouraging non-disclosure of information among various units of the bank. This shows that the IA to a large extent was independent in their judgment based on access to required information from the banks management. This was contrary to a study in Indonesia which observed that IA lacked independence leading to loss of transparency and accountability in management who restricted information access by IA (Rahmatika, 2014). Similar findings were documented in a

study among commercial banks and firms listed in Athens Stock Exchange in Greece which observed that the internal auditors had unrestricted access to organizational information (Karagiorgos, Drogalas, & Dimou, 2011; Drogalas, Karagiorgos, & Arampatzis, 2015).

FIGURE 16

Access to Information



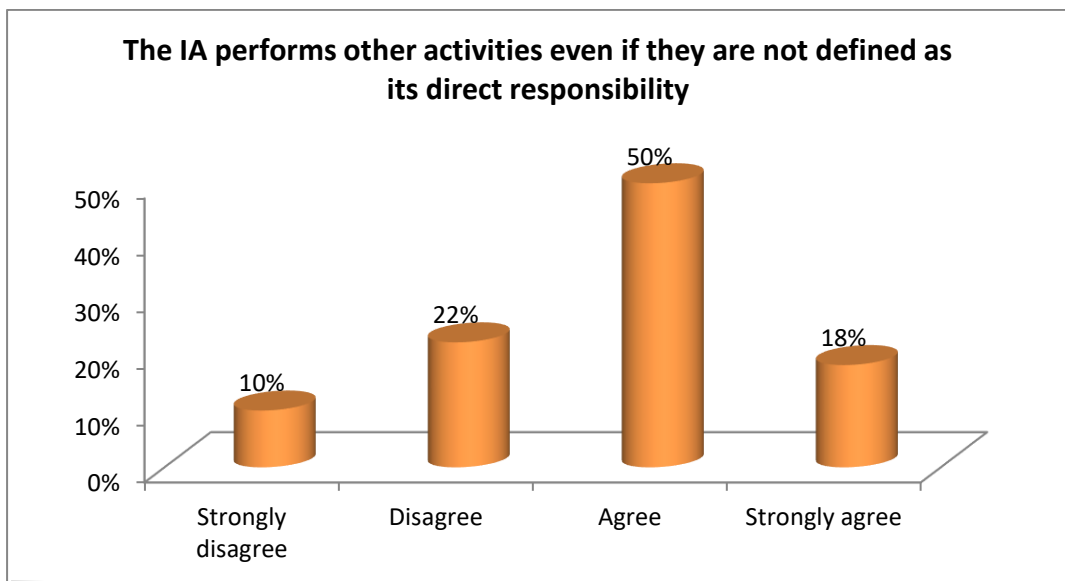
Source: Author (2016)

IA job description. The auditing profession is prone to expectation gaps resulting in role ambiguity and role conflict which negatively affects performance of internal auditors as the management, audit committees, board of directors or shareholders have different expectation of what IA is supposed to do in comparison with the IA professional rules. According to the respondents, IA staff was relatively involved in other roles outside their defined job description. This significantly reduces their independence as they played a role of consultancy to the management which risked the management viewing internal auditors as part of their department and therefore exposing them to organizational politics. This was similar to observations by Norman

et al (2010) who found that there was a tendency of IA to work with the management in solving issues identified by IA prior to meeting Audit Committee or presenting IA report to the board of management so as to avoid over-reaction from the audit committee or board of management.

FIGURE 17

IA Job Description



Source: Author (2016)

4.6 Audit Environment and Effectiveness of Internal Audit

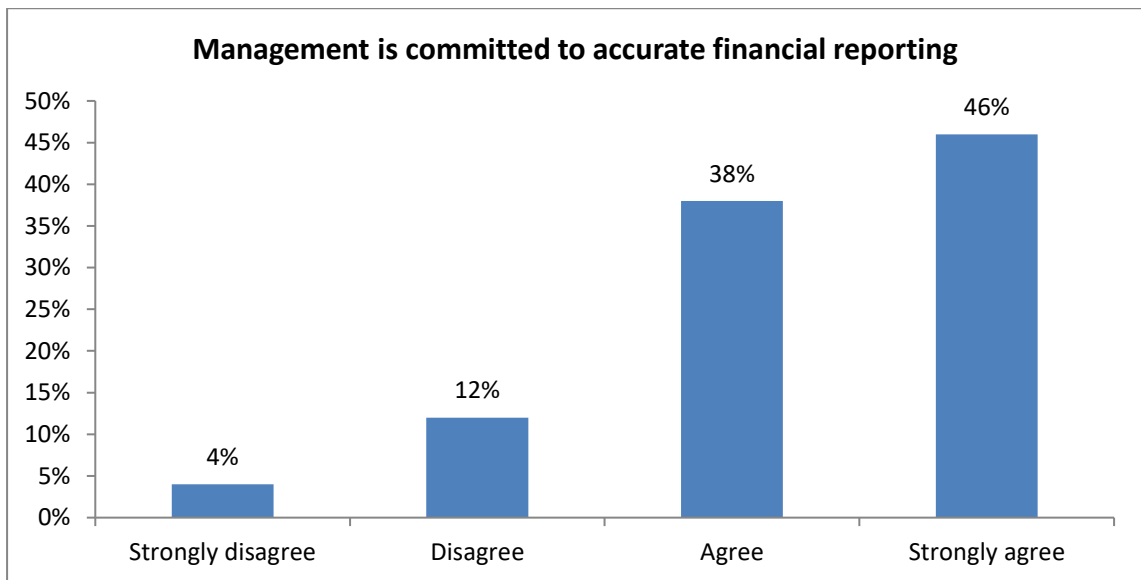
4.6.1 Organizational Ethical and Integrity Values

Management commitment to accurate financial reporting. According 84% of the respondents, management of the banks were committed to higher quality and accurate financial reporting and had sufficient knowledge and experience to supervise IA activities. However board of directors did not have sufficient knowledge to supervise IA departments although the IA department reported to the board. Furthermore according to the respondents, there was average documentation of management control override and as a results there were average investigation of deviations from

established policies are investigated. Having an audit committee that is knowledgeable about accounting and auditing issues will increase the effectiveness of the internal audit function as they will effectively question audit reports to assess the performance of the bank as well as the performance of the internal auditors.

FIGURE 18

Management Commitment to Accurate Financial Reporting



Source: Author (2016)

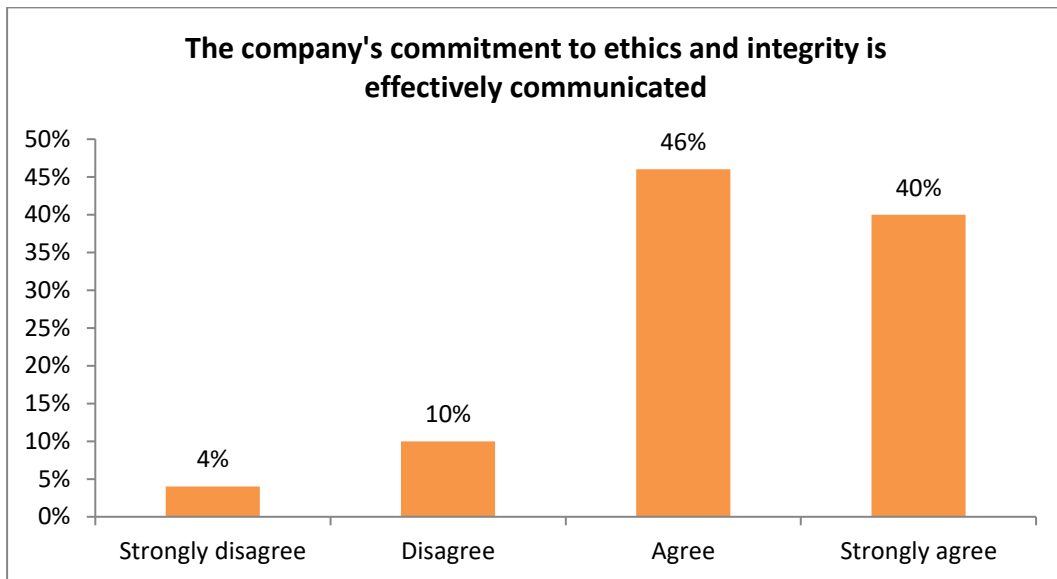
Communication of ethical values by management. An individual with lower ethical standards, when given an opportunity is more likely to commit fraud or turn a blind eye on fraud occurrence and less likely to enforce measures to prevent occurrences of fraud. In addition an entrenched culture of organizational dishonesty and information manipulation is likely to hinder functionality of the IA department who are at the monitors of the implementation of organizational code of ethics. According to social power theory, top management has the power to influence followers' decision making and internal auditors being part of employees of an organization normally make assessment under the ethical climate in the context of working environment and the

tone at the top. As a result the senior management of the banks should set the example in regards to upholding organizational ethical values since they are the role models which junior staff members emulate. If the management sets a good tone the internal auditors will be more likely to stick to their professional ethics in their judgment while poor ethics among top management will create IA sceptism (Wang & Fargher, 2014). However this relationship is mediated by the IA perception of moral intensity of the risk assessed or identified (Cianci, Arel, & Beaudoin, 2011).

According to 86% of the respondents, the top management effectively communicated their commitment to ethical and integrity values to employees of the banks. Contrary findings were made in a study among commercial banks in Greece which found that senior bank management had develop ethical values and communicated the same to the lower level employees but there was no indication whether these communicated ethical values were upheld by the management (Karagiorgos, Drogalas, & Dimou, 2011). Similar findings were made in a study among commercial banks in Ghana found that top management in the banks not only codified ethical values to be upheld within the bank but also upheld integrity and ethical values in their activities and also held everyone in the bank accountable for their internal control responsibilities (Ayagre, Appiah-Gyamerah, & Nartey, 2014).

FIGURE 19

Communication of Management Ethical Values

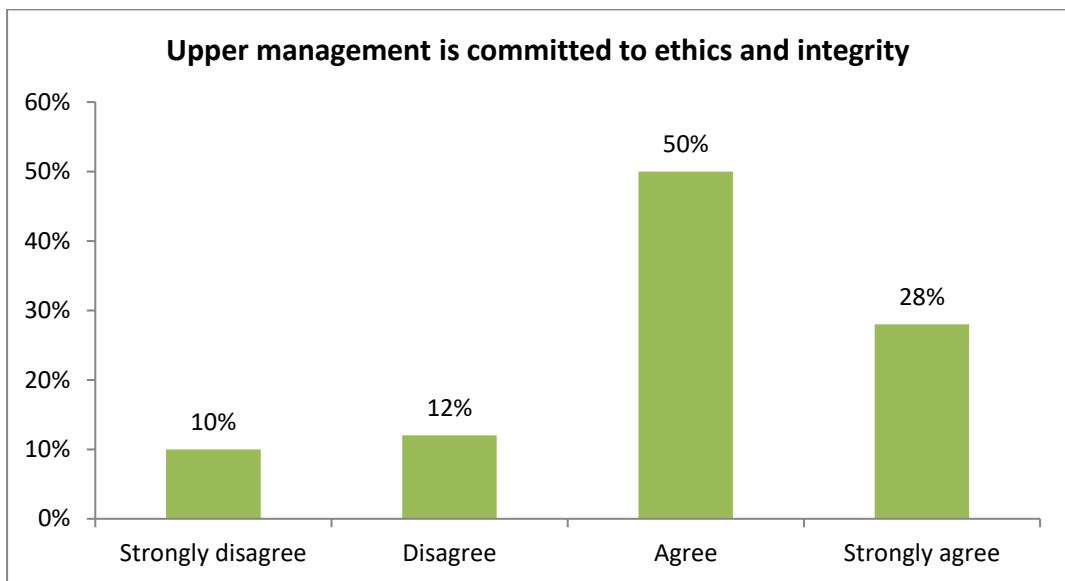


Source: Author (2016)

Management commitment to ethics and integrity. According to respondents 78% of the management was committed to ethics and integrity in executing their mandate. Commitment by the management to ethical values is likely to enhance a culture of fraud reporting among employees of the bank. This was similar to findings in a study among employees of the Kenya Revenue Authority who gauged that the management acted with integrity and upheld ethical values in decision making although there were wide variations in ratings of integrity of management (Mwachiro, 2013). Contrarily Wang and Fargher (2014) observed that they poor top management tone acted as an important signal to potential financial misstatements hence increased vigilance and reporting by the IA hence increased IA effectiveness.

FIGURE 20

Management Commitment to Ethics and Integrity



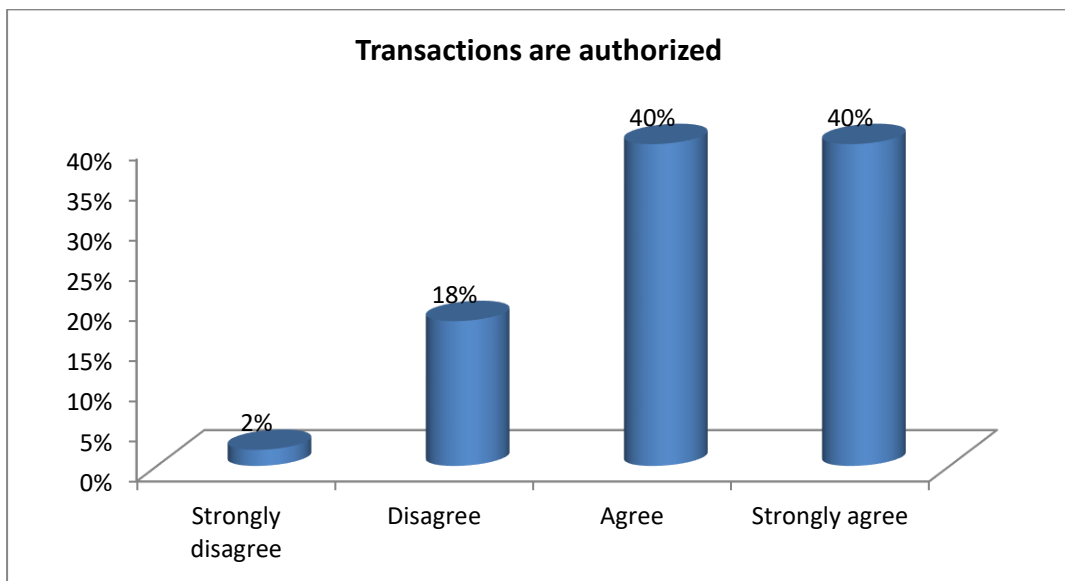
Source: Author (2016)

4.6.2 Allocation of responsibility and authority

Authorization and verification of transactions. According to respondents 80% of transactions in the banks were properly verified and authorized. Adequate authorization and verification of transactions diminishes the likelihood of fraud occurrence in the bank.

FIGURE 21

Authorization and Verification of Transactions

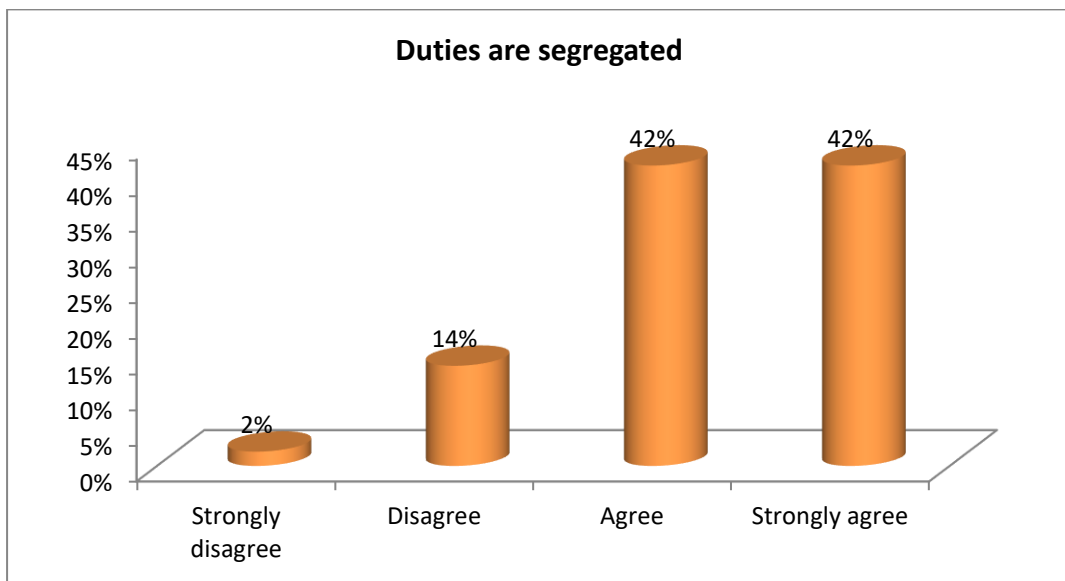


Source: Author (2016)

Segregation of duties. According to 84% of the respondents, duties within the bank were adequately segregated such that different people perform different jobs. However there was average periodic rotation of duties and critical decisions were averagely made within appropriate approvals. These findings were similar to a study among employees of the Kenya Revenue Authority which revealed that duties in transactions processes were adequately segregated but there was indifference with regards to security measures to safeguard against unauthorized access to organizational resources and information (Mwachiro, 2013). The findings were also similar to a study among commercial banks in Mogadishu which revealed clear separation of duties and presence of adequate control over access to bank's information and resources (Abdi, 2015). Contrary findings were made among internal auditors in commercial banks in Greece where about half of internal auditors thought that there was unclear determination of duties segregation (Karagiorgos, Drogalas, & Dimou, 2011).

Figure 22

Segregation of Duties

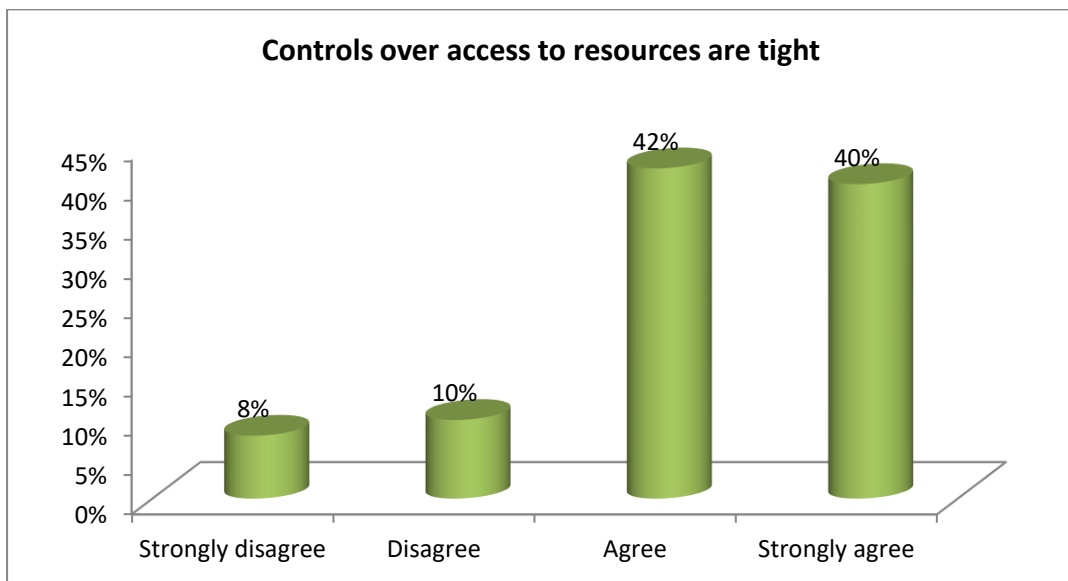


Source: Author (2016)

Control of access to resources and information. According to 82% of the respondents, there was adequate control over access to organizational resources and information which hindered unauthorized access. Contrary findings were also made in Nigeria where it was observed that there was low control of access to valuable organizational information and that likelihood of a unauthorized staff to access valuable financial information (Ejoh, &Ejom, 2014).

FIGURE 23

Control of Access to Resources and Information



Source: Author (2016)

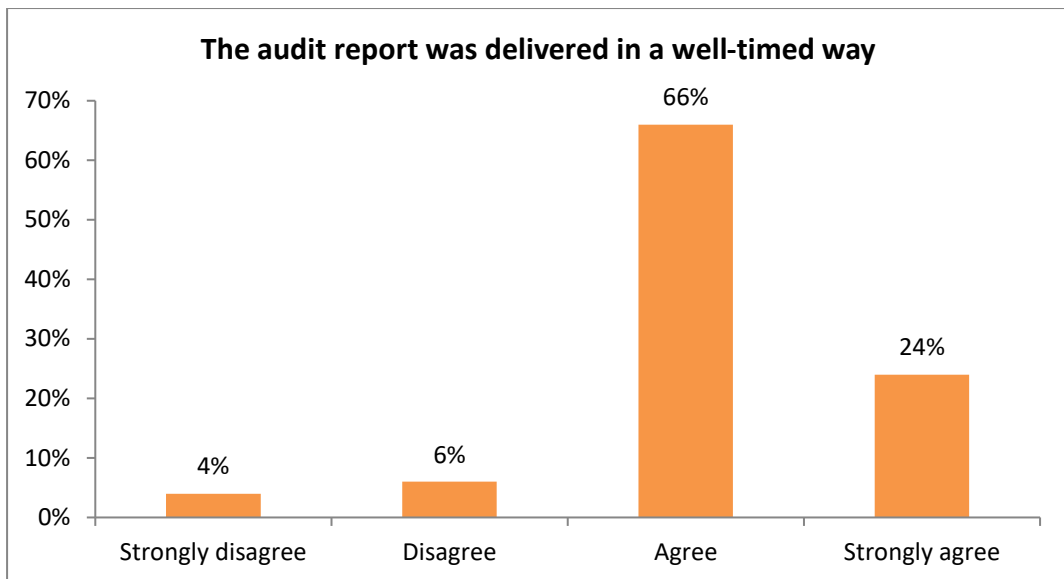
4.7 Effectiveness of Internal Audit

4.7.1 Usefulness of IA recommendation

For IA recommendations to contribute meaningful value to the banks it must guide improvement of management as well as helped in minimization of organizational risks facing the banks. However these recommendations cannot add value to the organization unless it is communicated within time limits. Timely communication of IA report and its recommendations enable the management to react to the issues raised in a timely manner thus effectively mitigating organizational risks identified. Delay in presentation of audit recommendations implies that the bank's external auditors will lack a basis of their audit work hence having to take a long time in auditing the bank systems which may be costly to the banks. According to 90% of the respondents, the audit reports were delivered in a timely manner to enable the bank react to the issues raised in the audit report.

FIGURE 24

Timing of audit reports

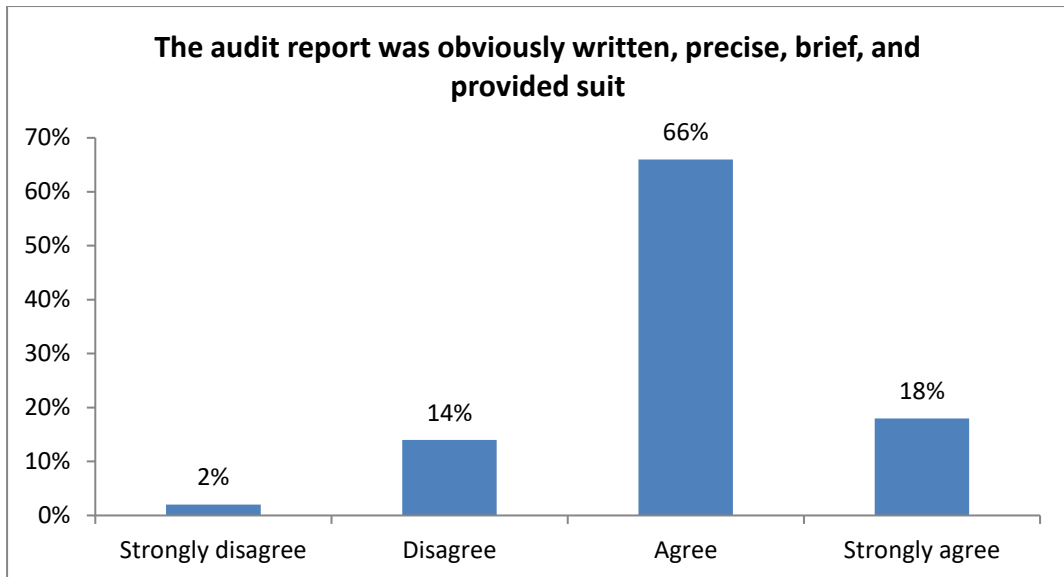


Source: Author (2016)

Quality of audit reports. Trivially written IA findings add no value to the organization or lead to inappropriate decisions and conclusions. This will imply that the banks might not realize Value for Money for investments made in maintain an IA department. As a result IA reports must be precisely written to add value to the bank and contribute to better corporate governance which improves the financial performance of the banks. According to 84% of the respondents the IA reports were precisely written presenting a suitable viewpoint of the banks at specific point in time which was mostly relied by the external auditors to evaluate the organizations. This indicated that the IA report produced was relevant and comprehensive.

FIGURE 25

Quality of audit reports



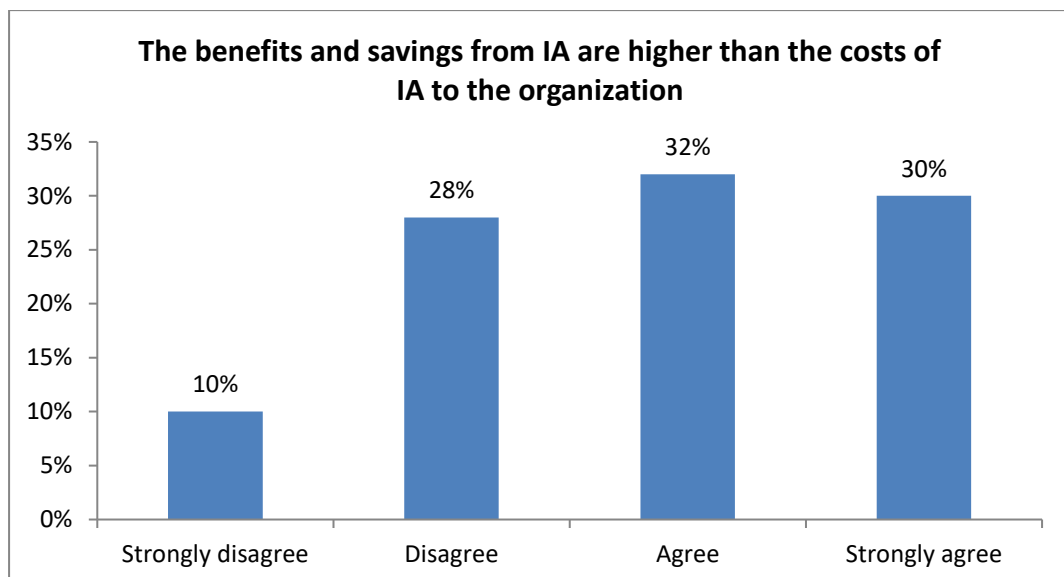
Source: Author (2016)

Value for money. For a control system to be described as effective there should be proportionate realization of benefits resulting from costs incurred in implementing a control activity. However 62% of the respondents were of the opinion that benefits and savings accruing from utilization of IA recommendations exceeded the costs of maintaining an IA department within the bank. This indicates that IA activities were mostly used as value added service to the banks rather than the traditional approach where IA is merely used for compliance to regulations required by the Central Bank of Kenya. These findings were contrary to findings made in a study among Tanzanian and Luthanian commercial which observed that the IA were minimally involved in risk management at the banks and therefore were perceived to serve little functions other than aiding the banks to comply with statutory requirements (Ramachandran, Subramanian, & Kisoka, 2012; Karmanova, 2013). These findings also contradicted a study among commercial banks in Ghana which revealed that although some

commercial banks had IA department, they were not strong enough to provide significant value to the concerned banks (Ndamenu, 2011). The findings were however similar to a study among commercial banks in Nigeria which found that IA not only helped in compliance with statutory requirements but also enhanced management effectiveness and efficiency of banking operations well above costs incurred in maintaining an IA department (Etuk, 2011).

FIGURE 26

Benefits versus costs of IA in the bank



Source: Author (2016)

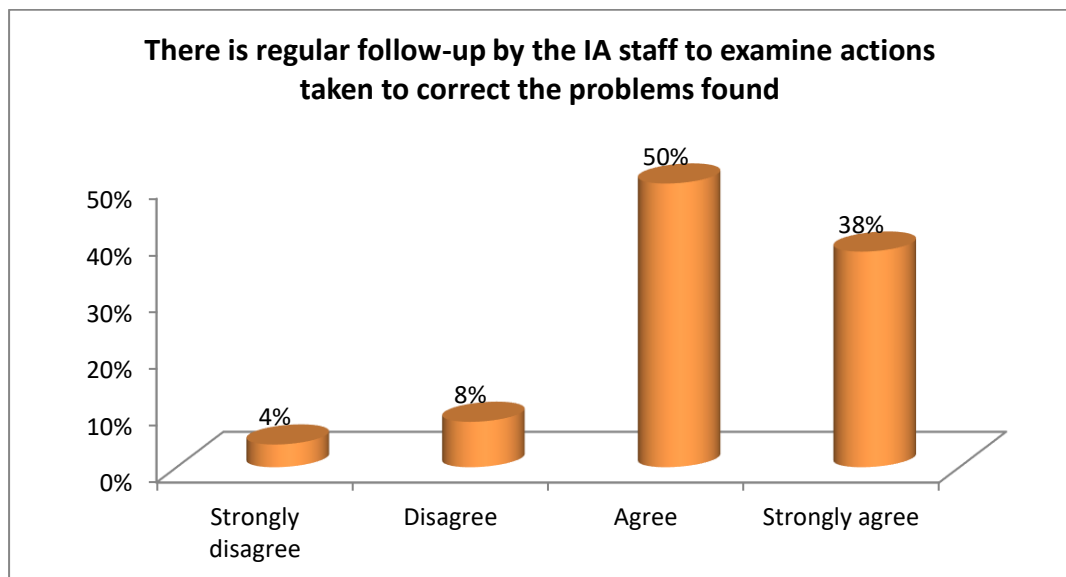
4.7.2 Effectiveness of IA communication

According to 88% of the respondents, IA had regular follow up of issues raised in IA recommendations to see if corrective actions were taken on problems identified in the IA reports. Communication plays a central role in functionality and effectiveness of IA since the IA should be clear to the auditors and as well be abreast with new development within the organization. Furthermore their reports should be clearly

communicated to the management for appropriate follow up on identified organizational risks. According to Mihret and Yismaw (2007), IA credibility and impetus of the IA recommendations will be significantly lost if there is no follow up of previous IA recommendations. These findings were similar to a study among Jordanian commercial banks which found that the management had consistent follow-up of the IA recommendations and IA performance which enhanced performance of IA departments in the subsequent IA reports (Awdat, 2015).

FIGURE 27

Follow-up of IA recommendations



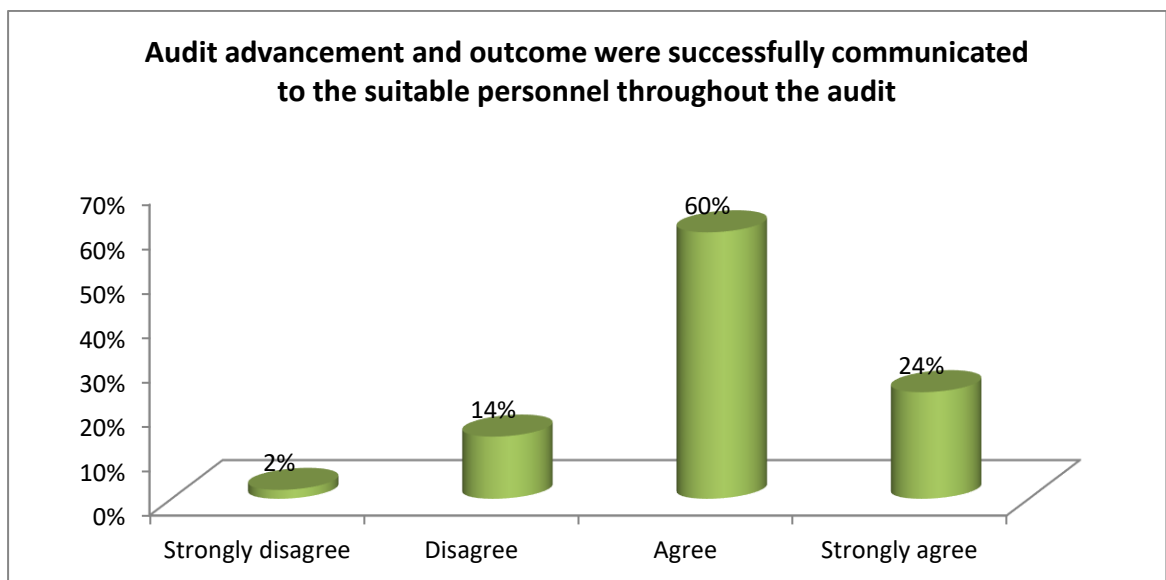
Source: Author (2016)

Audit outcome communication. Internal audit function needs to create solid communication lines with senior management and the audit committee who are the primary stakeholders in order for IA to effectively understand their expectations and needs to reduce chances of occurrence of role conflict and ambiguity resulting from expectations gap. Furthermore a well functional communication system between internal auditors and external auditors reduces audit redundancy as the external auditors will be able to draw heavily from IA reports which are considered to be

valuable based on insider information from IA reports. According to 84% of the respondents, audit advancement and outcome were successfully communicated to the suitable personnel throughout the audit. Similar findings were also recorded among commercial banks in Rwanda where it was found that internal auditors had an effective communication with not only the management, audit committees and board of management but also with the auditees (Nyirabigirimana, 2015). According to Norman et al (2010) there is a tendency of IA to work with the management in solving issues identified by IA prior to meeting Audit Committee or presenting IA report to the board of management so as to avoid over-reaction from the audit committee or board of management.

FIGURE 28

Audit outcome communication



Source: Author (2016)

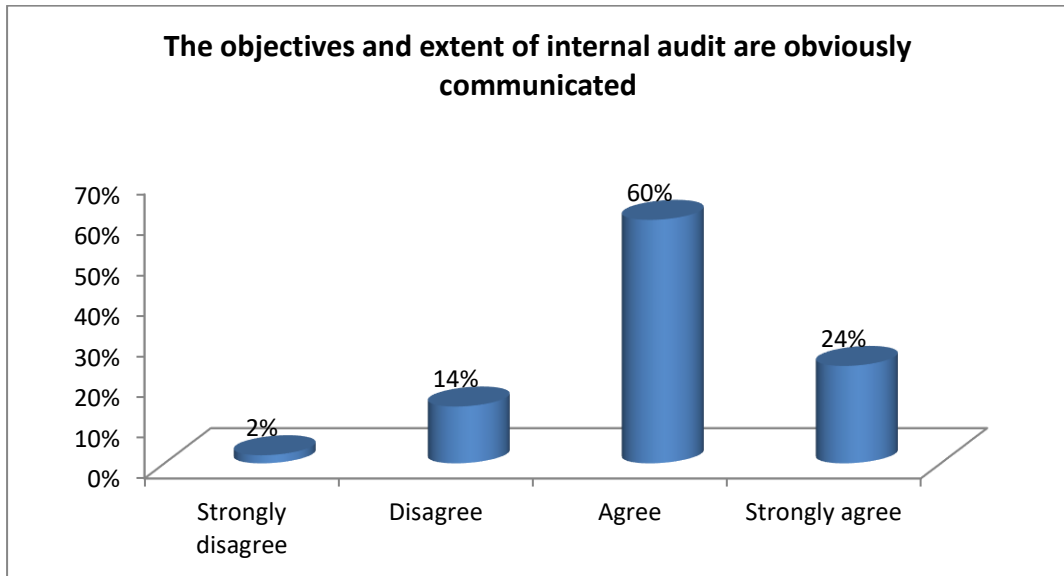
Communication with auditees. Involvement of auditees during IA is particularly necessary since they are the implementers of IA recommendations and hence it is wise for their opinions to be reflected in IA reports so as to make recommendations practically capable of being implemented. According to 84% of the respondents the objectives and extent of internal audit were obviously communicated to the auditees. This indicated that auditees were considerably involved in generation of IA reports and recommendations. During internal auditing process, the objectives and extent of IA was properly communicated to employees within the bank, and responses to audit queries were submitted in writing. However this might be biased since it only captures the perspective of IA and not the perspective of auditees. Contrary findings were made among commercial banks in Albania which observed that there was insufficient involvement of auditees in drawing audit reports which resulted in impractical recommendations from IA (Kristo, 2013).

Similarly in a study by Drogalas, Karagiorgos and Arampatzis, (2015) communication between IA and auditees was found to be effective among firms listed in Athens Stock Exchange. Similarly also among Tanzanian commercial banks it was found that internal auditors had high interaction with members of the audit committee that resulted better functionality of internal auditing (Ramachandran, Subramanian, & Kisoka, 2012). Contrary findings were made in a study among Greek commercial banks in which found that nearly 50 percent of banks employees believed that organizational objectives set by the management were unrealistic due to non-involvement of lower cadre employees during goal setting (Karagiorgos, Drogalas, & Dimou, 2011). Similar findings were made among Ghanaian commercial banks which found that the management had developed a communication system to track the

timeliness of the implementation of recommendations from IA reports (Ayagre, Appiah-Gyamerah, & Nartey, 2014).

FIGURE 29

Communication with the auditees



Source: Author (2016)

4.8 Determinants of IA Effectiveness

To establish the predictors of IA effectiveness, simple and multiple linear regression were run on averages for each of the independent variables (individually and combined) against the averages of items about IA effectiveness as shown in Table 4.2. The results in model 1 (simple linear regression) indicated that audit inputs significantly predicted up to 9.2% of IA effectiveness (Coefficient of Determination, $R^2 = 0.092$, p-value = 0.032). Results in model 2 (simple linear regression) indicated that audit process significantly predicted up to 15% of IA effectiveness (Coefficient of Determination, $R^2 = 0.150$, p-value = 0.005). Results in model 3 (simple linear regression) indicated that audit environment significantly predicted up to 16.5% of IA effectiveness (Coefficient of Determination, $R^2 = 0.165$, p-value = 0.003). Results in

model 4 (multiple linear regression) indicated that IA inputs, process and IA environment significantly predicted 29.2% of IA effectiveness (Coefficient of Determination, $R^2 = 0.292$, p-value = 0.001).

TABLE 5
ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.	R squared
1	Regression	.521	1	.521	4.872	.032 ^a	.092
	Residual	5.134	48	.107			
	Total	5.655	49				
2	Regression	.851	1	.851	8.497	.005 ^b	.150
	Residual	4.805	48	.100			
	Total	5.655	49				
3	Regression	.933	1	.933	9.485	.003 ^c	.165
	Residual	4.722	48	.098			
	Total	5.655	49				
4	Regression	1.626	3	.542	6.330	.001 ^d	.292
	Residual	3.938	46	.086			
	Total	5.563	49				

a. Predictors: (Constant), IA inputs
 b. Predictors: (Constant), IA process
 c. Predictors: (Constant), IA Environment
 d. Predictors: (Constant), IA environment, IA process, IA Inputs

Source: Author (2016)

As shown in the Table 4.3 below in model 4, when IA inputs, processes and environment were taken into consideration unit increase in IA processes caused 0.346 increase in IA effectiveness. However IA inputs and IA environment were not significant predictors of IA effectiveness. This showed that IA processes fully mediated the relationship between IA effectiveness and IA inputs and environment. When IA processes were taken into consideration, organizational integrity values and duties allocation did not significantly predict IA effectiveness. This was similar to results found by Stewart and O'Leary (2006) and O'Leary and Stewart, (2007) who

found that governance mechanisms and management integrity regarding accounting policies in an organization did not affect functionality of internal auditors. This was contrary to a study by Wang (2015) found that internal auditors' effectiveness were lower if the management tone is poor as compared to when the management tone is good. Contrarily also are, Davidson and Gramling, (2008) and Hansen, et al (2009) who observed that internal auditors normally alter their audit plans to reflect management's tone.

TABLE 6
Regression Coefficients Table

Model		Unstandardized Coefficients		t	Sig.
		B	Std. Error		
1	(Constant)	2.516	.263	9.566	.000
	IA inputs	.185	.084	2.207	.032
2	(Constant)	2.161	.321	6.735	.000
	IA process	.330	.113	2.915	.005
3	(Constant)	2.162	.304	7.118	.000
	IA Environment	.307	.100	3.080	.003
4	(Constant)	1.623	.341	4.753	.000
	IA process	.346	.126	2.752	.008
	IA Inputs	-.053	.104	-.510	.612
	IA environment	.213	.126	1.691	.098

Source: Author (2016)

4.9 Influence of IA Inputs on IA Effectiveness

As indicated in the Table 4.3 above, a unit increases in IA inputs causes 0.185 units increase in IA effectiveness. This implied that higher education and professional qualification of auditors, increased number of certified IA and adoption of modern IA technology and IA industry best practice enhanced IA effectiveness. This was similar to studies among Tanzanian, Ethiopian and Libyan commercial banks that found that auditors' competencies affected effectiveness of internal audit (Ramachandran,

Subramanian & Kisoka, 2012; Deribe & Regasa, 2014; Ashour, Sukoharsono & Ghofar, 2015). This was contrary to a study among Jordanian commercial banks which found that auditors' competence and proficiency did not affect IA quality (Al-Khaddash, Al-Nawas & Ramadan, 2013).

4.10 Influence of Internal Audit Process on IA Effectiveness

As indicated in the Table 4.3 above a unit increase in IA process causes 0.330 units increase in IA effectiveness. Further analysis revealed that relationship with external auditors (Pearson Correlation Coefficient, $R^2 = 0.421$, p-value = 0.002) and IA independence (Pearson Correlation Coefficient, $R^2 = 0.421$, p-value = 0.002) were positively correlated with IA effectiveness but management support (Pearson Correlation Coefficient, $R^2 = -0.124$, p-value = 0.391) was not significantly correlated with IA effectiveness. This implied that better relationship with external auditors and increased IA independence was associated with increased IA effectiveness. Existence of coordination mechanism between external and internal auditors helps mitigate against influences of poor top management tone even in situation where IA is fully independent from management influence (Cianci, Arel, & Beaudoin, 2011; Wang & Fargher, 2014). This was contrary to a study among commercial banks in Libya which found that management support positively correlated with IA but there was no significant correlation between IA effectiveness and IA independence as well as the relationship between internal and external auditors (Aburabe, 2015).

4.11 Influence of Audit Environment on IA Effectiveness

As indicated the Table 4.3 above, a unit increase in IA environment causing 0.307 units increase in IA effectiveness. Further analysis revealed that organizational ethical

values (Pearson Correlation Coefficient, $R^2 = 0.404$, $p\text{-value} = 0.004$) were positively correlated with IA effectiveness while there was no significant correlation between allocation of responsibilities and IA effectiveness (Pearson Correlation Coefficient, $R^2 = 0.121$, $p\text{-value} = 0.403$). This implied that better organizational ethical and integrity values were associated with increased IA effectiveness. Ethical values within an organization are expected to enhance good corporate governance which trickles down to all organizational levels including IA department. This was similar to a study by Wang (2015) found that internal auditors' effectiveness improved when the management tone was good. Similarly, Asare et al. (2008) found that internal auditors tended to ignore inaccuracies in financial reports when the management did not value adequate scrutiny of the accuracy of financial reports hence lower IA effectiveness. This was contrary to results found by Stewart and O'Leary (2006) and O'Leary and Stewart, (2007) who found that management integrity regarding accounting policies in an organization did not affect functionality of internal auditors.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section summarizes findings made from the study. Conclusions drawn from the study findings are also presented herein. Recommendations to the commercial banks are also contained in this section. The chapter also suggests areas for further research and as well as presentation of the limitations of the study.

5.2 Summary of Findings

This study sought to determine factors influencing effectiveness of Internal Audit in the banking sector in Kenya with special focus on the commercial banks in Nairobi. The researcher used cross sectional descriptive study design to explore the influence of IA inputs, IA processes and IA environment on IA effectiveness. The study questionnaire was administered to an equal number of internal auditors in the 40 commercial banks in Nairobi.

5.2.1 *Effectiveness of internal audit*

IA department was a value added service to commercial banks in Nairobi rather than the traditional approach where IA is merely used for compliance to regulations required by the Central Bank of Kenya. The department produced quality reports capable of being relied by external auditors thus resulted to banks realizing higher benefits and savings that exceeded the costs of maintaining an IA department within the banks. Furthermore IA departments had regular follow up of issues raised in

previous IA reports and recommendations to see if corrective actions were taken on problems identified in the IA reports.

5.2.2 *Internal audit input and effectiveness of internal audit*

The regression results revealed that there was a positive impact of IA inputs on IA effectiveness. IA inputs significantly predicted up to 9.2% of IA effectiveness with a unit increase in IA inputs causing 0.185 units increase in IA effectiveness. This implied that higher education and professional qualification of auditors, increased number of certified IA and adoption of modern IA technology and IA industry best practice enhanced IA effectiveness. However the relationship between IA inputs and IA effectiveness was fully mediated by interaction between internal and external auditors as well as independence of internal auditors

5.2.3 *Internal audit process and effectiveness of internal audit*

IA processes such as management support, interaction between internal and external auditors as well as independence of internal auditors were found to positively contribute to IA effectiveness. Audit process significantly predicted up to 15% of IA effectiveness with a unit increase in IA process causing 0.330 units increase in IA effectiveness. This implied that better relationship with external auditors and increased IA independence was associated with increased IA effectiveness. Existence of coordination mechanism between external and internal auditors helped counter the influences of poor top management tone even in situation where IA is fully independent from management influence. Management support on the other hand contributes to facilitate acquisition of better IA inputs hence enhancing functionality of IA and subsequent quality IA reports or recommendations.

5.2.4 *Audit environment and effectiveness of internal audit*

The banks' management was committed to ethics and integrity in executing their mandate. Audit environment significantly predicted up to 16.5% of IA effectiveness with a unit increase in IA environment causing 0.307 units increase in IA effectiveness. This implied that better organizational ethical and integrity values were associated with increased IA effectiveness. However the relationship between audit environment and IA effectiveness was fully mediated by interaction between internal and external auditors as well as independence of internal auditors.

5.3 Conclusions

Based on the study findings, this study concludes that IA in commercial banks was effective enabling the commercial banks to not only comply with regulations laid down by the Central Bank of Kenya but also IA acted as a value added service through which banks are assured of their processes and effectively manage organizational risks. IA departments among commercial banks in Nairobi were relatively staffed with adequate staff, however there was low proportion of certified internal auditors. There was also low adoption of modern technology in IA departments. Commercial banks that had better qualified and sufficient staff had increased levels of IA effectiveness. There was average support from the top management on issues regarding the functionality of IA departments. This was typified by lack of provision of sufficient number of staff in IA department relative to the amount of work needed to generate an IA report as well as provision of insufficient funds to the IA department. Internal auditors had constrained relationship with external auditors since the former perceived the later as fault finders. Commercial banks with better relationship between internal and external auditors and

more independent IA had increased IA effectiveness. Transactions in the banks were properly verified and authorized and duties within the bank were adequately segregated such that different people perform different jobs with periodic rotation. Management of the banks were committed to accurate financial reporting and high ethical values. Commercial banks with higher ethical values had increased IA effectiveness but allocation of responsibilities within the banks did not affect IA effectiveness.

5.4 Recommendations

Based on the study conclusions, the researcher recommends that IA department should consistently communicate with auditees to clearly explain the objectives of the internal audit as well as clearly dispel information the auditors required from the auditees. This will go a long way in improving collaboration between IA and auditees hence easing the work of IA considering number of IA and amount of work to be done. The bank management should ensure IA is properly staff with sufficient number of IA as well as ensure presence of sufficient certified IA to enhance quality of IA reports. The bank management should also make efforts in adoption of latest IA technology as well as IA industry best practice. The IA department should foster ways of collaborating with external auditors to reduce negative attitude among internal auditors as well as mitigate against any effects of top management tone as well as increase IA independence. The bank management should seek opportunities for capacity development of existing IA to boost their professionalism and ensure that all IA within the bank are registered and certified in their respective professional bodies for effective internal auditing. The bank

management should also set up systems for effective rotation of duties among staff to reduce chances of IA colluding with other staff in audit queries.

5.5 Limitations of the Study

The study was based on self-report on all aspects of IA audit effectiveness as well as IA inputs, processes and audit environment. This implied that the results were limited to the truthfulness of the head of internal audit department. Being a cross-sectional study design, the findings only apply for a specific time stamp which was limited since IA is a continuous monitoring of happenings within a bank if it has to detect and prevent occurrences of fraud. The study only evaluated one component of internal control system and thus small contribution to internal control system to the bank's corporate governance.

5.6 Recommendations for Future Research

There is need to replicate this study among other members of the internal audit department as well as members of audit committees since they are significant contributors to functionality of the internal audit department. This study showed that tone of top management contributed to IA effectiveness, there is need therefore to assess the contribution of general organizational culture on IA effectiveness.

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Appendices

Appendix 1: Consent Form

Dear Participant,

Introduction

I am **Balozi, M. Omasire** a student Masters Science of Commerce at KCA University. I am carrying out a study to determine the factors influencing Internal Audit effectiveness in the commercial banks in Kenya.

Your participation

Questions will be asked to you about internal audit within your bank. It may take your 1 hour to answer these questions. Your participation in this study is completely voluntary and there no consequences to you or your organization if you chose not to participate. You may refuse to answer any question or choose to stop the interview at any time. There is no payment for participation in this study.

Benefits/ Risks

There is no direct benefit to you from participating in this study. However your responses will be aggregated, summarized and analyzed for the award of the university degree, and at the same time policy makers in Kenya will utilize the study results to champion for more effective management of the financial sector.

There is minimal risk in participating in this study. We will ensure that all information you provide will be kept confidential and no identifiers will link specific responses to you as an individual. Names are not required in this study. Should you have any questions about the study please feel free to contact the University.

Signature of Respondent

Date

Appendix 2: Questionnaire

Section 1: Bio Data

1. Bio-Data

Age		Gender		Highest Level of Education	
<30		Male			
31 - 35		Female		Masters	
36 - 40				Graduate degree	
>40					

2. Economic characteristic

Monthly income (Kshs)	
≤100000	
100000 – 200000	
> 2000000	

Section 2: Factors influencing effectiveness of internal audit

a. Audit Inputs

3. How do you agree with the following statements regarding Internal Audit inputs? 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
IA employees have the appropriate and relevant education in auditing				
IA has experienced of employees,				
There is sufficient adoption of modern technologies and best practices of IA in the industry				
There is sufficient number of certified internal auditors				

b. Audit Process

4. How do you agree with the following statements regarding management support for Internal Audit? 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
The number of employees in IA is limited given the amount of auditing work to be done				
Management is not sufficiently aware of the needs of IA, as demonstrated by the small budget assigned to this department				

Management does not provide enough capacity building programs to IA staff				
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5. How do you agree with the following statements regarding the relationship between Internal Auditors and External Auditors? 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
There is good working relationship between internal and external auditor and external auditors trust their reports.				
There is sufficient informal communication between IA and external auditor				

6. How do you agree with the following statements regarding the independence Internal Auditors? 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
I have regular and direct working relations with the managerial team and terminating work of the IA requires the approval of the board of directors				
The IA staff has free and unrestricted access to information and data about the organization				
The IA staff are rotated and they performs other activities even if they are not defined as its direct responsibility				

c. Audit Environment

7. Please indicate your assessment of your organization adoption or implementation of the element in the most recently completed fiscal year. 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
Management is committed to high quality, accurate financial reporting				
The company’s commitment to ethics and integrity is effectively communicated throughout the organization in both word and action				
Upper management uphold ethics and integrity values				

8. Please indicate your assessment of your bank adoption or implementation of the element in the most recently completed fiscal year. 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
Transactions are not authorized				
Duties are not segregated				
Verifications of transactions and authorization are not done				
Controls over access to resources are not tight				

Section 3: Internal Audit (IA) Effectiveness

9. How do you agree with the following statements regarding the Internal Audits reports? 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

	1	2	3	4
The response of auditees to the audit is timely submitted				
The audit report was written, precise and brief				
The benefits and savings from IA are higher than cost incurred				

- a) How do you agree with the following statements regarding the communication of Internal Audits reports? 1 - Strongly Agree; 2 - Agree; 3 - Disagree; 4 – Strongly Disagree

Statement	1	2	3	4
There is regular follow up by the staff to examine actions taken on areas of concern				
Audit advancement and outcome were successfully communicated to the suitable personnel throughout the audit.				
The objectives and extent of internal audit are obviously communicated.				

Appendix 3: Work Plan

Activity	2016				
	May	June	July	August	Sept
Proposal writing					
Preparation of data collection instruments and pilot research					
Data collection (distribution of questionnaire's and interviewing)					
Data coding and interpretation					
Findings, conclusion and Project presentation					

Appendix 4: Budget

Item	Amount (Kshs)
Travelling and accommodation	20,000
Communication (telephone calls and data bundles)	10,000
Stationery	10,000
Type-setting and Printing	20,000
Data analysis	20,000
Data storage	10,000
Miscellaneous (10%)	15,000
Total	105,000