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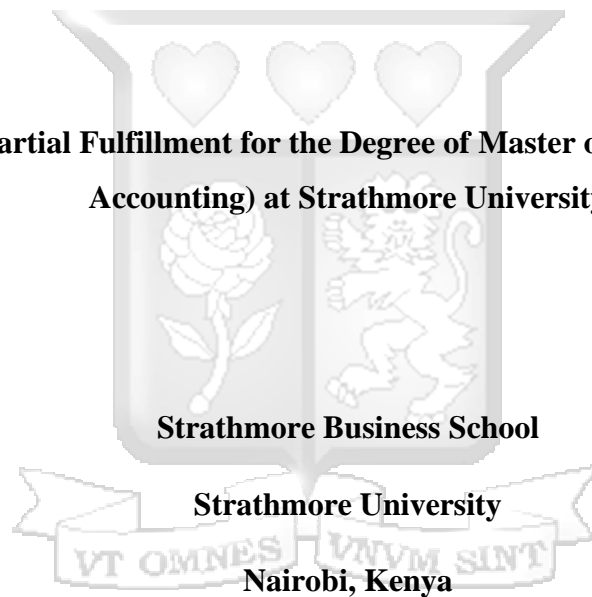
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**An Examination of The Drivers of External Audit Quality of Commercial Banks in  
Kenya**

**ANTHONY ONGOMA SHITANDI**

**Submitted in Partial Fulfillment for the Degree of Master of Commerce (Forensic  
Accounting) at Strathmore University**



**July, 2020**

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28<sup>th</sup> April, 2020

## Approval

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## ABSTRACT

This research focused on establishing whether adoption of the International Professional Practicing Framework (IPPF) by Internal Audit Activities (IAA) of Commercial Banks has an effect on the quality of External Audit reporting. The study used census sampling as it targeted two staff from each of the 42 commercial banks regulated by Central Bank of Kenya. This study utilised primary method of collecting data, by use of questionnaire, as well as secondary data that was generated through a review of relevant documents. The correlation findings show that characteristics of external audit was positively correlated to audit quality ( $r=0.542$ ,  $p = 0.01$ ). The results of the regression analysis indicate that external audit characteristics has an impact on external audit quality to a high degree. The influence of the external audit characteristics decreases after the introduction of IPPF ( $B=0.693$ ,  $p = 0.01$ ). The influence of governance and management is neither felt before nor after the introduction of IPPF. The mediator, in this case, is the international professional practice framework (IPPF). If significant, MV causes the relationship between the independent and dependent variables to weaken. If not significant, IPPF simply becomes an independent variable. IPPF was found to slightly influence audit quality ( $B=0.094$ ,  $p = 0.01$ ). The study established that adoption of IPPF positively influenced the quality of external auditing. The study also found out that external audit characteristics significantly influenced the quality of the external audit. Further, the study established that governance and management of banks influenced the quality of external audits. Commercial banks IAA should, therefore, be encouraged to follow IIA guidelines on the international professional practice framework. The guidelines of IPPF ensure that the internal audit functions are as per the recommended standards. They should also re-evaluate their governance and management to see whether they meet the standards set by CBK as well as IIA. A wider study needs to be conducted to focus on both public and private institutions in Kenya.

**Key words:** *International Professional Practicing Framework (IPPF), Internal Audit Activities (IAA), Institute of Internal Auditors (IIA).*

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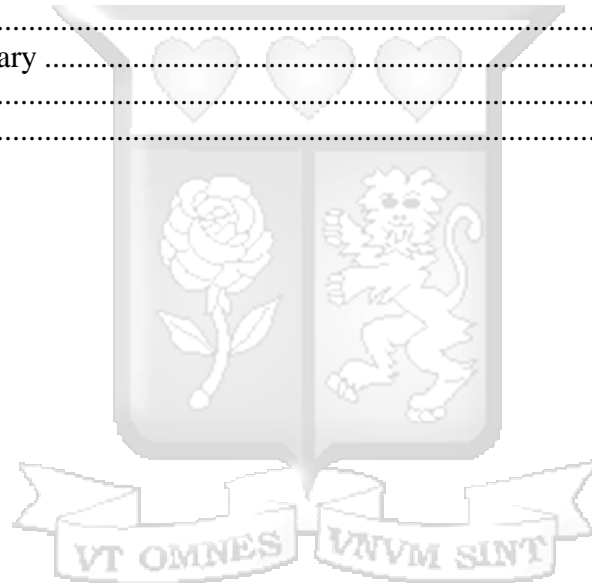
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## LIST OF ABBREVIATIONS

AFDB	African Development Bank
CAE	Chief Audit Executive
CBK	Central Bank of Kenya
CIA	Certified Internal Auditor
EACB	East African Currency Board
IAA	Internal Audit Activities
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IIA	Institute of Internal Auditors
IPPF	International Professional Practicing Framework
ISPPIA	International Standards for the Professional Practice of Internal Auditing
ISQC1	International Standard on Quality Controls 1
MOFNT	Ministry of Finance and National Treasury
NGSE	Nigerian Stock Exchange
QAIP	Quality Assurance and Improvement Program
RMG	Risk Management Guideline

## ACKNOWLEDGEMENTS

I return praise and honor to the God who gave me strength to undertake this research thesis after a four-year break from my studies, a period in which I acquired sufficient professional experience in Internal Audit.

I am also thankful to Dr. David Mathuva, my research supervisor, who accepted to take me up for supervision and worked tirelessly in assisting me to accomplish this research; often being more prompt in sharing his review notes than I was in actioning them. I am also grateful to my dad, Joe, who kept reminding me of the urgency, importance and need to successfully attain this milestone. Finally, my special thanks go to Betty, my best friend and mother to my sons, for immense support as I undertook this research.



## DEDICATION

To my son Harvey-Joe Shitandi. Somehow, some way, may you grow into a curious, knowledge seeking young man!



## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background of the Study**

Internal and external auditors have different aims and objectives and, consequently, different priorities and professional requirements. Nevertheless, they follow similar principles, look at some of the same systems and procedures, and use some conventional audit techniques (Anderson et al., 2015). Therefore, effective liaison between external and internal auditors can help to ensure quality, the best value, and overall efficiency are achieved from the total audit effort. In effect, a full understanding of the client by the external audit team can allow external audit testing to be reduced by way of greater reliance on internal control.

The Institute of Internal Auditors (IIA) is the largest international internal audit professional association. In its capacity as the guidance-setting body of the internal audit profession, IIA has put in place the International Professional Practices Framework (IPPF) (Institute of Internal Auditors, 2017). The framework gives its members authoritative guidance on the practice of Internal Audit. Members of the IIA Kenya Chapter are the critical driving force for the Adoption of the IPPF in Kenya. A study by IIA Kenya Chapter established that there is generally a shallow appreciation and adoption of IPPF by Kenyan Internal Auditors. The reason for this is because 85% of the sampled Internal auditors in the study stated that they were not members of the IIA. According to IIA Global, adoption of the IPPFs by Commercial Banks in the U.S. resulted in up to a threefold improvement in their governance, compliance, and internal control environment (Bierstaker et al., 2010).

The International Auditing and Assurance Standards Board (IAASB) sets top-notch international standards for external auditing and encourages their selection and execution (Anderson et al., 2015). Thus, the IAASB improves the consistency and quality of external audit practice all through the world and reinforces public trust in the professional practice of auditing. Independent validation of financial data is usually needed to give users of this information certainty that the data can be relied upon. For financial data to show the value assessment, it ought to be pertinent, convenient, and dependable to address the issues of clients (Evans et al., 2015).

IIA characterizes internal auditing as a free and targeted consulting and assurance action intended to enhance value and advance a company's activities (Bierstaker et al., 2010). By being embedded

in the organization, and reviewing the operations of an organization methodically as laid out in their Annual Audit Plan and Audit Manual, the internal audit activity easily meets and exceeds all measures recommended by IAASB for the attainment of quality audits (Abbott et al., 2020). IAASB characterizes the target of an audit of budget summaries as an attempt to permit the auditor to frame a feeling on the financial statements. It therefore must be dependent on having gotten adequate audit-proof about whether the books of accounting and resulting financial statements are liberated from material error. Further, it will necessitate the auditor to work to an appropriate professional standard and that "a quality audit" be performed for the external audit to satisfy its goal and the audit clients to believe in the subsequent supposition (Peytcheva et al., 2014).

Quality in an audit is determined by key components that boosts the probability that the audits are performed and reported reliably. According to IAASB's recommended framework on audit quality, for an audit to pass the quality test, the engagement team must exhibit appropriate values, ethics, and attitudes (Abbott et al., 2020). They must be experienced, skilled and sufficiently knowledgeable, and have enough time dedicated for the performance of the audit work. They should apply a thorough and continuous quality control procedures and audit processes and that comply with applicable standards, regulation and the law (Institute of Internal Auditors, 2017). They should also provide timely, frequent and useful reports and exercise appropriate level of interaction with the relevant stakeholders. This might not entirely be attainable by two weeks to a one-month external audit engagement team and hence the need for reliance on internal audit activity.

The governance and management of an organization plays a paramount role on the outcomes of audit. The corporate governance is usually the bridge between the organizations directors and the reporting system utilized (Bailey et al., 2004). A strong culture of independence is key if the company is to maintain a healthy and stable audit outcome. The governing body in an organization starts with the stakeholders who in turn appoint directors the management which is usually under the directors. The involvement of internal audit function and the audit committee determines the strength of the governing body (Türetken et al., 2020). When an organization implements a control risk self-assessment practices, its internal audit effectiveness increases (Marika & Giovanni, 2009).

Despite placing reliance on the work of internal auditors by external auditors, the ultimate responsibility for performing a quality audit on financial statements rests with the external auditors. External auditors are required to comply with the IAASB's International Standards on Auditing (ISAs) (Anderson et al., 2015). ISAs are proficient guidelines for the exhibition of a financial audit of financial data. These principles are given by International Federation of Accountants (IFAC) through the IAASB (Holt et al., 2013). Standard 610 of the current ISAs covers "Considering the work of internal audit." The first section of this standard requires an "understanding and preliminary assessment of the framework used by internal audit." Following this, external audit is then required to evaluate the internal audit activity, where the adoption of the IPPFs by the internal audit activity is part of the external auditor's risk assessment (Institute of Internal Auditors, 2011).

This research will assess the moderating effect of the adoption of International Professional Practicing Framework (IPPF) by Kenyan commercial banks on the quality of external audits. Different parts of the IPPF will be taken as a benchmark to gauge the current adoption of internal auditing in the sampled commercial banks and how they affect the quality of the output from external audits.

### **1.1.1 Commercial Banks in Kenya**

Kenyan finance sector is dominated by commercial banks. The Central Bank of Kenya Act Cap 491 and Banking Act Cap 488 are two laws in Kenya that regulate and control the operations of commercial banks. The Central Bank of Kenya performs a supervisory role for commercial banks in order to promote financial stability by establishing and sustaining a sound financial system. According to Chapter 488 of the Banking Act, a Commercial Bank is a firm that implements or purposes to implement banking business in Kenya. There are currently forty- three licensed Commercial Banks in Kenya.

The CBK has it as a mandatory regulatory requirement for banks to undergo an external audit and publish the results annually. However, for external audit engagement teams to produce audit opinions that are reliable and trustworthy, they are required by IFAC to comply with a stringent audit quality framework (Pickett, 2013). This framework holds it as necessary that the engagement team must dedicate adequate time for the performance of an audit assignment. They are required to apply thorough and continuous quality and process procedures that comply with applicable

standards and regulations. However, due to time and resource limitations, it is not possible for external audit teams to always meet these requirements entirely.

CBK has made it a regulatory requirement for all commercial banks to have internal audit activity embedded in their governance framework. To ensure the quality and reliability of audit output, internal audit practitioners follow the IPPF developed and maintained by the IIA. Just like the Quality Framework by IAASB, the IPPFs require internal auditors to be adequately educated, proficient, and skilled and have adequate time allotted. They should apply a continuous and exhaustive audit process and quality control procedures that comply with the applicable standards, regulations, and the law. They are needed to offer valuable, frequent, and timely reports; and relate properly with pertinent shareholders (Holt et al., 2013).

The Banking Act requires that all registered commercial banks hire qualified external auditors approved by the Central Bank and to submit to it annually the audited financial statements plus the audit report (CBK, 2015). The external auditors are compelled to conform to the provisions of the Banking Act and are supposed to report any breach of regulations, cases of fraud, and significant losses that are likely to be unfavorable to the financial performance of the banks. The Act stipulates those who qualify to be appointed as auditors and pays particular attention to auditor independence and professional competence; parameters used in this study as proxies of audit quality.

## **1.2 Statement of the Problem**

External audits are necessary for financial statements to be trusted by users. However, for external audit engagement teams to produce audit opinions that are reliable and trustworthy, they are required both by IFAC and IAASB to comply with a stringent audit quality framework. This framework requires the external audit team to be experienced, skilled, and sufficiently knowledgeable and have enough time dedicated to the audit work's performance. They should apply thorough and continuous quality control procedures and audit processes and comply with applicable standards, regulations, and the law (Institute of Internal Auditors, 2017). They should further provide timely, frequent, and useful reports and exercise an appropriate interaction level with the relevant stakeholders.

However, the external audit engagement team is constrained by time and, at times, in-depth technical knowhow of the operations of the organizations. A statutory audit will take approximately two weeks to one month. As such, the engagement team might not have sufficient



time to apply thorough and continuous quality and audit processes and provide timely, frequent, and useful reports and ensure an appropriate level of interaction with relevant stakeholders. Partly as a solution to this, the ISA 600 provides for and gives guidelines on the reliance on another auditor's work in the exercise of their external audit activity. Towards this end and to attain quality in internal controls monitoring, the CBK has made it a regulatory requirement for all commercial banks to have internal audit activity embedded in their governance framework.

The high reliance and expectation placed in commercial banks' internal audit divisions necessitate that specific quality standards need to be maintained in the way IAAs are undertaken. The IIA developed and supported a full range of guidance for practitioners through IPPF to help internal auditors ensure the highest quality level internal audit results in diverse environments. The IIA, a globally leading professional institution on internal auditing practices, issued three sections for mandatory guidance that any quality internal audit practice should adapt. They are a) definition of Internal Auditing, b) the standards for professional internal audit practice and c) code of ethics. IIA asserts that compliance with IPPF improves the quality and reliability of the External Audit process and outcome. No study has been undertaken to taste this assertion.

Studies done on characteristics of external audit have pointed out the significance of independence of auditors, audit fees, expertise etc in improving the financial performance of companies (Silviu, 2014; Aledwan et al., 2015 and Al-Dalabih, 2018). On the role of governance, studies have shown its positive influence on improving auditor's decisions (Dwekat et al., 2018), financial statement (Salehi et al., 2015), and quality of auditor's report (Ejeagbasi et al., 2015). Very few studies have been undertaken on the effect of IPPF on either the drivers of external audit or on the quality of external audit. It is therefore important to carry out a study that reflects on the IPPF as the moderating variables between drivers of external audit and the external audit quality.

Therefore, this study will seek to establish whether the current practices of IAAs in Kenyan Banks follow IPPF standards and if such compliance affects the quality of the external audit's output. The implication will be that regulators and professional bodies embrace commercial banks' internal audit functions to be in full compliance with the IPPF Framework. This would benefit the entire banking ecosystem can benefit from reliable internal control testing processes and improved quality of external audit reports.

### **1.3 Research Objectives**

#### **1.3.1 General Objective**

This research examined the drivers of external audit quality of commercial banks in Kenya.

#### **1.3.2 Specific Objectives**

The objectives that this research intended to achieve, specific to commercial banks in Kenya, were:

- i. To establish the effect of governance and management on the quality of external audit
- ii. To examine the effect of external audit characteristics on external audit quality
- iii. To establish the moderating effect of IPPF on drivers of external audit quality

### **1.4 Research Question**

With reference to CBK licensed commercial banks;

- i. What are the effects of management and governance on external audit quality?
- ii. To what extent does external audit characteristics influence external audit quality?
- iii. What is the moderating effect of IPPFs on drivers of external audit quality?

### **1.5 Significance of the Study**

This research may benefit different stakeholders in different ways, as stated below.

#### **1.5.1. Significance to public and private commercial banks**

Private and public commercial banks may benefit from the study as it identified the gaps between the internal audit activities as currently being undertaken by them against as it should have been as per the IPPF standard issued by the IIA. The areas of weaknesses, and effects of such areas on external audit quality, was identified for improvement, and recommended remedies may be used all commercial banks in Kenya.

#### **1.5.2. Significance to other researchers**

The research outcome might be a valuable addition to the body of knowledge on IIAs IPPF Compliance. It might serve other researchers working on the same or similar subject matters as a starting point and reference paper. No research that I am aware of has examined effects of adoption of IPPFs by Kenyan Commercial Banks against external audit quality. Further, this research paper will shed light on the local adoption of IPPF which is an international internal auditing framework.

## **1.6 Scope of the Study**

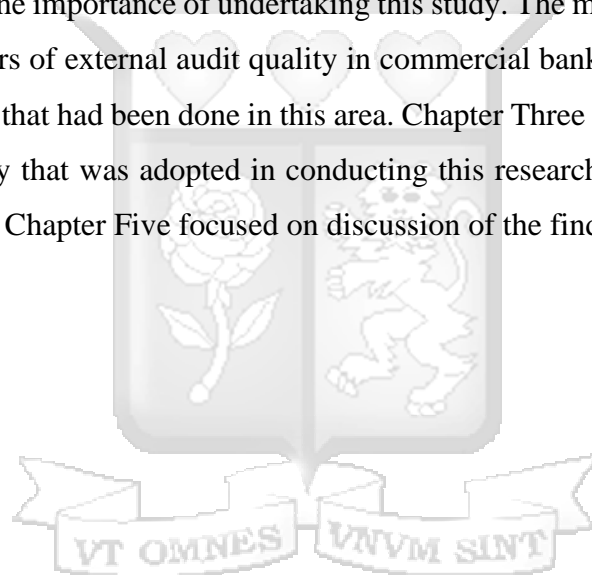
The study focused on the adoption of IPPF's as pronounced by the IIA and effect of such adoption on the quality of external audit as defined by the IAASB's Audit Quality Framework.

## **1.7 Limitations of the Study**

The research was only conducted within the commercial banking sector, living out a wide range of other regulated and under-regulated sectors of the economy. One sector of the economy may not necessarily be enough for the researcher to draw an inference that will be applicable across all sectors since industries vary in nature and their requirements from their internal audit function.

## **1.8 Organization of the research**

This chapter focused on the importance of undertaking this study. The main objective of this study was to examine the drivers of external audit quality in commercial banks in Kenya. Chapter Two reviewed academic work that had been done in this area. Chapter Three was devoted to discussing the research methodology that was adopted in conducting this research. Chapter Four presented the research findings and Chapter Five focused on discussion of the findings, research conclusion and recommendations.



## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter reviews literature on concepts related to IPPFs, external audit quality and its drivers. The first section looks at the theoretical review of literature. Theoretical literature covering the agency theory and lending theory are detailed. In subsequent sections, an empirical review based on the study's objectives is also covered. The section also gives background information about internal auditing. It also highlights the IIA as a global body that oversees IAAs and professional internal auditors worldwide. The chapter further summarizes the research variables using conceptual framework before finally detailing the research gaps.

### **2.2 Theoretical Review of Literature**

Various theories have been advanced on the role of internal audit and external audits in ensuring credible financial performance management and reporting. These have been outlined below:

#### **2.2.1 Agency Theory**

Agency theory addresses the issues that can, and that do, exist in an agency relationships between the shareholders as the principals and the management of the company as the agents (Meckling & Jensen, 1976). The first issue addressed is the conflict between the interests of the principal and those of his agents, Company executives. Secondly, the issues arising from the varying attitudes towards risk by the agent and the principal is also addressed. Due to differences in risk tolerance as well as core interests, the principal and agent may both be inclined towards decisions that aren't always aligned.

An agency relationship is an agreement under which at least one person(s) (principal) connects with someone else (agent) to play out some assistance for their sake, which includes appointing some dynamic power to the agent (Meckling & Jensen, 1976). Agency theory, in its purest form, assumes that principals and agents will take into account all available information rationally and instantly in their decision-making (Watt & Zimmerman, 1986). In imperfect markets, the principals cannot know everything at any one point in time, hence the need to incur agency costs as a means of monitoring. This involves contracting internal and external auditors.

Adam uses agency theory to check the internal audit office as a significant detecting body that empowers the executives to assess conceivable data asymmetry among principals and agents

(Adam, 1994). He further questions why some companies have internal audits while others don't and observe that more complex organizations are more likely to have internal audit departments than the less complex organizations. The rationale behind his argument is that more complex industries and organizations tend to have a high degree of information asymmetry, and hence the high appetite for monitoring to reduce this information asymmetry which in most cases results in the need for an internal audit function.

Larger internal audit functions tend to have a diverse skill representation from the staff that is geared towards reducing the wide range of information asymmetry problems. The agency concept is considered as the basic principle behind the demand for corporate governance, which forms the rising significance of internal audit monitoring duty in modern corporate governance (Carcello et al., 2005). Following from the above, it is apparent that agency theory clearly outlines the need for the existence of internal audit as well as the scope of the internal audit function. Under this study, the principal agent association was between the organizations' governance and the external auditors.

### **2.2.2 Lending Credibility Theory**

Lending credibility theory was introduced in 2005 by Dennis Hayes and others (Hayes et al., 2005). The theory is based on the argument that the main role of audit is to add credibility to the financial statements. Financial statements are used by management to enhance the faith that the stakeholder has in management's stewardship. If stakeholders have to make their judgments based on the information they receive, they must have faith that this is a fair representation of the economic value of the company (Joseph et al., 2011). Thus, auditing reduces the information asymmetry between management and stakeholders. It is important to for the auditor to lend credibility to the investors of the company. Financial statements are the credible way of ensuring that this happens.

The lending credibility theory asserts that auditing can enhance stakeholder's confidence in activities and prospects of the organisation (Volosin, 2007). The corporate ecosystem consists of diverse groups that participate in, or are affected by, reporting requirements of regulatory authorities. Such groups include potential investors, shareholders, company executives, lenders, staff, government, and others. For instance, the choices of investors are generally founded on financial reporting of the state of affairs as presented by the organization's officials (Denton et al., 2012). The external auditor is nominated by the corporation's shareholders, who he/she reports to.

The auditor's report aims to comment on the accuracy of executives' reports on the financial performance of the company is. It also helps to ensure the financials are presented as per the required framework.

The aim of the study was to examine the drivers of external audit quality. The lending credibility theory was used to determine whether the governance and management of commercial banks in Kenya lend credibility to their investors. The external auditors' role in giving credibility to the financial statements was also examined. Further, the role of IPPF was investigated in bridging the relationship between the governance and management, external auditors and the expected quality of audit.

### **2.3 Empirical Review of Extant Literature**

The empirical review was guided by the study specific objectives specific to Kenyan commercial banks; a) To determine the effect of governance and management on external audit quality, b) To examine the effect of external audit characteristics on external audit quality and c) To establish the moderating effect of IPPF on drivers of external audit quality.

#### **2.3.1 Effect of governance and management on external audit quality**

In Palestine, Dwekat and others examined the effect of mechanisms of corporate governance on auditor quality decisions. The author considered the connection between corporate governance and auditor quality decision to rely upon whether Palestinian firms consider auditor quality as a substitute or a supplement to governance mechanisms (Dwekat et al., 2018). The study included 46 firms under the stock exchange in the county. Pertinent information was gathered from the yearly reports of the tested organizations distributed. Auditor's quality was evaluated, utilizing the size of the audit company. The outcomes uncovered that organizations with a high proprietorship focus, big board size, and the presence of an audit council would, in general, recruit a top-notch auditor. Furthermore, results demonstrated a noteworthy positive inclination of higher absolute resource firms to utilize a quality auditor, while firms with greater influence will, in general, pick less-quality auditors. Besides, ownership of executive, board autonomy, CEO duality were found not to influence auditor's quality decision. The authors prescribed for controllers to support organizations for more compliance with corporate governance guidelines (Dwekat et al., 2018). A gap arises in this study since it was carried out in Palestine. The gap was filled by conducting the current study in Kenya focusing on commercial banks.

In Iran, Hoseinbeglou explored the impact of structure ownership dependent on audit quality (Hoseinbeglou et al., 2013). A total of 72 firms under the stock market consisted of the sample size. In his findings, there were no connections seen between corporate governance components and auditing quality. The authors presumed that the shareholders and the top managerial staff were hesitant to engage profoundly qualified auditors (Hoseinbeglou et al., 2013). The study by Hoseinbeglou et al., (2013) only focused on structure ownership as the dependent variable thus creating a gap which will be filled by having two independent variables (external auditor characteristics and governance and management) and one moderating variable (IPPF).

Salehi analyzed the effect of corporate governance and audit on the quality of divulgence of budget summaries (Salehi et al., 2015). The investigation thought of seven theories. It concentrated on a period between 2009-2014. Utilizing the R programming, the study broke down the information in two regression models. The findings showed no huge positive connection between audit quality autonomy and the quality of financial reports data exposure. Further, the study drew significant correlation between corporate governance and the depth of disclosures of financial summaries data (Salehi et al., 2015). A different software (statistical package for social sciences) was used by the current study.

HosseinniaKani carried out a comprehensive review and comparative summarizing the results of the published works. He focused on the efficacy of corporate governance mechanisms and their probable effects on audit quality (HosseinniaKani, 2014). Both boards of directors and audit committees' specifications were identified as critical influencing factors in the effectiveness of corporate governance, which interacts with audit quality. The use of qualitative research was replaced by quantitative research. The present study also focused on governance systems in addition to other factors such as IPPF and external audit characteristics.

In Nigeria, an investigation was carried out on the connection between corporate governance and the auditor's report quality (Ejeagbasi et al., 2015). The examination focused on the banking sector in the Nigerian Stocks Exchange (NGSE). The ex-post-facto, as the exploration depended on recorded information, was used as the research design. The sample size of 11 banks cited on the NGSE was tested to a dataset between 2007 to 2014. Results demonstrated that board structure had a negative and immaterial relationship with quality of audit output and reporting. Discoveries similarly demonstrated a positive direct connection between the partition of CEO and

administrator jobs and the audit quality. The examination presumed that effective corporate governance occurs from watchful and coexisting alert activities by the supervisors, the BOD, investors, and auditors (Ejeagbasi et al., 2015). Since the study was conducted in Nigeria, it paved way for another study to be undertaken in Kenya. Ejeagbasi et al., (2015) also targeted the NGSE while the current study focused on commercial banks.

In Ethiopia, research was conducted on the internal audit effectiveness of Ethiopia's public sectors (Getie & Wondim, 2007). The study expressed that Internal audit adequacy is seemingly an aftereffect of the exchange of internal audit quality, administration support; authoritative setting; and auditee traits. The study explored the internal audit service of public universities using a model developed from the above mentioned four factors. The research results emphasized that internal audit viability is unequivocally impacted by internal audit quality and the executives' support (Getie & Wondim, 2007). The study also showed that an internal audit of the organizations studied needed practice improvement. A gap by Getie & Wondim, 2007) was revealed since it was in Ethiopia. Present study was in Kenya.

### **2.3.2 Effect of external audit characteristics on external audit quality**

In London, Silviu examined the audit practices of listed firms (Silviu, 2014). He analyzed audit function, autonomy, jobs and obligations, association, relationship with the audit board of trustees, and audit report. Results showed that two firms had not actualized an interior audit office. A few organizations didn't express the situation of the inward audit division. In others, the division was subordinate to the CFO. Additionally, the study noticed that the company's audit function had various jobs and duties in the associations. It checked consistency with corporate governance rules, investigated the proficiency of activity, and examined money-related recording and bookkeeping rehearse. In certain organizations, the internal audit division was completely set up with experts, while in others, the audit work was redistributed (Silviu, 2014).

In Jordan, Aledwan analyzed audit quality's effect on the financial execution of firms under the stock market (Aledwan et al., 2015). The study was descriptive. It used correlational, and ex-post-facto plans were received in doing the exploration. Information was acquired essentially from the distributed yearly reports and records and notes to the organizations' budget summaries. The information gathered was evaluated and introduced in tables. Findings showed that auditor size and auditor freedom impacted the financial performance of cited firms in Jordan. In any case,



auditor autonomy has more impact than auditor size. They recommended an increase in auditors' remuneration. The study by Aledwan was carried out in Jordan hence the gap which was filled by present study conducted in Kenya.

Targeting industrial firms in Jordan, a study by Al-Dalabih aimed to know the outside auditor's job in ensuring the financial data (Al-Dalabih, 2018). The study had a sample of 70 auditors employed in industrial firms. He used a questionnaire survey in collecting data and managed to a response rate of 97%. The SPSS statistical software analyzed data. Findings showed that the outside auditor utilized data innovation in looking at the money related data recorded in the budget reports. Likewise, the external auditor is quick to guarantee the plausibility of the organization's budget reports. The investigation suggested the outside auditor be keen on refreshing the firm's electronic money-related framework (Al-Dalabih, 2018).

A further study conducted in Libya by Endaya and others investigated the direct connection between inside auditor's qualities and interior audit viability. The investigation was directed by the impact of senior administration support (Endaya and Hanefah, 2016). Standard multiple regression was applied. The total sample size for the investigation was 114 individuals from the auditors and accounts association in the country. Surveys were utilized as methods for earning information. Findings revealed that internal auditors' attributes significantly affected interior audit viability, and senior administration support has a direct impact. Additionally, results showed that characteristics of auditors within the company are identified with inward audit viability, and senior administration support is critical in this connection (Endaya and Hanefah, 2016). The study by Endaya and Hanefah was carried out in Libya hence the gap which was filled by present study conducted in Kenya.

In Malaysia, an investigation was done to inspect the connection between the audit board of trustees' attributes and outer auditors' attributes and fiscal quality report (Mohammad and Ahmed, 2017). Top 100 performing firms in the country's stock market were used as the sample size. The investigation of yearly reports demonstrates that the audit board of trustees (autonomy, proficiency, and meticulousness) has the forecast capacity to quality of reporting of finances. Results indicated that industry administration significantly affects the fiscal quality of reporting. The study by Mohammad and Ahmed was carried out in Malaysia hence the gap which was filled by present study conducted in Kenya.

In Semarang, Indonesia, Kuntari, and others analyzed auditor morals, auditor experience, audit expenses, and auditor morale on audit quality of state-owned accounting organizations (Kuntari et al., 2017). The study sample comprised of auditors who deal with state-owned accounting organizations. A total of 98 respondents from 14 open bookkeeping firms were targeted. Surveys were utilized in gathering information through a purposive sampling of 30 respondents. Results indicated that auditor morals had a critical constructive outcome on audit quality. The auditor experience had a hugely positive effect on audit quality. Further, audit charges had a beneficial outcome on audit quality. Auditor morale had a beneficial outcome on audit quality (Kuntari et al., 2017). The study by Kuntari et al was carried out in Indonesia hence the gap which was filled by present study conducted in Kenya.

In Nigeria, Osariemen analyzed audit advisory group characteristics and audit quality with accentuation to SEC code of 2011 (Osariemen et al., 2018). The investigation applied the deductive methodology through the ex-post-facto inquire about the plan. It likewise utilized the Binary probit relapse model in breaking down the different theories. The information used in the investigation was collated from the yearly reports of cited organizations on the floor of the NGSE (Osariemen et al., 2018). The study by Osariemen et al was carried out in Nigeria hence the gap which was filled by present study conducted in Kenya.

### **2.3.3 Effect of IPPF on drivers of external audit quality**

Pflugrath researched the impact of a professional code of ethics on the quality of auditors' decisions inside the setting of the new ISQC1 (Pflugrath et al., 2007). The study utilized a sample of 112 expert bookkeepers and auditing learners. The outcomes showed that the existence of a code of morals positively affects the quality of the choices made by proficient bookkeepers; however, not on learners. The principle of morals prompts a higher caliber of judgments (Pflugrath et al., 2007).

In Jordan, Al-Momani and Obeidat explored the effect of audit ethics on auditors' ability in accounting. It looked at the impact of auditor independence, trustworthiness, objectivity, unexpected expenses, promoting rights, commission assurance, association structure, and name on auditors' capacity to recognize the acts of innovative bookkeeping (Al Momani and Obeidat, 2013). The aftereffects of the investigation exposed that the moral standards' entirety influences auditors' capacity to recognize the acts of creative bookkeeping. The study found that auditors' ability to distinguish the actions of inventive bookkeeping is affected by the various guidelines of audit

morals (Al Momani and Obeidat, 2013). The research by Al Momani and Obeidat was done in Jordan hence the gap which was filled by present study conducted in Kenya.

In Egypt, Hegazy explored contrasts in the level of use and consistency with the IIA International Standards for the Professional Practices of Internal Auditing (Standards) (Hegazy and Farghaly, 2016). The examination focused on listed firms and gathered information by the use of polls. This review was directed in March 2014 about different points identifying with inward auditing (Hegazy and Farghaly, 2016). Hegazy and Farghaly did their research Egypt hence the gap which was filled by present study conducted in Kenya. The study also examined use and consistency IIA standards while present study examined role of external auditor characteristics, governance and management and IPPF (moderating variable) on external audit quality.

A study in Nigeria examined the effect of moral qualities on the act of bookkeeping work (Akadakpo and Enofe, 2013). A questionnaire was the main tool utilized for collecting the essential information, which was structured in five Likert-scale. The study uncovered other huge impacts that bookkeepers accept that affect their professional conduct and rules of firms (Akadakpo and Enofe, 2013). The study by Akadakpo and Enofe was carried out in Nigeria effect of moral qualities on the act of bookkeeping. The gap therefore being the area of study which will be filled by examining drivers of external audit quality of commercial banks in Kenya.

A study by Enofe studied the need for bookkeeping ethics in cultivating the mentality of auditor proficient suspicion (Enofe et al., 2015). It used a survey research design. Furthermore, the impact of different factors, for example, audit expenses, audit residency, and auditor experience level, were likewise inspected. Data collected from the very much organized survey was created and conveyed to target 75 auditors. Outcomes showed a positive and significant connection between bookkeeping morals and auditor proficient distrust (Enofe et al., 2015). The study inferred that bookkeeping morals would play a significantly fundamental part in improving auditor proficient caution. Henceforth, there is a requirement for bookkeeping administrative bodies and different partners to put forth deliberate attempts at guaranteeing that bookkeeping moral are normalized and implemented carefully (Enofe et al., 2015). The study by Enofe et al was done in Nigeria on need for bookkeeping ethics. The gap was filled by conducting the present study on drivers of external audit quality of commercial banks in Kenya.

Still in Nigeria, Arowoshegbe analyzed the impacts of bookkeeping ethics on audit quality (Arowoshegbe et al., 2017). The authors examined how moral standards sway the quality of audit reports given by proficient auditors. Results from the different writing looked into indicated the presence of a positive and critical connection between accounting morals and audit quality. The investigation inferred that accounting ethics assumes an indispensable job in improving auditor's capability. In this way, there is a requirement for Accounting Regulatory Bodies and different partners to put forth deliberate attempts in guaranteeing that bookkeeping morals are normalized and carefully implemented (Arowoshegbe et al., 2017). The investigation suggested that bookkeeping morals ought to be made viable as a noteworthy course in Nigerian Universities, to edify and instruct learners on the most proficient method to and how not to conduct as bookkeepers. The study by Arowoshegbe et al was carried out in Nigeria and focused on bookkeeping ethics. The gap was filled by conducting the present study on drivers of external audit quality of commercial banks in Kenya.

#### **2.3.4 Audit Quality**

The IIA developed a full range of guidance for practitioners and its members through IPPF, which are geared towards ensuring that internal auditors' outcomes are of the highest quality in diverse environments (Bierstaker et al., 2010). Under the IIA is the IPPF, which is a conceptual framework that establishes the authoritative guidance disseminated by the IIA. IPPF contains both the strongly recommended and mandatory guidance (Institute of Internal Auditors, 2011). The IIA considers adherence to obligatory guidance indispensable for the professional practice of internal auditing.

All mandatory guidance uses the word "must," which represents an unconditional requirement. They further consist of three parts, a) definition of internal audit, b) code of ethics, and most importantly c) the standards. It contains endorsed, highly suggested guidelines that use the word "should," which implies that conformance is expected unless circumstances justify deviation (Institute of Internal Auditors, 2017). As indicated by IIA, "internal auditing is an autonomous, target validation and consulting activity intended to include value and advance a company's tasks. It enables a firm to achieve its target by bringing a methodical, restrained way to deal with assessing and improve the suitability of risk management, control, and administration forms" (Bierstaker et al., 2010).

Because of its wide extension, internal auditing is directed in differing social and lawful situations; in companies that fluctuate in size, unpredictability, structure, and reason; and by people inside or outside the firms. While these conditions may influence the act of internal auditing in every condition, abidance with the International Professional Practice framework is basic in meeting the stakeholders expectations from the internal auditors and the internal audit movement (Pickett, 2013). The standards are obligatory requirements consist of statements of basic needs for the practice of internal auditing professionally and for IAA performance evaluation internationally pertinent at individual and organizational levels, and Interpretations aimed at clarifying concepts and key terms within the Statements (Bierstaker et al., 2010).

The IIA Code of ethics brings to life the standards, values and desires administering the conduct of practitioners and associations in their direction of internal auditing. It doesn't spell out explicit actions, rather, depicts the base prerequisites for social desires and expectations of Internal Audit practitioners. The drive behind IIA's Code of Ethics is to advance an ethical culture in the exercising of internal audit (Institute of Internal Auditors, 2017). IIA's Code of Ethics reaches out past the Definition of Internal Audit to incorporate two basic parts: a) rules that are pertinent to the expert act of internal auditing, b) rules of conduct depict the conduct standards expected of internal auditors (Institute of Internal Auditors, 2017). These guidelines help in the translation of the principles into down to earth applications and are expected to control the ethical direct of internal auditors. "Internal auditors" allude to institute individuals, beneficiaries of or aspirants for IIA proficient confirmations, and the individuals who perform internal audit benefits inside the definition of internal auditing (Anderson et al., 2015).

## **2.4 Summary and Research Gap of the Literature**

In Kenya, very few studies have been undertaken on the correlation between professional internal audit practices and the quality of External Audit reports of institutions. Research has vastly been conducted in the past on practices of internal auditing as well as drivers of external audit quality. The focus of those papers varies in terms of institutions, sectors, and industries. However, almost all the researches came up with similar conclusions that internal audit practice was a key driver of good governance in sampled institutions and industries. It is therefore apparent from the literature that despite its importance the topic has not been studied in-depth in the past. Hence this study

seeks to bridge the gap and find out the moderating effect of adoption of IPPFs within commercial banks on drivers of quality of external audit.

**Table 2.1: Summary of the literature and research gaps**

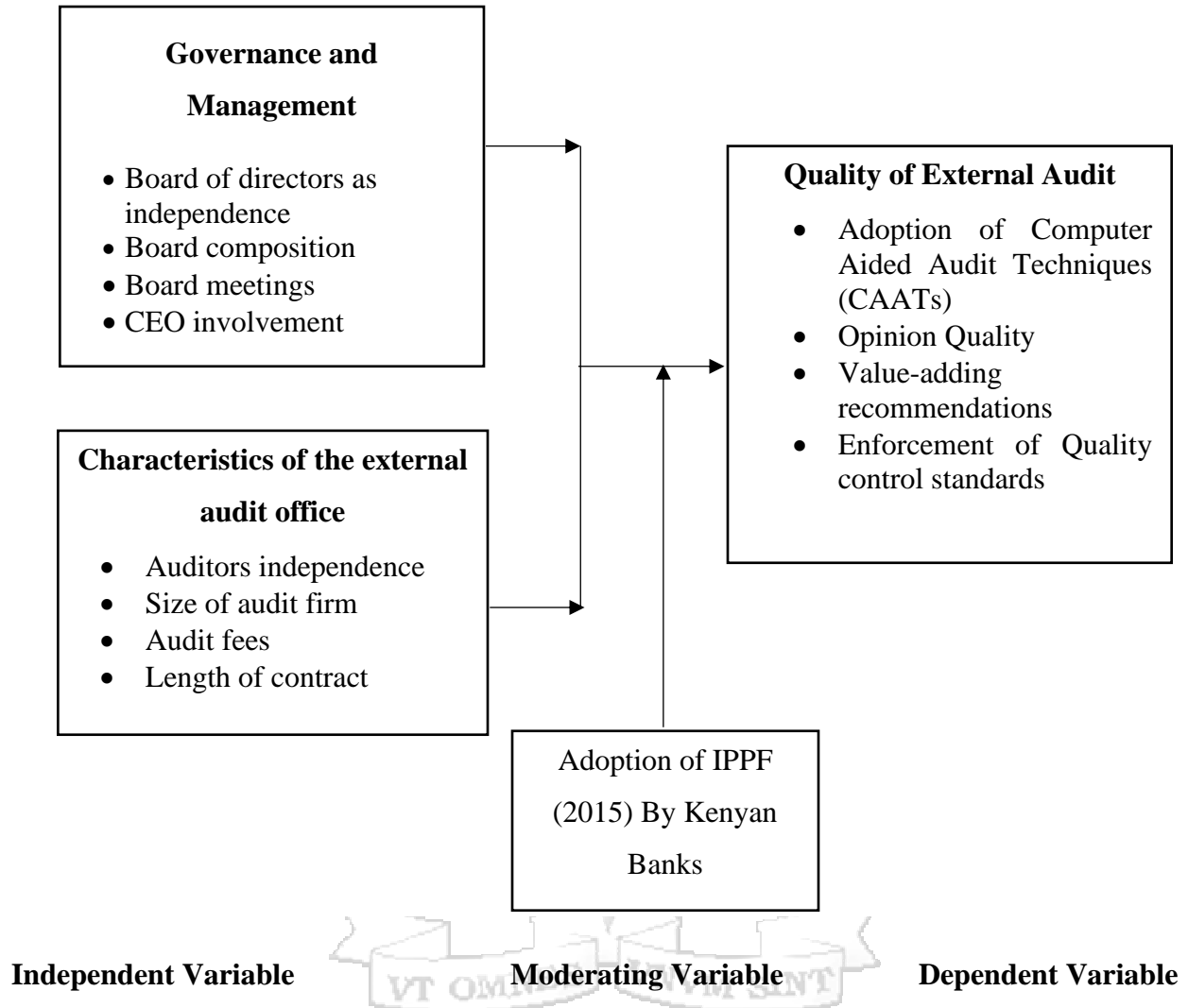
Author	Area/ location	Study	Finding	Gaps
<b>Effect of governance and management on external audit quality</b>				
Dwekat <i>et al.</i> (2018)	Palestine	Effect of mechanisms of corporate governance on auditor quality decisions.	Organizations with a high proprietorship focus, big board size, and the presence of an audit council would, in general, recruit a top-notch auditor	The study focused on corporations in Palestine
Salehi <i>et al.</i> (2015)	Iran	Effect of corporate governance and audit quality on the quality of divulgence of budget summaries	Link between quality of disclosures in financial reports and corporate governance	The study studies Tehran stock exchange and not commercial banks
Hoseinbeglou <i>et al.</i> (2013)	Iran	Impact of structure ownership dependent on audit quality	Connection between auditing quality and firm size	The study was conducted in Iran and not Kenya
Ejeagbasi (2015)	Nigeria	Connection between the quality of the auditor's report and corporate governance	Positive and significant relationship with auditing quality.	The study was centered on banking industry in Nigeria and not in Kenya
<b>Effect of external audit characteristics on external audit quality</b>				
Silviu (2014)	London	Internal audit practices	Investigation into performance of companies that had not implemented an internal audit department.	The study targeted FTSE100 and not commercial banks
Al-Dalabih (2018)	Jordan	Role of the external auditor	Use of technology in exploring the financial data.	The study was conducted in Jordan and not Kenya
Endaya and Henefa (2016)	Libya	Relation between Internal auditor effectiveness and auditor's characteristics	Significant impact was found	The study was conducted in Libya and not Kenya
Mohammad and Ahmed (2017)	Malaysia	External auditors' features and financial	Industry leadership impacted on financial reporting quality.	The study was done in Malaysia and not Kenya

		reporting quality connection		
Kuntari <i>et al.</i> (2017)	Indonesia	Auditor morals, experience, morale, and audit fees on audit quality.	Positive and significant impact found.	The study was conducted in Indonesia and not Kenya
Osariemen <i>et al.</i> (2018)	Nigeria	Audit committee attributes and audit quality	Positive relationship with audit quality	The study was carried out in Nigeria and not Kenya
<b>Effect of IPPF on drivers of external audit quality</b>				
Pflugrath <i>et al.</i> (2007)	Review	Effect of Code of ethics on the quality of auditors' work	Higher quality of judgments due to code of ethics	The study was review based and no primary data was obtained.
Al-Momani and Obeidat	Jordan	Audit ethics and auditors' ability	Ethical help detect the practices of creative accounting	The study was conducted in Jordan and not Kenya
Hegazy and Farghaly (2016)	Egypt	Degree of usage and compliance with the IIA	Significant levels of variation	The study was conducted in Egypt
Enofe <i>et al.</i> (2015)	Nigeria	Fostering the attitude of audit professional skepticism	Ethics improved improving auditor professional skepticism	The study was done in Nigeria and not Kenya
Arowoshegbe et al. (2017)	Nigeria	Accounting ethics and audit quality	Ethics improves auditor's proficiency	The study was in Nigeria

## 2.5 Conceptual Framework

A conceptual framework is used to show the interaction between dependent, independent and moderating variables. The independent variables in this study were the drivers of external audit quality. The indicators of the IV used included governance & management and characteristics of the external audit office. The dependent variable was the quality of external audit with indicators such as adoption of Computer Aided Audit Techniques (CAATs), opinion quality, value-adding recommendations and enforcement of quality control standards. The moderating variable is the adoption of IPPFs as introduced in 2015 by Kenyan banks.

**Figure 3.1: Conceptual Framework**



## 2.6 Operationalization

Table 3.1 has been used to illustrate the operation of the variables, as they were used in this study. The table captures details that are related to the independent variable, the dependent variables and the moderating variables.



**Table 2.2: Operational definition of variables**

Objective	Variable	Indicators	Measurements	Type of analysis	Tool of analysis
To determine the effect of governance on external audit quality	Independent variable- Governance & management	<ul style="list-style-type: none"> <li>• Board composition &amp; independence</li> <li>• Board meetings</li> <li>• CEO involvement</li> </ul>	Interval Ordinal Nominal	Descriptive	Mean, Percentage, Standard Deviation
To examine the effect of external audit characteristics on audit quality in commercial banks in Kenya	Independent-external audit characteristics	<ul style="list-style-type: none"> <li>• Auditors independence</li> <li>• Size of audit firm</li> <li>• Audit fees</li> <li>• Length of contract</li> </ul>	Interval Ordinal Nominal	Descriptive	Mean, Percentage, Standard Deviation
Determine the moderating effect of IPPF on drivers of audit quality	Moderating variable- IPPF	<ul style="list-style-type: none"> <li>• IPPF by Kenyan banks</li> </ul>	Ordinal	Descriptive	Mean and standard deviation.
To establish the moderating effect of IPPF on drivers of external audit quality	Dependent variable-external audit quality	<ul style="list-style-type: none"> <li>• CAATs Adoption</li> <li>• Opinion Quality</li> <li>• Value-adding recommendations</li> <li>• Quality control</li> </ul>	Ordinal	Descriptive	Regression, correlation

## 2.7 Summary of the Chapter

The chapter has reviewed literature on concepts that underpin the quality of external audit. The research objectives have been discussed in detail focusing on related literature in the same field. Two theories have been linked to the study. From the theories highlighted in this chapter, the agency theory underscores the necessity of internal audit as a key function to check on internal controls, key among them financial performance reporting by top management on behalf of stakeholders, especially the shareholders. The lending credibility theory takes this argument a

notch higher by requiring systems that can ensure the audited financial accounts are trusted when presented to the shareholder. To achieve this trustworthiness of financial reporting, all research review point at the need for appropriate standardization of approach and quality review mechanism. Finally, a research gap has been established.



## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter consists of five sections. The first section presents the research philosophy. The second section focuses on design and the case selection for this study. This chapter also outlines the data collection, analysis, and interpretation methods used for this research. The final segment describes the internal and external validity of the study.

### **3.2 Research Philosophy**

Research philosophy depicts the process of development of knowledge and the essence of that knowledge and outlines salient assumptions about how researchers perceive the world (Cooper & Schindler, 2008). The two main ways of undertaking this are ontology and epistemology. In ontology, the researcher uses a set of pre-methodological questions to ask how the social world is perceived (Creswell, 2014). On the other hand, epistemology focuses on examining how the researcher knows what they know and the methods they choose to use to test this knowledge's validity. There are three main epistemology positions: positivism, interpretivism, and realism. This study employed the positivism epistemology philosophy. Positivism promotes the application of natural sciences methods in the research of social reality. In natural science, the research is concerned with predicting, describing and comprehending the natural occurrence. In this study, quantitative research by use of close-ended questions ensured a positivism approach.

### **3.3 Research Design**

This study employs the use of descriptive research design. The design is used in describing the characteristics of elements, objects, or people (Creswell, 2014). The design was considered fit for this study since it aimed at examining the drivers of external audit quality. Such drivers were characteristics of external auditors and Governance and management. People were used (management in commercial banks) to relay the information to the researcher. The three types of descriptive research design are: case study, observational and survey method. The observational method involves closely monitoring behaviors or actions of animals or situations (Jackson, 2009). It is also known as the naturalistic method. The survey method involves the inclusion of participants who give responses to a particular subject. In this study, the survey method was used. The method allows the researcher to use tools such as questionnaires and interview guides in

collecting data. Secondary data from the existing documents and records supplemented the findings.

### **3.4 Population and sampling**

According to the Central Bank of Kenya Directory of Licensed Commercial Banks, Authorized Non-Operating Holding Companies, and Mortgage Finance Institutions, there were 42 licensed Commercial Banks in Kenya as of 2018.

#### **3.4.1 Sampling Frame**

The study used census sampling as it targeted two staff from all the commercial banks in Kenya. Census sampling was considered since the target population was just a small number of 84 respondents. The researcher delivered questionnaires to all respondents in their official addresses. This was followed up by a visit to the respondents to collect the completed questionnaires and follow-up questions.

#### **3.4.2 Sample and Sampling Technique**

Census sampling was adopted for the study with all commercial banks across all the three tiers being targeted. The study incorporated senior managers and operational level internal auditors within the internal audit units in the institutions chosen. The respondents were considered to understand the function of IAAs in the Kenyan Banking Sector.

### **3.5 Data Collection Methods**

This study used both primary and secondary data collection methods. Primary data collection sources were through questionnaires and follow-up interviews, whereas secondary data was generated through a review of relevant documents. These three different data sources were also used for cross-validation and triangulation of the data obtained from one source against another.

#### **3.5.1 Questionnaire**

Self-administered questionnaires were distributed to selected internal auditors at the Banks. The responses helped the researcher to understand the ratings internal auditors at different Commercial Banks gave to their Internal Audit Activities' (IAA's) compliance with the International Professional Practicing Framework in their respective Banks.

The Likert scale was used as an instrument measuring the respondents' level of agreement (disagreement) as to whether the Internal Audit Activities of the selected Commercial Bank were

conducted in compliance with the IPPF as pronounced by the Institute of Internal Auditors (IIA) for the latest five years of operation. This scale included no extent (NE or 1), a little extent (L.E. or 2), a moderate extent (ME or 3), a great extent (G.E. or 4), and a very great extent (VGE or 5). The researcher got to understand participants' opinions on compliance of the IAA's in their respective Banks in light of the IPPF. He used different criteria from the different sections of the IPPF as a benchmark.

The researcher created a good relationship with the participants to increase the response rate. He ensured that the respondents understood the questions asked. He made a follow-up every two days to the respondents who were unable to submit their surveys immediately. The researcher also made arrangements with some banks to send the questionnaires directly to their emails. The researcher also hired two assistants who helped ensure the process was a success to hasten the process.

### **3.5.2 Document Review**

The review of documents exposed me to the key facts about how Internal Audit Activities (IAAs) at the Commercial Banks were expected to be conducted both as per IPPFs, CBK guidelines, and the international banking standards Basel IV. Documents earmarked for review included internal audit charter, internal audit Manual, policy on audit ethics, organizational policy and procedural manuals, internal control framework in use, risk assessments are done, and risk-based internal audit annual plan. Others were i) audit program for various engagements, ii) working papers on audit engagements performed, iii) internal audit reports, iv) distribution policy on outputs of audit, v) correspondences with different stakeholders, and vi) minutes of different meetings.

### **3.6 Validity and Reliability of Research Instruments**

Validity refers to how well the measured indicators measured what they are supposed to measure (Jackson, 2009). The research instruments' validity was ensured through close guidance by the supervisors during the research instruments' development. The input from these people will be used to improve the content and construction of the tools. Reliability of measurement concerns how a particular measuring procedure gives similar results over several repeated trials (Creswell, 2014). To establish the reliability of the instruments, the researcher used the test-retest method. Pearson correlation coefficient was used to test reliability. A Cronbach Coefficient alpha of 0.84 was obtained; hence the instruments were considered reliable.

### 3.7 Data Processing and Analysis

Data collected using the questionnaire was analyzed through descriptive statistics using Statistical Packages for Social Scientists (SPSS). It helps to describe what the data looked like in terms of how broadly they are spread. Thus, it helped to describe the IAA's compliance with the IPPF using up-to-date information. The primary data obtained from the questionnaire was summarized and analyzed by the use of descriptive statistics such as proportions, percentages, means, and frequency distributions tables.

A factor analysis was done to determine the variability of the study factors. Further, a correlation of all the variables was determined. Multiple linear regression model was utilized to analyze the relationship between independent and dependent variables within a test of significance of 95% confidence level as follows.

#### 3.7.1 Model Specification

The following equation was used;

$$Y = \beta_0 + \beta_1 G\&M + \beta_2 XEA + \varepsilon \dots \dots \dots \text{Model 1}$$

$$Y = \beta_0 + \beta_1 G\&M + \beta_2 XEA + \beta_3 G\&M * IPPF + \varepsilon \dots \dots \dots \text{Model 2}$$

$$Y = \beta_0 + \beta_1 G\&M + \beta_2 XEA + \beta_4 X_1 * IPPF + \varepsilon \dots \dots \dots \text{Model 3}$$

Where

Y = Represents the dependent variable that measures the quality of the external audit.

G&M = Governance, and management

XEA = Characteristics of external audit

IPPF = International professional practice framework

$\varepsilon$  = is the error term representing all factors not captured in the analytical model.

$\beta_0$  = is the independent variable representing the autonomous part of the model.

$\beta_n$  = is the coefficient of the independent variable.

The following diagnostic tests were performed;

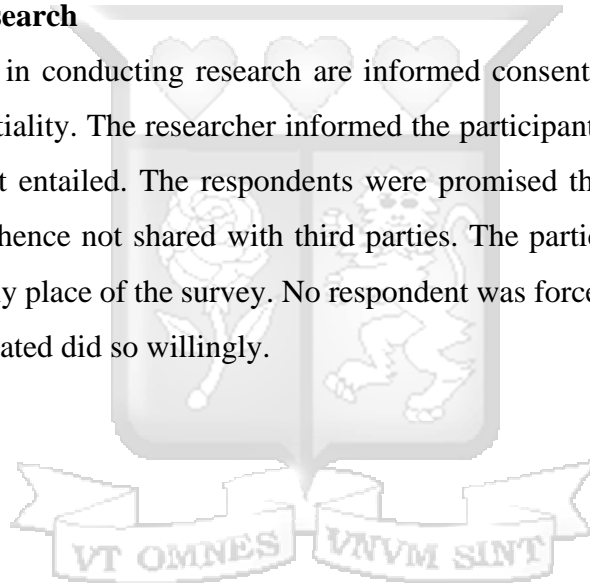
1. Normality tests. Regression assumes that variables have normal distributions. Non-normally distributed variables can distort relationships and significance tests.
2. Homoscedasticity also referred to as homogeneity of variance.
3. Multicollinearity test. Multicollinearity occurs when two (or more) independent variables are highly correlated, making it difficult to determine individual variables' separate effects.

### **3.8 Research Quality**

After seeking permission from the organizations, the researcher hand-delivered an invite letter to internal audit heads of respective commercial banks in Kenya. The researcher also arranged for follow-up interviews. All the interviewee's responses were fully transcribed.

### **3.9 Ethical Issues in Research**

The major ethical issues in conducting research are informed consent, respect for privacy, and anonymity, and confidentiality. The researcher informed the participants of his intention to carry out the study and what it entailed. The respondents were promised that their response was for academic purposes only hence not shared with third parties. The participants were asked not to indicate their names in any place of the survey. No respondent was forced or coerced to filling the polls, and all that participated did so willingly.



## CHAPTER FOUR: PRESENTATION OF RESEARCH FINDINGS

### 4.1 Introduction

The study aimed at assessing the effect of the adoption of the international professional practicing framework (IPPFs) on external audit quality. The following specific objectives guided the research; a) To determine the effect of governance and management on external audit quality, b) To examine the effect of external audit characteristics on external audit quality and c) To establish the moderating effect of IPPF on drivers of external audit quality.

### 4.2 Response Rate

The research employed both primary and secondary sources of data collection. In gathering primary data, the researcher used questionnaires were used. The study sample size targeted through questionnaires were 84 respondents. The researcher managed to obtain information from 75 respondents, thus making an 89% response rate. Such a success was attributed to the low number of individuals targeted in this study.

### 4.3 Background information

All respondents were required to indicate key information about them to help understand their responses. Such background data included gender, age category, level of education, area of operation, and experience as an auditor.

#### 4.3.1 Gender of the respondents

The respondents were asked to indicate their respective gender. Their response is summarized in Table 4.1

**Table 4.3: Gender of the respondents**

Gender	Frequency	Percent
Male	42	56
Female	33	44
Total	75	100.0

A total of 44% of the respondents were female, while 56% were male. This shows that employees from both genders participated in answering the questions. It is also an indication that more men are in the audit departments of the banks.



#### 4.3.2 Age bracket of the respondents

The respondents were also asked to specify their age bracket. Their responses are as shown in Table 4.5.

**Table 4.4: Age of the respondents**

Age bracket	Frequency	Percent
Below 25 years	4	5.3
25-35 years	24	32.0
36-45 years	32	42.7
Above 45 years	15	20.0
Total	75	100.0

Table 4.5 shows that the majority of the respondents (42.7%) were aged between 36-45 years, 32% between 25-35 years, and 20% between above 45 years. The remaining 5.3% were below 25 years. It shows that the staff in auditing departments fairly represented all age groups.

#### 4.3.3 Respondents education level

The study required the participants to indicate their education level. The level of one's education can be used to imply their understanding of auditing policies. Table 4.3 summarizes the response.

**Table 4.5: Education level of the respondents**

Education level	Frequency	Percent
Others	16	21.3
Diploma	13	17.3
Bachelor	18	24.0
Masters	28	37.3
Total	75	100.0

Many respondents had a Master's level of education (37.3%) followed by bachelor (24%) and others (21.3% each). The diploma respondents contributed to 17.3%. The participants were thus knowledgeable enough to understand the principles of auditing as well as the interplay of IPFF.

#### 4.3.4 Area of operation

The respondents were further asked to specify their focus area of specialization within the internal audit department. Their replies are summarized in table 4.4.

**Table 4.6: Area of operation**

Area of operation	Frequency	Percent
Financial audit	13	17.3
Performance audit	29	38.7
Operational audit	15	20.0
Compliance audit	18	24.0
Total	75	100.0

As shown in Table 4.4, many of the respondents were in teams that focused on performance audit (38.7%), followed by compliance audit (24%). Operation audit had 20%, while 17.3% of respondents were in a financial audit biased team. The respondents, therefore, hailed from all areas of operation hence fair representation.

#### 4.3.5 Audit experience in the organization

The study also needed the respondents to indicate an estimate of their professional experience. Their responses are displayed in Table 4.5.

**Table 4.7: Experience as an auditor**

Experience	Frequency	Percent
Below 5	14	18.7
5-10	29	38.7
11-20	19	25.3
Above 20	13	17.3
Total	75	100.0

Results show that many respondents (38.7%) had an experience of between 5-10 years, 25.3% between 11-2 years, and 18.7% of below five years. A total of 17.3% had experience of more than 20 years. This is an indication that the respondents had vast experience in audit. They were, therefore, the best candidates to respond to the study questions.

#### 4.4 Drivers of external audit quality

The study focused on studying the drivers of external audit quality. Among the identified drivers were governance and management and characteristics of internal auditing.

##### 4.4.1 Governance and management

The study examined the governance and management of banks by asking the respondents to respond to given statements. They were to show their level of agreement on a scale of 1-5. The first was no extent (NE), the second was a little extent (LE), third was moderate extent (ME), fourth was a great extent (GE), and fifth was a very great extent (VGE).

**Table 4.8: Governance and management**

Governance and management	Mean	Std. Dev
One-third of the company's board of directors are non-executive and independent directors	4.47	0.963
Board composition is representative and also caters for interest of minority shareholders.	4.45	0.501
Over the last 12 months, BOD meetings took place regularly.	4.40	0.658
CEO attend all the meetings of the board	4.53	0.684
CEO is a member of a recognized body of professional accountants	4.17	0.742
In the last 12 months CEO attended all committee meetings	4.72	0.452
The board's audit committee helps to ensure that the audit is conducted cost-effectively.	4.36	0.607
The BOD ensured an effective system of internal control was implemented.	4.49	0.724
The BOD has a corporate strategy and significant policies in place	4.19	0.833
Register of significant policies is being maintained.	4.39	0.655

Most respondents noted that, to a very great extent (73.3%), one-third of their company's board of directors comprised independent and non-executive directors. 6.7% noted this was the case to a great extent, 13.3% of the respondents agreed with this to a moderate extent whereas 6.7% indicated no extent. With a 4.47 mean confirmation, it is apparent that many of the commercial banks have one third of their board of directors as independent and non-executive members. A total of 45.3% and 54.7% agreed to a very great extent and to a great extent, respectively, that the composition of the board provided a framework for ensuring minority interests representation. Thus, a strong mean of 4.45 in response to minority shareholders representation through board composition.

About half (49.3%) of the respondents agreed to a very great extent that over the last 12 months BOD meetings had taken place regularly. A total of 41.3% and 9.3% each agreed to a great extent and moderate respectively. Thus, banks have meetings of the BOD that take place regularly in a year (mean=4.4). 89.3% of the respondents agreed to a great extent and to a very great extent that their CEO attended all the meetings of the board. The remaining 10.7% confirmed this to a moderate extent. Commercial bank CEOs attend all meetings of the board (mean=4.53).

On the CEO being a member of a recognized professional body of accountants, 42.7% of the respondents agreed to a great extent, 37.3% agreed to a very great extent. A total of 20% each indicated a moderate extent (mean=4.17). 72% of the respondents noted to a great extent that the CEO had attended all committee meetings in the last 12 months, the remaining 28% agreed with this assertion to a great extent. So, commercial bank CEOs attend all committee meetings in a year (mean=4.72).

More than half of the respondents, 50.7%, agree to a great extent that the Board audit committee was instrumental in ensuring cost effective audits. 42.7% agreed to this assertion to a very great extent and, 6.7% agreed to a moderate extent. Board Audit Committees, therefore, helps to ensure that the audit is conducted in a cost-effective manner (mean=4.36). Table 4.6 further indicates that 62.7% of respondents agree to a very extent that the BOD ensured that there was an effective system of internal controls in place, 24% of the respondents agreed to this assertion to a great extent while 13.3 of the respondents indicated a moderate extent of concurrence. It's then apparent that BOD ensures an effective system of internal controls is in place (mean=4.49).

In the matter of the BOD having formulated a corporate strategy and pronouncing significant policies, 45.3% of the respondents agreed to a very great extent, whereas 28% and 26.7% indicated to a great extent and to a moderate extent, respectively. It implies, therefore, that BOD in Kenyan commercial banks have corporate strategies in place as well as significant policies (mean=4.19). Further, in Table 4.6, 48% and 42.7% of the respondents, respectively, agreed to a very great extent and to a great extent that a register of significant policies was being maintained. Respondents who indicated a moderate extent were 9.3%. Hence, the commercial banks are maintaining a complete record of particulars of their significant policies (mean=4.39).

#### 4.4.2 Characteristics of external audit

The study also examined the characteristics of external audits in commercial banks. The respondents were to indicate the extent to which the given statements were likely to influence the quality of external audits of their organizations. They responded using a scale of 1-5. The first was no extent (NE), the second was a little extent (LE), third was moderate extent (ME), fourth was a great extent (GE), and fifth was a very great extent (VGE).

**Table 4.9: Characteristics of external audit**

Characteristics of external audit	Mean	Std. Dev
Independence of external auditors	4.67	0.475
Size of the external audit office	4.79	0.527
A reputable professional to the external audit office	4.72	0.452
Lawsuits against the office of the external auditor	4.49	0.844
Competition between external audit firms	4.55	0.684
Commitment to external audit standards	4.63	0.673
The length of the correlation between external audit office	4.81	0.392
Commitment to quality control standards	3.76	1.324
The size of the external auditor wages	4.19	0.766
Length of the contract between the audit firm and the bank	4.27	0.759

More than half the respondents (66.7%) agreed to a very great extent on the independence of external auditors influencing the quality of external audits while the remaining 33% agreed to a great extent. Thus, the independence of external auditors' influence quality of external audit (mean=4.67). A high number of respondents agreed to a very great extent (84%), and a great extent (10.7%) that size of the external audit office influenced the quality of external audit. The remaining 5.3% indicated a moderate extent. Therefore, size of the external audit office influenced the quality of external audit (mean=4.79).

Many respondents agreed to a great extent (72%) that a reputable professional to the office of external audits influenced the quality of external audits. Thus, a reputable professional to the office of external audits influenced the quality of external audits (mean=4.72). Most of the respondents (72.2%) agreed to a very great extent that lawsuits against the external audit office influenced the quality of external audits. Hence, lawsuits against the external audit office influenced the quality of external audits (mean=4.49).

A significant number of respondents agreed to a very great extent (65.3%) that competition between external audit firms influenced the quality of the external audit, 24% agreed to a great extent while 10.7% to a great extent. So, competition between external audit firms influenced the quality of the external audit (mean=4.55). A large number of participants noted that commitment to external audit standards influenced the quality of external audits to a very great extent (73.3%). The remaining 16% and 10.7% indicated a great extent and a moderate extent. Thus, commitment to external audit standards influenced the quality of external audits (mean=4.63).

A total of 81.3% of respondents agreed that the length of the relation between external audit office and the client influenced external audit quality to a very great extent (81.3%), 18.7% was noted to a great extent. Therefore, the length of the correlation between external audit office influenced external audit quality (mean=4.81). A sizeable number of respondents noted that commitment to quality control standards influenced the quality of external audits to a very great extent (45.3%) while a total of 21.3% noted to a moderate extent. Further, 16%, 12% and 5.3% were established for little extent, great extent, and no extent in that order. Thus, commitment to quality control standards influenced the quality of external audits (mean=3.76).

Few respondents (40%) indicated the size of the external auditor wages as influencing the quality of the external audit to a very great extent, 38.7% each to a great extent, and 21.3% to a moderate

extent. With a mean of 4.19, it is clear to say that size of the external auditor wages influenced the quality of the external audit. Very few respondents (45%) related lengths of the contract between the audit firm and the bank to quality of the external audit to a very great extent, 36% noted a great extent, and 17.7% to a moderate extent. A mean of 4.27 shows that lengths of the contract between the audit firm and the bank influenced quality of the external audit.

#### 4.5 Adoption of IPPF

Respondents were asked to describe their level of agreement to the below statements as pertains their organizations' compliance to IPPF. They responded using a scale of 1-5 with 5 = very great extent, 4 = great extent, 3 = moderate extent, 2 = little extent, and 1 = no extent.

**Table 4.10: Adoption of IPPF**

Adoption of IPPF	Mean	Std. Dev
Our organization IAA has an internal audit manual	3.81	1.023
Our organization IAA has a code of ethics consistent with the one pronounced by IIA	3.81	.881
Our organization IAA undertakes an organizational risk assessment and prioritizes them accordingly.	4.20	.788
Our organization has a standard control framework in use.	4.01	.647
Our organization does an annual audit plan based on risk assessment.	4.19	.817
Our organization has a standard engagement program/develops one before fieldwork.	4.28	.815
Our organization has working papers showing the evidence for the fieldwork and backing reported findings.	4.16	.901
We have a standard reporting format.	3.84	.871
Our organization has a policy on audit report/working paper retention and distribution policy.	3.83	1.032
Our annual audit plan incorporate consulting activities which are either based on risk assessment or management request.	4.05	1.077

A total of 41.3 of the respondents noted that their organization IAA had an internal audit manual and 28% agreed with this assertion to a very great extent. Others, 16%, and 14.7% noted a little extent and moderate extent (mean=3.81). Some respondents agreed to a great extent (20%) and a very great extent (52%) that their organization IAA had a code of ethics consistent with the one pronounced by IIA. A total of 17.3% indicated a moderate extent, while 10.7% each said to little extent (mean=3.81).

Many respondents, 42.7% and 34.7% of the respondents agree to a very great extent and to a great extent that their organization IAA undertook an organizational risk assessment and prioritized these risks accordingly in planning their audits. The remaining 22.7% agreed to a moderate extent (mean=4.2). More than half, 58.7%, of the respondents confirmed to a great extent that their organization had put in place a standard control framework. Those that agreed to a very great extent and to a moderate extent were 21.3% and 20% respectively (mean=4.01).

Almost half (46.7%) of the respondents noted that their organization did an annual audit plan based on risk assessment, to a great extent. An additional 38.7% confirmed this to a very great extent, 9.3% to a moderate extent and 5.3% to a little extent (mean=4.19). On the question of the IAA's of the organizations having a standard engagement program developed before fieldwork, 20.7% agreed to a very great extent, 22.7% agreed to a moderate extent and 20.7% great extent, respectively (mean=4.28).

Findings show that 17.3% of the respondents agreed to a moderate extent that their organization had working papers showing the evidence for the fieldwork and backing reported findings. 33.3% and 44% agreed to this assertion to a great extent and to a very great extent respectively. The remaining 5.3 % noted to a little extent (mean=4.16). A sizeable number of respondents (62.7%) agreed to a great extent that they had a standard reporting format, 17.3% indicated a very great extent. The others, 13.3% and 6.7%, each said a little extent and moderate extent (mean=3.84).

Less than half the respondents agreed to a great extent (40%) that their organization had a policy on audit report/working paper retention and distribution policy. A total of 29.3% said a very great extent, followed by 16% who noted a little extent, while 14.7% indicated a moderate extent (mean=3.83). Several respondents agreed to a very great extent (44%) and a great extent (33.3%) that their annual audit plan incorporated consulting activities that were either based on risk



assessment or management requests. The rest, 16%, and 6.7% noted a little extent and moderate extent congruently (mean=4.05).

#### 4.6 Quality of external audit

The study's dependent variable was the quality of the external audit. The respondents were asked several questions to help determine the external audit quality. They responded, as below;

**Table 4.11: Quality of external audit**

Quality of external audit	Mean	Std. Dev
Audit reports weaknesses in internal controls which can cause fraudulent activities and errors	3.97	1.162
The external auditor conducts internal controls tests and reports findings and recommendations to the Board audit committee.	3.96	0.625
The external auditor clearly states their responsibilities for testing internal controls and compliance with applicable laws and regulations.	3.96	1.084
The external auditors alert the Board audit committee and the executive about the adequacy of the internal control system.	3.81	0.911
The auditors point out any material weaknesses or reportable conditions in the internal controls.	4.37	0.673

The findings indicate that, to a great extent and very great extent, 14.7% and 49.3% the external auditor reports weakness in internal controls, which could cause fraudulent activities and errors (mean=3.97). Further to a great extent, the external auditor delivers the report and recommendations on tested internal controls to the board audit committee (mean=3.96). From the table, we can also note that the external audit office communicates its responsibilities for testing internal controls and compliance with applicable laws and regulations, to a great extent (mean=3.96). It's also apparent that external auditors alerted the board audit committee and the governing body about the adequacy of the internal control system in place, to a great extent (mean=3.81). The auditors pointed out any material weaknesses or reportable conditions in the internal controls to a great extent (mean=4.37).

#### 4.7 Factors Analysis

Factor analysis was conducted to reduce the dimensions and give better suggestions regarding the key factors that influence external audit quality. Through this process, the researcher was able to identify the key significant factors.

**Table 4.12: Communalities**

	Initial	Extraction
One-third of the company's Board of directors being either non-executive directors or independent directors.	1.000	.924
Board being composed in a manner that allows for minority shareholders representation.	1.000	.950
Regularity of the BOD Meetings over the last 12 months.	1.000	.981
Attendance of the CEO in all the Board meetings.	1.000	.869
CEO being a member of a recognized body of professional body of accountants.	1.000	.953
The CEO having attended all committee meetings in the last 12 months.	1.000	.963
The audit committee putting measures in place to ensure that the audit is conducted cost-effectively.	1.000	.902
The BOD ensuring that an effective system of Internal Control is in place.	1.000	.851
The BOD announcing significant policies and formulating a corporate strategy.	1.000	.923
Maintenance of a register with particulars of significant policies is being maintained.	1.000	.908
The independence of external auditors	1.000	.811
External audit firm/ team size	1.000	.874
Professional reputation of the external auditor	1.000	.961
Lawsuits against the external audit office	1.000	.964
Competition between external audit firms	1.000	.899
Commitment to external audit standards	1.000	.982
The length of the correlation between external audit office	1.000	.889
Commitment to quality control standards	1.000	.829
The size of the external auditor wages	1.000	.622
Length of the contract between the audit firm and the bank	1.000	.744
Our organization IAA has an Internal Audit Manual	1.000	.947
Our organization IAA has a code of ethics consistent with the one pronounced by IIA.	1.000	.918
Our organization IAA undertakes an organizational risk assessment and prioritizes them accordingly.	1.000	.784
Our organization has a standard control framework in use.	1.000	.875

Our organization does an Annual Audit plan based on risk assessment.	1.000	.766
Our organization has a standard engagement program/ Develop one before fieldwork.	1.000	.913
Our organization has working papers showing the evidence for the fieldwork and backing reported findings.	1.000	.977
We have a standard reporting format.	1.000	.745
Our organization has a Policy on Audit report/working paper retention and /or distribution policy.	1.000	.852
Our annual audit plan incorporate consulting activities which are either based on risk assessment or management request.	1.000	.966

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Extraction Method: Principal Component Analysis.

From the analysis in Table 4.12, the study revealed that most factors had an extraction greater than 0.7 proportion of variance. Commitment to external audit standards was the factor with the highest extraction at 0.982, followed by meetings of the BOD having regularly taken place over the last 12 months at 0.981. Our organization has working papers showing the evidence for the fieldwork and backing reported findings (0.977) and our annual audit plan incorporate consulting activities which are either based on risk assessment or management request (0.966). High extraction was also noted in Lawsuits against the external audit office (0.964), CEO attended all committee meetings during the last 12 months (0.963), a reputable professional to the office of external audit (0.961) and CEO is a member of a recognized body of professional accountants (0.953). High extraction of above 0.9 was noted in the composition of the board provides a mechanism for the representation of the minority shareholders (0.950), our organization IAA has an Internal Audit Manual (0.947), the Company has one-third of its Board of directors as independent and non-executive directors (0.924) and the BOD has formulated corporate strategy & announced significant policies (0.923). Relatively high extraction in our organization IAA has a code of ethics consistent with the one pronounced by IIA (0.918), our organization has a standard engagement program/ Develop one before fieldwork (0.913), complete records of particulars of significant policies are being maintained (0.908) and the audit committee helps to ensure that the audit is conducted cost-effectively (0.902) was recorded. An extraction of more than 0.8 was reported in our organization has a Policy on Audit report/working paper retention and /or distribution policy (0.852), the BOD ensured the implementation of an effective system of Internal Control (0.851), commitment to quality control standards (0.829) and independence of external auditors (0.811).

An extraction of more than 0.7 was recorded for statements such as our organization IAA undertakes an organizational risk assessment and prioritizes them accordingly (0.784), our organization does an Annual Audit plan based on risk assessment (0.766), we have a standard reporting format (0.745), and length of the contract between the audit firm and the bank (0.744). The least extraction of 0.622 was noted for the size of the external auditor wages.

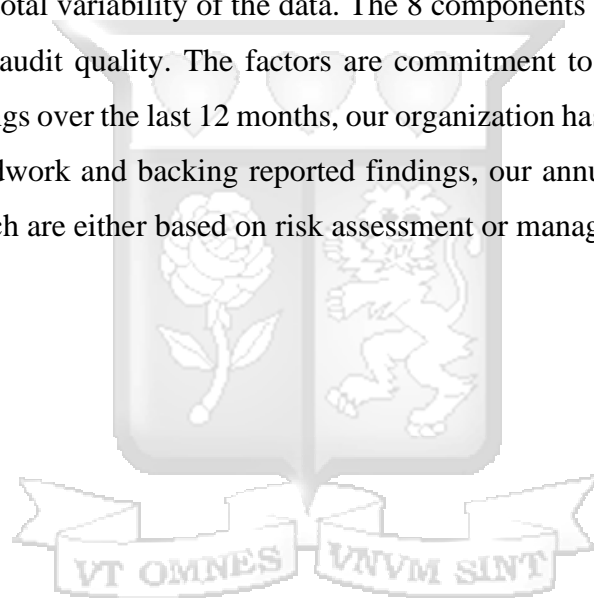
**Table 4.13: Contribution of extracted variable**

Component	Initial Eigenvalues			Extraction Sums of Squared Loadings		
	Total	% of Variance	Cumulative %	Total	% of Variance	Cumulative %
1	8.403	28.010	28.010	8.403	28.010	28.010
2	4.590	15.301	43.310	4.590	15.301	43.310
3	4.419	14.731	58.041	4.419	14.731	58.041
4	2.645	8.817	66.858	2.645	8.817	66.858
5	1.996	6.655	73.513	1.996	6.655	73.513
6	1.850	6.168	79.680	1.850	6.168	79.680
7	1.506	5.019	84.700	1.506	5.019	84.700
8	1.133	3.778	88.477	1.133	3.778	88.477
9	.868	2.893	91.371			
10	.733	2.442	93.813			
11	.562	1.874	95.687			
12	.523	1.742	97.429			
13	.267	.891	98.320			
14	.207	.691	99.011			
15	.132	.440	99.452			
16	.104	.348	99.799			
17	.047	.156	99.955			
18	.014	.045	100.000			
19	1.166E-015	3.888E-015	100.000			
20	9.312E-016	3.104E-015	100.000			
21	6.911E-016	2.304E-015	100.000			
22	6.716E-016	2.239E-015	100.000			
23	4.009E-016	1.336E-015	100.000			

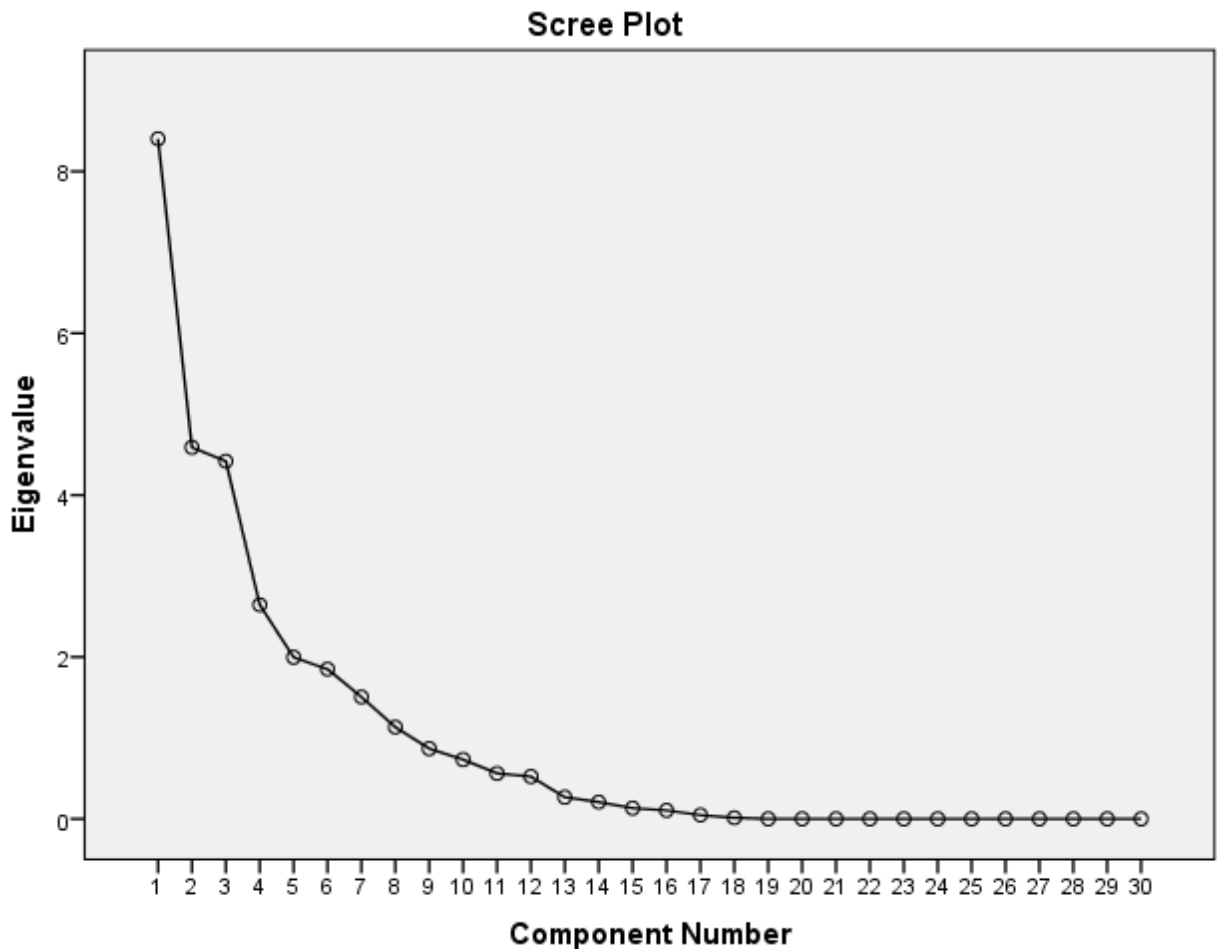
24	-6.279E-017	-2.093E-016	100.000
25	-1.880E-016	-6.268E-016	100.000
26	-2.379E-016	-7.930E-016	100.000
27	-6.334E-016	-2.111E-015	100.000
28	-7.388E-016	-2.463E-015	100.000
29	-9.152E-016	-3.051E-015	100.000
30	-1.255E-015	-4.182E-015	100.000

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The first 8 components the components all have an Eigen value of over 1.00 and together they represent 88.48% of the total variability of the data. The 8 components are probably adequate for influencing the external audit quality. The factors are commitment to external audit standards, regularity of BOD meetings over the last 12 months, our organization has working papers showing the evidence for the fieldwork and backing reported findings, our annual audit plan incorporate consulting activities which are either based on risk assessment or management request.



**Figure 4.2: Scree plot**



The scree plot shows that eight components had an Eigen value greater than 1.00. These 8 variables account for most of the total variability in data. The remaining 22 variables have an eigen value of less than 1 indicating that their contribution to total variability is very small. Under governance and management, the following variables had an eigen value of more than 1; regularity of BOD meetings over the last 12 months, CEO attended all committee meetings during the last 12 months, and CEO being a member of a recognized professional body of accountants. IPPF was represented by two variables with an eigen value of more than 1; our organization has working papers showing the evidence for the fieldwork and backing reported findings, and our annual audit plan incorporate consulting activities which are either based on risk assessment or management request.

#### 4.8 Inferential Statistics

The use of inferential statistics determined the relationship between the independent, moderating, and dependent variables. The independent variables represented the factors influencing the quality of external audits. They included characteristics of external audit and governance and management within the organization. The dependent variable was the quality of the external audit, while the moderating variable was the IPPF.

**Table 4.14: Correlation**

Variables	Governance & management	Characteristic of external audit	IPPF	Audit quality
Governance & management	1.000			
Characteristics of external audit	.361**	1.000		
IPPF	-.600**	.060	1.000	
Audit quality	.104	0.542**	.109	1.000

\*\*. Correlation is significant at the 0.01 level (2-tailed).

In verifying the existence or non-existence of linear correlation between the quantitative variables, the Pearson's coefficient was used as indicated in the table above. There is little evidence of multicollinearity between the explanatory variables as the correlations between them is not strong, hence all the variables are to be incorporated into the subsequent regression analysis. Findings also show that characteristics of external audit was positively correlated to audit quality ( $r=0.542$ ,  $p = 0.01$ ).

**Table 4.15: Model summary**

Model	R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Std. Error	R <sup>2</sup> Change	F Change	df1	df2	Sig. F Change
1	.757 <sup>a</sup>	.573	.517	.57483	.573	10.083	2	72	.002
2	.874 <sup>b</sup>	.764	.714	.44247	.191	11.317	1	71	.005

a. Predictors: (Constant), Characteristics, Governance

b. Predictors: (Constant), Characteristics, Governance, IPPF

c. Dependent Variable: External audit quality

Table 4.15 shows that the two models are statistically significant. Block 1 shows that the model is statistically significant before a moderator is introduced ( $p = 0.002$ ). Block two, however, shows that the variance increases as a result of the introduction of a modifier ( $R^2$  change = 0.191,  $p = 0.005$ ). This shows that, additionally, 19.1% is increased by the modifying variable. It can be concluded that there is significant moderation of IPPF on drivers of external audit quality.

**Table 4.16: ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.766	2	1.383	15.716	.000 <sup>b</sup>
	Residual	6.335	72	.088		
	Total	9.101	74			
2	Regression	2.894	3	.965	11.034	.000 <sup>c</sup>
	Residual	6.207	71	.087		
	Total	9.101	74			

a. Dependent Variable: Quality

b. Predictors: (Constant), Characteristics, Governance

c. Predictors: (Constant), Characteristics, Governance, IPPF

The ANOVA table shows that a statistical significance difference exists ( $p = 0.000$ ). After a moderating variable is introduced, a significant relationship still exists ( $p = 0.000$ ).



**Table 4.17: Coefficients**

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.037	.611		1.696	.094
	Governance & management	-.096	.096	-.106	-1.005	.318
	Characteristics of audit quality	.759*	.138	.581	5.506	.000
2	(Constant)	.500	.754		.663	.510
	Governance & management	.008	.128	.008	.059	.953
	Characteristics of audit quality	.693*	.148	.530	4.681	.000
	IPPF	.094*	.077	.160	1.211	.023

a. Dependent Variable: Quality of external audit

b. \*significant at the 1% level.

$$Y = b_0 + b_1X_1 + b_2X_2 + b_3X_3 + b_4X_4 + \dots + b_nX_n$$

The first equation as shown in the first model is as follows;

$$Y = 1.037 - 0.096X_1 + 0.759X_2$$

As per the first equation, the relationship between drivers of external audit quality and audit quality is shown. Characteristics of audit quality seems to have a positive significant effect (B=0.759, p =0.000) on audit quality.

The second equation from the second model is as follows;

$$Y = 0.5 + 0.008X_1 + 0.693X_2 + 0.094X_3$$

Where

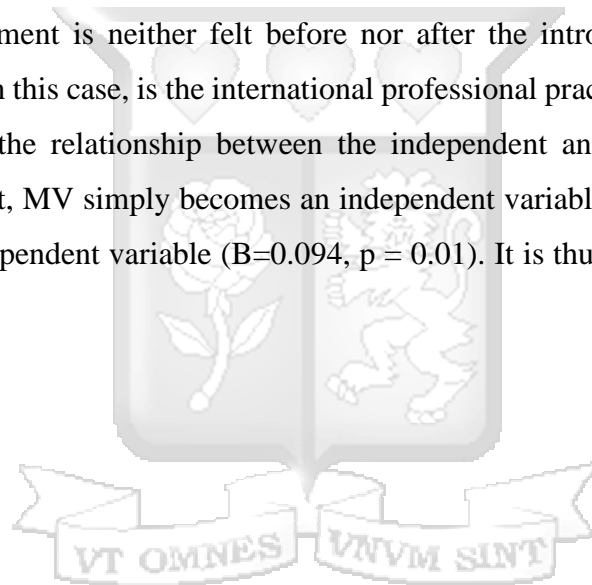
$$\text{Constant} = 0.5$$

$B_1 = 0.008$ , implies that a one-unit change governance and management results in 0.008 units increase in quality of external audit.

$B_2 = 0.693$ , indicates that a unit change in characteristics of external audit results in 0.693 units increase in quality of external audit.

$B_3 = 0.094$ , shows that one-unit change in the adoption of international professional practicing framework results in 0.094 units increase in quality of external audit.

The results of the regression analysis indicate that external audit characteristics has an impact on external audit quality to a high degree. The influence of the external audit characteristics decreases after the introduction of a moderating variable (MV) ( $B=0.693$ ,  $p = 0.01$ ). The influence of governance and management is neither felt before nor after the introduction of a moderating variable. The mediator, in this case, is the international professional practice framework (IPPF). If significant, MV causes the relationship between the independent and dependent variables to weaken. If not significant, MV simply becomes an independent variable. Table 4.15 shows IPPF slightly influences the dependent variable ( $B=0.094$ ,  $p = 0.01$ ). It is thus clear that IPPF acts as a moderating variable.



## **CHAPTER FIVE: DISCUSSION, CONCLUSION, AND RECOMMENDATIONS**

### **5.1 Introduction**

This chapter first presents a summary of findings. The chapter also covers the conclusions. Contribution to knowledge is another subsection covered in this chapter. Further in the chapter is the recommendations and areas of further studies. Finally, limitations of the study are outlined.

### **5.2 Summary of findings**

#### **5.2.1 Effect of governance and management on external audit quality**

Findings indicated that Kenyan commercial banks had one-third of their board of directors as independent and non-executive directors. The results agree with Enofe et al. (2013) on the significance of board independence in influencing audit quality and reporting. The composition of the board was found to provide a mechanism for the representation of the minority shareholders. Similar results were also reported by Wan Zanani et al. (2008), who found a significant positive relationship between board representation and transparent reporting and audit findings tracking.

The meeting of the BOD was reported to have regularly taken place. It is recommended that the board meet several times a year to strengthen an organization (Enofe et al., 2013). CEOs in commercial banks attended some committee meetings during the last 12 months. CEO duality is an element that has been reported by several researchers to have played a significant role in curbing fraud and, as a result improving the quality of external audit and audit recommendations execution (He et al., 2017). The audit committee helped to ensure that the audit is conducted cost-effectively.

The audit committee's size and diligence were reported by Gana & Krichen (2013) to have had a significant influence on financial reporting quality. Audit Committees comprising of independent board members tend to be more effective, according to Jiraporn et al. (2017). The study thus established that banks' governance and management significantly influence the quality of external audits. Findings are in line with Al-ajmi (2009), who pointed out that corporate governance affected firms' audit quality. Strong governance and management mean that they demand better quality from the external auditors (Lifschutz & Jacobi, 2010). According to the lending credibility theory, the company's investors rely on the board, the management, including the CEO, to ensure swift operation. The findings of this study have confirmed this.

### **5.2.2 Effect of external audit characteristics on external audit quality in commercial banks in Kenya**

According to Abbott et al. (2020), auditors' competence and independence influenced reporting quality. Auditors' competence was also recommended by Mansouri et al. (2009), who said that it helped in fraud detection. Further, the internal audit office size influenced the reliance on internal audit reports by external auditors. Other external audit characteristics that affect audit quality include; commitment to external audit standards and the length of the relationship between external audit office and the client. Equally, the commitment to quality control standards influences the quality of external audits. However, according to Dee et al. (2018), the external auditor wages' size had little influence on external audits' quality. He further reported that the contract's length to perform the audit also had less impact on external audit reports' quality. Following this, the characteristics of external audits are seen to affect the quality of external audits. According to lending credibility theory, the auditors are tasked with offering credibility to financial statements. Results, therefore, show that the theory is applicable in this study.

### **5.2.3 Moderating effect of IPPF on drivers of external audit quality**

Earlier studies have found low to no adoption of IPPF by IAA in Kenya's state-owned corporations (Okibo & Kamau, 2012). Findings established that banks IAA largely comply with IPPF. They all have an internal audit manual and a code of ethics consistent with the one pronounced by IIA. It was reported that the IAA of commercial banks undertook an organizational risk assessment and prioritized audit activities according to this. The IPPF is vital in helping internal auditors meet the responsibilities set aside by the IIA.

Findings also indicated that banks reported doing an annual audit plan based on risk assessment. Further, their organizations have a standard engagement program/develops one before fieldwork. Banks were reported to have working papers showing the evidence for the fieldwork and backing reported findings and had a standard reporting format. Also, the banks had a policy on audit report/working paper retention and distribution policy. Their annual audit plan incorporates consulting activities that are either based on risk assessment or management requests. Therefore, it implies that many commercial banks have adopted the international professional practicing framework (IPPF) either by design or by default due to being in the highly regulated industry. It

is recommended by the Basel Committee report for banks to have permanent internal audit functions (Basel Committee and Banking Supervision, 2012).

The findings of this variable confirm the significance of agency theory. The relationship between the external auditors and the company governance and management works well when there is an agent. In this case, the agency is the IPPF, which was seen to moderate the external audit quality to its drivers. The introduction of IPPF (agent) improves the external audit quality.

### **5.3 Conclusions**

The study concludes the governance and management of banks has an impact on the quality of Audit performed by external auditors. The management of banks is headed by CEO whose attendance to board meetings influences the decisions made. The CEO also acts as a representative of all the organization staff as he/she understands everything taking place in the bank. His attendance, therefore, also significantly influences the decisions made concerning the implementation of external audit recommendations. The governance of an organization is by the board of directors. They represent the other company stakeholders more so the shareholders. They come up with major decisions that affect the transformations of companies. Their independence means that they are not compromised by any agent within the company.

The study also concludes that external audit characteristics significantly influence the quality of the external audit. The size and composition of the audit team are essential. The number should, however, not be too small or too big for auditing to be effective. The independence of auditors and their competence determines the end product of their work. Audit companies with several and significant lawsuits are an indicator of questionable integrity. Commitment to quality control standards also influences the quality of external audits.

The study establishes that banks must adopt international professional practicing frameworks (IPPF). The adoption of IPPF positively influences the quality of external auditing. Many commercial banks have an internal audit manual in the IAA. The banks IAA have a code of ethics consistent with the one pronounced by IIA. The IAA of commercial banks undertook an organizational risk assessment, prioritized them accordingly, and had a standard control framework. Banks reported doing an annual audit plan based on risk assessment.

Further, their organization has a standard engagement program/develops one before fieldwork. They have working papers showing the evidence for the fieldwork and backing reported findings and had a standard reporting format. Also, the banks have a policy on audit report/working paper retention and distribution policy, and their annual audit plan incorporates consulting activities that are either based on risk assessment or management requests.

#### **5.4 Research contribution to body of knowledge**

This research adds to the already existing knowledge of drivers of external audit quality. Researchers in this field may form their study foundations by use of the study outcomes. Findings have shown the importance of both characteristics of external audit and the IPPF in influencing audit quality.

#### **5.5 Recommendations and areas of further studies**

Based on the study findings, several recommendations were suggested. The government should ensure that commercial banks comply with IPPF. This will ensure that the oversight work of the government officers, such as the external auditors and the regulators, is eased. It would also increase transparency in the sector and result in better protection for depositor's monies and an increase in taxes collected.

Commercial banks should, therefore, consider re-evaluating their governance and management to see whether they meet the standards. Governance and management are essential elements that dictate the quality of external audit reporting in an organization. The shareholders should thus consider appointing directors with relevant experiences in all areas of management to help instill discipline in the sector.

Commercial Banks should be encouraged to follow IIA guidelines on the international professional practice framework. The compliance of these guidelines gives external auditors greater comfort in their reliance on the Internal Audit work, thereby significantly improving the External Audit efficiency and quality of their output.

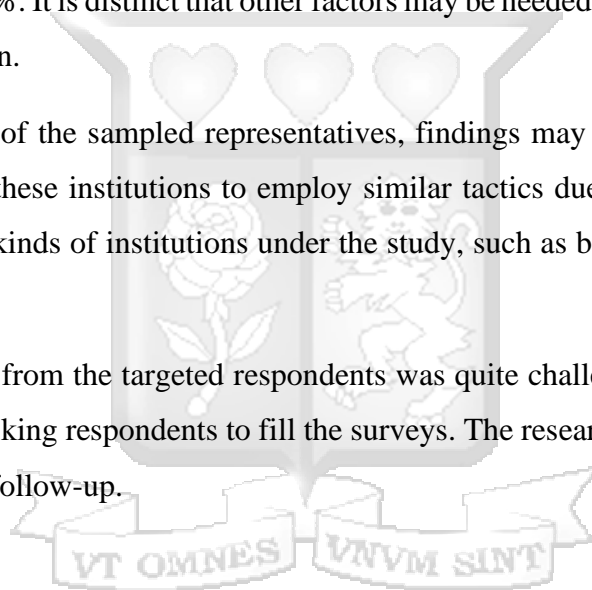
Professionalism ensures living up to the predefined professional body standards, including ethical and reporting output guidelines. Commercial banks should ensure that their IAA staff are members of a relevant professional body and are trained on the IPPF standards. This, in effect, assures the quality and thoroughness of Internal Audit reports provided to Senior Management, the Board, and External Auditors, ensuring effective governance.

### **5.6 Limitations of the study**

The study focused on drivers of external audit quality. It specifically targeted governance and management as well as characteristics of external audits. The  $R^2$  showed that these variables contributed to 57.3% of the drivers. With the introduction of IPPF as the moderating variable, the number increased to 76.4%. It is distinct that other factors may be needed to increase these numbers to eliminate this limitation.

Due to the homogeneity of the sampled representatives, findings may have been compromised. There is a likelihood of these institutions to employ similar tactics due to the Kenyan law. It is crucial to have different kinds of institutions under the study, such as both the public and private sectors.

Getting sufficient results from the targeted respondents was quite challenging. A lot of time was spent convincing and tracking respondents to fill the surveys. The researcher had to get assistance to help him in doing the follow-up.



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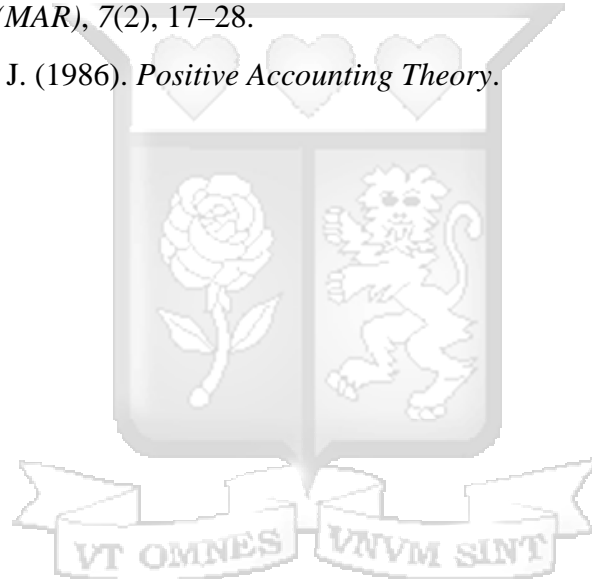
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## APPENDICES

### APPENDIX 1: Letter of introduction

Anthony Ongoma Shitandi, MCom Candidate

**E-mail:** daongoma87@gmail.com

**Cell:** +254 (0) 728427639

Dear Sir/Madam:

Attached is a questionnaire designed to collect data about Internal Audit Activities within the commercial banking industry in Kenya. This questionnaire has been circulated to all the Internal Audit departments of CBK regulated Commercial Banks, including yours. By responding to the items in this questionnaire you are providing me with critical data that will be used to generate part of the information needed for a study on internal audit practices in the Kenyan banking sector. This study is being conducted in partial fulfillment for the degree of Master of Commerce by the undersigned at Strathmore University, Kenya. The results of the study are expected to contribute to the understanding of governance, compliance and internal audit practices of the Financial Sector in Kenya.

Please do not write your name on the questionnaire as the study is anonymous. In analysis of the data no reference to any specific organizations or individual respondents will be made as conclusions of the study will be drawn in aggregate terms. I therefore assure you that all information that you provide will be treated with strict confidentiality. Further, your participation in this survey is completely voluntary.

If you are interested in receiving a summary of the results of the study, please write your e-mail address on the questionnaire or send an e-mail requesting a copy using my e-mail addresses at the upper right corner of this page. Your candid and thoughtful responses are highly appreciated. Thank you for your participation.

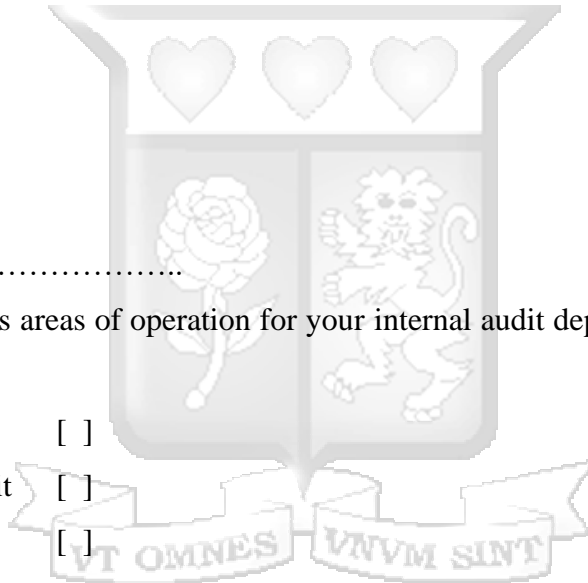
Kind regards,

Anthony Shitandi.

## APPENDIX II: Questionnaire

### SECTION A: Demographic Information

1. What is your gender? Male ☐ Female ☐
2. What is your age?  
Below 25 ☐ 25-35 ☐  
36-45 ☐ Above 45 ☐
3. What is your level of education?  
PHD ☐  
Masters ☐  
Bachelor ☐  
Diploma ☐  
ACCA ☐  
CIA ☐  
Others (specify).....
4. What are the focus areas of operation for your internal audit department? Tick applicable ones.  
Financial Audit ☐  
Performance Audit ☐  
Operational Audit ☐  
Consulting ☐  
Compliance Audit ☐  
Others (specify).....
5. Experience as internal auditor in years  
Below 5 ☐  
5-10 ☐  
11-15 ☐  
15-20 ☐  
Above 20 ☐



## Section B: Governance & Management

6. To what extent do you agree with the following statements with regard to governance and management at your bank? On a scale of 1-5 where 1-to no extent, 2-little extent, 3-moderate extent, 4- great extent, 5- very great extent. Please rate by ticking in the appropriate box on a scale of 1-5.

Statements	1	2	3	4	5
The Company has one-third of its Board of directors as independent and non-executive directors					
The composition of the board provides a mechanism for the representation of the minority shareholders.					
Meetings of the BOD have regularly taken place over the last 12 months.					
CEO attend all the meetings of the Board					
CEO is a member of a recognized body of professional accountants					
CEO attended all committee meetings during the last 12 months					
The audit committee helps to ensure that the audit is conducted cost-effectively.					
The BOD ensured the implementation of an effective system of Internal Control.					
The BOD has formulated corporate strategy & announced significant policies					
Complete records of particulars of significant policies are being maintained.					

## Section C: Characteristic of the external audit office

7. To what extent do you think the following statements with regard to the characteristic of external audit office influence quality of external audit (1-to no extent, 2-little extent, 3-moderate extent, 4- great extent, 5- very great extent). Please rate by ticking in the appropriate box on a scale of 1-5.

Statements	1	2	3	4	5
Independence of external auditors					
Size of the external audit office					
A reputable professional to the office of external audit					

Lawsuits against the external audit office					
Competition between external audit firms					
Commitment to external audit standards					
The length of the correlation between external audit office					
Commitment to quality control standards					
The size of the external auditor wages					
Length of the contract between the audit firm and the bank					

#### Section D: IPPF Compliance

Indicate the extent to which you agree with the following statements regarding your organization's compliance with IPPF. Use a scale of 1-5 where 1-to no extent, 2-little extent, 3- moderate extent, 4- great extent, 5- very great extent

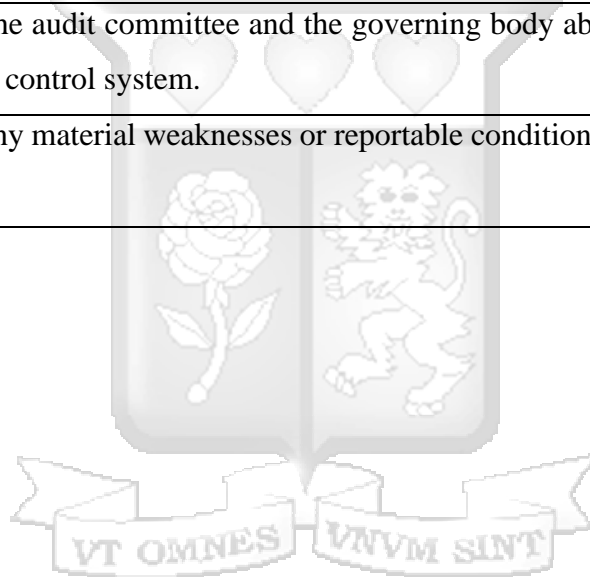
Statements	1	2	3	4	5
Our organization IAA has an Internal Audit Manual					
Our organization IAA has a code of ethics consistent with the one pronounced by IIA.					
Our organization IAA undertakes an organizational risk assessment and prioritizes them accordingly.					
Our organization has a standard control framework in use.					
Our organization does an Annual Audit plan based on risk assessment.					
Our organization has a standard engagement program/ Develop one before fieldwork.					
Our organization has working papers showing the evidence for the fieldwork and backing reported findings.					
We have a standard reporting format.					
Our organization has a Policy on Audit report/working paper retention and /or distribution policy.					
Our annual audit plan incorporate consulting activities which are either based on risk assessment or management request.					

### Section E: Quality of External Audit

1. How do the following statements with regard to internal controls apply in your organization (1-to no extent, 2-little extent, 3- moderate extent, 4- great extent, 5- very great extent)?

Please rate by ticking in the appropriate box on a scale of 1-5.

Statements	1	2	3	4	5
Audit reports test weaknesses in internal controls which can cause fraud					
The auditor tests internal controls and delivers its report and recommendations to the audit committee.					
The external auditor communicates its responsibilities for testing internal controls and compliance with laws and regulations.					
External auditors alert the audit committee and the governing body about the adequacy of the internal control system.					
The auditors point out any material weaknesses or reportable conditions in the internal controls.					





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