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Risk Maturity Assessment and Audit Quality of Tier One Commercial Banks in Kenya

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Abstract

In the recent past the Kenyan banks have experienced a number of corporate failures related to transparency and accountability, their attention was focused on corporate governance matters instead of risk based audit. In 2016, Chase bank, Dubai bank and Imperial bank was positioned under financial management statutory due to suspicions of money laundering and fraud. The purpose of this study was the analysis of risk maturity assessment on audit quality of Tier I commercial banks in Kenya. Specifically to establish the influence of periodic risk audit planning on audit quality; to establish the influence of individual audit assignment on audit quality of tier I commercial banks in Kenya. Descriptive research design was adopted. The study targeted a population of 1597 staffs who constituted respondents from, accounting and finance, internal audit and Risk and compliance department of tier I commercial banks in Kenya. Stratified random sampling was used to select a sample of 104 respondents. Structured questionnaire was used to collect data. Data was analysed by use of inferential and descriptive statistics. Tables was used for data presentation since it is to understand and internalize data and primary data was used. Pilot study was conducted in tier two commercial banks in head office, Nairobi. The internal consistency was tested by use of Cronbach (Alpha – α) model with the alpha coefficient of above 0.7 being considered reliable. Multiple regression analysis was used to determine the strength and direction of the relationship between the independent variables and the dependent variables. These correlations were further subjected to significance test to determine whether the observed correlations were significant. A significance level of 0.05 was therefore set for testing the research hypotheses. The study revealed that Risk Maturity Assessment had the highest coefficient, Beta = 0.261, followed by Periodic risk audit planning with Beta = 0.207 and lastly Individual audit assignment with Beta = 0.174; this indicates that Risk Maturity Assessment makes the strongest unique contribution in explaining the quality of audit in Tier I Commercial Banks in Kenya, Periodic risk audit planning had the second largest unique contribution while Individual audit assignment had the least unique contribution in explaining the variation in the quality of audit in Tier I Commercial Banks in Kenya, Periodic risk audit planning. Among the three predictor variables, Risk Maturity Assessment was found to be the strongest predictor of the quality of audit in Tier I Commercial Banks in Kenya, followed by Periodic risk audit planning risk planning, and lastly Individual audit assignment. The study findings are expected to be of value to the banks stakeholders and form a basis for improving audit quality of banks by enhancing risk based audit. The study concludes that risk based auditing through risk assessment, Periodic risk based planning and individual audit assignment should be enhanced. This would enable the commercial banks to be able to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability, hence enhancing financial performance and audit quality. The study recommends that management in commercial banks in Kenya should adopt effective risk based audit practices such as risk assessment, periodic risk based planning and individual audit assignment to enhance effective and efficient audit reports. The study recommends that the management of commercial banks should consider risk based audit in auditing process and risk management.

Key words: *Periodic Risk Audit Planning, Individual Audit Assessment, Commercial Banks*

1. Introduction

Most of developed nations have raised concerns regarding corporate accountability which is linked with the necessity for applicable risk based audit which encompasses risk assessment and risk management (Beekes & Brown, 2013). According to Basel Committee on Banking Supervision (2012) the prejudice of this area has given rise to different levels of emphasis on risk management, risk assessment, risk identification and risk analysis which is, similarly, mirrored in the control guidelines of evolving nations. The evaluation and consideration of the risk based audit approach is a normal consequence of striving for improvement and the development of the services that the auditing profession provides (Lutta, 2013).

According to Ernst & Young (2015) risk based audit approach is designed to be used throughout the audit to efficiently and effectively focus the nature, timing and extent of audit procedures to those areas that have the most potential for causing material misstatements in the financial report. Risk assessment procedures are used to gather sufficient background information about the clients and its environment which was used to assess the risks of material misstatement of the financial statements and to design the nature, timing and the extent of further audit procedures (PCAOB, 2010).

2. Research Problem

In recent commercial banks have experienced several financial scandals and others have collapsed, which have triggered world-wide concern with corporate governance highlighted apparent failures of accountability (Philip, 2014), and subsequent new laws, regulations in response to them (The Sarbanes-Oxley Act, 2002) provide compelling evidence that risk based audit, serves as part of sound corporate governance framework (Rostum & Elkebrokk, 2013). In Kenya, commercial banks operate in an institutional environment where internal auditing is a statutory requirement. Despite all of the recent attention focused on RBA, research on the existence or extent of this sector in general in financial Institutions has been scant.

Enterprises and found that effectiveness and contribution of internal audit in promoting corporate governance for companies listed in the NSE. Kibara (2007) similarly carried out a survey of internal auditors risk management practices in the banking industry in Kenya and found that seven banks out of twenty one (33 %) had not established a separate risk management department. Keitany (2012) studied the internal audit control function and its implication for risk assessment by the external auditor and found that extent of reliance of internal controls was not sensitive to the strength of internal audit departments, companies should not do away with it. Despite the influence of risk based audit on financial performance in organization, studies on risk based audit on financial performance of banks in Kenya has been neglected.

3. Objectives of the Study

The following were specific objectives of the study:

- i. Assess the influence of periodic risk audit planning on audit quality of tier I commercial banks in Kenya.
- ii. Establish the influence of individual audit assignment on audit quality of tier I commercial banks in Kenya.

4. Significance of the Study

The study will contribute to the existing body of knowledge on risk based audit and audit quality. Researchers shall benefit from both theoretical literature review and the findings of this study aimed at establishing the link between risks based audit and audit quality. This study identified further research areas where other researchers will have an opportunity to carry out further research and expand knowledge in risk based audit and audit quality. In addition, the study offered an insight into the relevance of risk management in enhancing corporate governance and improving audit quality of tier I of commercial banks in Kenya. Directors and management of tier I of commercial banks are expected to appreciate the importance of risk based audit practices and assist in rating their level of compliance against those of their competitors.

5. Review of Literature

5.1 Periodic Risk Based Planning

Institute of Chartered Accountants of Australia (2011) point out that periodic risk based planning means coming up with a general strategy and a detailed approach for the expected nature, timing and extent of the audit. The auditor plans to perform the audit in an efficient and timely manner (Kenya National Audit Office, 2013). Planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan, which includes planned risk assessment procedures and planned responses to the risks of material misstatement. (Mutua, 2012).

CAS 300 Preparation of an Audit of Financial Statements requires that an auditor plan their audit to reduce audit risk to a suitably low level. Audit risk is the risk that an auditor issues an unchanged or clean audit opinion when the financial statements are in fact materially misstated. The planning platform involves determining the audit strategy as well as finding the nature and the timing of the techniques to be performed (Mutai, 2014). In most organizations' internal audit offices do not develop a strategic plan, the exercise of which would have enabled the audit staff to evaluate risk and identify high-risk areas that deserve audit attention.

5.2 Individual Audit Assignment

Audit assignments means implementation of individual risk based assignments to offer assurance on part of the risk management framework which includes on the monitoring of the business's audit system; individual engagement and

professionalism and mitigation of individual or groups of risks (IAASB, 2014).

Individuals are assigned to precise engagements based on their skilfulness sets, suitable professional and industry practice, the nature of the assignment or commitment, and available capacity (Mutai, 2014). The Principal audit engagement and quality control reviewer tasks are ratified by business unit management and also may be acknowledged by regional and national leadership based on the individual characteristics of the entity we audit. The principal audit engagement policymaking contemplates that the engagement team equally has the suitable competencies and capabilities, including capacity to perform the audit engagement in accordance with firm policies, professional standards, and applicable legal and regulatory requirements, to enable an appropriate auditors' report to be issued (Ernst & Young, 2015).

6. Research Methodology

Saunders & Thornhill, (2009) defines research design as an overall plan for research undertaking. The study used a descriptive survey design. According to Oso (2009) descriptive survey design is a concerned with procedures used to scrutinize populations by choosing samples to analyse and discover happenings. The study adopted a descriptive cross-sectional research design, which according to Kothari (2014), is used when the problem has been defined specifically and where the researcher has certain issues to be described by the respondents about the problem. The study involved the evaluating the effect of risk based audit on audit quality of tier I commercial banks in Kenya. This design was suitable since it was easier to sample the population to collect data that can be generalized on the entire study population on risk based audit on audit quality of tier I commercial banks in Kenya.

Gaurav (2014) argues that data collected was processed, analyzed and presented in accordance with the outlined measures. The study data analysis involved the transformation of data into meaningful information for decision making, editing, error correction, rectification of omission and finally putting together or consolidating information. Kothari, (2014) argues that regression is the working out of a statistical relationship between one or more variables. The research data to be collected was analyzed qualitatively and quantitatively.

7. Research Findings and Discussion

7.1 Descriptive Statistics

7.1.1 Periodic Risk Audit Planning

Measurement of this variable was done by subjecting staff to statements that solicit their opinion based on their level of agreement to the statements.

From the findings, nearly all respondents were in agreement with the statement that auditors should have a clear understanding of the client, the client's business activities and business environments in which the clients operates; 69.1% strongly agreed and 24.7% agreed. This implies that as a strategy for risk mitigation, auditors ought to understand their clients well to discharge their duties effectively. There was also wide agreement among tier I bank staff that poor audit work often arises because there was no planning. This opinion was shared by 61.7% of the staff who strongly agreed and 35.8% who agreed. The key to proper planning is setting planning objectives: 48.1% and 45.7% strongly agreed and agreed respectively. A majority of the respondents were of the opinion that planning is designed to allow the auditor to conduct and evaluate business risks: 56.8% agreed while 37.0% strongly agreed

Table 1 Periodic Risk Audit Planning

Periodic risk audit planning Risk Planning	SD(1)	D(2)	U(3)	A(4)	SA(5)
The auditors should have a clear understanding of the client, the client's business activities and business environments in which the clients operates	0 (0.0%)	0 (0.0%)	5 (6.2%)	20 (24.7%)	56 (69.1%)
Poor audit work often arises because there was no planning	2 (2.5%)	0 (0.0%)	0 (0.0%)	29 (35.8%)	50 (61.7%)
The key to proper planning is setting planning objectives	0 (0.0%)	0 (0.0%)	5 (6.2%)	37 (45.7%)	39 (48.1%)
Audit planning is designed to allow the auditor to conduct and evaluate business risks	0 (0.0%)	0 (0.0%)	5 (6.2%)	46 (56.8%)	30 (37.0%)
The auditors with greater audit planning are likely to generate more efficient audits	0 (0.0%)	0 (0.0%)	3 (3.7%)	32 (39.5%)	46 (56.8%)
Audit planning involves developing specific audit program and scope to test the audit process	0 (0.0%)	6 (7.4%)	23 (28.4%)	27 (33.3%)	25 (30.9%)
Strategic audit planning is defined as the auditor's	0	9	12	36	24

decision-making process about obligations to achieve and determining how it is successful	(0.0%)	(11.1%)	(14.8%)	(44.4%)	(29.6%)
Strategic audit planning is an important driving force of audit quality through both audit efficiency and audit effectiveness	5 (6.2%)	3 (3.7%)	12 (14.8%)	44 (54.3%)	17 (21.0%)
Audit resource allocation is one of the elements of audit planning procedure and audit planning development	3 (3.7%)	0 (0.0%)	17 (21.0%)	37 (45.7%)	24 (29.6%)
Audit efficiency, excellence, and effectiveness are under the influence of audit resource allocation	0 (0.0%)	3 (3.7%)	10 (12.3%)	52 (64.2%)	16 (19.8%)
Audit method planning is the important process which responds to the business risk assessment.	3 (3.7%)	3 (3.7%)	9 (11.1%)	39 (48.1%)	27 (33.3%)
The annual risk based audit plan should be updated on a quarterly basis	3 (3.7%)	4 (4.9%)	11 (13.6%)	47 (58.0%)	16 (19.8%)
The risk based audit plan is typically done once a year and will often begin by late third quarter or early fourth quarter	2 (2.5%)	0 (0.0%)	10 (12.3%)	43 (53.1%)	26 (32.1%)

7.1.2 Individual Audit Assignment

The objective for the study was to examine the influence of individual audit assignment on audit quality of tier I commercial banks in Kenya. The study therefore subjected to the respondents various statements assessing individual audit assignment.

Table 2 Individual Audit Assignment

Individual Audit Assignments	SD(1)	D(2)	U(3)	A(4)	SA(5)
The quality of audit assignments are all enhanced by and depend on clear lines of reporting and advice, including supervision and mentoring	0 (0.0%)	0 (0.0%)	7 (8.6%)	39 (48.1%)	35 (43.2%)
The objective of each audit assignment should be clearly documented in all cases and should support Internal Audit's primary objective	2 (2.5%)	0 (0.0%)	21 (25.9%)	39 (48.1%)	19 (23.5%)
Individual understanding of the business area and of its risk profile will continue to develop throughout the audit assignment	0 (0.0%)	0 (0.0%)	17 (21.0%)	24 (29.6%)	40 (49.4%)
Risks to the delivery of the objectives of the particular audit assignment will arise during the course of every assignment.	3 (3.7%)	2 (2.5%)	14 (17.3%)	37 (45.7%)	25 (30.9%)
Objectives for each assignment are likely to include, compliance with the Internal Audit Standards including due professional care requirements;	0 (0.0%)	0 (0.0%)	8 (9.9%)	51 (63.0%)	22 (27.2%)
Objectives for each assignment are likely to include, the training and development of Internal Audit staff;	3 (3.7%)	0 (0.0%)	18 (22.2%)	43 (53.1%)	17 (21.0%)
Documentation of Audit Risks is needed to demonstrate due professional care over the conduct of an audit assignment	3 (3.7%)	2 (2.5%)	7 (8.6%)	31 (38.3%)	38 (46.9%)
The level of documentation should be appropriate to the scale and risk of the assignment	2 (2.5%)	3 (3.7%)	23 (28.4%)	32 (39.5%)	21 (25.9%)
Strategic underlying objectives (Audit Risks) will arise during the course of every assignment	0 (0.0%)	3 (3.7%)	19 (23.5%)	23 (28.4%)	36 (44.4%)
Key risks are not identified due lack of the right skills, experience, supervision or specialist expertise	2 (2.5%)	2 (2.5%)	0 (0.0%)	45 (55.6%)	32 (39.5%)
A time and expenses budget should be agreed for the assignment, including allocating the time to be incurred on each part of the assignment.	6 (7.4%)	0 (0.0%)	3 (3.7%)	37 (45.7%)	35 (43.2%)

There was wide agreement among respondents that individual understanding of the business area and of its risk profile will continue to develop throughout the audit assignment. This is evidenced by the responses where 49.4% strongly agreed while 29.6% agreed and 21.0% were undecided. This show that majority of the staff believed that individual understanding of the business area played a significant role in enhancing the audit quality. There was also agreement among tier I bank staff that risks

to the delivery of the objectives of the particular audit assignment will arise during the course of every assignment: 45.7% agreed while 30.9% strongly agreed and 21.0% were not decided. Objectives for each assignment are likely to include, compliance with the Internal Audit Standards including due professional care requirements as cited by 63.0% of the staff who agreed and 27.2% who strongly agreed besides 9.9% who were not decided.

7.2 Inferential Statistics

7.2.1 Model Summary

Table 4 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.603 ^a	.363	.339	.32836

a. Predictors: (Constant), Individual audit, Periodic risk audit planning

From the findings in the above table the value of adjusted R squared (co-efficient of determination) was 0.339 an indication that there was variation of 33.9 % on audit quality of tier I commercial banks due to changes in Individual audit and periodic risk audit planning at 95% confidence interval. This shows that 33.9 % changes in audit quality of tier I commercial banks could be accounted for by changes in Individual audit and periodic risk audit planning.

7.2.2 ANOVA

Table 5 ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	4.741	3	1.580	14.656	.000 ^b
	Residual	8.302	77	.108		
	Total	13.043	80			

a. Dependent Variable: Audit quality

b. Predictors: (Constant), Individual audit, Periodic risk audit planning

The Analysis of Variance (ANOVA) statistics measure whether the variability observed between the variables was significant. The ANOVA results were, $F(3, 77) = 14.656$, $p(0.00 < 0.05)$, meaning that the variance is significant which means that the model proposed is significant in explaining the relationships. Therefore, the adopted Multiple Linear Regression model well predicted the dependent variable and fits to model the data.

7.2.3 Regression Coefficient

Table 6 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.632	.123		5.121	.000
	Periodic risk audit planning	.304	.159	.207	3.952	.187
	Individual audit assignment	.209	.161	.174	2.302	.017

a. Dependent Variable: Audit Quality

The researcher further performed a multiple linear regression analysis to determine the effect and relationship that existed between risks based auditing (Periodic risk audit planning and Individual Audit) and the audit quality in tier I commercial banks in Kenya.

The established regression equation was:

$$Y = 0.632 + 0.304X_1 + 0.209X_2 + e$$

6. Conclusion and Recommendations

6.1 Conclusions

From the findings Periodic risk audit planning had a statistically significantly unique contribution in the prediction of the audit quality of tier I commercial banks in Kenya, ($\beta = 0.304$, $t = 3.952$, $p = 0.016 < 0.05$); thus the researcher rejected the null hypothesis and concluded that Periodic risk audit planning has a significant influence on the audit quality of Tier I commercial banks in Kenya. Periodic risk audit planning had Part Correlation coefficient of 0.318, thus it uniquely explains $0.318^2 = 10.1\%$ (Part Correlation Coefficient Squared) of the variance in the audit quality of tier I commercial banks in Kenya. Periodic risk audit planning had a positive standardized beta coefficient = 0.207 an indication that a one Unit change in the Periodic risk audit planning is likely to result in an increase in the quality of audit for tier I commercial banks in Kenya by 0.207 standard deviations units. The study therefore concludes at 5% level of significance that Periodic risk audit planning has a significant positive influence on the quality of audit for tier I commercial banks in Kenya.

Risk based audit should help management in assessing the risks and recommend corrective measures for improvement. Auditors understanding of the bank's risk, consideration of risk assessment in the detection of errors, auditors recognition of work environment in risk assessment, auditor's involvement of management in risk evaluation process and auditors identification of changes that have impact on performance affects risk maturity assessment in deploying on audit quality of tier I commercial banks in Kenya.

6.2 Recommendations

The study recommends that management of commercial banks in Kenya should give emphasis to auditors on the understanding of the risk based audit, risk assessment in the detection of errors, work environment in risk assessment, participation of management in risk evaluation process and identification of changes in order to effectively control and improve the quality of personnel in internal audit, ensure adequate funds and the complexity of operations in the audit quality.

The study also suggests that management in tier I commercial banks in Kenya should bear the obligation of outlining effective execution of audit recommendation on risk based audit plans, response of risk based audit reports in time and sufficient resources. This would enhance transparency and accountability through improved efficiency, accuracy, completeness, timeliness, convenience and clarity.

Management of tier I commercial banks in Kenya need to advance and retain suitable qualified professionals in order to ensure the quality audit reports, internal auditor's performance, technical, professional skills, readiness to embrace change, auditing standards and proficiency of the internal auditor required knowledge, skills, and other competencies needed to perform individual responsibilities.

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