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INTERNAL AUDIT PROFESSION AND FINANCIAL PERFORMANCE IN COMMERCIAL BANKS IN RWANDA A CASE OF KENYA COMMERCIAL BANK, RWANDA PLC

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Abstract: -
In all the countries in the world, commercial banks contribute greatly in the economic development of a country (Beck, Demirgüç-Kunt & Levine, 2006). Therefore, tracking the performance of commercial banks has been of great importance both for scholars and for policy makers. The main objective of this research was to investigate the role played by internal audit profession in the financial performance of commercial banks in Rwanda, taking a case of Kenya Commercial Bank, Rwanda plc. The research followed three specific objectives, namely, to investigate internal audit profession in KCB Bank Rwanda plc; to determine the level of financial performance of KCB Bank Rwanda plc and to find out the relationship between internal audit profession and financial performance of KCB Bank Rwanda plc. The research used descriptive and correlational research design with a target of 87 employees all taken as the sample for this research. Structured questionnaires were distributed to the sample and 79 were filled and returned. The collected data was analyzed using IBM SPSS version 22. The results showed that the most of the employees in KCB Bank Rwanda plc are male who represent 72.15% of the total respondents, majority of the respondents were between 31-35 years represented by 42(53.2%) of the respondents. The findings on objective one revealed that 57% of the respondents strongly agreed that audit independence is important for the internal auditing at 32.9% agreed. The findings on objective two revealed that 73.4% of the respondents indicated high level of satisfaction in terms of financial performance of the Bank. On objective three, the findings revealed that all the indicators used for measuring internal audit were positive and significantly related to ROA, ROE and interest margin (some at 5% and others at 10%), except for audit due care which was not significantly related to ROE and interest margin. The findings further revealed that the adjusted R^2=0.81 for ROA, adjusted R^2=0.164 for ROE and adjusted R^2= 0.292 for interest margin. Further, the ANOVA analysis for ROA, ROE and interest margin revealed that all the three models were significant at 5%. The regression equations with audit independence, professional competence and audit due care as predictor variables showed that both audit independence and professional competence have positive coefficient on ROA, ROE and interest margin. The researcher highly recommends prudential adoption of internal auditing function within the banking sector. Policy makers should come up with standardized measures in relation to internal auditing. The managers should be at the forefront to ensure that the internal auditing function operates independently without managerial influences and with due diligence. This recommendation is informed by the positive effect that auditing has on the financial performance of commercial banks.

Keywords: *Financial Audit, Financial Performance, Commercial Bank, Audit Independence Audit Due Care, Audit Professional Competency.*

1. INTRODUCTION

The growth and development of a given economy world over depends, among other things, on the performance of its financial sector. The financial sector is made up of various financial institutions and players who facilitate the flow of funds from one point to another. The banking sector has been among the main players in the financial sector and dominates the sector in most countries especially the emerging markets and the developing countries. Moreover, the banks play major role in ensuring efficient allocation of funds from idle sources to areas that require the funds. As stated by Beck, Demirgüç-Kunt and Levine (2006), the main functions of commercial bank include intermediation function between savers and borrowers, resource allocation, credit creation and maturity transformation. These and other roles played by banks act as avenues for economic growth. Hence, the banking sector has attracted attention from scholars and policy makers. How the banking industry performs is of paramount importance for the economy. This has necessitated the need for auditing as a means to provide assurance about the financial statements reports for commercial banks as prepared by the accountants.

The growth of the finance sector has undoubtedly been the most important impact on the success of any country's economy for many years. In order to ensure that this growth is sustainable for long period, the bank performance is a key in promoting this. For this to happen, commercial banks have come to acknowledge that auditing function is vital in enhancing the efficient management of assets in the banks which eventually leads to improvement of the banks' financial performance (Basel Committee, 2002). The auditing function serves a crucial economic role in the eyes of the public by reinforcing the confidence and trust in the financial reports and statements made by public institutions as well as by the private institutions. It also strengthens the accountability that the financial reports provide.

For instant, the generally acceptable auditing practices issued by the International Auditing Practices Committee (IAPC) have highlighted the need for auditing practices for all organizations. The objective is to ensure uniformity of the auditing report and practises as well as to provide assurance to the users of the accounting information. The incidents that have occurred in financial sector over the decades and in recent time the financial crises of 2007/2008 have pointed to the necessity of the need for auditing in the financial sector more than ever. The ongoing free market system and capitalism in all over the world have led new actors to enter into finance world with the globalization. This has given rise to the deep crises in the banking which act as a backbone of the financial sector, particularly, in the developing countries where required infrastructure and political environment have not been ready yet.

According to Shokoohi, Saeidi and Malekmahmoudi (2015), internal controls include all the strategies set by organizations to guarantee the integrity of accounting and financial information, meet operative and productive goals, and transmit management objectives. Internal control systems work more effectively if well linked with the various divisions with effective communications between the different units in an organization. It is important that internal controls just give sensible however not outright affirmation to an entity's management and other interested parties that the firm's goals will be accomplished (Hayes *et al*., 2005). One of the main tools of internal control strategies that organizations use is auditing. Cunningham (2004) states that the framework of internal control which incorporates auditing function starts as inner procedures with the positive in order to help the organization to meet their strategic goals. The management of an organization are mandated to provide oversight actions. It sets the substance of destinations and has the obligation over the internal control systems (Cunningham, 2004). Financial audit is an indispensable piece of any organization's financial and business approaches and systems (Vadiei & Kuchaky, 2008). The financial audit which comprises of ensuring that the financial reports are transparent is one of the key measures that the management has to provide to the shareholders and other interested parties. The end goal of these measures is to secure the organization's assets from unnecessary wastage and improper usage. It also aims at providing a means that guarantees quality and efficient use of available resources to achieve optimum goals as well as guaranteeing consistency with the strategic goals of the organization. Internal audit aims also at the assessment of the effectiveness of execution of organization activities to ensure that targets are obtained within the required timeframe (Mafiana, 2013; Obert & Munyunguma, 2014).

In addition, a sound of internal auditing systems can help the organizations to prevent frauds, errors and minimize wastage (Uket & Joseph 2012; Eniola & Akinselure, 2016). Various users of financial information access these information through financial statements as prepared by the accountant. Some of these include the shareholders, the government, potential investors, the general public, and others. All of these need the financial information for different purposes. Financial audit provide assurance to the users of these information.

In the modern banking, different elements are combined in order to provide effective internal auditing function of the performance of commercial banks. This has necessitated the need for accountability of organizations in their use of available resources both to the management and to the shareholders. This accountability is also needed by other parties that are internal or external to the organization. Because of these, competency and professionalism have become a need for the financial auditor and the auditing function as a whole. In addition, the advancement in technology has made it more and more essential for the audit function to constantly provide the management with needed advice on how well to operate and run the business. The commitment by the management of a bank to drive the bank performance can be well augmented by ensuring the financial audit perform their duty professionally and with due diligence.

All over the world, auditing has been recognized as one of the key measures of providing internal control of the organizational operation and use of resources. The Institute of Internal Auditors (the IIA) has emphasized the need for auditing for the performance of organization. The financial audit plays an important role in assuring users of financial statement information that the information provided give a true picture of the organization. In UK, the auditing firms are governed by the Institute of Chartered Accountants (ICA). One of the requirements in auditing is for the auditors to be independent and offer reports that give assurance to the stakeholders. In UK and many other countries for instance, the auditor's independence is required by law (Fearnley & Beattie, 2004).

In Asia, the need for the audit function was more emphasised after the financial crises of 199798. The accounting scandals that included embezzlement and insider lending, underscore the importance of sound accounting and auditing practices and oversight (Baxter & Cotter, 2009).

Kallamu and Saat (2015) in their research in Malaysia revealed that exists an association between auditor's independence and financial performance of the financial companies. Usman, Sudarma, Habbe and Said (2014) conducted research in Indonesia on the effect of independence and competence of audit profession on performance of government inspectorate.

In Africa, the audit profession has been adopted in many countries and companies alike. In Nigeria, Ojeka, Iyoha and Obigbemi (2014) show that many organizations practice auditing function and revealed a positive relationship between auditing and financial performance. However, Maroun and Gower (2013), point out that various challenges hinder the effectiveness of auditing function in Africa particularly in South Africa. One of the challenge they highlight is lack of protection of the auditors in carrying out their duty. At one hand they are required to whistle blow any mischief while on the other hand, compliance with their profession by reporting criminal offences does not guarantee them protection.

In Rwanda, the banking industry remains the main force that drives the financial sector growth and development. The financial sector in Rwanda comprises also of the insurance, pension, the SACCOs and the microfinance sectors. However, the banking sector controls the sector and therefore provides greater influence to the financial sector. It is also a key driver to Rwanda economic growth and development. The National Bank of Rwanda (2018) revealed that the banking sector which control over 73% of the total assets dominates the financial sector. As reported by the National Bank, the banking sector comprises of eleven commercial banks, one development bank, three microfinance banks and a cooperative bank. The sector has had a constant growth in assets, profits and increased operations in the rural areas. However, to maintain the financial performance and stability experienced in the banking sector, internal audit is needed both for quality of reporting and for assurance of investors on the soundness of the financial reports.

2. Problem Statement

A financial audit usually aims at providing reasonable assurance about the financial statements. This assurance is needed by various stakeholders who may have different interests on the financial information. Since the goal of an audit is to also express opinions of an organization, it needs to be as objective and reliable as possible. The audit and the oversight mechanisms within the commercial banks should be able to help the banks in their management and financial performance. The financial audits are also responsible for making sure that the financial information provided by different financial do not contain substantial or material misstatements due to either error or fraud. However, for the auditor to be more transparent and objective, there should be much commitment from the management without restricting the functions and the independence of the auditors. One of the main challenges facing the auditing of financial statements is the interferences that come from the management, especially when an internal auditor holds other posts in the organization. This affects the auditing independence and transparency of the auditing function and opinion. The audit chairman and the audit members of KCB hold other different posts within the bank (KCB, 2018a). This leads to possible interferences on the objectivity and independence of the auditor report stemming from conflict of interest when forming the audit opinion. At the same time lack of professional auditors in Rwanda has made most firms rely on other international auditors (IMF, 2017). According to MINICOFIN (2011), internal auditors ought to be alert to the risks and exposures that could allow fraud to occur in the institution. They therefore should be vigilant and put into place audit measures and steps to detect fraud. However, as reported in the KCB (2018b) sustainability report, there were 1,213 number of reported fraud cases in the year 2018 that led to ten employees being dismissed in relation to internal fraud. These challenges have affected the financial performance of many organizations in Rwanda including financial institutions like commercial banks. Due to these challenges, this research aimed at investigating the effect of internal audit profession on financial performance of commercial banks in Rwanda, taking a case of Kenya Commercial Bank, Rwanda plc.

3. Research Questions

The research also seeks to answer the following questions

i) What is the practice of internal audit profession in KCB Bank Rwanda plc?

ii) To what level is the financial performance of KCB Bank Rwanda plc?

iii) Is there a relationship between internal audit profession and financial performance of KCB Bank Rwanda plc?

4. Conceptual Framework

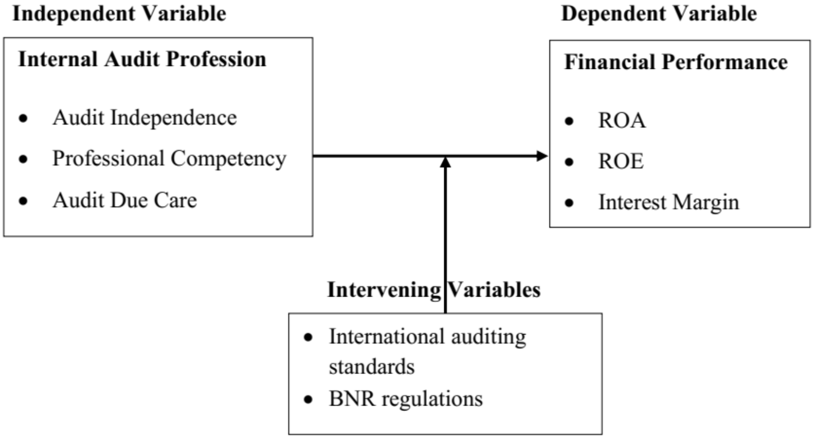

Figure 1: Conceptual Framework

Source: Researcher, 2020

The conceptual framework depicts the main study variables that guided the whole of this research. On one side of the framework is the independent variable internal audit profession while on the other side is the dependent variable financial performance. The indicators that were used to measure the independent variable included the audit independence, professional competency of the auditors and the audit due care. To find out these indicators in this research, structured questionnaires were used for that purpose. These indicators are expected to be measured to find their effect or relation against the financial performance of commercial banks as measured by return on asset, return on equity and interest margins. At the same time the intervening variables are also indicated which include international auditing standards and National Bank of Rwanda regulations.

5. Conclusions

The performance of commercial banks is of key importance to policy makers, government, to the clients and for the overall health of financial and economic outlook of a country. It shows that various stakeholders are interested with the financial performance of commercial banks. Due to the importance attached to the role played by the commercial banks, due diligence should be done in regard to their financial performance as well as their reporting. To safeguard this, internal auditing is an important function that ensures that the bank management is efficient.

Moreover, commercial banks are among the most highly regulated institutions. However, to make them have more prudential practice and to make the work of supervision easy for the regulators, internal audit function is a key tool. This research has shown that internal audit has a significant influence on the financial performance of commercial banks. It is therefore important for the managers in the banks to ensure that there is a well-functioning department for internal auditors. They should also ensure that the auditors are independent and are competent enough to carry out their function.

In line with the theories suggested in this research, namely, the agency theory, the stewardship theory and the theory of inspired confidence, it is the duty of the auditors to act with due diligence for the interest of the shareholders. They should also be there to foresee that the bank operates for the good of the shareholders and other key stakeholders to inspire public confidence in its financial and in its reports. The practitioners within the banking sectors agree that public confidence plays a key role in the stability of the banking industry. Hence, when the auditors are playing this part of ensuring that the public has confidence on the audited financial results, then they are contributing not only to the financial performance of the bank being audited but also to the overall financial stability of the banking industry. This clearly is an indication that this research affirms and supports the theories proposed initially in chapter two. The regression model conducted confirmed that the three variables measuring audit profession, that is audit independence, professional competence and audit due care, have a significant effect on the financial performance of commercial banks as measured by ROA, ROE and interest margin.

In addition, the performance of organizations and their reporting provide key information for the current and future investors. If this information is to carry weight that it deserves a qualification by a professional auditor is a sure way. Most of the stakeholders rely on such information for decision making. Therefore, auditing of the commercial banks is critical for the banking industry.

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