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Effects of Risk Based Audit on Financial Performance of State Owned Corporations in Kenya: A Case Study of State Owned Corporations in The Ministry of Labour Social and Security Services.

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Effects of Risk Assessment and Internal Audit Standards on Financial Performance of State Owned Corporations in Kenya: A Case Study of the Ministry of Labour Social and Security Services.

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Abstract

Risk based internal auditing impacts a firm's usage of its own internal audit function to boost risk management and control as well as power which in turn influences accountability and enhances accuracy of financial statements thereby influencing financial performance in institutions of finance. Recent corporate collapses and financial scandals have triggered worldwide concern with corporate governance emphasized apparent failures of accountability. State corporations in Kenya have in the recent past experienced a number of corporate failures related to corporate power structures in place. The general objective of this study was to establish the effect of risk based audit on performance of state owned corporations in Kenya. The specific objectives was to establish effect of risk assessment on performance of state owned corporations in Kenya and to investigate the effect of internal audit standards on performance of state owned corporations in Kenya; Descriptive design was used in the study. 160 employees were used from the selected from corporation owned by the state as the population target. This comprised of directors, managers, and administrators of departments from, NITA, National Human Resource Planning and Development National Council for Children, Registrar of Trade Unions, and National Council for Persons with Disability, National Employment Bureau, NSSF and Productivity Centre for Kenya. The study engaged census approach since the population was minor. Primary data was collected by use of structured questionnaires and was studied quantitatively using statistical package for social sciences (SPSS). SPSS engendered both descriptive statistics such as frequencies, mean, percentages of the received responses. Inferential statistics included regression and bivariate correlation. The study established that risk assessment and internal audit standard were positively and ominously related to performance of state owned corporations. Built on the results above the study determined that risk based auditing through risk assessment and internal audit standard positively affected the financial performance of state

owned corporations in Kenya. The study endorsed that management of parastatals should implement effective risk based audit practices such as risk assessment, internal audit standards, control environment and information system to enhance effective and efficient performance.

Keywords: *Risk assessment, Internal audit, Performance and State owned corporations in Kenya*

1.0 Introduction

1.1 Background of the study

Risk based Audit (RBA) is a methodology which is principally embedded on the inherent risk tangled in the activities or system and offers assurance that risk is being managed by the management within the defined risk appetite level. It is emphasized that risk-based auditing concentrates on the analysis and management of risks. According to Beeches and Brown (2006) risk-based audit involves risk assessment and internal audit standards.

The role of the board of director's examination on the effects of corporate strategies formulation on the auditors' planning judgments, established that auditors reverts to the role of the board when making judgments with respect to control risk assessments. Keitany (2000), studied on the internal audit control and implication function on risk assessment by external auditors, established that the extent of dependence on internal controls were insensitive to the strength of internal audit departments. A study on the impact of risk-based audit on financial performance in Kenya's insurance companies conducted by Kasiva (2012) used 44 respondents that comprised relationship officers, finance officers, accountants, credit officers, and internal auditors established that RBA through risk management ought to be enriched to allow the organization concerned to discover risks on time.

Kasiva (2012) added that fraud risk assessment is one zone that merits important dependence on internal audit work. In addition to this it is thought that internal auditors are more privy with the operations of their firm more than the external auditors are suited to carry out fraud risk assessment. Kibaara (2007) in his research of internal auditors' risk management practices in the Kenya's banking sector, examined bank internal auditors' risk assessment practices and recognized that, banks in Kenya were in the process of enlisting the Enterprise Resource Management process and strategies in line with risk assessment.

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Employment creation, Co-ordination of National employment, Internship and Volunteers for public service, Community Development, Protection and advocacy of needs of Persons with Disabilities, Social Assistance programmes, Workplace Inspection and Workman's Compensation.

1.2 Statement of the problem

A risk-based audit approach is intended to be used all over the audit to efficiently and effectively concentrate on the timing, nature, and extent of audit measures to those areas that have the most probable for causing material misstatement(s) in the financial report (Fraser, 2013). Risk based auditing is very significant to a performance of a firm. It makes a company stick to its objective and policies (Coram *et al.* 2008). Many corporate downfalls and monetary scandals have triggered universal concern with corporate governance emphasized on obvious disappointments of accountability (Spira and Page 2003).

Internal procedures in state corporation organisations are mostly archaic and highly ineffective in as far as classifying business risks to enable inhibition or mitigation from its occurrence. State corporations in Kenya have in the recent past knowledgeable a number of corporate failures related to corporate governance structures in place. Risk based auditing has hoisted out as an important contributor to effective risk management. However, in public organizations, possessions of risk based internal auditing on realizing financial control and yield remain elusive (Ferguson & Moroney, 2008). By detecting financial losses in public management actions, internal audit delivers a basis for modifying cost shortages that are not measured which lead to huge losses of public funds (Eden and Moriah 1996). Public establishments are facing the risk of scam in management of communal funds.

State owned corporation have had inadequate or lack of risk-based auditing. The corporations are prone to fraud and other forms of financial embezzlement. Many of the state corporations still brawls with Liquidity problems, financial reports are not made on time, accountability for the financial resources is still deficient, frauds and misappropriation of institutional properties have been exhumed and a number of decisions made have not borne the expected results. This may have led to poor performance of state corporations. Therefore, there was need to carry out this research to assess the risk of assessment and internal audit standard on performance of state owned corporations in Kenya.

1.3 Specific objectives

- i. Establish effect of risk assessment on performance of state owned corporations in Kenya
- ii. Determine the effect of internal audit standards on performance of state owned corporations in Kenya

1.4 Research questions

- i. What are the effects of risk assessment on performance of state owned corporations in Kenya?
- ii. To what extent does an internal audit standard affect performance of state owned corporations in Kenya?

2.0 Literature Review

2.1 Theoretical review

Many theories have been articulated to explain the relevant issues impelling financial performance in organizations and auditing theory was used in relation to the study. Auditing theory supports to elucidate the need for auditing in organizations. It also discloses certain laws that govern the audit procedures and its happenings. The theory augments the appreciative relationships and interrelationships between diverse parties of an organization. A sub-theory of auditing theory is the policeman theory. According to this theory, the auditor is responsible for discovering, searching, and preventing fraud. Lately, the chief focus of the auditors has been to provide rational assurance and prove the truth and independence of the financial statements. Fraud detection is a critical topic in the debate on the auditor's obligation, and normally where frauds in financial statement have been revealed, the weight increases in the responsibilities of auditors in detecting fraud (Hayes et al., 2005).

2.2 Empirical review

Kirogo, Ngahu, & Wagoki (2014) conducted a study on effect of Risk-Based Audit on Financial Performance: A Survey of Insurance Companies in Nakuru Town, Kenya. Descriptive survey was employed. The target population comprised of 52 management employees in 27 insurance firms in Nakuru town. Census was employed to elect the sample size in the study. Data was collected using a structured questionnaire with questions on a 5-point Likert scale. Data was analyzed using mean, standard deviation, percentage and Pearson correlation analysis and the results presented in tables. The Statistical Package of Social Sciences software was used to assist in data analysis. The study concludes that risk based auditing through risk assessment positively affected the financial performance of insurance companies in Nakuru Town. Risk assessment enables the insurance companies to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability and enhanced financial performance of insurance companies. Thus the study found a strong association between risks based auditing and financial performance of insurance companies. The study recommends that management of insurance companies in Nakuru Town should adopt effective risk based audit practices such as risk assessment to enhance effective and efficient financial performance.

Kasiva (2012) conducted a study on the impact of risk-based audit on financial performance in Kenya's insurance companies. The study used 44 respondents that included finance officers, internal auditors, credit officers, relationship officers, and accountants found out that risk-based auditing through risk management should be enhanced to enable the organization concerned to detect risks on time. Kasiva (2012) further argues that fraud risk assessment is one area that deserves significant reliance on internal audit work. In this light, it is reasoned that due to the fact that internal auditors are more privy with the operations of the firm they work for than external auditors, are particularly suited to carry out fraud risk assessment. In a survey of internal auditors' risk management practices in the Kenya's banking sector,

Yung (2008) conducted a study on risk based internal auditing in Taiwanese banking industry. The study explored factors associated with Taiwanese Banks' demand for RBIA from perspectives of risk management, internal control, corporate governance and internal auditors' technical competence, by use of data from a survey of domestic banks together with information from corporate annual reports. The survey was designed to gather information on the current use

of RBIA in the banking industry. The questionnaire was developed based on the Standards for the Professional Practice of Internal Auditing (IIA 2004a) and the Implementation Rules for Bank Internal Audit and Internal Control Systems (FSC 2007), and included four parts: part one asked about current status of the bank's risk management; part two requested for the definition of RBIA activity in audit charter and technical competence of internal auditors; part three investigates the performance of RBIA in related to audit planning, nature of work and communication; and part four inquired about basic information of the Banks. The sample consisted of all of the 39 domestic Banks, and of the 39 surveys mailed, 29 completed responses were returned for a response rate of 74.4%. The findings of this study indicated a significant negative correlation exists between the level of RBIA employed by a bank and the board size. Results from the present study suggested that a firm's risk management framework is highly associated with the role of internal auditing in the firm. However, the study has not established the extent to which RBIA affected financial performance.

Kibara (2007) conducted a survey of internal auditors risk management practices in the banking industry in Kenya. The study sought to establish banks internal auditors' perception of their distinct role in the bank wide ERM process, and whether there was any conflict between internal audit and risk management departments being established to take over the ERM process. Bank internal auditors risk assessment practices in Kenya were also probed. To achieve the objectives set, a survey involving all heads of internal audit departments in the banking industry in Kenya was conducted. Data analysis was done, and out of the 27 banks sampled, 14 returned responses with response rate of 52%, it was concluded that the outcome of the study fairly represented the banking industry internal auditors' practices and perception of risk management. Kibet (2008) concluded that the internal audit function played a role in corporate governance. The limitations of the study were time constraints, restriction to state owned corporations and having to make prior arrangement in order to meet the heads of IADs. Recommendations of further study were effectiveness and contribution of internal audit in promoting corporate governance for companies listed in the NSE. Additionally, a study on the influence of internal audit and audit committee on financial reporting quality was recommended

2.3 Conceptual framework

According to Kombo and Tromp (2009), a concept is an abstract or general idea inferred or derived from specific instances. A conceptual framework is a set of broad ideas and principles taken from relevant fields of enquiry and used to structure a subsequent presentation. Kothari (2004) defines an independent variable also known as the explanatory variable is the presumed cause of the changes of the dependent variable, while a dependent variable refers to the variable which the researcher wishes to explain. Figure 1 shows the conceptual representation.

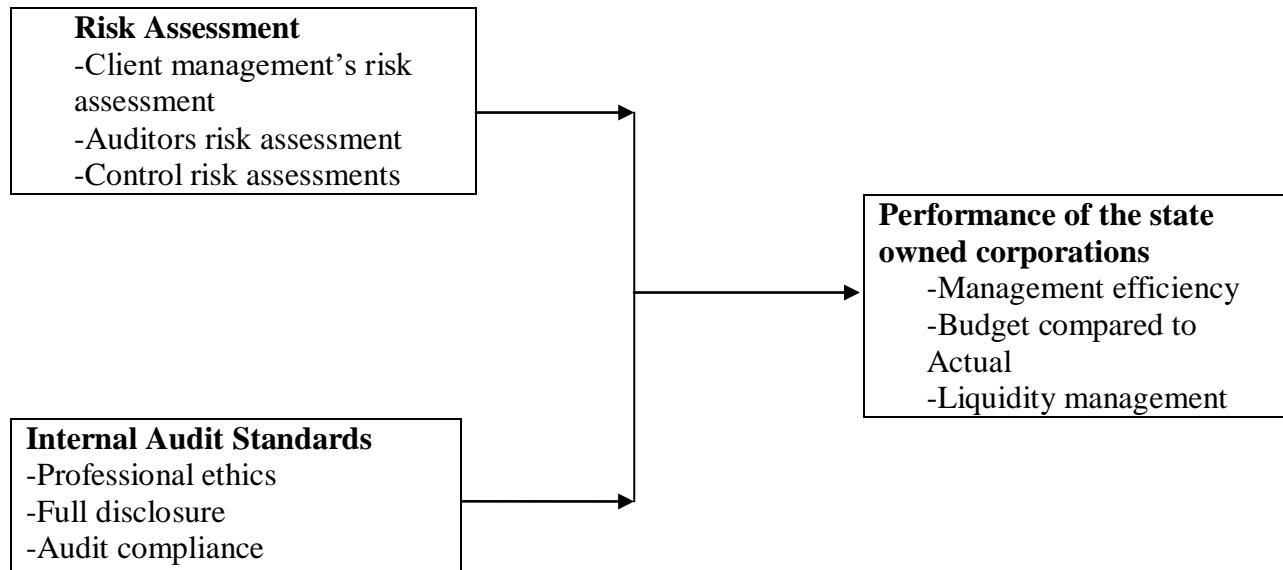


Figure 1: Conceptual framework

3.0 Research methodology

The study adopted a descriptive survey design. The sample size of 160 respondents working as employees from the selected state owned corporation as the target population. This included directors, managers, and supervisors of departments from National Council for Children, National Human Resource Planning and Development, National Council for Persons with Disability, Registrar of Trade Unions, NITA, NSSF, National Employment Bureau and Productivity Centre for Kenya. Questionnaires were used to obtain data, which was analyzed by the use of descriptive statistics. A Likert scale of five responses was used. Likert scale is an interval scale that specifically uses five anchors of strongly disagrees, disagree, neutral, agree and strongly agree. The Likert scale measures the level of agreement or disagreement. Correlation and regression analysis was used to assess the effect of risk based audit on performance of state owned corporations in Kenya.

4.0 Results and findings

4.1 Risk Assessment

4.1.1 Descriptive statistics of Risk Assessment

The first objective of the study was to assess the effect of risk assessment on performance of state owned corporations in Kenya. The respondents were asked to respond on statements on risk assessment. The responses were rated on a five Likert scale as presented in Table 1. Majority of 80%(50%+30%) of the respondents agreed with the statement that In the organization, risk assessment is a continuous and permanent process, 70%(35%+35%) agreed with the statement that risk identification and management is a responsibility of all employees of the organization.,

70% (40%+35%) of the respondents agreed that control is focused upon avoiding the unacceptable business/performance risks in order to reduce it to an acceptably low level, 80% of the respondents agreed that there is consideration of risk assessment in the detection of errors , while 85% of the respondents agreed that Risk monitoring is carried out to identify errors in financial reporting.

On a five point scale, the average mean of the responses was 3.94 which mean that majority of the respondents were agreeing with most of the statements; however the answers were varied as shown by a standard deviation of 1.09.

Table 1: Risk Assessment

Statement	1	2	3	4	5	Mean	Std. Dev
In the organization, risk assessment is a continuous and permanent process.	5.00%	5.00%	10.00%	50.00%	30.00%	3.95	1.03
Risk identification and management is a responsibility of all employees of the organization.	5.00%	10.00%	15.00%	35.00%	35.00%	3.85	1.16
Control is focused upon avoiding the unacceptable business/performance risks in order to reduce it to an acceptably low level	10.00%	5.00%	15.00%	40.00%	30.00%	3.75	1.23
There is consideration of risk assessment in the detection of errors	5.00%	10.00%	5.00%	55.00%	25.00%	3.85	1.07
Risk monitoring is carried out to identify errors in financial reporting	0.00%	10.00%	5.00%	30.00%	55.00%	4.3	0.96
Average						3.94	1.09

4.2 Internal Audit Standards

4.2.1 Descriptive statistics of Internal Audit Standards

The second objective of the study was to establish the effect of internal audit standards on performance of state owned corporations in Kenya. The results are presented in Table 2 below show that 70% (10%+70%) of the respondents agreed that internal auditors observe professional ethics & standards, 70% of the respondents agreed that the organization use International Auditing standards (IAS) to guide the internal audits ethics, 80% of the respondents supported that there is compliance with accepted audit standards, another 80% agreed that There is an active and independent Audit Committee while 70% agreed that There is full disclosures about compliance risk and risk management.

Using a five point scale Likert mean, the overall mean of the responses was 3.91 which indicates that majority of the respondents agreed to the statement of the questionnaire. Additionally, the standard deviation of 1.21 indicates that the responses were varied. The results herein imply that internal audit standards influence the performance of state owned corporations in Kenya.

Table 2: Internal Audit Standards.

Statement	1	2	3	4	5	Mean	Std. Deviation
Internal auditors observe professional ethics & standards.	15.00%	5.00%	10.00%	10.00%	60.00%	3.95	1.51
The organization use International Auditing standards (IAS) to guide the internal audits ethics	5.00%	15.00%	10.00%	40.00%	30.00%	3.75	1.18
There is compliance with accepted audit standards	5.00%	5.00%	10.00%	40.00%	40.00%	4.05	1.08
There is an active and independent Audit Committee	5.00%	5.00%	10.00%	40.00%	40.00%	4.05	1.08
There is full disclosures about compliance risk and risk management	10.00%	5.00%	15.00%	40.00%	30.00%	3.75	1.23
Average						3.91	1.21

4.3 Regression Analysis

The results presented in table 3 present the fitness of model used of the regression model in explaining the study phenomena. Risk assessment and internal audit standards were found to be satisfactory variables in performance. This is supported by coefficient of determination also known as the R square of 58.8%. This means that Risk assessment and internal audit standards explain 58.8% of the variations in the dependent variable which is performance of state owned corporations in Kenya. This results further means that the model applied to link the relationship of the variables was satisfactory.

Table 3: Model Fitness

Indicator	Coefficient
R	0.767
R Square	0.588
Adjusted R Square	0.119
Std. Error of the Estimate	0.42694

Table 4 provides the results on the analysis of the variance (ANOVA). The results indicate that the overall model was statistically significant. Further, the results imply that the independent

variables are good predictors of performance of the state owned corporations. This was supported by an F statistic of 5.006 and the reported p value (0.001) which was less than the conventional probability of 0.05 significance level.

Table 4: Analysis of Variance

	Sum of Squares	df	Mean Square	F	Sig.
Regression	3.65	4	0.913	5.006	0.001
Residual	20.962	115	0.182		
Total	24.612	119			

Regression of coefficients results in table 5 shows that risk assessment and participation in performance are positively and significant related ($r=0.191$, $p=0.02$). The table further indicates that internal audit standards and participation are positively and significant related ($r=0.182$, $p=0.027$).

Table 5: Regression of Coefficients

Variable	B	Std. Error	t	Sig.
(Constant)	1.729	0.538	3.212	0.002
Risk assessment	0.191	0.081	2.357	0.020
Internal audit standards	0.182	0.081	2.237	0.027

5.0 Conclusions

Based on the findings above the study concluded that risk based auditing through risk assessment positively affected the financial performance of state owned corporations in Kenya. Risk assessment enables the state owned corporations to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability and enhanced performance of state owned corporations. Thus the study has found a strong association between risks based auditing and performance of state owned corporations

In addition the study concluded that a state owned corporation's performance is highly associated with the role of internal audit standards. Risk based internal auditing when enhanced enables the organization to detect risks on time and concentrate on high risk areas leading to increased transparency and accountability, hence enhancing performance

6.0 Recommendations

The following recommendations based on the study findings are suggested to help boost the performance of the state owned corporations in Kenya. The study recommend that management of state owned corporations should adopt effective risk based audit practices such as risk assessment, internal audit standards, control environment and information system to enhance effective and efficient performance.

In order to achieve this, it is recommended that management of State Corporations in Kenya should emphasize on internal auditors understanding the risk based internal audit approach and

in particular embrace risk assessment in the detection of errors, understand their work environment in risk assessment, involve management in the risk evaluation process and identification of changes in order to effectively control risks, improve the quality of personnel in internal audit, adhere to internal auditing standards, undertake proper and efficient annual planning, having independent directors and an audit committee, responding to risk based internal audit reports in time thereby increasing transparency and accountability to achieve efficiency, accuracy, completeness, timeliness, convenience and clarity in financial reporting which in turn will improve on performance of state owned corporations in Kenya.

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