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Effects of Moderated ISAS on Financial Performance of NSE-Listed Banks in Kenya

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Abstract
The study investigated the effect of moderated international standards of auditing (ISAs) on the financial performance of the Nairobi Stock Exchange (NSE) listed banks in Kenya. The study posits that moderated ISAs have significant effects while the non-moderated ISAs has not so significant effect on the financial performance of the NSE listed banks in Kenya. It used a descriptive case study to analyze the effect of the variable on financial performance using Likert collected responses. The results established that moderated ISAs positively influenced the financialperformance. To enhance performance and mitigate adverse corporate governance issues requires that the banks offer auditors independence and authority in the management protocols and establish internal audit unit to undertake periodical audits. To facilitate faster delivery of audit services including the detection and prevention of frauds and/or non-compliance with public expenditure management, the listed banks should provide a conducive work environment that enables the use of cutting-edge ICT technology to support auditing functions, promote continuous training and develop institutional mechanisms (e.g., enforcement, auditing, or corporate governance structures) to encourage compliance with international standards.

Key Words; *auditor, standards, CBK, reporting, governance*

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I. Background of the Study

Internal audit provides information communication sharing and assurance on institutional operations that enhance organizational performance (Reid & Ashelby, 2002, Ahmad, Jusoff & Othmans, 2009). Regionally, higher profits have been experienced. Investigations proved average ROA was 2% on the internal audit activities in the research study on the profitability of banks in Sub-Saharan Africa (Flamini et al,2009). IAF protects company assets, improves decision-making, protects irregularities and offers management auditing services (Chagwony & Rotich, 2015, Muchiri & Jagongo, 2017, Ruto, 2015). However, despite other financial management reforms, institutions have kept performing less than desired in both the public and private segments, especially in the third world countries (Shamshuddin & Bharathii, Alzeban & Gwilliam, 2014). Accounting disgraces in distinguished global institutions such as Enron where stock prices reduced from $90.75-$0.26, Parmalat where there was a double billing scheme that 300 employees were aware and WorldCom where fraudulent balance sheet entries of up to $3.8 billion(11 billion being overstated) among others have revealed company management deficiencies.

Statement of the Problem

There are many financial management reforms introduced and enhanced over time that are meant to enhance financial performance across different organizations. The steadiness and efficiency of organizations have been the focus of past initiatives of financial management reforms. Despite this, data shows that firms in the banking sector have posted inconsistent performance over the years with commercial banks in Kenya reporting a decline in performance in the recent past. According to Onuonga, 2014, the increase in profit before tax in 2013 was 16.6%, 20.6% in 2012, 12.9% in 2009, and 13.4% in 2008. The only year that had a higher increase in PBT was in 2010 with a 52% increase. Failure in financial governance had led to; corporate frauds, improper accounting, and incorrect financial reporting leading to financial underperformance and collapse (Lumumba, 2015). This is not a good trend notwithstanding the financial management reforms. The sustainability of the good performance in these banks proved a major challenge. This raises the question as to whether the adoption of moderated international standards factors could be the weak link. The study therefore aimed at ascertaining the effect of moderated international standards of auditing on the financial performance of Kenyan banks that are listed on the NSE.

General Objective

The objective of the research was to determine the effects of adoption of moderated international standards of auditing on the financial performanceof NSE-listed banks in Kenya.

II. Research Methodology

This descriptive case study involved11primary NSE listed banks in Kenya.The population of importance in this investigation was the 11 NSE listed banks in Kenya that have transacted between 2013 and 2017.The focus of the study was the internal audit Department of these banks. Data collection procedure observed all the necessary ethical considerationsincluding explaining the purpose of the study and assuring the respondents of confidentiality.

Data was analyzed using the following regression model:

$$Y_{ij} = \beta_{0jm} + \beta_{1j} X_{i1\text{m}} \ldots + \text{an}\ \beta_{pj} X_{ip\text{m}} + \epsilon_{ij}$$

Where:

Y is the Financial Performance of the bank.

β_0 is the regression constant.

β_1, is the coefficient of independent variable.

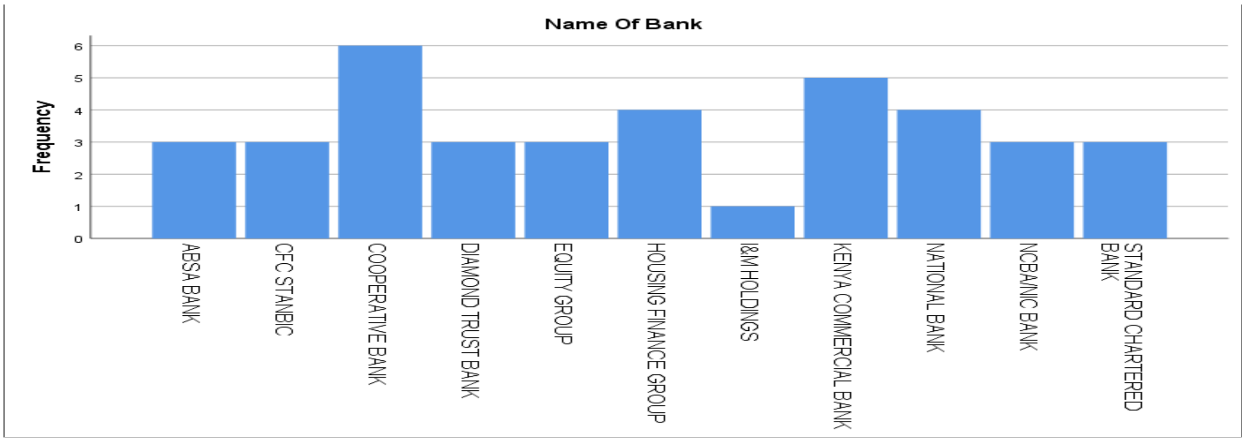
X_1 is the adoption of ISAs

X_m is the moderating variable (CBK regulations)

ε is the error term.

Response Rate

The results showed a response rate at 86.4% since each bank was given repeated chances to participate through its officers. All of them had post-secondary school level education to which some had done professional courses such as CPA, ACCA, CIFA, CPSPK, and OCP among others. The respondent's length of service in the banks shows that 71% had worked for 9 years in the institution before exiting to other institutions.



Correlation analysis

The Pearson correlation coefficient was used to determine the effects of ISAs and Financial performance. A table of correlations showing the classification of the applications of the ISAs and the corresponding values for ROA and ROE is as shown in Table 1.

Table 1: Correlations for the effect of adoption of ISAs on Financial Performance

Measures of International Standards of Auditing	ROA Pearson Correlation(p-value)	ROE Pearson Correlation(p-value)
According to recognized auditing regulations, Internal auditors perform services linked to information other than financial reports.	-.034(.843)	-.005(.978)
Auditors perform their duties objectively and by acknowledged professional standards	-.043(.802)	.015(.932)
Internal audits use a systematic, disciplined method to examine development of risk management, control, and governance in the	-.046(.787)	-.031(.856)

banking system.		
Performing auditing work by the ISA has a major impact on auditing effectiveness.	.027(.869)	.022(.710)
The most essential element to an Internal auditor's added value is adherence to professional standards.	-.079(.643)	-.045(.792)
The financial performance of NSE-listed banks is influenced by ISAs and audit-related services.	-.183(.339)	-.256(.544)
N	38	38

Higher values of correlations with ROE and ROA were recorded for the Standards of audits and audit-related services, which were 0.256 and 0.183 respectively. The lowest values of correlations with ROE and ROA were recorded for the Performing auditing work according to the ISA contributes significantly to influence the effectiveness of auditing, which were 0.022 and 0.027 respectively. ROE and ROA for Internal auditor's added value after adherence to professional standards correlations were 0.045 and 0.079 respectively. ROE and ROA Internal audits use of a systematic and disciplined method for examination, control, and governance of risk management correlations were 0.031 and 0.046 respectively. Auditors perform their duties objectively and by acknowledged professional standards showed an interesting twist with ROE being relatively low and ROA being relatively high with 0.015 and 0.043 respectively. ROE and ROA Internal auditors perform services linked to information other than financial report correlations were 0.005 and 0.034 respectively. Each of the indicated measures showed that there was a weak positive linear effect of implementation of the ISA protocols on financial performance. With the values of the correlation, it is evident that none of the sub-constructs has a significant linear effect on the measures used to determine the financial performance of the firms.

A computed ANOVA for both the dependent variables is as tabulated in Table 2, with F=1.021, p-value= 0.476 for ROA and F=0.935, p-value=0.548 for ROE. In conclusion, none of the measures was significant. This, as a result, also indicates that the results attained for the section were purely by chance and none of them would be obtained upon using the second sample of data even from similar banking facilities.

Table 2: ANOVA Table for ISA

		Sum of Squares	df	Mean Square	F	Sig.
ROA	Between groups	44.835	16	2.802	1.021	.476
	Within groups	54.916	22	2.746		
	Total	99.751	38			
ROE	Between groups	1307.159	16	81.697	.935	.548
	Residual	1746.978	22	87.349		
	Total	3054.137	38			

Moderating effect of the CBK regulations on the relationship between international standards of auditing and Financial Performance.

Evaluating the effect of the CBK regulations was done using structural equation modeling to investigate the effect of ISAs on the financial performance of the organization (Nimon &Reio,2011).

The defined model is as follows.

$Y_{ij} = \beta_{0jm} + \beta_{1j} X_{i1m} + \cdots + an\beta_{pj} X_{ipm} + \in_{ij}$,

where the dependent variables are the ROA and ROE used to measure the financial performance of the banking institutions under observation. The above equation aims at testing whether the subjection of the CBK regulations on the ISAs affect the performance of the NSE-listed banks in Kenya. The results obtained are as shown in the Table 3.

Table 3: Analysis of Variance for moderated IAPs

Source	Dependent Variable	Type III Sum of Squares	Df	Mean Square	F	Sig.
Corrected Model	ROA	6.243[a]	4	1.561	.641	.037
	ROE	295.849[b]	4	73.962	.964	.041
Intercept	ROA	341.963	1	341.963	140.542	.000
	ROE	12901.108	1	12901.108	168.216	.000
ISA*CBK regulation	ROA	.032	1	.032	.013	.909

	ROE	11.766	1	11.766	.153	.698
Error	ROA	75.429	31	2.433		
	ROE	2377.507	31	76.694		
Total	ROA	708.723	38			
	ROE	26902.354	38			
Corrected Total	ROA	81.672	35			
	ROE	2673.356	35			

a. R Squared (ROA) = .762
b. R Squared (ROE) = .611

The constructed model for both the dependent variables satisfies the significance test done against a 0.05 level of significance. The p-values for both models are 0.037 and 0.041, which are lower than 0.05. Since the model is significant, then one can proceed to interpret the parameter estimates. The parameter estimates of the different variables included in the general linear model are as shown in the Table 4.

Table 4: Regression coefficients for moderated variables

Parameter Estimates							
DV	**Parameter**	**B**	**SE**	**t**	**Sig.**	**95% CI**	
						LB	**UB**
ROA	Intercept	4.005	0.338	11.855	0	3.316	4.695
	ISA* CBK	0.022	0.19	0.115	0.009	-0.365	0.409
ROE	Intercept	24.602	1.897	12.97	0	20.73	28.471
	ISA. D	0.418	1.066	0.392	0.038	-1.76	2.592

From the parameter estimates, the constructed model is as below.
$Y_{ij} = \beta_{0jm} + \beta_{1j} X_{i1m} \dots + an\beta_{pj} X_{ipm} + \epsilon_{ij}$
$ROA = 4.005 + 0.022 * (\text{ISA} * \text{CBKregulation})$
$\text{ROE} = 24.60 + 0.418 * (\text{ISA} * \text{CBKregulation})$

Since the model is significant for both ROA and ROE, it is sufficient evidence that the regulations issued by the CBK have a statistically significant effect on the effect of ISAs on financial performance of the banking institutions. Additionally, this serves also as an indication that any type of effect of the regulation's observable on the moderated ISAs affected the financial performance of the institution and is not due to chance. The independence of the IA seemed to have a weak negative influence on the financial performance while the others contributed positively. As shown in the table, the p-values in the parameter estimate tables, the ISA and independence of the IA had values 0.007 and 0.009 respectively for the ROA model. The same variables had values 0.046 and 0.038 for the ROE model. In both cases, the values were <0.05; hence, significant. The outcome proved that a similar result can be observed another time even when using a different sample with the same characteristics as the current population

III. Discussion of the Findings

One of the primary reasons for implementing the ISAs is to ascertain that the functions of the auditing department occur efficiently, which in turn improves the processes of making certain various decisions of the management team (Chalu, 2020; Haapamäki & Sihvonen, 2019). Some of the constructs considered when considering the contribution of the ISAs include execution of auditing duties as per the ISAs, conforming to the set professional standards, the role of the standards in affecting the performance of commercial banks, the added roles of the Internal auditors, and their manner of conduct when carrying out the designated duties. Besides these, the IA also contributes to the expansion of management of risks, control, and control using a methodical and systematic approach in the banking institutions. With proper implementation of the required standards, it becomes easier for the involved firm to identify existing weaknesses and improve upon them for better financial health. Boolaky and Soobaroyen (2017) associate the success of any implemented ISA with the underlying institutional factors. The inclusion of the variable is essential as it enables the adoption of an explanation based on conformity to the planning, production, and management techniques employed by the institution (Boolaky & Soobaroyen, 2017). With this, there is evidence that although the ISA is fundamental for the auditing department, the inclusion of the condition of the firm under investigation is key when establishing the capability to determine better financial performance.

Hypothesis testing

H_{o1}: there is no significant effect between adoption of international standards of auditing and financial performance of NSE-listed banks in Kenya, was accepted.

In conclusion, the implementation of the ISAs does not have a substantial influence on the financial performance of the NSE-listed banks in Kenya. As a consequence, none of the measures were significant. This, as a result, also indicates that the results attained for the section were purely by chance and none of them will be obtained upon using the second sample of data even from similar banking facilities.

These findings differ with Chalu (2020), who opine in the importance of the ISAs in achieving the organization's objectives. Castro et. al (2020) also share similar sentiments after research undertaken on the implementation of the ISAs effects on financial institutions in Brazil. The researchers established that the effective implementation of the ISAs plays a pivotal duty in the promotion of improving the performance of the institutions. However, the cited studies, included the moderating variable effect, hence significant. One of the primary reasons for implementing the ISAs is to ascertain that the functions of the auditing department occur efficiently, which in turn improves the processes of making certain various decisions of the management team(Haapamäki & Sihvonen, 2019).

CBK Regulations Moderating effect on IAP and Financial Performance

The objective looked into the effect of the Central bank of Kenya regulation on ISAs adoption of the internal and the overall influence on the financial performance of the NSE-listed banks in Kenya. The respective R squared values for ROA and ROE were at 0.762 and 0.611 respectively which showed a good fit. The constructed model for both the dependent variables satisfies the significance test done against a 0.05 level of significance with the p-values for both models at 0.037 and 0.041 for ROA and ROE, which are lower than 0.05.The simplified Structural equation model (SEM) revealed that the ISAs became a significant factor in determining the financial performance when working in conjunction with the CBK regulations

Recommendations and recommendations for further studies.

Therefore, this study recommends the adoption and employment of moderated ISAs to keep improving the NSE-listed bank's financial performance. It is also important for the NSE listed banks to facilitate faster delivery of services including the detection and prevention of frauds and or non-compliance with public expenditure management, by providing a conducive work environment that enables the use of cutting edge ICT technology to support auditing functions, promote continuous training and develop institutional mechanisms (e.g., enforcement, auditing, or corporate governance structures) to encourage compliance with international standards. A study on the impact of internal controls on investment bank financial performance in Kenya would be fascinating; this would provide a broader view of how adoption of ISAs affects not only commercial banks but also investment banks in Kenya. Due to the COVID-19 limitations, research on moderated internal audit practices effects on financial performance of NSE-listed banks in Kenya without this limitation is also recommended.

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APPENDIX 1:LIST OF NSE LISTED COMMERCIAL BANKS IN KENYA

1. Absa PLC Group
2. CFC Stanbic Holdings
3. Co-operative Bank
4. Diamond Trust Bank
5. Equity Group
6. Housing Finance Group
7. I&M Holdings
8. Kenya Commercial Bank Group
9. NIC Group
10. National Bank
11. Standard Chartered bank

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