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EFFECT OF STRATEGIC AUDIT QUALITY ON FINANCIAL PERFORMANCE OF LISTED COMMERCIAL BANKS IN KENYA

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ABSTRACT

Strategy governance is very important for banking industry to foster strategy implementation and improvement in performance. Bank Managers desperately need to know when particular strategies are not working well, so that interventions through corrective measures are undertaken before it is too late. It is with this in mind that this study sought to establish the effects of strategic audit quality on financial performance in listed commercial banks in Kenya.The objective of the study was to examine effects of strategic audit quality on financial performance in commercial banks listed at the Nairobi Stock Exchange, Kenya. The study adopted descriptive survey research design. The study carried a census survey where all the10 listed commercial banks were considered. Primary data was obtained through questionnaires.Descriptive statistics, Inferential statistic regression and correlation techniques used to analyze data. The study found that strategic policy auditing enhances proactively of the board, improves the level of compliance in the bank operations, influences decisions on cash reserve ratio as well as the empowerment of the chief executive officer to make reasonable interpretations of the board policies. The study revealed that through strategy control and monitoring, financial governance and strategic audits greatly influence financial performance in commercial banks listed at NSE. Regression analysis revealed that strategic audit quality has a significant and positive relationship with banks' financial performance in commercial banks listed at the NSE. The study also concluded that strategic audit quality plays a critical role in improving banks' financial performance.

Key Words: Strategic Governance, Strategic Audit Quality and Financial Performance

1.1 INTRODUCTION

In the 21st century, strategic governance practices that constitute basic activities examining the underlying bases of a firm's strategy, strategic audit auditing influence performance in organizations. Most importantly is adequate and timely feedback which is the cornerstone of effective strategy monitoring and evaluation. Strategy audit quality is a critical tool to foster performance in organizations. The strategic-management process results in decisions that can have significant, long lasting consequences. Erroneous strategic decisions can inflict severe penalties and can be exceedingly difficult, if not impossible, to reverse (McAdam and Bailie, 2002). Most strategists agree, therefore, that strategy au8dit quality is vital to an organization's well-being; timely evaluations can alert management to problems or potential problems before a situation becomes critical (Johnson, 2002). Approximate information that is timely is generally more desirable as a basis for strategy evaluation than accurate information that does not depict the present. Ratanasongtham (2016) noted that strategies audit planning in firms in Thailand have significant positive influence on auditing outcomes and auditing outcomes have significant positive influence on audit quality and achieving expected profitability level. The formulation of a particular strategy can only be examined, through the strategy outcome after a period of time. According to Siciliano, (2002) when an organization realizes that strategy is a function of the pattern of decisions and actions it takes, then it becomes clear that appropriately designed performance measures can encourage the monitoring and evaluation of strategy. Business strategic measures are one way of providing information about where the organization is heading. Leading organizations are using strategic systems as a means of communicating to their employees about what is important.

Most strategists agree that strategy governance is very important for financial institutions as it enables them to evaluate problems or situations that may affect the process of strategy implementation and execution. According to David, (2010) strategy controlling includes examining the base strategy, comparing results and taking corrective actions (Mollah, 2007).Strategy governance also measures the effectiveness of the organizational strategy. This may require taking certain precautionary measures or even changing the entire strategy (Porter 2004). Strategic governance can be used as process of monitoring and evaluating as to whether the various strategies adopted by the banks are helping its internal environment to be matched with the external environment thus allowing managers to focus the banks' strategies through a critical long-term perspective. This would involve a detailed and objective analysis of the bank and its ability to maximize on its strengths and market opportunities.

Managers desperately need to know when particular strategies are not working well, so that interventions through corrective measures are undertaken before it is too late. Strategic governance, strategic audit quality can therefore be carried out by reviewing current strategies, measuring performance and taking corrective actions. This in alignment with strategy evaluation and execution is needed because success today is no guarantee of success tomorrow. Success usually creates new and different problems thus complacent organizations may experience demise (Pierre, 2000). The evaluation, execution and control phase requires that relevant organizational information is obtained for attainment of the desired strategic performance and this should be compared with the existing standards (Potůček, 2004).

1.2 Statement of the Problem

In the banking industry, strategic governance is considered to encompass the processes by which commercial banks are managed strategically. Central to strategic governance is strategic audit quality and stewardship (Kearns, 2010). This view was supported by Ratanasongtham (2016) that strategic audit quality foster strategic planning involves audit efficiency, audit excellence, and audit effectiveness. Recently, Commercial banks in Kenya collapse such Chase bank attributed inadequate strategic governance and weak conventional corporate governance (CBK, 2010). Commercial banks resort to strategic governance to reduce frauds and mitigate risks. Listed commercial banks have focus on Strategic audit quality in an effort to spot bottlenecks in strategy implementation and detect unintended effects from an investment plan, strategies and its activities (Kibet, Makokha, & Namusonge, 2016). However, despite the significance of strategic audit quality in commercial banks, scholars have not given it much attention (Renders Gaeremynck & Sercu, 2010). .This motivate the study to determine effect of strategic audit quality on financial performance in listed commercial banks in Kenya

1.3 Objective of the Study

The objective of the study was to examine effect of strategic audit quality on financial performance in commercial banks listed at the Nairobi Stock Exchange in Kenya

1.4 Research Hypothesis

H_{01}: Strategic audit quality has no significant effect on financial performance of commercial banks listed at Nairobi Securities Exchange in Kenya

2.0 LITERATURE REVIEW

Recognizing the number of different ways that intended and realized strategies may differ underscores the importance of strategy evaluation and control so that the firm can audit its performance and take precise corrective measures if the actual performance differs from the intended strategy objectives and planned results.

2.1 Theoretical Review

The rational goal approach focuses on the organization's ability to achieve its goals. An organization's goals are identified by establishing the general goal, discovering means or objectives for its accomplishment, and defining a set of activities for each objective (Peters, 2010). The organization is then evaluated by comparing the activities accomplished with those planned for however; these criteria are determined by various factors. The systems resource model analyzes the decision-makers's capability to efficiently distribute resources among various subsystems' needs. The systems resources model defines the organization as a network of interrelated subsystems (Hill and Jones, 2006). Each organizational problem requires a specific allocation of resources. Thus it is a bargaining model which presumes that an organization is a co-operative, though this may sometimes seem to create a culture of competitive resource distributing systems in the organization.

Decisions, problems and goals are more useful when shared by a greater number of people. Each decision-maker bargains with other groups for scarce resources which are vital in solving problems and meeting goals. The overall outcome is a function of the particular strategies selected by the various decision-makers in their bargaining relationships. This model measures the ability of decision-makers to obtain and use resources for responding to problems important to them (Kim, and Yoon, 2007). The processes of planning, strategy monitoring and evaluation make up the Result-Based Management (RBM) approach, which is intended to aid decision making towards explicit goals (Thuita & Kibati, 2016).

2.3 Strategic Audit Quality

The audit process undertaken within an Organization should be thorough and of good quality. There are various forms of audit that are carried out within an organization, these may include financial, budgetary, compliance and even strategic governance audits. Strategic governance audit can be described as that examination and evaluation of areas affected by the operations of the strategic management processes within the Organization. This audit is crucial when performance indicators show that the strategy is not working or is producing negative side effects, high-priority items in the strategic plan are not being accomplished, a shift or change occurs in the external environment and management want to fine-tune a successful strategy and to ensure that the strategy that has worked in the past continues to be in tune with subtle internal or external changes that may have occurred (Johnson & Scholes, 2002). To aid in control, firms will occasionally perform audits to ensure that certain aspects of their operations are in order. Such audit may include operational audits and strategic audits. To assess a firm's current operating health, short-term financial, market, technological, and production positions are used, while current strategic health is based on strategic market positioning, technological positioning, production capabilities, and financial health.

For an increasing number of local and global banks, overseeing environmental affairs is a technical function performed by specialists hence an important strategic-management concern. Financial Product design and development require critical audit to achieve market and financial performance. Banking institutions that effectively manage environmental affairs are benefiting from constructive relations with employees, consumers, suppliers, and distributors. Instituting an environmental audit can include moving environmental affairs from the staff side of the organization to the line side. Some banks are also introducing environmental criteria and objectives in their performance appraisal instruments and systems (Jensen and Murphy, 2000). In order to minimize compliance gaps in corporate financial reporting and auditing, it is necessary to augment required skills and competency of professional accountants and auditors, and effective and efficient regulation of the accounting profession. More importantly, corporate executive officers and financial officers need to do more to support transparency, accountability, and full compliance with the applicable financial reporting requirements in commercial banks (Moustafa, 2007). The Board of Directors which is responsible for the long-term strategic direction for profitable growth of the Bank, are accountable to the shareholders for legal compliance and maintenance of the highest corporate governance standards and business ethics.

2.4 Strategic Audit Quality and financial performance in Organizations

The strategic choice approach became widely used as the underlying theoretical foundation in investigating corporate governance research issues from the 1980s to the mid-1990s (Pierre and Peters, 2000). The ability of the firm in adapting to its environment is argued as the main explanation of the organizational outcomes obtained by the firm. Strategy is the primary link between the organization and the environment. A list of functions undertaken by strategy managers under the strategic agenda include scanning the internal and external environment for information, procuring strategic assets, strategic planning, implementing and evaluating strategic measures for divestments, acquisitions, research and development expenditures and capital expenditures. Strategy audit environment changes include technological transformation in audit practices or the implantation of audit technologies in professional structures (Robson et. al 2007). Technological changes in auditing are associated with the changes within the organization field of audit. Here, audit environment changes in this study refers to the point of audit environment change for instance new technology, new process of certification of financial statements, and changes to audit methods and procedures including the new accounting standard and auditing standard (Robson, 2007).

The review of the study revealed that, management strategic role which comprises the oversight of strategy formulation and execution has become of major interest due to its influence on firm performance. Most importantly, top management are exhorted to participate more actively not only in strategy formulation , reviewing, ratifying and evaluating the proposed strategy but also in strategy implementation to contribute to corporate financial performance. In strategy audit work environments, audit strategic planning has become a major activity that the auditor was conducted it in order to achieve the effectiveness of the audit report, gain returns, and enhance strategy audit success (Kosmala & MacLullich, 2003). The auditors with greater audit planning are likely to generate more efficient audits that encourage them to maintain the competitive and their clients.

2.5 Conceptual Framework

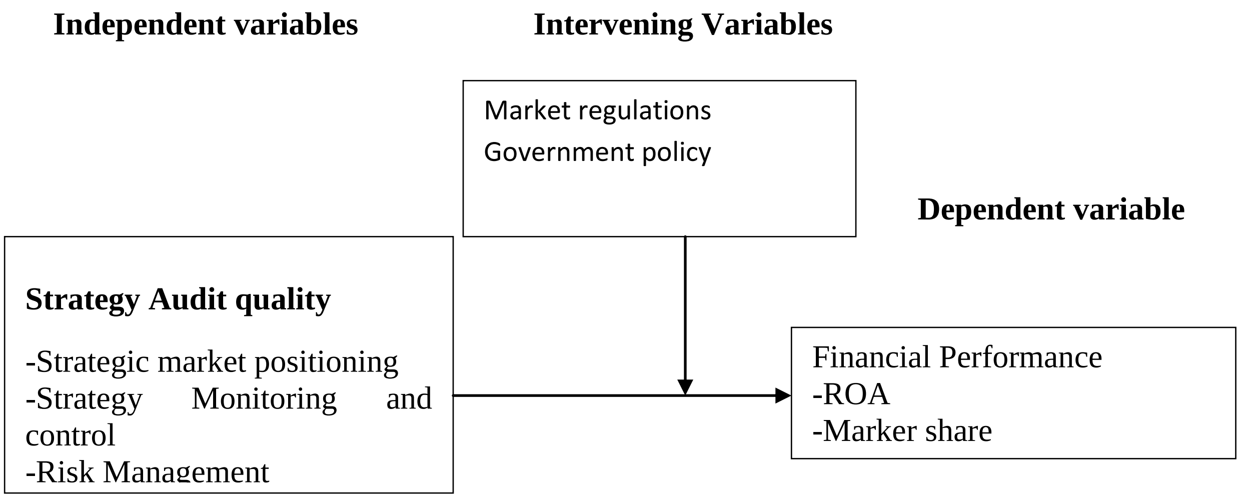

Figure 1. 1 : Conceptual Framework

3.0 RESEARCH METHODOLOGY

3.1 Research Design

The study adopted descriptive research design for it portrays an accurate profile of situations. The descriptive survey design involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data. Descriptive survey research design helped in collection of data to test a study hypothesis. According to Kothari, (2008) this is a design used to describe the characteristics of a particular phenomenon in a situation. It was used to obtain information concerning the current status of the industry, to survey what exits with respect to the conditions in a situation. The design helped the study to collect data effects of strategic audit quality on financial performance in commercial banks listed at the Nairobi Security Exchange in Kenya. The target population for the proposed study included10 listed commercial banks. The study considers all the listed banks hence a census study.

The study used primary and secondary data. Primary data was obtained through self-administered questionnaires with closed and open-ended questions. The questionnaires included structured and unstructured questions and were administered to the 40 respondents who were bank managers, corporate managers, Chief auditors and financial managers. The closed ended questions enabled the researcher to collect quantitative data while open-ended questions enabled the researcher to collect qualitative data. Secondary data was collected from banks records, books and the central bank of Kenya

3.2 Data Analysis and Presentation

The collected data was edited, coded and classified so as to present the results of the data analysis in a systematic and clear way. Descriptive statistics such as mean and standard deviation were carried. Inferential statistic regression and correlation were used to establish a causal effect relating strategic audit quality on financial performance of the firm. A Linear regression model was $Y = \alpha + \beta_1 X_1 + ẹ$ (Where Y= Return on Assets, α = Constant Term, β_1= Beta coefficients, X_1=Strategic Audit Quality and ẹ = Error Term)

4.0 RESULTS AND DISCUSSIONS

4.1 Introduction

This chapter presents analysis and discussion of results. Data was collected from banks' staff who was managers and involve in strategic governance in commercial banks. Most 72% of the respondents had master degree as the highest level of education attained. Hence had better understand the effects of strategic audit quality on financial performance in commercial banks.

4.2 Strategy Audit Quality and Banks' Financial Performance

Table 1: Strategy Audit Practices and Financial performance

Strategy Audit Practices	Frequency	Percentages
Financial governance	30	83
Budgetary	25	69
Compliance	20	56
Strategy control and monitoring	31	86
operational audits	22	61
strategic audits	28	78

Table strategy audit practices adopted in an effort to achieve financial performance in listed Commercial banks in Kenya. From the results in Table1, 86% of the respondents indicated that strategy control and monitoring greatly influence financial performance in commercial banks listed at NSE, 83% indicated financial governance 78% influence financial performance in banks. The results also indicated that strategic audits and budgetary auditing as supported by 78% and 69% of the respondents respectively. The findings further indicated that operational audits and compliance audit greatly influences a banks' financial performance as indicated by 61% and 56% of the respondents respectively. The study concurred with Johnson and Scholes, (2002) who found that organizations carry out auditing of their operations to ensure that certain aspects of their operations are carried out as designated in their strategic framework and in line with the organization vision and broad objectives.

4.3 Bank's management audit of the banks Strategies

Table 2: Strategy audit quality and Financial Performance

Statement on Strategy Audit Quality	Mean	Std Dev
Strategic market positioning	4.53	0.55
Technological evaluation	4.29	0.44
Production capabilities,	4.84	0.79
Financial capability	4.77	0.61
Developing performance appraisal instruments and systems	4.82	0.68
Ensure bank board are accountable to the shareholders for legal compliance and maintenance	4.45	0.55

Table 2 indicates results on influence of strategy quality auditing on financial performance in listed commercial banks. From the findings, respondents indicated that bank management audit bank production capabilities, developing performance appraisal instruments and systems, financial capability and Strategic market positioning influence financial performance in listed commercial banks to a very great extent (M= 4.84, 4.82.4.77 and 4.53) respectively. The results in Table 2 also indicated that strategy quality audit accountability, legal compliance and maintenance of relationship as well as strategic technological evaluation influence bank financial performance to a great extent (M=4.45 and 4.29) respectively. This implied that strategic audit quality practices such as bank production capabilities, strategic market positioning and financial capability contribute to financial performance. The finding was in consistency with Johnson and Scholes (2002) revealed that execution of strategy auditing function influence strategy implementation and improve firm financial performance.

4.4 Correlation Analysis

The study took correlation matrix analysis to examine the association between strategy audit quality and financial performance in the listed commercial banks. The correlation factor ranged from $-1 \leq 0 \geq 1$. The acceptance confidence level was 95% or significance level of 0.05. The study conducted a Pearson Moment Correlation analysis which is represented by r.

	Financial Performance
	0.728*
Strategy Audit quality	
PV	0.0016
N	36

* Correlation is significant at the 0.05 level (2-tailed).

From the results, there existed a significant, strong and positive correlation between Strategy audit quality and financial performance in commercial banks listed at NSE having scored a correlation coefficient r= 0.728 , PV=0.0016 at 95% confidence level.

4.5 Regression Analysis

A linear regression model was applied to determine the relationship between effects of audit quality and financial performance in commercial banks listed at NSE

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.745	.275		6.340	.001
	Strategy Audit quality	.769	.0.063	.000	12.201	0.001
	R	0.72				
	R Square	.518				
	Adjusted R Square	.418	0.24			
	F-Statistic	5.191				.001(a)

a predictor, Audit quality
b Dependent Variable: Financial performance

From model summary regression results, Adjusted R^2 is 0.481 indicating that was a variation of 48.1% of financial performance varied with variation in audit quality in the banks at a confidence level of 95%. The study established that there existed a significant goodness of fit of the model $Rc(PP) = \beta_0 + \beta_1 AQ + + \varepsilon_{it.}$ Based on the findings, in Table 4.19 the results indicate the $F_{Cal} = 5.191 > F_{Cri} = 1.3796$, $P = 0.001 < 0.05$. From the above regression model, it was found that financial performance of the commercial banks Listed at NSE would be at 1.1745 in absence of audit quality. From the regression results, there existed a significant and positive relationship between audit quality and financial performance in listed commercial banks in Kenya as $B_1=0.769$, PV=0.001 and t=12.201). This implied that a unit increase in audit quality of the adopted and executed strategies would results into increase in financial performance by factor 0.769. The study rejects the null hypothesis that strategic audit quality has no significant influence on financial performance in commercial banks listed at NSE and accepts the alternative hypothesis that strategic audit quality has significant influence on financial performance in commercial banks listed at NSE in Kenya. The results were consistent with Peters (2010) established that there was an increase in revenue turnover and profits when top management increased their involvement in strategic governance. The finding were also consistency with Pearce II and Zahra (1991) found effective monitoring and evaluation of strategy implementation improve bank profitability as there was increase in return on assets and increase in return on equity.

5.0 SUMMARY OF FINDINGS CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of the findings

The study established that strategic policy enhance proactively of the board in the bank to and improve level of compliance in bank operations, influence decisions on cash reserve ratio as well as the empowerment of the chief executive officer to make reasonable interpretations of board policy. The study revealed that adherence to strategic policy help in defining of responsibilities between the management and board, increase loan recovery and influence reduction of bank and lending rates greatly influence by level of compliance in enhancing strategic governance in the bank. This enabled the banks to formulate strategies and well implement them thus achieving what it was intended to achieve. The study revealed that law and regulations governing the operations in the bank enabled the bank to reduce frauds and risks, ensure critical management information to the executive team was sufficiently, accurate and timely delivered. These enabled appropriate management decision making strategies formulations and implementation that influenced bank financial performance as the banks gains customers' confidence, attract more customers, improve recovery of loans and reduced non-performing loans thereby improving bank profitability.

The study also established that audit practices greatly influence financial performance. This evidenced by 70% of the respondents who indicated that strategy auditing was very important. The study revealed that through strategy control and monitoring, financial governance and strategic audits greatly influence financial performance in commercial banks listed at NSE. From the findings, bank management audit bank production capabilities, developing performance appraisal instruments and systems, financial capability and Strategic market positioning to a very great extent. The audit bank in terms of ensuring bank board was accountable to the shareholders for legal compliance and maintenance and technological evaluation to a great extent. Therefore, quality auditing plays critical roles in ensuring strategic objectives were achieved and influence gaining of high return on assets.

5.2 Conclusions

The study concludes that strategic governance influence strategic planning, scanning the internal and external environment for information and implementing and evaluating strategic measures for investmentsfor bank to achieved high profit margin. The study concludes that strategy governance was vital to commercial bank well-being as timely strategic audit could alert bank management on existing problems or potential challenges before a situation out of control leading to loss. The study concludes that bank management ensure its operations were implemented by ensuring the set strategies, rules and regulations were adhered to ensure success and effective financial service delivery. Effective auditing of the strategies should be the focus of the bank management to foster success in strategy implementation and reduction of risks facing the bank improving bank profitability. The study concludes that bank management should carry out audit of the bank production capabilities, strategic market positioning and financial capability to a great extent to enhance bank financial performance. Auditor's competency level influence financial performance in commercial banks to a great extent. The study concludes that board of directors influence strategic governance as it has a great influence in evaluation and monitoring strategic performance in commercial banks listed at NSE.

5.3 Recommendations of the Study

The study recommend that strategic governance should be emphasized in organizations as it a management can analyze timely strategic audit which could alert management on existing problems or potential challenges before a situation out of control leading to loss. The study recommend that organizations management should ensure its operations were implemented by ensuring the set strategies, rules and regulations were adhered to ensure success and effective financial service delivery. Furthermore, to maximize benefits of strategies audit, listed commercial banks required satisfactory achievement from audit vision and audit environment changes to foster strategic audit quality and improve on banks' profitability. The study further recommends that management in banking institutions should audit employee's needs that contribute to effective execution of adopted strategies and develop effective employee training policy to enhance more skills acquisition, enhance creativity of staff and to effectively implement strategies and improve on bank financial returns

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