

# Internal Auditor's Role and Corporate Financial Performance in Kenya

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## Abstract:

The internal auditor's job is to independently vouch for the efficiency of the organization's risk management, governance, and internal control systems. The purpose of this study was to ascertain the effects of risk assessment, financial statement audits, and internal auditor evaluations of controls on financial performance. This essay began by outlining the function of internal audit. An empirical study of the literature is then conducted with regard to financial performance and reviews of internal controls, financial statements, and risk management. The study found that there is evidence in the literature linking financial success and internal auditor functions.

**Keywords:** Financial Performance, Financial Statements Audit, Risk management review, Internal controls Review

**DOI/ARK:** ark:/69431/AJoCS.v1i1.5

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## 1. Introduction

Auditing in general is a matter of importance to an organization financial performance (Sirois, Bédard, & Bera, 2018). Services of an auditor whether internal or external are relevant in detection of errors. The term auditing come from a Latin word 'au dire' meaning "to hear". Several authors have defined the term. Auditing enables the auditor to judge the balance sheet and the profit and loss account are properly drawn so as to exhibit a true and fair value of the business. The relevance of the final audit report from the auditor whether internal or external, is appreciated. The importance of an audits calls for the need of internal audit in an organization which is carried out by an internal auditor to evaluate its internal controls, corporate governance and accounting processes risks identification, company goals compliance and finally write reports concerning their reviews of the company's operations to the management with recommendations and corrective measures (Mihret & Grant, 2017).

The role of internal auditor has over the years gained importance since it adds value to the company or organization overall performance. The financial performance of an organization or company changes over time as profits fluctuate from one year to another while other companies record continuous losses as a result of the report they get from the process of

internal auditing conducted by an internal auditor. Internal auditor plays a great role in company internal control system which assesses the company efficiency and he has a responsibility of ensuring that the company is running in an orderly manner in order to achieve its targets, plans and objectives. According to Al-Thuneibat, Al-Rehaily, and Basodan, (2015). Auditors conduct their work by collecting audit evidence to back up their findings. For that kind of evidence gathering, the internal auditor must be independent (Kamau, Nduati, & Mutiso, 2014). This research seeks to find out whether actually internal auditor's role has an effect on the financial performance of automobile industry in Kenya, a major focus on the motor vehicle company.

The internal auditor in a company plays major roles and duties during internal audit. The internal auditor occupies a unique position in an organization. He/she is employed by the management but is also expected to review the conduct of management (Agarwal & Medury, 2014). Internal audit is part of the management controls among the others that is charged with the responsibility of evaluating and reviewing the internal control system and examines the books of accounts. (Mexmonov, 2020). An internal auditor assesses the company operations, reviews operation. Several large firms across the globe have appreciated that, it is not possible to run business without being audited which has now been made as the central part of every organization. In research conducted in Malaysia by Maina (2017) established that, internal audit is well positioned to recognize and appreciate the business progression of any company while acting as financial performance consultants in reducing risks.

The financial performance of a company is the result that is attained as a result of the activities contributed by individuals and units of the company. The measurements can be obtained using various ways based on the purpose meant for the information that is obtained. The actions of the managers should ensure that it focuses on maximizing the value of equity of the owners that is the most important tenet (Mwaura, 2014). Performance financially is the subjective measures of how efficient can make use of their available assets for the purpose of generating revenue. It is also used in measuring the general measures of the company health in terms of finances over a certain span of time and can be applied in comparing same companies in aggregate. Financial performance can be measured in various ways but the main thing to consider when using any method is that the measures have to be in aggregate (Ndung'u, 2021). There are many ratios that are applied when measuring profitability and the main ones include; ROA, ROE and NIM (Al-Homaidi, Tabash, Farhan, & Almaqtari, 2018). The main ratio is the ROA which shows the levels of any business. The ratio is computed using the income to the overall assets. The ROE is the ratio that compares the profits made by the organization and the total amount of equity invested by the stakeholders; and it is what stakeholders get in return after risking their investment (Ongore & Kusa, 2013).

Suppliers, employees, customers also consider financial performance of a company hence the services of an internal auditor are of crucial importance in the maintenance of the overall financial wellness of a company. Internal auditors examine financial statements, evaluate internal controls, review the entity risks, and from their report they communicate to the management comprehensive and detailed assurance, recommend corrective measures to be undertaken in its operation to so as improve the overall financial performance and correct the deficiencies.

## **2. Role of internal audit**

This section highlights the various internal auditor's roles in relation to corporate financial performance in Kenya.

## **Risks review and Financial Performance**

The internal auditor in his/her performance of the roles the scope covers conducts risks review through various techniques. The internal Audit standards require an internal auditor to carry out annual risk assessments that is, the operational risks, project related risks, process related risks and in order to develop a risk-based internal audit plan. Properly done risks reviews by internal auditors in automobile industries may reduce risks encountered and result to improved financial performance. KPMG noted that the company executive management may rely on internal audit in the identification, measure, control of business risk (Eulerich, Kremin, & Wood, 2019).

Risk assessment conducted by an internal auditor during the process of risks review provides a basis for independent, objectives achievements and improved operations in an organization. It involves risk identification and risks analysis. Internal auditors play an important role in risk assessment (Vinnari & Skærbæk, 2014). Analysis of the risks follows after identification to determine the impact they may have and give the organization leadership assurance and advice in managing the risk. The risks are then evaluated to determine how significant they are to the company and their impact. Risk control measures are also examined to ensure that they either eliminate the risk or the latter. The internal auditor gives assurance to the management which has to decide whether to adopt the recommended measures or find alternatives (Odoyo, Omwono, & Okinyi, 2014).

## **Financial Statements Audit and Financial Performance**

Financial statements audit involves the examination of company's books of accounts (Palepu, Healy, Wright, Bradbury, & Coulton, 2020). Financial statements should show a true and fair view of the company performance and position hence a financial statement audit is important as it gives the organization the assurance that the financial statements are free from errors. The balance sheet is a statement of the company's financial position prepared based on the company assets, liabilities and equity (Fatihudin, Jusni, & Mochklas, 2018). The internal auditors plays a role in detecting errors of fraud on balance sheet items. He /she reviews the balance sheet items. Income statement shows the financial performance of a company. It shows its profitability or whether it is making losses. The internal auditor examines the items on the income statement such as the revenue through sales, cost of goods, taxes and interests before arriving at the final results. They scrutinize income statement, identify potential errors and falsehoods before presenting their findings in the internal auditor's report. Statement of cash flows shows cash inflows, outflows of cash, cash equivalents from operating, financing and investing activities (Liman & Mohammed, 2018). These activities transactions need to be audited and reviewed to ensure that fraud, errors, misstatements if detected are corrected. Cash flow statements are useful tools for planning hence if not well presented they can affect the financial performance of a company.

## **Internal controls review and Financial Performance**

The internal control Systems comprises of components like the control environment (Nyakundi, Nyamita, & Tinega, 2014). Controls help Safeguard Company assets, strengthening the financial controls, making sure the business is carried out well and management policies are adhered to achieve company objectives. The internal auditor during review of the internal controls has to examine and audit the various components in order to ensure that the company goals are achievable. He/she has to evaluate the physical controls, transactions recording,

competence of personnel, arithmetic and accounting control, transactions authorization, segregation of duties and supervision which are features of an internal control. Sawan, (2013) did a study on Belgian and US companies. Inner control encourages the viability and productivity of operations, guarantees the unwavering quality of inward and outer reporting and helps consistence with laws and directions (Himanth, 2018). The internal auditor therefore must play a great role to ensure sound financial performance of the company. The internal auditor has to assess the controls, finally report to the management with recommendations to improve the processes. Information on control system, improvements, are communicated in informal and formal internal audit reports (Feng, Li, McVay, & Skaife, 2015). Auditors have a responsibility to consider the needs of those who use accounting information as they review the organizations internal control system (Kamau, 2022). While reviewing the internal controls internal auditors have to take into consideration the control environment which is basically made up of the management activities, attitude, awareness and support by those charged with management. The internal auditor focuses on evaluating the factors in the control environment.

Control activities are the policies that help the management directives to be achieved. The internal auditor has to examine and review the company control activities in order to give assurance to the management on areas of weakness and corresponding recommendations (Abdullah, Ismail, & Smith, 2018). Information system relevant to financial reporting should be evaluated and reviewed by the internal auditor. It contains processes of reporting company transactions in order to maintain accountability and also generates and communicates information about activities which affect the organization. The internal auditor also reviews how the company monitors the controls to determine whether they are working as intended and then communicates and recommends the corrective actions that should be undertaken (Shamsuddin & Johari, 2014). Bett & Memba, (2017) study on impacts of systems of internal controls on financial performance of universities in Uganda, measured internal control from the point of view of control environment, control environment and internal audit whereas financial performance was measured by liquidity.

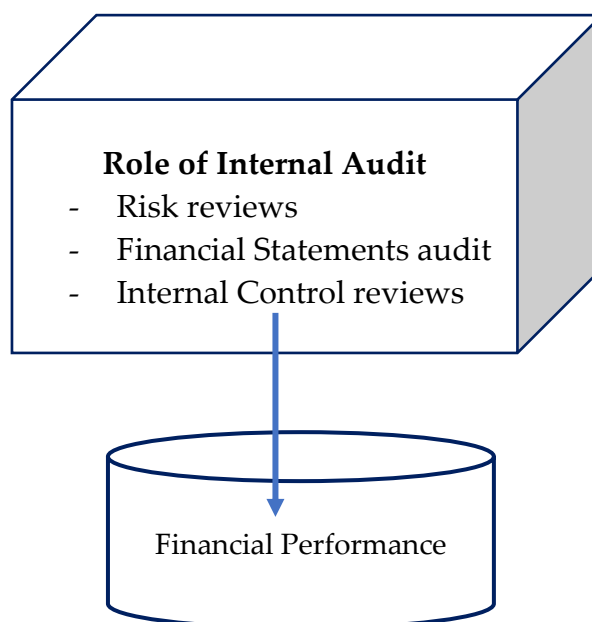


Figure 1: The linkages

## 5. Conclusion

The benefits of internal auditors' roles in Kenya's financial performance have been the subject of several studies that have used empirical data. Studies indisputably demonstrate a connection between the functions of internal auditors and financial performance. Risk management is aided by risk reviews, which reduce the possibility of unneeded losses occurring. Additional internal controls help the organization strengthen its weak spots. Internal auditors' examination of the internal controls gives the assurance that they are operating as intended. Internal auditors' examinations of financial statements may aid in spotting any unexpected tendencies and thereby improving performance.

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