

**EFFECTIVENESS OF INTERNAL AUDITORS’  
PROFESSIONALISM ON THE QUALITY OF AUDIT  
WORK: A CASE OF SAVINGS CO-OPERATIVE  
SOCIETIES IN BOMET COUNTY, KENYA**

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**Abstract**

*The purpose of the research was to determine the effect of professional ethics of auditors on perceived audit quality. Specifically, the study sought to determine the effect of integrity, independence, objectivity and professional competence standards on perceived quality of audit. This study adopted a case study design methodology of SACCOs within Bomet County because the researcher was interested in intensive investigation of the units under consideration. Random sampling was used to select 10 SACCOs in Bomet County. The study targeted 6 respondents from each SACCO who were considered to be key informants consisting of; CEO, Audit committee chairperson, Operations manager, Accountant, Human resource manager and internal auditor. To achieve the objectives of the study, questionnaires with 28 questions were distributed to a sample of SACCO personnel of the audit profession numbered (60) respondents, (54) of them were collected, underwent all the analysis and one sample t- test and regression were used to test the hypotheses of the study. It was found out that there was*

*positive effect of a high degree of auditors' professional ethics on perceived audit quality. The results revealed that there was a high degree of agreement on the effect of the auditors' independence standards on perceived audit quality.*

*Keywords: Effectiveness, Professionalism, Quality of Audit Work, Auditors Independence, Auditors Integrity*

## **INTRODUCTION**

Auditing plays an important role in developing and enhancing the economical companies and international works. Depending on the opinion of the auditors of accounts about the just of the financial lists, the main goal of reviewing is to add trust on the information included in the financial lists. This information are considered as the green light for decision makers in their investments and knowing the expected revenues, costs and risks which participate in enhancing the investments whether on the level of the individual or the level of total income (Al-Khaddash, et al, 2013).

A cooperative is an autonomous association of persons united voluntarily to meet their common economic cultural needs and aspirations through a jointly owned and democratically controlled enterprise. The key idea behind a co-operative society is to pool the scarce resources, eliminate the middlemen and to achieve a common goal or interest (Ministry of Cooperative Development and Marketing, 2007). Cooperatives are good vehicles for assisting the people to improve their socio-economic situation. They are institutions that derive their strength and validity from member solidarity cooperation and concern for each other.

### **Statement of the Problem**

According to inspection report by SACCO Societies Regulatory Authority (SASRA, 2014) there have been mismanagement, fraud and corruption practices leading to financial crisis of giant SACCOs in Kenya; some have even been placed under receivership yet the findings of the auditors give them clean bill of health. This raises a concern on auditors' professional ethics. Many existing studies have focused on factors affecting audit quality. Beatie et al (2010) in their study on Factors Affecting Audit Quality in United Kingdom, professional ethical behavior was not among the factors. Ulrika (2011) focused on internal auditors' number of assignments and age as factors affecting audit quality in Sweden companies. Husam et al (2013) in their study on factors affecting quality of auditing in Jordan Commercial Banks, little was mentioned on professional ethical behavior. Muli (2014) in his research on Effect of Internal Audit Reporting

Quality on Financial Performance of Savings and Credit Cooperative Societies in Murang'a County, he focused mainly on the effect of objectivity of the internal audit reports on financial performance of SACCOs with no regard to auditors' professional ethics. Given the limited studies in SACCOs linking the effect of auditor's professional ethics on perceived audit quality and inadequate evidence in the existing literature, there was need for the research. Thus, the researcher sought to determine the effectiveness of auditors' professionalism on quality of audit work. The study specifically sought to; determine the effect of auditors integrity on the quality of audit work and to establish the effect of auditors independence on the quality of audit work

### **Theoretical Review**

The institutional theory originates from the view that an organization is structured and works to achieve social outcomes in the public (Schneider, 2014). Goodwin (2014) posited that institution internal audit functions are hard and complex to realize and that the external picture of the organization may be weakly associated with the organization's internal operations (Sterck and Bouckaert, 2014). Institutional theory is of the view that the organization has structured operations to ensure social accountability. The real functioning of the organization is complemented by an effective internal audit process (Millichap, 2012). The internal auditor roles focus on improving corporate governance in an institutionalized context which is the basis for the adoption of the institutional theory. These then demands for greater scrutiny of the organization's financial reporting to safeguard the interest of the stakeholders. Evaluation of the internal auditor's role cannot be avoided particularly where the function is a key feature of organizational effectiveness (Dalila, 2013). Fundamentally, internal auditors roles have now become much more essential as a control within organizations and a key to effective risk management. Internal auditors are heavily involved in the organization in the continuous internal audit process and ultimately share with the boards their recommendations which are expected to contribute to the organization's objectives (Jamal, 2011). Similarly while performing their roles, all measures have to be taken to maintain their independence, authority and objectivity, as a result of being too involved in the organizations operations (Cattryse, 2014).

The Agency theory offer explanations on how firms can effectively relate with each other and stakeholders where agents determines the responsibility to be undertaken (Dess, Lumpkin & Eisner, 2009). The theory argues that under features of partial information flow and risk, which arise from the two parties (agencies) the challenges that need to be dealt with are adverse selection and moral hazard (Lin, Vargus & Bardhan, 2013). Agency theory therefore focuses on agency constraints or conflicts of interest between parties on management practices that has led to the need for good governance and resulted into approaches that focused on control

mechanisms. The theory led to various financial studies which sought to explain prudent financial management in the organizations. The separation of management from ownership in public institution offers an ideal context for the operationalization of agency theory. The shareholders are regarded as the principal with the interest of achieving maximum outcome interests from the organization. Conflict arises as the separation of ownership from management leads to inability of the owners to monitor management actions and activities and results in the need to employ certain source of information systems and control measures to minimize agency costs (Krishnan & Visvanathan, 2013). Internal auditors are used as a control mechanism for evaluating management action against the expectations of the board and shareholders (Montondon & Fisher, 2009). Despite their existence, information inequalities constraint management and directors and the expectation that the internal audit function is an effective control system that promotes good governance (Lin et al, 2013). This is supported by IIA, (2012) which opined that one of the expected outcomes when assessing the role of internal auditors is whether the function assists the organization to promote corporate governance processes.

### **Review of Related Literature**

Audit report quality is, in essence, a complex and multi-faceted concept (Soh and Martinov-Bennie, 2011). It is subject to many direct and indirect influences. Various stakeholders have differing interpretation of audit quality due to their direct or indirect involvement in the process of internal auditing or how they perceive quality of an audit. The complexities and dynamism of the concept of internal audit quality therefore requires a deeper and wholesome understanding which can only be received from study or research. The corporate governance practices in the organization also influence the audit quality in that firm. When a company has a culture of good ethical behaviour and transparency, for example, this can positively influence the quality of its internal audit (Gramling et al, 2004).

The professional care requires the auditor to follow up the standards of technical and ethical profession and strives to improve the efficiency and quality of service provided as well as the execution of professional responsibilities to best as possible (Arens & Loebbecke, 2000). The auditor must refrain doing any conduct that may defame the profession and its professionals by not using methods or means discreditable to the profession or other auditors, or exaggeration in recommending the services provided by him (Thunaibat, 2010). The profession conduct also requires the next auditor should communicate with the previous one within the framework of determining his approval to accept or reject the contract with the client (Arens et al, 2005).

The practicing auditor must be virtually and appearance independent when doing professional works, where that independence is considered the backbone of exercising auditing profession. The auditor must execute his duty with dignity, objectivity and full intellectual independence (Al-Tamimi, 2006). The auditing committee shall be responsible for assisting the auditor to maintain neutrality and independence from administration (Arena & Azzone, 2007). Independence is affected by many things; for example: a) the auditor must not have direct financial or non-materialistic relation with the institution being audited, being a director or a member of the Board of Directors of the company or a founder in certain public company (Al-Tamimi 2005), or lent or borrowed any amount from the establishment, any of its directors, or any member of the Board of Directors or major shareholder (Abu-Zaid et al, 2008) as well as if there is unpaid fees amount may affect the independence (Arena & Azzone, 2007).

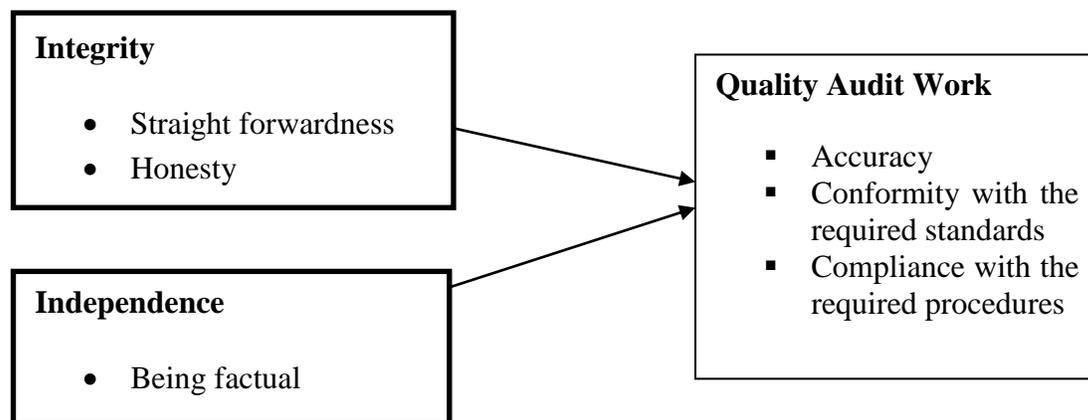


Figure 1: Conceptual Framework

## RESEARCH METHODOLOGY

Survey research design was used in this study. According to Denscombe (2003), this research design is an efficient way of collecting information from a large number of respondents and the ability to use statistical techniques to determine statistical significance. The study involved field survey of internal auditors and senior management in 10 SACCOs within Bomet County to obtain information on the effect of auditors' professional ethics on audit quality. The data collected was quantitative in nature. Out of 60 sampled respondents, 54 returned their responses which was a 90% response rate. Babbie (2011) suggested that a response rate of 60% is good while a response rate of 70% is very good. The pilot testing Cronbach's Alpha measurement of homogeneity was calculated and value of 0.9450 was actualized.

## RESULTS AND DISCUSSION

The results are presented and discussed as follows.

Table 1: One-Sample Statistics

Variable	N	Mean	Std. Deviation	Std. Error Mean
Integrity of the auditor	54	4.43	0.742	0.101
Independence of the auditor	54	4.22	0.691	0.094

From table 1, integrity of the auditor was rated highest with a means score of 4.43 (SD=0.742) followed by professional competence of the auditor with a mean score of 4.26 (SD=0.705).

### Regression Analysis

The study sought to run the regression model for the study to determine the relationship between auditors' professional ethics factors and perceived audit quality amongst SACCOs in Bomet County, Kenya. The study findings are presented in the Table 2 below.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.861 <sup>a</sup>	.741	.733	.25610

a. Predictors: (Constant), Integrity, Independence, Objectivity, Professional Competence

The Adjusted R Squared for all value tells us that the model accounts for 74.1% of variance in the perceived quality of audit in SACCOs. 74.1% of the variations in the perceived quality of audit in SACCOs can be explained by the identified independent variables: integrity, independence, objectivity and professional competence.

Table 3: Significance of the Model

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	20.507	53	4.101	28.105	.001 <sup>b</sup>
	Residual	5.400	53	.146		
	Total	25.907	53			

a. Dependent Variable: Perceived Audit Quality  
b. Predictors: (Constant), Integrity, Independence

The model is significant as shown by the F- test and the F- value of 28.105; the P-value is 0.001 which indicates the statistical significance of the model. The ANOVA test produced an f-value of 28.105 which was significant at 0.05 significance level ( $p = 0.001$ ). This depicts that the regression model is significant at 95% confidence level; that is, has 1% probability of misrepresentation.

### Fit of the Model

In testing the significance of auditor's integrity in the relationship, it depicts p-value of 0.044, making it much statistically significant. It has a regression coefficient of 0.121, a strong positive relationship. A unit of auditor's integrity results to 12.1% changes in perceived audit quality.

In testing the significance independence of the auditors during audit process, it depicts p-value of 0.050, making it much statistically significant. It has a regression coefficient of 0.054, a strong positive relationship. A unit of independence of the auditors results to 5.4% changes in perceived audit quality. A p-value of 0.0477 explains that the regression coefficient corresponding to auditor's objectivity is statistically significant in explaining the perceived audit quality.

Table 4: The Fit of the Model

Model	Unstandardized Coefficients		t	Sig.
	B	Std. Error		
(Constant)	6.227	2.419	1.644	2.575
Auditor's Integrity	.121	.331	.034	.044
Auditor's Independence	.054	.356	.016	.050

The predictors Equation

$$Y = 6.227 + 0.121X_1 + 0.054X_2 + 0.382$$

Y= Perceived Audit Quality

X<sub>1</sub>= Auditor's Integrity

X<sub>2</sub>=Auditor's Independence

### SUMMARY OF FINDINGS

The results revealed that there is high agreement degree on the effect of auditors' integrity standard on perceived auditing quality. From the research findings, the hypothesis H<sub>01</sub>: Auditors' integrity standards have no significant effect on perceived audit quality was rejected which implied that integrity standards have significant effect on audit quality. The second objective of

the study was to determine the effect of auditors' independence on perceived audit quality. The results revealed that there is a high degree of agreement on the effect of the auditors' independence standards on perceived audit quality. The hypothesis H<sub>02</sub>: Auditors' independence has no significant effect on perceived audit quality was rejected implying that auditor's independence has significant effect on audit quality.

The study makes the conclusions that integrity of auditors significantly affects perceived audit quality. Secondly, auditors' independence standards have significant effect on perceived audit quality.

## RECOMMENDATIONS

Based on the results that have been concluded, it is necessary that the supervising and governing agencies of auditing profession to hold training courses, workshops and symposia on the standards of auditing and professional working general including the ethical rules of auditing in particular. Second, there is necessity to activate the principles of institutional governance and improve compliance with the application of the ethical conduct by the law and auditing standards executors'; whether they are members of institutional governance, or auditors. It is also necessary to strengthen the role of the audit committees to support the independence and neutrality of the auditor, as well as verifying the efficiency and professional level performance.

Future study should be conducted in other sectors beyond the SACCO sector such as micro finance institutions, NGOs and other such organizations whose activities affect the majority poor.

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