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Effect of Financial Auditors' Proficiency on Risk Management Process among Commercial Banks in Kenya

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ABSTRACT

This study investigates the effect of financial auditors' proficiency on the risk management process of commercial banks in Kenya. Given the increasing incidents of fraud and financial instability in the banking sector, this research examines the competencies, articulation, expertise, and prudence of financial auditors and their influence on risk management practices. Employing a descriptive research design and a positivism research philosophy, data were collected from a sample of 230 respondents across 39 commercial banks. The study reveals that auditors' proficiency significantly enhances risk identification, analysis, evaluation, and treatment. Moreover, the regulatory environment moderates the relationship between auditors' proficiency and the risk management process, emphasizing the need for regulatory compliance. These findings offer valuable insights for banks, regulatory bodies, and policymakers to improve risk management strategies. The study also provides a basis for further academic research and contributes to the existing literature on financial auditing and risk management.

Keywords: *Financial auditors, proficiency, risk management, commercial banks, Kenya, regulatory environment, audit competence, financial stability*

1. INTRODUCTION

The financial sector worldwide faces unprecedented challenges, with increasing complexities arising from rapid technological advancements, globalization, and regulatory changes (Shatnawi, Hanefah, & Eldaia, 2019). In this context, the role of financial auditors has become more crucial than ever. Financial auditors are responsible for ensuring the accuracy and integrity of financial statements, which are vital for informed decision-making by stakeholders (Deyganto, 2019). In Kenya, the banking sector plays a pivotal role in the economy, providing financial services that facilitate economic growth and development (Central Bank of Kenya [CBK], 2024). However, the sector has been plagued by issues of fraud, mismanagement, and financial instability, leading to the collapse of several banks (Omware, Atheru, & Jagongo, 2020). The proficiency of financial auditors is instrumental in addressing these challenges by enhancing the risk management processes within banks.

The proficiency of financial auditors encompasses a range of skills and attributes, including technical competence, effective communication, ethical judgment, and the ability to adapt to regulatory changes. These attributes enable auditors to identify and mitigate risks effectively, thereby safeguarding the financial stability of banks (Zuwena, Hamad, & Yussuf, 2021). As financial instruments and transactions become more complex, the need for proficient auditors who can navigate these complexities and ensure compliance with regulatory standards becomes increasingly important. This study explores the impact of financial auditors' proficiency on risk management processes in Kenyan commercial banks, highlighting the critical role auditors play in maintaining financial stability and integrity.

1.1 Problem Statement

The banking sector in Kenya has witnessed the collapse of several financial institutions due to inadequate risk management practices. These failures have resulted in significant financial losses, eroded public confidence, and posed threats to the stability of the financial system (CBK, 2024). Despite the crucial role of auditors in risk management, there is limited empirical evidence on how auditors' proficiency influences risk management practices in Kenyan banks. This study seeks to fill this gap by investigating the relationship between financial auditors' proficiency and the risk management process among commercial banks in Kenya. Understanding this relationship is essential for developing strategies to enhance risk management practices and prevent future financial crises.

1.2 Objectives

The general objective of the study is to investigate the effect of financial auditors' proficiency on the risk management process among commercial banks in Kenya. The specific objectives are:

1. To investigate the effect of auditors' competence on the risk management process.
2. To determine the effect of auditors' articulation on the risk management process.
3. To investigate the effect of auditors' expertise on the risk management process.
4. To investigate the effect of auditors' prudence on the risk management process.
5. To determine the moderating effect of the regulatory environment on the relationship between financial auditors' proficiency and the risk management process.

1.3 Significance of the Study

The findings of this study have significant implications for various stakeholders. For commercial banks, the insights gained will help improve the proficiency of their financial auditors, thereby enhancing their risk management processes and contributing to financial stability. For regulatory bodies such as the Central Bank of Kenya and the Kenya Bankers Association, the study provides evidence to support the formulation of policies and regulations aimed at strengthening the banking sector (Mwende, Machogu, & Otieno, 2021). Policymakers can use these insights to develop strategies that promote the adoption of best practices in auditing and risk management. Academicians and researchers will benefit from the study's contribution to the existing literature on auditors' proficiency and risk management, providing a foundation for further research and scholarly discourse.

2. LITERATURE REVIEW

2.1 Theoretical Framework

The study is anchored on three key theories that provide a conceptual framework for understanding the relationship between auditors' proficiency and risk management.

Fraud Triangle Theory developed by Cressey (1950), the Fraud Triangle Theory explains the causes of fraud in organizations. It identifies three forces—pressure, opportunity, and rationalization—that lead individuals to commit fraud. This theory supports the auditors' prudence variable, emphasizing the need for auditors to exercise caution and ethical behavior. Auditors must be vigilant in detecting and preventing fraudulent activities by maintaining professional skepticism and adhering to ethical standards (Nelwan, Bellatrix, & Tansuria, 2021).

Resource-Based Theory Popularized by Barney (1991), the Resource-Based Theory focuses on how organizations can utilize their internal resources, including human capital, to achieve competitive advantage. It supports the auditors' competence, expertise, and articulation variables, highlighting the importance of skilled

auditors in enhancing risk management (Cruz, 2019). The theory posits that firms with valuable, rare, inimitable, and non-substitutable resources can achieve sustained competitive advantage, which is crucial for effective risk management.

Agency Theory Proposed by Jensen and Meckling (1976), the Agency Theory explores the relationship between principals (shareholders) and agents (managers) within organizations. It underscores the importance of aligning the interests of both parties to ensure effective risk management (Garfein & Madiba, 2020). Auditors play a crucial role in bridging the information asymmetry between principals and agents, providing assurance on the accuracy of financial statements and the effectiveness of internal controls.

2.2 Conceptual Framework

Figure 1 shows the conceptual framework that will be adopted by the study.

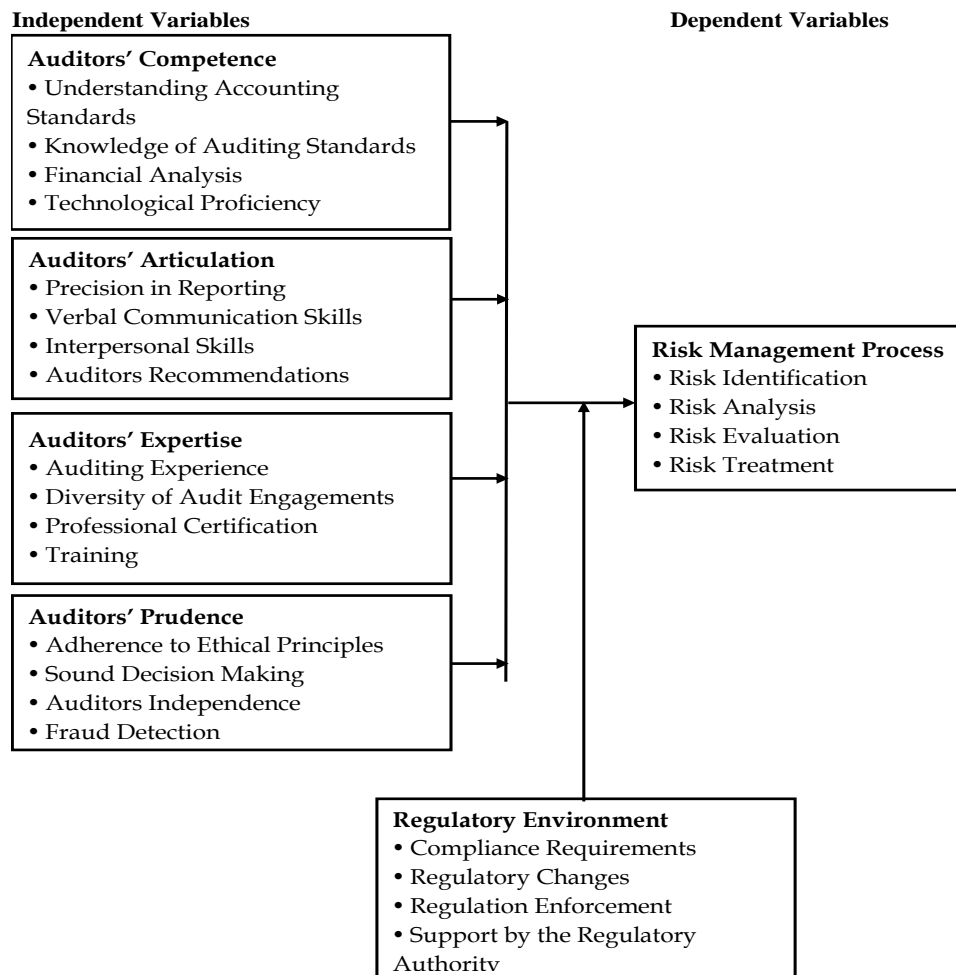


Figure 1: Conceptual Framework

2.3 Empirical Studies

Numerous studies have explored the impact of auditors' proficiency on risk management. Alsaeedi and Kamyabi (2023) found that auditors' competence significantly affects the risk management process in Iraqi auditing firms. Their study emphasized the importance of auditors' understanding of accounting standards and regulatory

requirements in enhancing risk management practices. Similarly, [Defond, Junxiong, and Shuqing \(2024\)](#) concluded that auditors' articulation impacts risk management in Chinese companies, highlighting the role of effective communication in ensuring accurate risk assessment and reporting.

Studies by [Natsir, Yuldi, and Tenri \(2023\)](#) in the USA and [Alkilani, Hussin, and Basariah \(2020\)](#) in Jordan highlighted the importance of auditors' expertise in managing risks. These studies demonstrated that auditors with diverse audit engagements and professional certifications are better equipped to identify and address potential risks ([Adato, 2022](#)). In the African context, [Angmor and Diaboh \(2022\)](#) found that auditors' competence is crucial in managing risks in Ghanaian banks, emphasizing the need for continuous training and professional development.

Locally, studies by [Wanyama and Omwano \(2021\)](#) and [Mwende, Machogu, and Otieno \(2021\)](#) have demonstrated the positive impact of auditors' proficiency on risk management in Kenyan institutions. These studies provide a foundation for examining the Kenyan context and highlight the need for further research to understand the dynamics of auditors' proficiency and risk management in the banking sector.

3. RESEARCH METHODOLOGY

3.1 Research design

This study adopts a descriptive research design to investigate the effect of financial auditors' proficiency on the risk management process among commercial banks in Kenya. The descriptive design is appropriate for this study as it allows for a comprehensive analysis of the characteristics of the population under study, focusing on measures of central tendency and dispersion ([Sekaran & Bougie, 2020](#)). This approach facilitates the collection and analysis of quantitative data, providing a detailed understanding of the relationship between auditors' proficiency and risk management.

3.2 Population and Sampling

The target population comprises 546 employees from 39 commercial banks in Kenya, including directors, auditors, and management staff. A stratified random sampling technique was used to select a sample size of 230 respondents, ensuring representation from each stratum. The stratified random sampling technique is appropriate for this study as it ensures that each subgroup within the population is adequately represented, reducing bias and enhancing the generalizability of the findings ([Saunders, Lewis, & Thornhill, 2019](#)).

3.3 Data Collection Tools

Primary data were collected using structured questionnaires based on a 5-point Likert scale. The questionnaires were designed to capture information on auditors' competence, articulation, expertise, prudence, and the regulatory environment. The drop-and-pick method was used to distribute the questionnaires, ensuring a high response rate and accurate data collection. The use of questionnaires is advantageous as it allows respondents to provide information at their convenience, enhancing the reliability and validity of the data collected ([Creswell & Creswell, 2022](#)).

3.4 Data Analysis and Presentation

Data were analyzed using multiple linear regression models to assess the impact of auditors' proficiency on risk management. The moderation effect of the regulatory environment was also examined using interaction terms

in the regression model. The Statistical Package for Social Sciences (SPSS) was used for data analysis, providing robust statistical tools for testing the hypotheses and interpreting the results. Diagnostic tests were conducted to ensure the validity and reliability of the regression models, including tests for multicollinearity, heteroscedasticity, and normality (Field, 2017).

The relationship between the independent and dependent variables was guided by the equation 3.2, 3.3 and equation 3.4 below. Equation 3.2 is without the moderating variable while equation 3.3 incorporates the moderating variable. 3.4 is the interaction between the moderating variable and the independent variables

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon \dots \dots \dots \text{Equation 3.2}$$

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_ZZ + \varepsilon \dots \dots \dots \text{Equation 3.3}$$

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_{1Z}X_1*Z + \beta_{2Z}X_2*Z + \beta_{3Z}X_3*Z + \beta_{4Z}X_4*Z + \varepsilon \dots \dots \dots \text{Equation 3.4}$$

Where:

- Y: Risk Management Process (dependent variable)
- X₁: Auditors Competence (independent variable)
- X₂: Auditors Articulation (independent variable)
- X₃: Auditors Expertise (independent variable)
- X₄: Auditors Prudence (independent variable)
- Z: represents the moderating variable (Regulatory Environment)
- β₀: represents the constant
- β₁ to β₄: represents the beta coefficients
- β_Z: represents the beta coefficient of the moderating variable
- ε: represents the error term
- β_{1Z}X₁*Z: Interaction between Auditors Competence and Regulatory Environment
- β_{2Z}X₂*Z: Interaction between Auditors Articulation and Regulatory Environment
- β_{3Z}X₃*Z: Interaction between Auditors Expertise and Regulatory Environment
- β_{4Z}X₄*Z: Interaction between Auditors Prudence and Regulatory Environment
- β_{1Z}, β_{2Z}, β_{3Z}, and β_{4Z}: represents the beta coefficients of the product term (the interaction between the independent variables and the moderating variable) (X*Z).

3.5 Ethical Considerations

Before initiating any field activities, the study ensured compliance with several ethical protocols to protect the rights and welfare of all participants. An introductory letter was obtained from the Technical University of Mombasa's School of Graduate Studies, which helped establish the study's credibility and purpose. Prior to fieldwork, approval was sought and received from the Technical University of Mombasa's Scientific and Ethical Review Committee, ensuring that the research methods and objectives adhered to ethical standards. Additionally, research permission was secured from the National Commission for Science, Technology, and Innovation (NACOSTI), affirming that the study met national regulatory requirements. Informed consent was a cornerstone of the research process. All participants were informed about the study's objectives, procedures, potential risks, and benefits before they agreed to participate. This was facilitated by providing participants with a consent information sheet and an informed consent form, ensuring that they understood and voluntarily agreed to partake in the study

4. EXPECTED OUTCOME

The study found that financial auditors' proficiency significantly enhances the risk management process in commercial banks. The findings indicate that auditors' competence, articulation, expertise, and prudence are positively correlated with effective risk identification, analysis, evaluation, and treatment. The regression analysis revealed that each dimension of auditors' proficiency contributes uniquely to the risk management process, underscoring the multifaceted nature of auditing proficiency.

Auditors' competence, measured by their understanding of accounting and auditing standards, financial analysis skills, and technological proficiency, was found to have a significant positive impact on risk management. Competent auditors are better equipped to identify potential risks and assess their implications, enabling banks to implement appropriate risk mitigation strategies.

The ability of auditors to communicate financial information accurately and effectively was also found to be a crucial factor in risk management. Auditors with strong verbal communication and interpersonal skills can effectively convey risk-related information to management, facilitating informed decision-making and timely risk mitigation.

Auditors' expertise, reflected in their auditing experience, diversity of audit engagements, and professional certifications, was shown to enhance risk management practices. Experienced auditors bring a wealth of knowledge and insights that enable them to identify complex risks and recommend effective mitigation strategies.

Auditors' prudence, characterized by adherence to ethical principles, sound decision-making, and independence, plays a critical role in risk management. Prudent auditors exercise professional skepticism and objectivity, ensuring that risks are identified and addressed without bias or undue influence. The study also found that the regulatory environment moderates the relationship between auditors' proficiency and the risk management process. A supportive regulatory environment provides a framework for compliance and oversight, reinforcing the role of auditors in enhancing risk management practices. The interaction between auditors' proficiency and the regulatory environment highlights the importance of aligning internal risk management practices with external regulatory requirements.

5. DISCUSSION

The findings confirm that financial auditors' proficiency is crucial in enhancing risk management practices among commercial banks. Auditors' competence and expertise facilitate accurate risk identification and analysis, while their articulation and prudence ensure effective risk evaluation and treatment. These findings align with the Resource-Based Theory, which posits that organizations with skilled and knowledgeable personnel can achieve a competitive advantage in managing risks.

The study highlights the need for banks to invest in continuous training and professional development programs for their auditors to enhance their proficiency. By fostering a culture of learning and development, banks can equip their auditors with the skills and knowledge needed to navigate the complexities of modern financial transactions and regulatory requirements.

The regulatory environment plays a pivotal role in reinforcing risk management practices by providing a framework for compliance and oversight. Regulatory bodies must ensure that regulations are clear, consistent, and supportive of banks' efforts to manage risks effectively. The alignment between internal risk management practices and external regulatory requirements is essential for maintaining financial stability and integrity.

The study also underscores the importance of effective communication in risk management. Auditors with strong articulation skills can bridge the gap between risk assessment and management, ensuring that risks are

communicated clearly and addressed promptly. This finding is consistent with the Fraud Triangle Theory, which emphasizes the need for auditors to exercise vigilance and ethical behavior in preventing fraud.

Overall, the study contributes to the existing literature on auditors' proficiency and risk management, providing valuable insights for banks, regulatory bodies, and policymakers. By enhancing auditors' proficiency and aligning risk management practices with regulatory requirements, banks can mitigate risks and enhance financial stability.

6. CONCLUSION AND RECOMMENDATIONS

The study demonstrates the significant impact of financial auditors' proficiency on the risk management process in Kenyan commercial banks. Auditors' competence, articulation, expertise, and prudence are vital in mitigating risks and enhancing financial stability. Competence allows auditors to understand and apply accounting standards effectively, while articulation ensures that they communicate financial information accurately and persuasively. Expertise, gained through diverse audit engagements and professional certifications, equips auditors with the skills necessary to identify and address complex risks. Prudence ensures that auditors adhere to ethical principles, make sound decisions, and maintain independence, all of which are critical for effective risk management. The study also highlights the moderating effect of the regulatory environment, emphasizing the need for compliance and alignment with external requirements. A supportive regulatory framework enhances auditors' ability to perform their duties effectively and reinforces the importance of aligning internal risk management practices with regulatory standards.

To strengthen the risk management process further, it is recommended that commercial banks invest in continuous training and development programs for their auditors to enhance their proficiency. By fostering a culture of learning and innovation, banks can equip their auditors with the skills needed to address emerging risks and adapt to regulatory changes. For regulatory bodies, it is crucial to strengthen compliance requirements and provide support to banks in implementing effective risk management practices. Clear and consistent regulations will aid banks in aligning their operations with regulatory expectations, ensuring stability within the financial sector. Policymakers should develop strategies that promote the adoption of best practices in auditing and risk management. Encouraging collaboration between banks, regulators, and policymakers will enhance the effectiveness of risk management practices and foster a robust financial system. Finally, further research is needed to explore additional factors influencing risk management in the banking sector, particularly the role of technology and data analytics in enhancing auditors' proficiency and risk management practices.

Disclosures

This study did not receive any funding.

The authors declare having no conflict of interest of any nature or kind.

Authors Contribution. Both JOO and CGK were involved in writing this paper. All authors have read this manuscript and assume the responsibility for its contents.

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