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Effect of Audit Process on Financial Stability of Micro Finance Institutions in Rwanda

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Abstract

The study sought to establish the effect of audit process on financial stability of Micro Finance Institutions in Rwanda. Furthermore the study used auditing theory. Moreover, Research Design, Population, Sampling Frame and Size, and Data Processing and analysis were used during the study. The targeted population was 504 while the sample size was 152 respondents. The study employed Analysis of variance (ANOVA) model for analyzing the data. The findings indicate that there is a statistically significant effect on audit process on financial stability of Micro Finance Institutions in Rwanda since the P value is actual 0.000 which is less than 5% level of significance. Therefore, implementation of effective human resource policies and procedures enhance organization's control environment.

Keywords: The effect of audit process on financial stability of Micro Finance Institutions in Rwanda.

1 Introduction

Financial performance for banks is very important because managers need to know how well the banks are performing. Most studies divide the determinants of commercial banks performance into two categories, namely internal and external factors. Internal determinants of profitability, which are within the control of bank management, can be broadly classified into two categories, i.e. financial statement variables and nonfinancial statement variables (Wan Ibrahim, and Ismail, 2015). The non-bank financial sector has attracted considerable interest on both sides of the Atlantic and in both the U.S. and Europe, a number of studies have aimed to quantify the size of the non-bank. Noeth and Sengupta (2011), Pozsar and Singh (2011), Pozsar et al. (2012), Tobias and Shin (2009), for the studies focusing on the USA and Bouveret (2011) for studies focusing on Europe. In addition policymakers and regulators on both sides of the Atlantic are reviewing how to strengthen the oversight of the sector and reduce its opacity (see, for example, Financial Stability Board 2011a and 2011b and European Commission (2012)). In advanced economies, macroeconomic deleveraging through accommodative monetary policy has helped scale down private sector debt by supporting inflation and growth. However, given continued strengthening of deflationary forces and uncertain growth, private sector debts are likely to remain high in major advanced countries.

Specific objective

To establish the effect of Audit Process on Financial Stability of Micro Finance Institutions in Rwanda.

Research Hypothesis

H01: There is no effect of Audit Process on Financial Stability of Micro Finance Institutions in Rwanda.

1.1. Statement of the Problem

The financial sector is one of the most heavily regulated sectors in the economy and banking is by far the most heavily regulated industry. The Rwanda financial sector is largely dominated by banking sector which hold around 66.9 % of the total financial sector assets. The pension sub-sector comes second, with 17.1 % of the total financial sector assets. Insurance institutions hold 9.7 % of the total financial sector's assets. Microfinance institutions account for 6.3 % of total financial sector assets. The National Bank of Rwanda (BNR) is the sole regulator of the above mentioned financial sector sub-sectors. Other integral components of the financial sector in Rwanda are: Forex bureaus; capital market and; payment system. Regulation is costly and can give rise to moral hazard problems. In addition distortions between regulated and unregulated institutions can occur (Barth et al., 2006). Studies done concerning the internal control systems and financial performance do not show directly the effect of compliance and financial stability on financial stability of Micro Finance Institutions (MFI) in Rwanda. This study therefore sought to bridge this evident research gap by investigating the effects of audit process on financial stability of micro finance institutions in Rwanda.

2. Theory

Theory of Auditing

Auditing has been present for years in different stage of development following the evolution of accounting. Starting since the epoch when the records were approved after a public reading, to the era when government's officials were measured by their honesty. Different authors have started the development of the audit theory such as Mautz and Sharaf (1961) with their publication titled The Philosophy of Auditing; also Tom Lee (1986) with his approach in the book Company Auditing, and later David Flint (1988) with his book Philosophy and principles of auditing (as cited in Moizer, 1989). The auditing analysis in this demonstration will be framed on the postulates proposed by David Flint (1988) as a foundation for the theory of auditing.

Flint (1988) stated that there is a matter of public accountability demanding an independent audit for its demonstration with clear definition and intention, based on evidence that only skilled auditors gather, measure it, and compare it against the standards, which generates economic or social benefit (as cited in Moizer, 1989).

Followed by the times of the industrial revolution were the ownership of companies started separating from management; when owners required more protection of their investments increasing the use of auditors, consequently; to the times were an auditor was always searching for frauds or errors and then to ascertain the actual financial condition and earnings of an enterprise (Mugo , 2013).However, the acceptance of auditing as an academic discipline is not old and just after the development of different concepts and techniques within the audit model such as the use of sampling, the study of the internal control environment, and the risk assessment, is when more focus to the theoretical and conceptual framework of auditing it is been devoted.

Huber and DiGabriele, (2015). discussed the concept of theories in social science from the perspective of "theory as an ordering-framework (p. 50)", indicating that theory allows the use of the observed data and their relationships to predict and explain empirical events. Additionally Cooper and

Schindler (1998) define theory as "a set of systematically interrelated concepts, definitions, and propositions that are advanced to explain and predict phenomena (facts) (p. 47)". Another concept is expressed by Singleton and Straits (2005) explaining theory as a "set of interconnected propositions" (p. 19). The success in the explanations or predictions of any phenomena depends on the level that the theory holds and do not fails fitting in the situation, and the challenge is to perfect the process of matching theory and fact (Cooper & Schindler, 1998).

Different authors have started the development of the audit theory such as Mautz and Sharaf (1961) with their publication titled The Philosophy of Auditing; also Tom Lee (1986) with his approach in the book Company Auditing, and later David Flint (1988) with his book Philosophy and principles of auditing (as cited in Moizer, 1989). The auditing analysis in this demonstration will be framed on the postulates proposed by David Flint (1988) as a foundation for the theory of auditing.

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This study adopted descriptive cross sectional design. Hannah, (2013) describes research design as the arrangement of condition from collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. Research design is the blue print for the collection, measurement and analysis of data. It is a plan and structure of investment conceived so as to obtain answers to research questions (Coopers & Schindler, 1998). This study adopted a descriptive cross sectional design to answer the research questions. According to Orodho (2003), descriptive survey is a method of collecting data by interviewing or administering a questionnaire to a sample of individuals which can be used when collecting information about peoples' attitudes, opinions, habits or any other social issues. Descriptive research is a description of the state of affairs as it exists (Orodho 2003). Sekaran and Bougie (2011) concurs with Orodho (2003) by asserting that descriptive study is undertaken in order to ascertain and be able to describe the characteristics of the variables of interest in a situation.

Sekaran and Bougie (2011) aver that descriptive study has several advantages such as; helps in understanding the characteristics of a group in a given situation, assists in systematic thinking about aspects in a given situation. It also offers idea for further probe and research and helps in making certain simple decisions. Zikmund, Babin, Carr and Griffin (2010) say that descriptive research is to describe characteristics of objects, people, groups, organizations, or environments. In other words, descriptive research tries to "paint a picture" of a given situation by addressing who, what, when, where, and how questions. Descriptive research design is appropriate for this study as it helped in understanding the relationship between Compliance and Financial Stability of Micro Finance Institutions in Rwanda and therefore answer the "what" question of the study. The researcher was use of longitudinal survey design since the nature of research also relied on secondary data of published financial reports of Micro Finance Institutions in Rwanda. The data was for the last seven years namely year 2010 to year 2016.

3. Methodology

Research Design

This study adopted descriptive cross sectional design. Hannah, (2013) describes research design as the arrangement of condition from collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. Research design is the blue print for the collection, measurement and analysis of data. It is a plan and structure of investment conceived so as to obtain answers to research questions (Coopers & Schindler, 1998). This study adopted a descriptive cross sectional design to answer the research questions.

Target population

The target population of this study were for senior managements of Micro Finance Institutions in Rwanda. In Rwanda, there are eighteen Micro Finance Institution according to National Bank of Rwanda Financial Stability Rao et al. (2017). For the sake of this research, the researcher targeted the MFI senior management (Chief executive officer, finance manager, credit manager, risk manager and senior accountant), seven MFI directors and twelve shareholders of the MFI.

Sampling Frame and Size

The sampling frame was determined from the population of 504 individuals from eighteen MFIs in Rwanda. Sampling is the procedure a researcher uses to gather people, places or things to study. It is a process of selecting a number of individuals or objects from a population such that the selected group contains elements representative of the characteristics found in the entire group (Orodho, 2003).The researcher used a sample representation of thirty (30%) of 152 from each of the strata identified and to ensure equal representation.

4. Data Processing and Analysis

The data was collected and analyzed, with respect to the study objectives, using both descriptive and inferential statistics. The tools of analysis adopted in this study was Statistical Package for Social Sciences (SPSS) version 21 for descriptive data and advanced Microsoft excel for quantitative data. The data was analyzed using descriptive statistics such as mode, median, mean, standard deviation.

Little background, mention a little on the objective, statement of the problem and mention some literature (citations).

Research Hypothesis

H01: There is no effect of Audit Process on Financial Stability of Micro Finance Institutions in Rwanda.

Table 4. 1 Response rate

Population	Questionnaire distributed	Questionnaire received	% responses
Senior Management	49	49	100
MFI BOD	38	38	100
MFI Shareholders	65	65	100

Total of 152 questionnaires were distributed to the respondents and all of them were successfully filled and returned. Fosnacht (2013) posited that a response rate of 75% and above is acceptable. Babbie (1990) stated that a response rate of 50% is adequate while Bailey (1987) set an adequate response rate at 75%. Mugenda (2008) avers that a response rate of 50% is adequate. This study’s response rate was thus deemed acceptable. The response rate at 100% is comparable to similar studies in the domain of relationship in banking such as Agarwal, et al. (2009) whose study on the banking/NBFIs reported a response rate of 80%. Additionally, Ahmed and Uchida (2005) study on the impact of relationship in banking and NBFIs in Japan and Bangladesh had a response rate of 80.2%.

4.1. Gender Distribution

The study findings in Figure 4.2 indicate that there were more male respondents than their female counterparts. Male respondents accounted for 56% of the entire sample while female respondents only accounted for 43.9%. This implies that the MFIs of Rwanda are largely dominated by males in terms of gender.

Table 4. 2: Gender distribution

Gender	Frequency	(%)
Male	133	56.1
Female	104	43.9

4.3. Audit Process

The study examined the effect of Audit Process on Financial Stability of Micro Finance Institutions in Rwanda. Table 4.5 shows the chief audit executive's relationships with the audit committee and senior management.

Table 4. 5: The Chief Audit Executive's relationships with the audit committee and senior management

Audit Process	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Audit Process (AP1)	0	1	27	55	17	3.88
Audit process (AP 2)	0	1	17	60	20	4
Audit Process (AP 3)	0	1	17	59	23	4.04

As reflected from the above table, Majority (72%) of respondents agreed and strongly agreed while 27% were not sure and 1% disagreed with the statement. This implies that the chief audit executive's relationships with the audit committee and senior management are critical to the success of the internal audit function. The results are in line with a study by Doorley, and Garcia, (2011).They asserted that the chief audit executive must also consider the organizational aspects of internal audit. He or she will base the audit department's structure on the organization as a whole. For a publicly traded company, the CAE will need to foster coordination between the external auditor and the department he or she leads. Delegating management responsibility within the department applies to this area as well.

The study from table 4.5, was conducted to establish on whether there are many operational aspects of the audit committee's relationship with the internal audit function, majority of respondents (80%) agreed and strongly agreed, while 17% were not sure and 1% disagreed with the statement. This implies that it is important for the effective oversight of the internal control framework and culture. The results concur with Burton, Starliper, summers, and Wood, (2014) who urged that internal auditing provides a variety of services to the organization. These services may range from conducting financial, performance, compliance, system security, and due diligence audits, to participating on committees to select new accounting software, to revising the organization's code of conduct, to teaching training courses in internal control to new managers.

From table 4.5, Majority of respondents (80%) agreed and strongly agreed that the chief audit executive reports functionally to the audit committee while 18% were not sure and 2% disagreed whether they on the planning, execution and results of audit activities. This implies that reporting mechanism is being applied and there is no doubt for the performance of the company. This is in line with the results of the findings by Patanakul, (2014) on whose study was the Audit Committee without delay of any issue of risk, control or management practice that may be of significance. He urged that the Chief Audit Executive (CAE) reports the most critical issues to the audit committee quarterly, along with management's progress towards resolving them. Critical issues typically have a reasonable likelihood of causing substantial financial or reputational damage to the company.

Whether you are an auditor assessing internal control at your client, a preparer signing off on controls, a board member assessing organizational exposure, or a small business owner concerned with minimizing fraud, (Okike, 2011).

4.4. Assessment of Internal Control

The study determine that internal audit functions need an adequate complement of staff with the appropriate experience and qualifications.

Table 4. 3. Assessment of Internal Control

Audit Process	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Audit Process (AP 4)	0	2	18	55	25	4.04
Audit Process (AP5)	0	0	18	59	23	4.04
Audit Process (AP 6)	0	9	22	43	26	3.85

Table 4.3. shows that majority of respondents (82%) agreed and strongly agreed that Internal audit functions need an adequate complement of staff with the appropriate experience and qualifications for the risks and businesses they audit, while 18% were not sure and 2% disagreed with the statement. This implies that the organisation has competent and experienced staff and consequently the performance of the organisation is not in question. The study by Team, Perrault, Kilo and Hettinger, (2013), urged that the audit committee is responsible for ensuring that management has implemented an effective system of internal control to manage the risks facing the organization. In larger and more complex organizations an internal audit function can provide cost-effective and independent assurance that internal control is effective, provided that it has an appropriate role and mandate. Whether you are an auditor assessing internal control at your client, a preparer signing off on controls, a board member assessing organizational exposure, or a small business owner concerned with minimizing fraud, (Okike, 2011).

From Table 4.3, Indicates that, most of respondents (82%) agreed and strongly agreed that the organization may assign responsibility for audit activities to a corporate internal audit department or include some audit activities in the responsibilities of line functions while 18% were not sure and 1% disagreed based on respondent's views. This implies that audit function has assigned responsibilities and thus it is likely to perform professionally. The study concur with findings by (Bhasin, 2016) who pointed out that as organizations work towards reducing the losses due to fraud, their anti-fraud programmes are increasingly looking towards the internal audit function for support in light of the fact that over time as internal auditors review systems in the organization, they develop an overall knowledge of the organization's processes, risks, control systems and personnel which can contribute to an effective fraud risk management (Bhasin, 2016).

An annual internal audit plan from table 4.3, Majority of respondents, (69%) agreed and strongly agreed, while 22% are not sure and 9 % disagreed with the statement that there is key to matching the work of internal audit to the needs of an expectations of the audit committee, external auditors and senior management. Based on respondents view, it donates that, the expectation of internal auditors are adhered to. This is in line with the findings by Chappelet, and Mrkonjic, (2013) who asserted that Internal audit departments can be major contributors to the effectiveness of governance, risk management, and internal control processes, but they need to focus on the areas of highest risk, perform their services effectively, and clearly communicate the results of their work.

4.5. Boards, audit committees and senior management rely on internal audit reports.

The study was established to investigate whether Boards, audit committees and senior management rely on internal audit reports.

Table 4. 4 Boards, audit committees and senior management rely on internal audit reports.

Audit Process	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Audit Process (AP 7)	0	8	20	50	22	3.84
Audit Process (AP 8)	0	6	24	47	23	3.86
Audit Process (AP 9)	0	7	20	57	16	3.82
Audit Process (AP10)	0	6	22	40	32	3.97

From Table 4.4, the researcher was interested to know whether Boards, audit committees and senior management rely on internal audit reports. The results showed that majority of respondents (72%) agreed and strongly agreed with the statements, 20% were not sure and 8% disagreed board rely on internal audit reports to confirm the quality of the system of control. Based on the above results, this denotes that, internal audit reports are being relied to take genuine decision. This is in agreement with results by Celesio, (2012) on whose study asserted that, the company of the board's various committees, including the audit committee, is established through such a resolution. Such resolution is an example of corporate governance setting the rules by which a corporation operates. This type of resolution is documented in the records of the board and not generally revised unless some circumstances require a change.

From table 4.4, on whether internal audit reports are only of value when managers address the problems and deficiencies identified by the audits or make informed decisions to accept the risks. From table 4.8, most of respondents (70%) agreed and strongly agreed, while, 24% were not sure and 6 % disagreed with the statements. According to the results shown above, it implies that internal audit reports have substances, since they addresses deficiencies for the management to take decision. The result collaborate the findings by Soh, and Martinov-Bennie, (2011), whose study urges that Internal auditors are expected to maximize the assurance provided to the Board, the Audit Committee and Management, contribute to the continuous improvement strategies of the organization without impairing its objectivity and independence. Internal auditor's role involves providing guidance and expertise in areas including, but not limited to, corporate governance, fraud policies and prevention, and information technology systems,

Response in table 4.4, indicated that substandard credits are adequately protected since the majority (73%) of respondents agreed and strongly agreed, while 20% were not sure and 7% disagreed with the statement that Substandard credits are adequately protected by the current sound worth in service delivery and paying, in regard to the responses above, one is enough to conclude that the organizations are healthy. The results contradicts with the findings by Chikomba, Dube, and Tsekea, (2013), on whose study is well-managed credit risk rating systems that promote bank safety and soundness by facilitating informed decision making. Rating systems measure credit risk and differentiate individual credits and groups of credits by the risk they pose. This allows bank management and examiners to monitor changes and trends in risk levels. The process also allows bank management to manage risk to optimize returns.

The response in table 4.4., majority (72%) of respondents agreed and strongly agreed that the prevention, deterrence and detection of fraud are the responsibility of management while 22% were not sure and 6% disagreed.In accordance with the results in table 4.4, management has strong controls to detect fraud. This implies that there is sound system detecting wrong doings. Findings supported by Antonikova, (2015), urged that an audit committee should take an active role in the prevention and deterrence of fraud, as well as an effective ethics and compliance program. The audit committee should constantly challenge management and the auditors to ensure that the organization has appropriate antifraud programs and controls in place to identify potential fraud and ensure that investigations are undertaken if fraud is detected.

4.6. Organization's Structure.

Study sought to Investigate Organization's structure and tone at the top help to establish and enforce individual accountability for performance of internal control responsibilities.

Table 4. 5: Organization's Structure.

Audit process	Strongly disagree (%)	Disagree (%)	Not sure (%)	Agree (%)	Strongly agree (%)	Mean
Audit Process (AP11)	0	8	28	42	22	3.78
Audit Process (AP 12)	0	7	20	46	27	3.93
Audit Process (AP 13)	0	6	24	51	19	3.82
Audit Process (AP 14)	0	6	27	43	24	3.85

On being asked whether the organization's structure and tone at the top help to establish and enforce individual accountability for performance of internal control responsibilities. From table.4.5, most of respondents (64%) agreed and strongly agreed, while, 28% were not sure and 8% disagreed with the statement. It implies that there is individual accountability for performance of internal control responsibilities. The results are in agreement with, Shawyun, (2012) who revealed that an effective system of internal control can give managers the means to provide accountability for their programs, as well as the means to obtain reasonable assurance that the programs they direct meet established goals and objectives.

From Table 4.5, majority of respondents (73%), agreed and strongly agreed that organization periodically review the quality of information on service delivery to assess its quality of information to assess its reliability and timeliness, while 20% were not sure and 7% disagreed with the statement. This implies that there is quality of information on service delivery, Results Findings concur with findings by AN, U. A. D. I. (2015), on study that Public services need information that is fit for purpose with which to manage services and account for performance. The result occur with the study by Wu, Wang and Chang, (2017) ,Public services need information that is fit for purpose with which to manage services and account for performance. For example, service providers need good information to make judgments about the efficiency, effectiveness and responsiveness of their services.

The employees of the organisation are satisfied with the way investment goals are being accomplished

From table 4.5, majority of respondents (67%), agreed and strongly agreed that the employees of the organisation are satisfied with the way investment goals are being accomplished while 26% were not sure and 6% disagreed with the statement. Basing on majority's view, investment goals are achieved satisfactory. The findings collaborate with the results by Roberts, (2017), immersed in an accelerated journey of personal and professional growth, you will build the cross-functional and analytical skills to identify, frame, and solve complex business problems that advance your path to leadership and your company's long-term performance.

Factor Analysis of Audit Process

Factor analysis was carried out before analysis of the results to describe variability among the observed and check for any correlated variables with the aim of reducing data that was found redundant. Factor analysis carried out on the audit process on table 4.9. Statements scoring more than 0.300 which is the minimum requirement for inclusion of variables into the final model (Hair, Black & Babin, 2010; Kothari, 2004) were included. Factor analysis has become an important statistical instrument of investigation in modern science, being an adequate tool to investigate the principles of interaction of components and their integration system (Kaplunovsky, 2005).

Table 4. 6. Factor analysis of Audit Process

AUDIT PROCESS.		Component
Audit process	1	0.853
Audit process	2	0.541
Audit process	3	0.76
Audit process	4	0.799
Audit process	5	0.661
Audit process	6	0.51
Audit process	7	0.849
Audit process	8	0.679
Audit process	9	0.897
Audit process	10	0.721
Audit process	11	0.533
Audit process	12	0.746

Table 4.7: Dependent Variable: Financial Stability

Model	Sum of Squares	Df
Regression	77.526	4
Residual	60.353	204
Total	137.878	208

a. Dependent Variable: Financial Stability
b. Predictors: (Constant), Financial Controls, Financial risk management, Audit process, Governance.

Audit process coefficients are presented in table 4.7. The results show that Audit process contributes significantly to the model since the p-value for the constant and gradient are less than 0.05. The findings imply that one positive unit change in use of Audit process to a change in financial stability effectively at the rate of 60.353. This confirms the positive effect of audit process on financial stability. An F statistic of 65.512 indicated that the overall model was significant. The findings imply that audit process was statistically significant in explaining financial stability in the Micro Financial Institutions in Rwanda.

Coefficients.

Table 4.7. Shows that Audit Process has a positive significant regression coefficient of 0.322 (p-value<0.00).

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	77.526	4	19.381	65.512	.000b
Residual	60.353	204	.296		
Total	137.878	208			

a. Dependent Variable: Financial Stability
b. Predictors: (Constant), Financial Controls, Financial risk management, Audit process, Governance.

Audit process coefficients are presented in table 4.7. The results show that Audit process contributes significantly to the model since the p-value for the constant and gradient are less than 0.05. The findings imply that one positive unit change in use of Audit process to a change in financial stability effectively at the rate of 60.353. This confirms the positive effect of audit process on financial stability. An F statistic of 65.512 indicated that the overall model was significant.

Findings imply that audit process was statistically significant in explaining financial stability in the Micro Financial Institutions in Rwanda.

Table 4.7, shows that Audit Process has a positive significant regression coefficient of 0.322 (p-value<0.00).

4.7. Financial Audit process on Financial Stability

The study revealed that audit process has significant effect on financial stability, it can be concluded from this study that there exists a positive significant relationship between audit processes, financial stability, the study thus rejects the null hypothesis and concludes that there is significant relationship between audit process and Financial Stability in the Micro financial institutions of Rwanda. The findings indicated positive significant correlation coefficients between the independent variable audit process and the dependent variable financial stability. Study focused on audit process that determine which elements of the control audit process and procedures should be addressed by engagements in the periodic audit plan; how to scope, staff, and plan such engagements; and which items to consider in performing related audit work, including evaluating and reporting deficiencies.

5. Recommendation

5.1. Audit Process on Financial Stability

The study recommended that;

For authentic and professional financial stability, it is vital to have accountability, transparency and openness in reporting and disclosing organizational information with the aim of clear practices of good governance. Internal controls in human resources will only be realized through the implementation of effective human resource policies and procedures that enhance an organization's control environment.
The management should establish a system of quality control designed to provide reasonable assurance that an organization management and its personnel comply with regulatory and legal requirements, code of ethics and standards on quality of control and auditing is a crucial to the office.

6. Conclusion

The study revealed that audit process has significant effect on financial stability, it can be concluded from this study that there exists a positive significant relationship between audit processes, financial stability, the study thus rejects the null hypothesis and concludes that there is significant relationship between audit process and Financial Stability in the Micro Finance Institutions of Rwanda. The findings indicated positive significant correlation coefficients between the independent variable audit process and the dependent variable financial stability. Study focused on audit process that determine which elements of the control audit process and procedures should be addressed by engagements in the periodic audit plan; how to scope, staff, and plan such engagements; and which items to consider in performing related audit work, including evaluating and reporting deficiencies.

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