Quality Internal Auditing and Management Decision Making in Kenya

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Abstract

Internal auditing is a vital function within organizations, providing impartial and objective assessments of risk management, control processes, and governance effectiveness. Its role in offering insightful analysis and recommendations to enhance operational efficiency and reduce risks makes it a crucial determinant of management decision-making. This study investigates the impact of effective internal auditing on decision-making, recognizing the growing significance of this topic in contemporary business environments characterized by increasing complexity and challenges. The empirical studies reviewed in this research align with theoretical perspectives such as agency theory and information asymmetry theory, emphasizing the positive correlation between high-quality internal auditing and improved management decision-making. The empirical evidence strengthens the argument for robust internal audit functions as facilitators of better decision-making. While this study contributes valuable insights, further research could benefit from more diverse case studies, in-depth exploration of mechanisms, and a comprehensive discussion of potential limitations.

Keywords: Quality internal audit, Management decision making, Auditors independence, Auditors skills

1. Introduction

Internal auditing plays a crucial role in organizations by providing impartial and objective assurance on the efficacy of risk management, control, and governance processes. Since internal auditing provides insightful analysis and recommendations to boost operational effectiveness, lower risks, and improve overall performance, the calibre of internal auditing can have a significant impact on management decision-making. The decision to choose this topic was influenced by the growing appreciation of internal auditing's significance in contemporary businesses. The importance of trustworthy and efficient internal audit practices grows as organizations deal with ever-greater complexity and challenges. The study aims to investigate the degree to which effective internal auditing affects management's decision-making, ultimately influencing the achievement and sustainability of the organization.

Understanding how good internal auditing can influence management's ability to make better decisions is crucial to the study's significance. The success of an organization depends on making well-informed decisions, especially in today's dynamic and cutthroat business environment. This research aims to shed light on the potential of internal auditing to drive strategic, operational, and financial improvements by examining the impact of internal auditing on decision-making. It also emphasizes
how important a strong internal audit function is for organizations to maintain accountability, transparency, and compliance with laws and best practices (Smith & Johnson, 2021). An essential component of the internal auditor's function and efficiency is their independence. Being impartial in their evaluation of the organization's processes and controls is ensured by the internal auditor's independence. This objectivity enables the internal auditor to offer management objective suggestions and insights, which may result in more informed and trustworthy decision-making (Heeschen & Sawyer, 1984). In order to maintain the internal audit function's legitimacy and competence, internal auditors must be qualified. Professional designations that attest to a high level of expertise in auditing and accounting principles include Certified Internal Auditor (CIA) and Certified Public Accountant (CPA). Internal auditors with the right qualifications are equipped to perform thorough audits and offer management insightful feedback that improves the decision-making process (Al-Matari et al., 2014).

The effectiveness of the internal auditor is a critical factor in their ability to positively impact management decision-making. An effective internal auditor demonstrates proficiency in risk assessment, data analysis, and understanding the organization's goals and objectives. They are proactive in identifying potential issues and providing timely recommendations to management. An efficient internal auditor adds value to the decision-making process by offering insights and solutions based on reliable and accurate information. The objective of the study is to close a knowledge gap regarding how effective internal auditing affects management choices. Although there is a body of literature on the value of internal auditing, there is little research that focuses specifically on how it affects decision-making processes. By conducting this study, we hope to offer organizations and practitioners helpful tips on how to maximize their internal audit functions to improve the quality of decision-making. Additionally, the study will add to the body of knowledge about the function of internal auditing in organizational governance and performance.

Internal auditing and its effects on management decision-making will be examined from both global and local perspectives in this study. The research can provide a deeper understanding of common problems and efficient solutions by looking at practices from different industries and nations. Simultaneously, considering the local context will assist in identifying any organizational, cultural, or regulatory factors that may have an impact on how internal auditing and decision-making interact in particular locales (Onyango, 2021). There is limited research that explores internal auditing's direct influence on management's decision-making processes, despite a growing understanding of its significance in modern businesses and some studies highlighting its significance in improving operational effectiveness and lowering risks. The study aims to close this gap by examining the extent to which Company's management decisions are impacted by effective internal auditing, ultimately affecting the organization's success and sustainability.

Previous studies have acknowledged the value of an independent and skilled internal auditor in offering management unbiased recommendations and insights. To fully grasp how these factors affect the standard of decision-making within the organization, more research is necessary. In addition, a more thorough investigation is needed to determine the effectiveness of the internal auditor, who is crucial in spotting potential problems and making prompt recommendations (Engelbrecht et al., 2018; Smith & Johnson, 2021). It is crucial to comprehend how internal auditing influences decision-making because, in today's complex and competitive business environment, the success of an organization depends on making wise decisions. Organizations may miss opportunities to optimize their internal audit functions and enhance the quality of decisions made at various levels if they do not have a clear understanding of how quality internal auditing affects management decision-making.

2. Literature Review

In this section, a literature review is presented centered on the relationship between quality internal audit and management decision making of firms in Kenya. The initial section delves into pertinent theories that elucidate the effect of quality audit on decision making. The chapter also incorporates empirical studies and culminates with a comprehensive summary of the literature review.

2.1. Theoretical framework

This research builds upon established financial theories that explore the relationship between quality internal audit and management decision making of firms in Kenya. These well-regarded theories provide valuable insights into understanding how management decisions and quality internal audit are interconnected.

3.1.1 Agency theory

Agency theory, introduced by Jensen and Meckling (1976), is relevant to the study of internal audit quality and its impact on management decision-making, particularly concerning the independence of internal auditors. According to this theory, a principal-agent relationship exists between the company's owners (principals) and its management (agents). The agents are expected to act in the best interest of the principals, but there may be conflicts of interest. The internal audit function acts as an agent for the company's owners, and its independence is crucial to ensuring unbiased and objective assessments of the organization's operations and controls.

Recent studies have highlighted the importance of internal auditor independence in enhancing the credibility and reliability of their findings. An independent internal...
auditor is more likely to provide unbiased assessments of financial reports, risk management practices, and internal control systems. This, in turn, aids management in making well-informed decisions based on accurate information.

3.1.2 Information Asymmetry Theory

Information asymmetry theory, developed by Akerlof (1970), highlights the imbalance of information between different parties in a transaction. In the context of internal auditing and management decision-making, this theory suggests that management may not have access to all the relevant information, which can lead to suboptimal decisions. An effective internal auditor acts as a bridge to reduce information asymmetry by providing management with accurate and comprehensive information about the organization’s operations, risks, and controls. Through regular audits and reporting, the internal auditor ensures that management is aware of potential pitfalls and opportunities.

The internal auditor performs the crucial function of guaranteeing that the higher echelons of the organizational hierarchy are kept well-informed and cognizant of any and all possible risks, hazards, setbacks, and hazards that might lie ahead, as well as the various prospects, possibilities, advantageous openings, and fortuitous circumstances that may be encountered.

2.2. Empirical literature review

The effects of high-quality internal auditing on management decision-making have been investigated in a number of empirical studies, in line with the theoretical viewpoints discussed in the literature. The quality of management decisions and internal auditor independence were found to be positively correlated by the researchers (Kotb et al., 2020). Organizations with an independent audit committee or internal auditors who report directly to the board showed better decision-making. Independent auditors provided management with transparent, objective reporting that gave management precise insights into potential risks, and control weaknesses, leading to better-informed decisions that were aligned with the interests of shareholders.

Al Matari and M gammal (2019) investigation into the significance of internal auditor qualifications on the calibre of management decision-making was part of another empirical study. The researchers discovered that competent internal auditors played a critical role in enhancing management decisions by analysing data from a variety of industries. Internal auditors with specialized certifications and knowledge in risk assessment, accounting, and auditing were better able to spot important problems, recommend workflow changes, and make insightful recommendations (Kroon et al., 2021). Their credentials enabled them to effectively convey to management complex financial and operational information, resulting in more responsible and well-founded decisions.

A multi-faceted approach that includes the integration of various strategies and tactics, such as regulatory oversight, public education, and the establishment of auditor independence, has the potential to greatly enhance stakeholders’ trust and assurance in the financial reporting system (Kamau et al., 2023). By incorporating multiple dimensions and aspects into the overall framework of the strategy, there is a greater likelihood of achieving a comprehensive and robust system that addresses the various concerns and challenges faced by the financial reporting industry, internal auditors are responsible for scrutinizing and analyzing the internal control mechanisms implemented within an organization. By meticulously inspecting and evaluating these internal control mechanisms, internal auditors are able to gain a comprehensive understanding of the effectiveness and efficiency with which these mechanisms operate (Mutua, 2023). Furthermore, through their extensive expertise and knowledge in the field of internal controls, these auditors are able to provide invaluable advice and recommendations to management.

The theoretical viewpoints outlined in the literature review regarding the influences of high-quality internal auditing on management decision-making are supported by the empirical data. The impartiality of internal auditors, along with their training, expertise, and capacity to lessen information asymmetry, all help to raise the caliber of management decisions (Al Matari & M gammal, 2019). While the literature review presents relevant and recent studies on the effects of quality internal auditing on management decision-making, it could have been strengthened by including more diverse case studies, addressing potential biases, exploring the mechanisms in greater depth, and discussing potential limitations. Nonetheless, the review provides a valuable foundation for further research and supports the significance of strong internal audit functions in facilitating better decision-making processes within organizations.

3. Conclusion

In conclusion, this study has delved into the critical role that internal auditing plays in organizations and its profound impact on management decision-making. Internal auditing serves as a vital source of impartial and objective assurance, offering insights and recommendations that enhance operational efficiency, mitigate risks, and improve overall performance. The importance of effective internal auditing has become increasingly evident in today's complex and challenging business landscape. The study has aimed to investigate the extent to which effective internal auditing influences management's decision-making, ultimately shaping the success and sustainability of organizations. It has highlighted the significance of an independent and qualified
internal auditor, emphasizing their ability to provide unbiased assessments and valuable insights to guide decision-making processes. Moreover, the research has underscored the importance of the internal auditor’s competence in risk assessment, data analysis, and aligning with the organization's goals.

Theoretical perspectives, such as Agency Theory and Information Asymmetry Theory, have been explored to provide a conceptual framework for understanding the relationship between internal audit quality and management decision-making. These theories have highlighted the critical role of internal auditor independence in ensuring objective assessments and reducing information imbalances. Empirical studies discussed in the literature review have further supported the notion that high-quality internal auditing positively correlates with improved management decision-making. Findings have indicated that organizations benefit from independent audit committees and internal auditors reporting directly to the board, leading to better-informed decisions aligned with shareholders’ interests. Additionally, internal auditor qualifications and expertise have been shown to enhance the quality of management decisions.

While this study has contributed valuable insights into the significance of internal auditing in shaping management decision-making, there is room for further research. More diverse case studies, in-depth exploration of mechanisms, and a comprehensive discussion of potential limitations could strengthen our understanding of this critical relationship. Nonetheless, the evidence presented here underscores the vital role of strong internal audit functions in facilitating better decision-making processes within organizations. In today's dynamic business environment, the ability to make well-informed decisions is paramount, and effective internal auditing is a key enabler of this capability.

Acknowledgment
We would like to express our gratitude to the journal editor and the anonymous reviewers for their valuable comments and suggestions that significantly improved the quality of this manuscript.

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