

Effect of Internal Audit Function on Financial Performance of Postbank Kenya

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Abstract

Internal audit is an independent and objective assurance and consulting function that enhances organizational governance, risk management, and internal control systems. In banking institutions, an effective internal audit function is expected to strengthen accountability, improve operational efficiency, and enhance financial performance. However, empirical evidence regarding the contribution of internal audit functions to the financial performance of state-owned financial institutions in Kenya remains limited. This study was therefore conducted to examine the effect of the internal audit function on the financial performance of the Post Office Savings Bank in Nairobi County, Kenya. The study adopted a descriptive and correlational research design. A census approach was used to target 40 respondents drawn from the internal audit, finance, risk, and compliance departments, audit committees, and branch management at Postbank Nairobi County. Primary data were collected using structured questionnaires based on a five-point Likert scale. Of the 40 questionnaires distributed, 32 were completed and returned, representing an 80% response rate. Data were analyzed using SPSS version 25 and Microsoft Excel. Descriptive statistics were used to summarize the data, while Pearson correlation and multiple regression analyses were employed to examine the relationship between dimensions of the internal audit function and financial performance at a 0.05 level of significance. The findings revealed that all dimensions of the internal audit function were positively and statistically significantly related to financial performance. Internal control systems exhibited the strongest positive correlation with financial performance ($r = 0.468, p < 0.01$), followed by the staff size of the internal audit department ($r = 0.433, p < 0.05$), management support ($r = 0.375, p < 0.05$), and the quality of the internal audit function ($r = 0.371, p < 0.05$). The regression model was statistically significant ($F = 3.016, p = 0.035$) and explained 30.9% of the variation in financial performance at Postbank ($R^2 = 0.309$). The study concludes that the internal audit function significantly influences financial performance at Postbank. Strengthening the quality of internal audits, enhancing internal control systems, increasing management support, and ensuring adequate audit staffing are essential to improving financial performance in state-owned financial institutions.

Keywords: *Internal Audit Function, Internal Control Systems, Management Support, Financial Performance, Post Office Savings Bank*

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1. Introduction

Internal audit is an important component of corporate governance in financial institutions because it provides independent assurance on the effectiveness of internal controls, risk management, and governance processes. According to the Institute of Internal Auditors (IIA, 2024), internal audit supports accountability, transparency, and operational efficiency by evaluating organizational systems and recommending improvements. In banking institutions, effective internal audit functions contribute to better financial management, fraud prevention, regulatory compliance, and improved organizational performance. Financial institutions operate in highly regulated, risk-sensitive environments that require robust oversight mechanisms to ensure sustainability and financial stability (Alzeban & Gwilliam, 2020).

Globally, organizations continue to strengthen internal audit functions following corporate failures and financial scandals that exposed weaknesses in governance and control systems. Studies have shown that the quality of internal audits, internal control systems, management support, and audit staff competence significantly influence organizational performance (Mihret & Yismaw, 2007; Chambers & Odar, 2020). In Kenya, state-owned financial institutions such as Post Office Savings Bank (Postbank) operate under increasing pressure to improve efficiency, accountability, and financial performance. Despite existing regulatory frameworks and internal audit structures, many public institutions continue to experience operational inefficiencies and financial performance challenges (Maina, 2021).

Although several studies have examined internal audit practices in commercial organizations, there is limited empirical evidence on how internal audit functions influence financial performance in Kenyan public financial institutions. In particular, few studies have examined the combined influence of audit quality, internal control systems, management support, and the internal audit department's staff size on financial performance. This study, therefore, examines the effect of the internal audit function on the financial performance of Postbank in Nairobi County, Kenya, with a specific focus on internal audit quality, internal control systems, management support, and the size of the internal audit department.

2. Literature Review

Mihret and Yismaw (2007) conducted a study on the effectiveness of internal auditing in public-sector organizations in Ethiopia and found that management support, auditor competence, and organizational independence positively influenced audit effectiveness. The study concluded that strong management commitment enhances the implementation of audit recommendations and improves organizational performance.

Alzeban and Gwilliam (2020) examined the factors affecting internal audit effectiveness in public-sector organizations and found that internal audit quality, auditor independence, and internal control systems significantly contribute to organizational financial performance. The study emphasized that organizations with effective audit structures experience improved accountability and governance outcomes.

Rahmatika (2014) investigated the influence of internal audit functions on the reliability of financial reporting and governance in Indonesian public institutions. The findings showed that effective internal audit systems improve the quality of financial reporting and strengthen internal control processes, thereby contributing positively to organizational performance.

Salat (2018) examined the effect of internal audit practices on the performance of non-governmental organizations in Kenya. The study established that audit quality, internal controls, and management support significantly influence organizational performance. The researcher concluded that organizations with effective internal audit systems are more likely to achieve improved operational and financial outcomes.

3. Methodology

This study adopted a descriptive and correlational research design to examine the effect of the internal audit function on the financial performance of Post Office Savings Bank (Postbank), Nairobi County, Kenya. The study targeted employees working in the internal audit, finance, risk and compliance, audit committee, and branch management departments. A census approach was adopted because the target population was small and manageable. The study involved 40 respondents drawn from Postbank headquarters and selected branches within Nairobi County. Respondents included internal auditors, finance managers, senior accountants, risk and compliance officers, branch managers, and heads of departments. Data collection was conducted between January 2025 and March 2025.

Primary data were collected using structured questionnaires based on a five-point Likert scale ranging from Strongly Disagree (1) to Strongly Agree (5). The questionnaire captured demographic information and variables relating to internal audit quality, internal control systems, management support, staff size of the internal audit department, and financial performance. A pilot study was conducted outside Postbank to assess the clarity and reliability of the research instrument prior to final data collection. Data were analyzed using SPSS version 25 and Microsoft Excel. Descriptive statistics, Pearson correlation analysis, and multiple regression analysis were used to examine relationships between study variables. Statistical significance was tested at the 0.05 level.

4. Results

This section presents statistical findings on the effect of the internal audit function on the financial performance of the Post Office Savings Bank (Postbank) in Kenya. The results are organized into descriptive statistics, reliability analysis, correlation analysis, and regression analysis.

4.1 Descriptive Statistics

4.1.1 Quality of Internal Audit Function

Descriptive statistics were used to summarize respondents' perceptions of internal audit quality, internal control systems, management support, the size of the internal audit department's staff, and financial performance.

The quality of the internal audit function recorded a high overall mean score of 4.50 (SD = 0.70), indicating strong agreement among respondents that internal audit activities at Postbank are professionally executed. The highest-rated item related to adherence to professional auditing standards (Mean = 4.75, SD = 0.51), while auditor expertise recorded the lowest mean,

though still high (Mean = 4.34, SD = 0.65). This suggests that the quality of internal audit at Postbank is perceived to be strong, particularly in terms of independence and compliance with professional standards.

Table 1: Descriptive Statistics for Quality of Internal Audit Function

	N	Minimum	Maximum	Mean	Std. Deviation
Internal audits conducted by qualified, skilled professionals enhance an organization's internal processes and boost returns, ultimately leading to better overall performance.	32	1	5	4.44	0.84
Internal audit staff possesses the necessary expertise to assess all of the organization's systems.	32	3	5	4.34	0.653
Independence in internal auditing is crucial for enhancing audit processes. The internal audit function operates independently, performing its duties without external influence.	32	3	5	4.56	0.669
Adhering to professional internal auditing standards when executing audit activities is crucial to enhancing the effectiveness of the internal audit department.	32	3	5	4.75	0.508
Grand Mean	32.0	2.5	5.0	4.5	0.70

4.1.2 Internal Control Systems

Internal control systems recorded an aggregate mean of 4.20 (SD = 0.84), indicating general agreement that effective controls are in place. The strongest item was the contribution of internal controls to return on equity (Mean = 4.41, SD = 0.76), while segregation of duties recorded the lowest mean (Mean = 4.06, SD = 0.88). These results indicate that while internal controls are largely effective, there is room for strengthening control structures related to role separation.

Table 2: Descriptive Statistics for Internal Control Systems

	N	Minimum	Maximum	Mean	Std. Deviation
Efficient internal audit controls can help to boost return on equity within Post Bank Kenya.	32	2	5	4.41	0.756
The Bank has placed effective risk assessment measures for the internal audit process.	32	2	5	4.13	0.871
All departments at Post Bank maintain good record-keeping to make the audit process easier.	32	2	5	4.19	0.859
The absence of separation between accounting and custodial functions obstructs the detection of financial misconduct, indicating weak internal controls.	32	2	5	4.06	0.878
Aggregate mean	32	2	5	4.1975	0.841

4.1.3 Management Support

Management support for internal audit recorded an aggregate mean of 4.28 (SD = 0.79). Open communication and access to information recorded the highest agreement (Mean = 4.47, SD = 0.57), while provision of physical facilities and audit tools showed relatively higher variability (Mean = 4.00, SD = 1.08). This indicates that although management support is generally strong, consistency in resource provision remains an area for improvement.

Table 3: Descriptive Statistics for Management Support

	N	Mean	Std. Deviation	Minimum	Maximum
Management support ensures that internal audit recommendations are taken seriously and viewed as opportunities for improvement.	32	4.34	0.787	2	5
Management supports auditors by fostering open communication, ensuring access to necessary information and resources, and promoting cooperation among departments	32	4.47	0.567	3	5
Management allocates sufficient competent personnel with the right skills and experience to participate in the audit process	32	4.31	0.738	3	5
Management provides auditors with access to the necessary physical facilities, such as meeting rooms, office space, IT resources, and necessary tools and equipment, such as software, hardware, and audit software, to enable them to carry out their audit work	32	4	1.078	1	5
Aggregate Mean	32.00	4.28	0.79	2.25	5.00

4.1.4 Staff Size of the Internal Audit Department

The staff size of the internal audit department recorded an aggregate mean of 4.44 (SD = 0.79), reflecting strong agreement that staffing levels and competencies are adequate. Regular training and skill diversity had the highest mean (Mean = 4.66, SD = 0.55), while communication between the audit and accounting departments had the lowest mean (Mean = 4.25, SD = 0.92). This suggests that Postbank has a competent audit team, though inter-departmental coordination could be improved.

Table 4: Descriptive Statistics for Staff Size of Internal Audit Department

	N	Mean	Std. Deviation	Minimum	Maximum
Internal auditing requires a diverse skill set, making regular training essential to uphold professional competence and ensure effective audit performance.	32	4.66	0.545	3	5
The internal audit team clearly communicates its requirements to the accounting department during the audit to improve audit effectiveness	32	4.25	0.916	2	5
Auditors at Post Bank possess the professional qualifications necessary to carry out their audit responsibilities effectively.	32	4.34	0.971	1	5
Audit committees support auditors by providing independent oversight, facilitating access to information, and ensuring that the audit process focuses on identifying and mitigating risks.	32	4.5	0.718	2	5
Aggregate Mean	32	4.4375	0.7875	2	5

4.1.5 Financial Performance Indicators

Financial performance indicators recorded an aggregate mean of 4.44 (SD = 0.85). Respondents agreed that internal audit recommendations improve return on equity (Mean = 4.41, SD = 0.95) and that audit thoroughness enhances the accuracy of financial performance reporting (Mean = 4.47, SD = 0.76). These findings indicate that internal audit is perceived as a key contributor to Postbank's financial performance.

Table 5: Descriptive Statistics for Financial Performance Indicators

	N	Mean	Std. Deviation	Minimum	Maximum
Internal audit recommendations contribute to improvements in the bank's Return on Equity.	32	4.41	0.946	2	5
The thoroughness of internal audits improves the accuracy of our company's ROE.	32	4.47	0.761	3	5
Aggregate Mean	32	4.44	0.8535	2.5	5

4.2 Reliability Analysis

Reliability of the research instrument was assessed using Cronbach’s Alpha. All constructs recorded an identical Cronbach’s Alpha coefficient of 0.759, which exceeds the minimum acceptable threshold of 0.70. This confirms satisfactory internal consistency and reliability of the measurement items used in the study.

Table 6: Reliability Analysis Results

	N	Cronbach’s Alpha	Recommendations
Quality of Internal Audit Function	4	0.759	Reliable
Internal Control Systems	4	0.759	Reliable
Management Support	4	0.759	Reliable
Staff Size of the Internal Audit Department	4	0.759	Reliable
Financial Performance Indicators	2	0.759	Reliable

4.3 Correlation Analysis

Pearson correlation analysis was conducted to examine the relationship between internal audit function variables and financial performance.

The quality of the internal audit function showed a positive and statistically significant correlation with financial performance ($r = 0.371, p < 0.05$), indicating that improvements in audit quality are associated with better financial outcomes.

Internal control systems showed a moderate positive correlation with financial performance ($r = 0.468, p < 0.01$), the strongest among the independent variables. This suggests that effective controls play a central role in enhancing financial performance.

Management support also showed a positive and significant relationship with financial performance ($r = 0.375, p < 0.05$), while the staff size of the internal audit department recorded a positive and significant correlation ($r = 0.433, p < 0.05$). These results demonstrate that adequate staffing and management commitment are important drivers of financial performance.

Table 7: Correlation Analysis Results

Variables	Quality of Internal Audit Function	Internal Control Systems	Management Support	Staff Size of Internal Audit Department	Financial Performance Indicators
Quality of Internal Audit Function	1	0.119	0.179	0.14	0.371*
Internal Control Systems	0.119	1	0.614	0.452	0.468
Management Support	0.179	0.614	1	0.709	0.375*
Staff Size of the Internal Audit Department	0.14	0.452	0.709	1	0.433*
Financial Performance Indicators	0.371*	0.468	0.375*	0.433*	1

4.4 Regression Analysis

Multiple regression analysis was conducted to determine the combined effect of variables in the internal audit function on financial performance.

The model summary shows an R value of 0.556 and an R² value of 0.309, indicating that 30.9% of the variation in financial performance is explained by internal audit quality, internal control systems, management support, and staff size. The adjusted R² of 0.206 confirms the model's explanatory power after adjusting for predictors.

Table 8: Model Summary

Model	R	R Square	Adjusted Square	R-Std. Error of the Estimate
1	0.556	0.309	0.206	1.3145

The ANOVA results indicate that the regression model is statistically significant (F = 3.016, p = 0.035), confirming that the independent variables jointly influence financial performance.

Table 9: ANOVA Results

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	20.846	4	5.212	3.016	0.035
Residual	46.654	27	1.728		
Total	67.5	31			

Regression coefficients show that all independent variables have positive effects on financial performance. Internal audit quality ($\beta = 0.254$, $p < 0.05$) and internal control systems ($\beta = 0.200$, $p < 0.05$) recorded the strongest effects. Staff size of the internal audit department also showed a significant positive effect ($\beta = 0.189$, $p < 0.05$), while management support recorded a smaller but statistically significant contribution ($\beta = 0.036$, $p < 0.05$).

Table 10: Regression Coefficient Results

Model	Unstandardized Coefficients (B)	Std. Error	Standardized Coefficients (Beta)	t	Sig.
(Constant)	-3.052	4.01		-0.76	0.45
Quality of Internal Audit Function	0.254	0.19	0.216	1.33	0.02
Internal Control Systems	0.2	0.15	0.271	1.34	0.02
Management Support	0.036	0.18	0.053	0.2	0.01
Staff Size of Internal Audit Department	0.189	0.17	0.257	1.12	0.000

4.5 Discussion

The findings of this study demonstrate that the internal audit function plays a significant role in influencing the financial performance of the Post Office Savings Bank (Postbank) in Kenya. The descriptive results showed consistently high mean scores across internal audit quality, internal control systems, management support, and staff size, indicating that respondents perceive internal audit as an essential governance mechanism within the institution. These findings support the theoretical argument that effective internal audit strengthens accountability, reduces operational risks, and improves organizational performance.

The strong positive relationship observed between internal audit quality and financial performance ($r = 0.371$, $p < 0.05$) is consistent with prior research emphasizing the importance of auditor competence, independence, and adherence to professional standards. Mihret and Yismaw (2007) argue that audit effectiveness depends heavily on audit quality and management responsiveness, while Alzeban and Gwilliam (2020) found that organizations with strong internal audit quality exhibit improved financial control and governance outcomes. The high mean adherence score in this study suggests that Postbank benefits from structured audit practices aligned with international frameworks.

Internal control systems recorded the strongest correlation with financial performance ($r = 0.468$, $p < 0.01$), highlighting their central role in safeguarding assets and reducing financial risk. This finding aligns with COSO's internal control framework (Committee of Sponsoring Organizations, 2013), which emphasizes that effective controls enhance operational efficiency and financial reliability. Similarly, Al-Matari, Al-Swidi, and Fadzil (2014) found that robust control environments significantly improve organizational performance. The present study confirms that strong control mechanisms within Postbank contribute directly to financial sustainability.

Management support was also positively associated with financial performance ($r = 0.375$, $p < 0.05$). Although its regression effect was smaller than that of other variables, its significance underscores the enabling role of leadership in audit success. Endaya and Hanefah (2013) note that management commitment determines whether audit recommendations are implemented effectively. Without executive backing, audit findings often fail to translate into operational

improvements. The relatively higher variability observed in resource provision suggests that consistent managerial support remains an area for strategic strengthening.

The adequacy of audit staff size showed a significant positive effect on financial performance ($r = 0.433$, $p < 0.05$), reinforcing the importance of human capital in audit effectiveness. According to Becker's Human Capital Theory (1993), investment in employee competence directly enhances organizational outcomes. Zain, Subramaniam, and Stewart (2006) similarly reported that well-staffed audit departments produce higher quality audits and stronger governance performance. The emphasis on training and professional development observed in this study indicates that Postbank recognizes the value of maintaining a skilled audit workforce.

The regression model, which explains 30.9% of the variation in financial performance ($R^2 = 0.309$), suggests that while internal audit is a major contributor to performance, other organizational and environmental factors also play a role. This finding is consistent with broader governance research indicating that financial performance is influenced by multiple interacting systems, including leadership structures, regulatory frameworks, and market dynamics (Sarens & De Beelde, 2006).

5. Conclusion

This study concludes that the internal audit function significantly contributes to Postbank Kenya's financial performance. Strong internal controls, high audit quality, adequate staffing, and active management support collectively improve accountability and operational efficiency. Strengthening these audit dimensions is therefore essential for enhancing financial sustainability in state-owned financial institutions.

6. Recommendations

- Based on the findings of the study, the following recommendations are proposed to improve the effectiveness of the internal audit function and enhance financial performance at Postbank Kenya and other state-owned financial institutions.
- First, Postbank management should strengthen the quality of the internal audit function by ensuring that internal auditors receive continuous professional training and adhere to international auditing standards. Enhancing auditor competence, independence, and professionalism will improve the effectiveness of audit processes and financial oversight.
- Second, the bank should continue strengthening internal control systems by improving risk assessment procedures, segregation of duties, and record-keeping practices. Effective internal controls will help minimize operational risks, reduce financial irregularities, and improve accountability within the institution.
- Third, management should provide greater support to the internal audit department through adequate resource allocation, implementation of audit recommendations, and promotion of open communication between auditors and management. Strong management commitment is essential for enhancing audit effectiveness and improving organizational performance.
- Finally, Postbank should ensure that the internal audit department is adequately staffed with qualified and experienced personnel. Increasing staff capacity and supporting continuous professional development will improve audit coverage, efficiency, and the overall contribution of internal audit to financial performance.

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