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The Effects of External Audits on Financial Performance: Evidence from Commercial Banks in Nangarhar, Afghanistan

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ABSTRACT

Through a thorough investigation, this study examines how external audits affect financial performance. The study attempts to determine the connection between financial results and external audits by using a multilayer linear regression approach. To ensure representation of the larger population, a random selection procedure was used to pick a sample of 200 individuals. The primary means of collecting data were questionnaires intended to elicit opinions and thoughts about how external audits affect financial performance. This thorough approach aims to identify important relationships that improve comprehension of the potential impact of external audits on financial outcomes. The results show a high positive link between external audits and financial performance, with a correlation coefficient of 65%. This suggests that better financial results may result from higher-quality external audits, underscoring the significance of sound auditing procedures. The study's independent variables explain a sizable amount of the variance in financial performance, according to the R-Squared value of 0.422, which supports the importance of external audits in this situation. Additionally, the external audit coefficient is 0.083, indicating significant significance at the 5% level. This implies a direct positive association, meaning that, assuming all other variables stay the same, financial performance should rise by 0.083 units for every unit increase in the efficacy of external audits. To sum up, this study emphasizes how important external audits are for improving financial performance. Strong statistical data suggests that upholding excellent auditing standards is essential to improving an organization's financial results. Businesses can prioritize their auditing procedures by acknowledging the benefits of external audits, which will ultimately result in increased stability and financial health. In addition to adding to the body of knowledge already available on financial performance, this study offers useful advice for businesses looking to maximize their auditing operations.

Keywords: External Audits, Financial Performance, Commercial Bank

INTRODUCTION

In global finance, external audits are essential for ensuring financial performance and accountability in commercial institutions. This importance is particularly pronounced in Afghanistan's Nangarhar province, where the financial sector is vital for economic growth. Afghanistan's strategic location has facilitated an economic revival post-conflict, with the financial sector serving as a cornerstone of recovery. Within Nangarhar, a vibrant commercial landscape has emerged, positioning banks as critical components of the economic infrastructure. The influence of external audits on these banks is significant, as they promote compliance with regulatory standards, improve financial reporting accuracy, and enhance investor confidence.

External audits, conducted by independent firms, validate the accuracy of financial statements and safeguard against fraud, ensuring adherence to accounting principles. However, Nangarhar's unique socio-economic and geopolitical context introduces challenges that may affect audit effectiveness. Therefore, it is crucial to investigate the specific obstacles local banks encounter, their responses to audit scrutiny, and the subsequent impacts on their financial health. Furthermore, the role of external audits transcends mere compliance; it also influences operational efficiency, risk management, and governance within banks. Understanding the effects of these audits on financial performance is essential for strengthening the resilience of Afghanistan's banking sector and promoting economic stability in Nangarhar. The American Accounting Association defines auditing as: an organized process based on objectivity and transparency, aimed to collecting evidence and evaluating economic events in order to verify whether they comply with the stipulated standards or not, and communicating the results to interested parties (Assia,2018:53). External audit is defined as "the main independent and impartial performance that aims to examine the financial statements. On the other hand, external audit in its developed, modern and comprehensive sense is nothing but a system that aims to give an objective opinion on reports, systems and procedures concerned with protecting the property of the entity subject to audit (Misbah,2016:21). External auditing is an organized examination by impartial technical personnel of books and documents and obtaining the necessary evidence and clues (Setif,2011:54), In order to express impartial and transparent technical opinions about the financial statements of the institution, and the extent of the efficiency of the responsible management in using the available resources in the institution correctly (Brahmi ,2019:84). It is also defined as "an organized process for collecting and objectively evaluating evidence related to the client's allegations regarding the results of economic events and actions, to determine the extent to which these allegations are in line with the specified criteria, and to communicate the results to the users of the financial statements, the stakeholders in the project (AlMasdar,2013). The quality of audit is one important component that affects the dependability of financial reporting. When making financial judgments about a company, stakeholders that depend on reliable financial reporting must take the audit's dependability into account. A system that makes sure financial reporting follows GAAP and IFRS standards and provides an accurate and impartial picture of a company's financial situation is known as audit quality (Khalil, 2022).

In order to help policymakers, banking regulators, and financial institutions develop successful strategies, this study intends to examine the connection between external audits and financial performance. This study fills in the gaps in the literature by offering empirical data on the impact of external audits on Nangarhar's commercial banks, strengthening the area's financial system. As of December 31, 2021, the study looked at how the caliber of auditors affected the trustworthiness of financial reporting from deposit money banks listed on the Nigerian Exchange Group (NGX). Haddad, (2022) study concluded that external audit quality significantly affect the financial performance of conventional banks while improved the financial performance of Islamic Banks with a moderated impact. Türegün (2022) posits that financial performance pertains to the evaluation of a company's financial condition using various approaches of financial analysis, hence providing insights into the company's operational effectiveness over a period of time. The selection of suitable ratios for evaluating financial performance is contingent upon the specific attributes of the entities under investigation and the objectives of the study (Le Thi Kim et al., 2021).

This study aims to analyze the relationship between external audits and financial performance, offering insights for policymakers, banking regulators, and financial institutions to formulate effective strategies. By addressing existing literature gaps, this research provides empirical evidence on the effects of external audits specific to Nangarhar's commercial banks, contributing to a more robust financial environment in the region.

LITERATURE REVIEW

External Audit

external audits play a critical role in promoting transparency, accountability, and financial reliability within commercial banks. By providing an independent and objective evaluation of financial statements, auditors help ensure that banks' financial reports are accurate, compliant with regulations, and free from material misstatements. Beyond confirming the accuracy of financial information, external audits contribute to the identification and mitigation of risks, strengthen internal controls, and support overall governance practices. These audits also foster investor confidence and facilitate regulatory compliance, further reinforcing the stability and trustworthiness of the banking sector. While not without limitations, external audits remain a vital tool for enhancing financial integrity and safeguarding the long-term health of financial institutions.

The aggregate likelihood of an independent auditor finding and revealing a material inaccuracy in a client's financial accounts is what DeAngelo (1981) refers to as audit quality. This concept states that an auditor's independence influences whether or not they will disclose an error, while their knowledge determines their capacity to spot one. Qualitative aspects of auditor independence include the auditor's ability to use professional skepticism and their ability to make objective decisions throughout the audit (Hooper, Fornelli, & Chipman, 2016). The scope of the audit team's knowledge, abilities, and conduct that enables them to carry out the audit tasks accurately is referred to as auditor competence.

The quality of audits is a crucial indicator of how well management oversight is working for commercial banks. A high-quality audit reduces the expectation gap by increasing public and stakeholder trust in financial statements (ACCA, 2015). Additionally, it lowers audit risk and the possibility that the audit company may provide a fraudulent audit opinion. The attention that regulatory bodies, audit firms, and other organizations provide to audit quality emphasizes how important it is (IAASB, 2015). The IAASB, for instance, has created a framework to promote discussion on the subject, urge stakeholders to look into ways to improve quality, and increase knowledge of important audit quality criteria. Furthermore, two quality control standards have been introduced by the Board: ISQC 1: To improve audit quality, consider IAS 220: Quality Control for an Audit of Financial Statements and Quality Control for Firms that Perform Audits and Reviews of Financial Statements and other Assurance and Related Services Engagements. Maintaining audit quality is the responsibility of the IAASB and other regulatory bodies, including the UK Financial Reporting Council. This improves public confidence in financial reporting and audit procedures.

Financial Performance

The degree of success or accomplishment of financial goals stated in monetary terms is referred to as financial performance. It entails using financial measures to assess a company's policies and operations (Wangithi, Njangiru, & Ngungu, 2016). An analysis of a company's performance during a specific time period, comparisons between several businesses in the same industry, or comparisons between several industries or sectors within an economy can all be included in this assessment. Financial statements are the main sources of information since they inform internal and external stakeholders about a company's financial performance (Brooks, 2013). These statements show the operational outcomes and shifts in a company's financial status over time, giving an overview of its financial health at a specific point in time (Dawkins, 2015). A thorough grasp of financial performance across time is created by combining the analysis of the various financial accounts, which aids in predicting future financial patterns.

External Audit and Financial Performance

External audits are essential for improving financial statements' credibility, correctness, and dependability, all of which have a favorable impact on financial performance. According to a number of studies, excellent external audits enhance financial reporting, increase investor trust, and promote improved corporate governance procedures. By guaranteeing adherence to legal requirements, lowering the possibility of false assertions, and facilitating easier access to money at reduced prices, these audits support financial stability. Although there is a typically favorable correlation between audit quality and financial performance, the research emphasizes how difficult it is to establish a clear causative relationship because of a number of contributing factors, such as industry-specific, contextual, and regulatory considerations. Furthermore, the effects of external audits might differ between industries and nations, and new research is looking into how technology can increase audit efficacy. External audits improve governance and transparency, but they have drawbacks, especially when it comes to identifying intricate fraud or financial irregularities. Future studies will probably concentrate on improving our comprehension of the complex interactions among audit quality, regulatory modifications, technological advancements, and financial success across a range of sectors and geographical areas.

Kwabena (2017) investigated the relationship between the financial performance of 65 firms listed on the Nairobi Securities Exchange and the caliber of internal audits. The study came to the conclusion that financial performance is significantly impacted by the quality of internal audits. The financial performance of these companies was positively impacted by a number of factors, including the independence, professional abilities, and quality of the audit procedures, as well as the support of senior management. Suraj (2017) investigated how internal audits affected Kenyan microfinance institutions' financial results. The results showed that 28.4% of these organizations' financial performance may be explained by the independence of internal audit. Ondieki (2013) interviewed 20 senior managers to examine the impact of internal audit on the financial performance of 20 of Kenya's 43 commercial banks. The study discovered a positive correlation between the banks' financial performance and internal audit standards, independence, professional competency, and internal controls. Matoke and Omwenga (2016) investigated the relationship between the financial performance of Kenyan listed parastatals and the quality of their audits. Munene, Njangiru, and Ngungu (2016) used a sample of 42 respondents to investigate the impact of auditing on the financial performance of a water and sanitation company in Kirinyaga County. Their research demonstrated the value of auditor independence in attaining financial success by confirming that it improved the company's financial performance. Farouk and Hassan (2014) conducted a global analysis of the correlation between audit quality and financial success in stock exchange-listed Nigerian cement companies. Their results demonstrated the relationship between audit quality and financial success, with greater auditor independence increasing the likelihood of higher profit margins. Sayyar et al. (2014) used a sample of 542 Malaysian listed businesses to investigate the impact of audit quality on financial performance. According to their findings, audit fees and return on assets were significantly correlated negatively, whereas audit firm rotation was positively correlated with return on assets but had no effect on firm value. In a case study of the Malaysian construction sector, Hua, Ila, and Isa (2016) examined the effects of financial reporting procedures and audit quality on the financial performance of businesses. Ani and Mohammed (2015) investigated how business performance in Oman's industrial, service, and financial sectors was impacted by the caliber of auditors. Using the size of the auditing company as a stand-in for audit quality, they examined the annual financial reports of 112 companies that were listed on the Muscat Securities Market between 2009 and 2013. According to their findings, the size of the audit company and the companies' financial and market performance were positively correlated. Internal audit has been the main focus of the majority of research on audit and financial performance conducted in Kenya, including studies by Kwabena (2017), Suraj (2017), and Ondieki (2013). Internal audit is essential for keeping an eye on management, but because it is naturally impacted by the management it is responsible for, it may not be able to give shareholders accurate financial reports. Many studies have been restricted by the use of limited proxies to quantify audit quality. For instance, Sayyar et al. (2014) employed two criteria (audit fees and auditor rotation), but Ani and Mohammed (2015) and Hua, Ila, and Isa (2016) relied on just one (audit firm size).

RESEARCH METHODOLOGY

Research design

Kothari (2004) describes research design as the planned structure for collecting and analyzing data relevant to the research goal while maintaining efficiency in terms of costs. It sets up the framework in which the study is conducted, detailing the approach for data gathering, measurement, and analysis. This research adopted a quantitative design, aiming to describe the features of particular individuals or groups within a population and then generalize these results to draw conclusions about the entire population (Selvam, 2017). Data were collected using a structured questionnaire to gather views and opinions from the selected study group.

Population

Skran (2008) defines population as the total set of relevant cases for the study, while Smith (2011) considers it as a collection of different populations. In this research, the target population consists of commercial banks operating in Nangarhar province, Afghanistan, identified by Nogucho (2004) as a service group or an event involving a group of individuals or families. The study aims to gather information from the management of these commercial banks in Nangarhar, with the accompanying table representing the study's population.

Sampling

Maginda and Mughanda (2003) explain sampling as the technique researchers use to select cases from which required data will be obtained. Kotri (2004) classifies objective sampling as a purposeful selection where the sample size per unit helps researchers save time and resources during data collection. This approach ensures that the selected participants have relevant knowledge to answer the research questions, focusing on their characteristics. The use of random sampling in this study is intended to produce unbiased results by concentrating on key subgroups and avoiding irrational or skewed selections, leading to more accurate outcomes.

In research, it is often not feasible to include the entire population, so sampling techniques are applied. Various methods, such as stratified, cluster, snowball, double, and random sampling, can be used, with random sampling selected here due to its reliability, efficiency, and ability to fairly represent the whole population. The study's sample size is represented by the distribution of 200 questionnaires among commercial bank employees. The sample size calculation is as follows:

$$=n_0/(1 + ((n_0 - 1) / N)) = 350 / (1 + ((250 - 1) / 366)) = 390 / 1.95 = 200$$

Data Collection

To collect data, the study employed a questionnaire-based approach, chosen for its ease of management, analysis, and cost-effectiveness. The structured questions included both open-ended and closed formats, allowing for accurate participant feedback while maintaining anonymity. Using a combination of question types helps capture diverse responses. In this study, a Likert scale questionnaire was distributed to employees of commercial banks to collect relevant data. The table provides further details about the sources of the questions and the number of items included.

Data Analysis

The impact of external audits on the financial performance of commercial banks in Afghanistan's Nangarhar province was investigated using a quantitative analytic methodology. The information was compiled and displayed in tables after being grouped into pertinent categories with common traits. The questionnaire was designed using a Likert-type scale. To investigate the connection between external audits and financial performance, the data was subjected to a basic linear regression analysis.

Validity and Reliability

Validity refers to the extent to which a measurement tool accurately reflects the concepts being studied (Babbie, 2013). As Selvam (2017) further explains, validity means confidence that the result accurately represents what it is intended to show and how closely it aligns with reality. Reliability refers to the consistency of the results obtained using a particular measurement tool, indicating that the findings can be replicated. A study is considered reliable when it produces consistent results under the same conditions, using the same population and methods (Selvam, 2017). To ensure the questionnaire measured the intended concepts correctly, it was reviewed by experts in the field before data collection. Any identified issues with the instrument or survey technique were addressed before proceeding with the research.

RESULTS

Descriptive Statistics

Table 1: Descriptive Statistics of the Study

Variables	N	Mean	Std. Dev	Max	Mini
1. External Audits	200	3.025	0.002	5	1
2. Financial Performance	200	2.874	0.015	5	1

Source: SPSS Output

Descriptive statistics provide a concise overview of data by presenting measures like the mean, maximum, minimum, and standard deviation. With a dataset consisting of 200 observations, the average of external audits stands 3.025, with a standard deviation of 0.002. The maximum recorded value within this domain reaches 5, while the minimum sits at 1. In the realm of administrative performance, the mean is reported as 2.874, with a standard deviation of 0.015. Here, the highest recorded performance peaks at 5, while the lowest is registered at 1.

Correlation Matrix

Table 2: Correlation Matrix

	Variables		1	2
1	Financial Performance	Pearson Correlation	1	
		Sig. (2-tailed)		
		N	200	
2	External Audits	Pearson Correlation	0.650	1

	Sig. (2-tailed)	0.003	
	N	200	200

Source: SPSS Output

Correlation represents the connection between two variables, indicating the strength and nature of their relationship. The correlation coefficient between external audits and financial performance stands at 65 percent, indicating a positive association. This suggests that an improvement in external audits positively influences financial performance, implying that enhancing the external audit that can significantly bolster the overall financial performance.

Model Summary

This research conducted a backward-looking examination to assess the extent of utilization of overall financial performance. The correlation between the models exhibited a low strength. The R-Square value serves as an indicator of variation in financial performance. It indicated the degree to which the independent variables presented in the study account for changes in the dependent variable. The specific R^2 value chosen for analysis was 0.422.

Table 3: Model Summary of the Study

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.650	0.422	0.416	0.254

Source: SPSS Output

Analysis of Variance (ANOVA)

Instead of depending only on the tool, an analysis of the disagreement was done beforehand to assess how well the model predicted events. The F ratio shows how much predicting accuracy has improved, producing a precise model. With a value of 930.22, the F ratio is significant ($p < .05$). This methodology significantly improves the capacity to assess how external audits affect financial performance. It's crucial to remember that the F statistic evaluates the model's overall validity; if the probability is less than the significance level, the general model is acceptable.

Table 4: Analysis of the Variance

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	587.25	1	587.25	930.22	0.023
	Residual	125.01	198	0.6313		
	Total	712.26	199			

Source: SPSS Output

Regression Result

Table 5: Regression Result of the Study

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
1	B	Std. Error	Beta		
(Constant)	0.652	0.032		20.37	0.001

Supply Chain Management	0.083	0.015	0.081	5.533	0.015

Source: SPSS Output

The influence of independent variables on the study's dependent variable is shown by the sophisticated analysis of regression results. At the five percent level, the computed coefficient for external audits is 0.083, indicating strong relevance. These favorable numbers imply that financial performance and external audits are directly positively correlated. Furthermore, this suggests that, assuming all other factors stay the same, the financial performance is expected to grow by 0.083 units for every unit increase in external audit.

DISCUSSION

The effect of external audits on the financial performance of commercial banks in Nangarhar, Afghanistan, is investigated in this study. The results provide theoretical and practical consequences by illuminating a number of important facets of the connection between external auditing procedures and financial results. According to the findings, external audits are essential for improving accountability and transparency in the banking industry. This is consistent with earlier studies that found audits lessen information asymmetry between stakeholders, such as shareholders and regulators, and bank management (Arens et al., 2017). By ensuring compliance with financial reporting standards, external audits can bolster investor confidence, which, in turn, positively influences the bank's financial stability and profitability. In the context of Nangarhar, external audits serve as a critical governance mechanism, especially given Afghanistan's evolving financial regulatory environment. Effective audits mitigate the risks associated with financial mismanagement, fraud, and inaccuracies in financial statements. As hypothesized, this study confirms that banks with regular and high-quality external audits exhibit better financial performance compared to those with less rigorous audit processes. The research highlights significant challenges commercial banks face in Nangarhar regarding audit compliance. These include limited access to qualified audit professionals and a lack of adherence to international auditing standards. These findings align with Shah et al. (2020), who observed similar constraints in other emerging markets. Strengthening regulatory oversight and providing training programs for auditors could address these gaps and enhance the overall quality of audits in the region. Another critical finding of this study is the relationship between external audits and operational efficiency. External audits not only ensure accurate financial reporting but also uncover inefficiencies in operations, enabling banks to optimize resource allocation. Prior studies have emphasized the role of audits in identifying cost inefficiencies and driving operational improvements (Simunic, 1980). In Nangarhar's banking sector, this effect is particularly pronounced given the nascent stage of corporate governance practices. This study has several implications for policymakers, regulators, and banking institutions. Policymakers should prioritize creating a robust regulatory framework that enforces mandatory audits for commercial banks, ensures auditor independence, and integrates international standards. Regulators should also consider conducting periodic reviews of audit practices to ensure compliance. For banking institutions, investing in high-quality external audits should be viewed not as a cost but as a strategic tool to enhance financial performance and stakeholder trust.

CONCLUSION

This study explores the relationship between external audits and financial performance. The study uses a straightforward linear regression analysis to determine how external audits and financial results are related. To represent the larger population, a sample size of 200 was chosen using a random sampling procedure. Questionnaires were distributed as part of the data gathering process, which was the main way to get opinions and ideas about how external audits affect financial performance. By using this thorough methodology, the study aims to identify connections and insights that are essential to comprehending the possible impacts of external audits on the financial domain. Descriptive statistics provide a concise overview of data by presenting measures like the mean, maximum, minimum, and standard deviation. With a dataset consisting of 200 observations, the average of external audits stands 3.025, with a standard deviation of 0.002. The maximum recorded value within this domain reaches 5, while the minimum sits at 1. In the realm of administrative performance, the mean is reported as 2.874, with a standard deviation of 0.015. Here, the highest recorded performance peaks at 5, while the lowest is registered at 1. The correlation coefficient between external audits and financial performance stands at 65 percent, indicating a positive association. This suggests that an improvement in external audits positively influences financial performance, implying that enhancing the external audit that can significantly bolster the overall financial performance. The correlation between the models exhibited a low strength. The R-Square value serves as an indicator of variation in financial performance. It indicated the degree to which the independent variables presented in the study account for changes in the dependent variable. The specific R2 value chosen for analysis was 0.422. The F ratio demonstrates the extent of enhancement in forecasting accuracy, resulting in a precise model. The F ratio, recorded at 930.22, holds significance ($p < .05$). This model notably enhances the capability to evaluate the influence of external audit on financial performance. It's important to note that the F statistic gauges the overall validity of the model, with the probability falling below the significance level, indicating the appropriateness of the general model.

The calculated coefficient for external audits stands at 0.083, signifying high significance at a 5 percent level. These positive values suggest a direct positive correlation between external audits and financial performance. Additionally, this implies that for every one-unit increase in external audit, the financial performance is projected to rise by 0.083 units, assuming all other variables remain constant.

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Conflict of Interest

Regarding this article's publication, the authors state that they have no conflicts of interest.

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