Internal Audit Function and Financial Management of Kenyan County Governments

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Abstract- Provision of efficient and effective modes of service delivery for firm operations rely on effective control mechanism for management of an institutions' finances. The financial system should comply with both local and international regulations regarding an institution's operational requirements. By and large, this specific examination tries to inspect the impacts of internal audit function on activities of Kenyan County Governments, zeroing in on their monetary area. The study examined how internal audit function affected the Kenyan county government financial management system. The study was grounded on stakeholder theory and adopted cross sectional descriptive research design and targeted all the 47 county governments of Kenya. The study used secondary data accessed from the Office of Controller of Budgets (OCOB), Office of the Auditor General (OAG) and Commission for Revenue Allocation (CRA). The data was quantitative and analyzed using descriptive, inferential analysis and diagnostic tests. The study established that internal audit function (β=.966, $p<0.05$) had significant effect on financial management among the 47 county governments in Kenya. The internal audit function through internal auditors and internal audit committee led to higher financial management in the counties. Thus, the study concluded that internal audit function is a significant driver of financial management. This study recommends that the executive leadership of the counties in Kenya should provide the right internal work environment and the internal auditors and the audit committee members of the all the counties in Kenya should work together to safeguard the public interest.

Index Terms*-* Internal audit function, internal auditors, internal audit committee, financial management

I. Introduction and Background of the Study

Worldwide, monetary scandals in corporate associations have set off response for tighter guideline and upgraded principles for bookkeeping and business management (Sarbanes–Oxley Act, 2016). The survey reported that according to the American financial scandal World.Com and Enron in the year 2002, where the financial backers lost more than $180 billion. This prompted the sanctioning of Corporate and Auditing Accountability and Responsibility Act (p. 33). These major monetary outrages were brought about by inferior internal control frameworks like feeble business administration that Sarbanes Oxley Act of 2002, attempted to address.

Corporate scandals have been witnessed in different parts of the world including in South Africa, with the occurrences of accounting outrages were noted in Randgold and Exploration institutions; In Nigeria, Cadbury Company dismissed its chief executive officer and financial officer for misappropriation of funds in 2016 and most Kenyan business institutions and government agencies record wanting results regarding financial administration. The survey by the Capital Market Authority (CMA) showed that most institutions recorded a decreased contribution to the Kenyan economy. At the same time, the unprecedented financial management strategies in most organizations, firms, public entities and business institutions have a negative impact on the general economy on Kenya.

According to reports from Capital Market Authority (2014) and the Auditor General's report (2016), the models incorporated by Kenya Airways found a deficiency of Ksh10 billion, Mumias Sugar organization had a deficiency of Kshs.3.4 billion; Uchumi incredible markets Ksh. 226 million, Eveready East Africa constrained Kshs. 248 million, while CMC keeping was suspended from NSE (p. 69). There is reduced financial management in several business institutions as documented in the CMA reports (2014). Nyakundi, Nyamita and Tinega (2014) document that financial revealing is incapable due to debasement, cheats, and insufficient suggestions that have brought on negative monetary management in many companies throughout Kenya. These surveys paint a bad picture and hence the need for internal controls that help in monetary revealing, viability and productivity of tasks and consistence with cloth legal guidelines and guidelines. Wang'ombe and Kibati (2016) argue that this is considering that no matter the presence of elaborate association of inward controls initiated in Kenyan region congregations, they hold on encountering economic problem which has compromised their patience in devolution administration conveyance.

Financial management, as shared by Kato, Akugizibwe, Bugambiro and Ntim (2019) covers aspects of cash handling and management activities. The activities work for economic wellbeing, in a stated timeframe and comparisons with similar corporates. Financial management covers the associations between activities undertaken and profits through elements such as Returns on Investments, Return on Assets, esteem expansion, exertions of products and other income generating activities for the business entity. The execution can be in monetary or non-monetary elements; with the monetary aspects including return on assets, returns on equity, returns on investment, returns on capital employed and sales growth.

Financial management in organizations can be attained through adoption of Committee of Sponsoring Organizations of the Treadway Commission, COSO (2013) framework. One of its key aspects is the internal audit function. Internal audit involves evaluating and evaluating internal controls and products that the various sectors of the institution are playing with their reduced capacity. In the audit, the internal audit will be evaluated on a case-by-case basis, for example, the audit and evaluation process, the site of fraud and control, financial information and waste disposal and failure.

Kenya has 47 devolved units of governance –the county governments and other independent bodies such as Commission on Revenue Allocation (CRA), Salaries and Remuneration Commission (SRC) and Office of the Controller of Budget (COB). Since 2013, the Kenyan County Governments have tenaciously being confronted with a major test because of affirmed, uncontrolled obligation and shortfall financing, high repetitive uses, helpless neighborhood income development, misappropriation of assets, incautious administration of monetary dangers and inappropriate political impedance on the budgetary cycle and monetary execution. The research considered if adoption of internal audit function will result in better financial management.

II. Statement of the Problem

The firms operating without an internal audit function are likely to face the dangers of collapse and disintegration. Some of the dangers the firm is likely to face the issue of erroneous fiscal summary and loss of resources for the firm; taking and fumble of the organization's indispensable records which might be used by a worker to exploit. Other problems include inaccurate and problematic monetary records, non-execution of accounting arrangements, low liquidity proportions, inauspicious monetary announcing, low responsibility, fakes, and blunder of assets.

Many of the county governments; since their inception in 2013 have reporting having budget deficiencies that have resulted in them not being able to adequately fund recurring and developmental costs within their jurisdiction. The above is illustrated by the inability of some devolved governments to clear costs incurred by different contractors and suppliers on time and who have to work on debt basis. At times, the county workers have gone without pay for months and even issued strikes in demand for the salaries and wages. This consequently has shown that absence of appropriate monetary administration has prompted the troubles that are being witnessed (Auditor General's Report, 2016). Thus, the study explored how internal audit function affects the financial management of Kenyan County Governments.

The study adopted null hypothesis and tested at significance level of 0.05

H_0: There is no impact of internal audit function on financial management of Kenyan County Governments.

III. Literature Review

Theoretical Review

Stakeholder Theory

Freeman remains the original proposer of stakeholder theory perhaps in 1994. Firstly, the above theory recognizes and modeled various players involved in the daily running of an organization. Basically, the theory hinges on the organization of business institutions and relating organization ethics involved in developing an ethical workplace scenario. Stakeholder theory builds on a traditional view that an organization thrives on the ownership of its shareholders or stockholders. As such, every activity of the organization focuses on elevating the premises of the above owners while prioritizing on their needs. Accordingly, Freeman (1984) believes that "other parties such as staffs, clients, supplies, government agents, associations and unions and local communities are part of the interested parties. Stakeholders may also include the competing agents as they affect the firm" (p.70). Stakeholder theory outlines the intricate of running a business institution thus seems suitable in the implementation of the current study.

The theory holds that "the success of any business is linked to creation of value to its stakeholders who include suppliers, staffs and customers and local communities" (Freeman, 1984, p. 89). The theory therefore unifies the functions involving the management of an organization into a single entity of protecting stakeholders' wealth. The interests of all the above stakeholders must resonate and rhyme in a manner to drive the whole organization in a single direction. Both the managerial and entrepreneurial roles should be merged into one entity for the overall success of a business institution. In the end, factors involving internal control function setup can be involved in the stakeholder theory to consider the effects of such variables in controlling stakeholders' desires.

Empirical Review

Researchers Ejoh and Ejom (2014) conducted an extensive study on the issues involving internal audit and overall performance of business firms in Malaysia. The study revealed the need for audit committee independence required to achieve an effective accounting experience. Also, the examination provided recommendations for more research activities centered on the different factors that influence internal audit and financial management of business institutions. Their examination has two future proposals. To start with, future investigations ought to analyze the job of the board and the collaboration between inner review quality and review panel freedom.

Moreover, Onyango (2014) utilized distinct examination configuration to decide the impact of internal audit work on the exhibition of Kenyan devolved authorities. The focus was on 47 devolved authorities in Kenya as the main population with chief governments' representatives working in the money division being utilized as the respondents. The investigation set up those county authorities did not execute inner reviews prescribed by the Auditor General to improve the executives of monetary assets. Furthermore, the investigation set up that the workers did not submit week after week reports and did not hold gatherings to examine the advancement of exercises.

Nwaobia, Ogundajo and Theogene (2016) published a work area/scientific survey configuration to lead an investigation on the interior audit activities involving monetary administrations of Rwanda and Nigeria: spanning the straightforwardness gap in open area monetary detailing. "The investigation revealed that the capacity for internal audit can improve straightforwardness in open financial administration and announcing self-rule as far as autonomy and exceptional with both human resources and significant infrastructural offices" (Nwaobia, *et al.*, 2016, p. 33). The scientists noticed that to achieve straightforward monetary administration and detailing in open workplaces, there ought to be exacting adherence to the countries' established structure as far as arrangement and show of budget summaries, accommodation and survey just as convenient report of the "Auditor General to the National Assembly's PAC".

Ndifon (2014) also did an extensive research on major practices involving internal control and their relationship with a firm's overall performance of higher learning institutions based in Nigeria. Having based the study at a tertiary institution at Cross River College, the researcher observed a link between inward monetary management and general set up in a business institution. The study also revealed that, there is distinction in terms of responsibilities between the employees in the financial department and their supervisors. However, the research showed no underlying relationship between existing internal control frameworks and general monetary operation for the institution under study. Also, the research revealed that the institution lacked necessary transactional control and monitoring systems required to alleviate theft of public property and any kind of fraud.
Ndiwa (2016) also carried out a study at "African Institute of Research and Development Studies (AIRDS)" where he examined the link between internal framework and overall institutional performance. The study focused at the population at the main campuses of AIRDS due to availability of required data at the institution. The researcher discovered that the above institutions experienced dwindling monetary management systems amidst large resources. Consequently, the institution closed several of its campuses. Further discoveries of the study included: there are significant similarities between internal control systems in relation to institutions' financial performance and overall performance.

Conceptual Framework

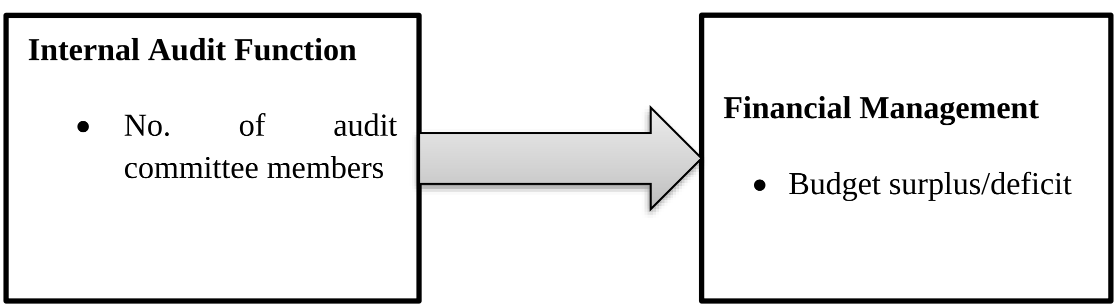

Figure 1: Conceptual Framework

IV. Research Methodology

The study used a cross-sectional research design and the target population was all the 47 Kenyan county governments. The study was based on secondary data that was sourced from financial statements for five years (2016-2020). The researcher extracted data from the Annual Budget Implementation Review Reports on its execution; recurrent and past financial performance estimates and absorption rates of financial resources by the county governments. The analysis was done as per the research objective and since the data was quantitative in nature, then it was documented and analyzed using SPSS. To test the correlation amid the study variables Y and X for dependent and independent respectively for the study; and multiple linear regression technique was adopted:

$$\mathbf{Y = \alpha + \beta_1 X_1 + \varepsilon,}$$

Where:
Y= Financial Management
X_1= Internal audit function
α = Constant
ε = Error term

V. Findings and Discussions

Descriptive Statistics

Table 1: Descriptive Statistics

	N	Min	Max	Mean	Std. Dev.
Financial Management	235	2.76	3.70	3.286	.197
Internal audit function	235	.48	.78	.665	.065

The findings in Table 1 reveal that financial management had minimum value of 2.76, maximum of 3.70 with mean of 3.286 and standard deviation of .197. This means that on average, the County governments had budget deficits/surplus of Kshs. 3.286 million. In terms of internal audit function, the value of average was given as .665, an indication that the county governments in Kenya had different members on the audit committees.

Diagnostic Tests

Multicollinearity Test

Table 2: Multicollinearity Test

	Collinearity Statistics	
	Tolerance	**VIF**
Internal audit function	.982	1.019
Mean	**.982**	**1.019**

This was conducted through VIF values that were computed and summarized. Table 2 gives the mean VIF value as 1.019 with the values ranging from 1-10. The results imply a lack of multicollinearity in the data set and thus the suitability of the data set in carrying out regression.

Normality Test

Table 3: Normality Test

	Shapiro-Wilk		
	Statistic	**Df**	**Sig.**
Financial Management	.919	3	.449
Internal audit function	.989	41	.954

The normality tests were conducted through the determination of Shapiro-Wilk test and findings showed that p-value was above 0.05 ($p > 0.05$) an indication that the data set was normally distributed and suitable for use in regression analysis.

Heteroskedasticity Test

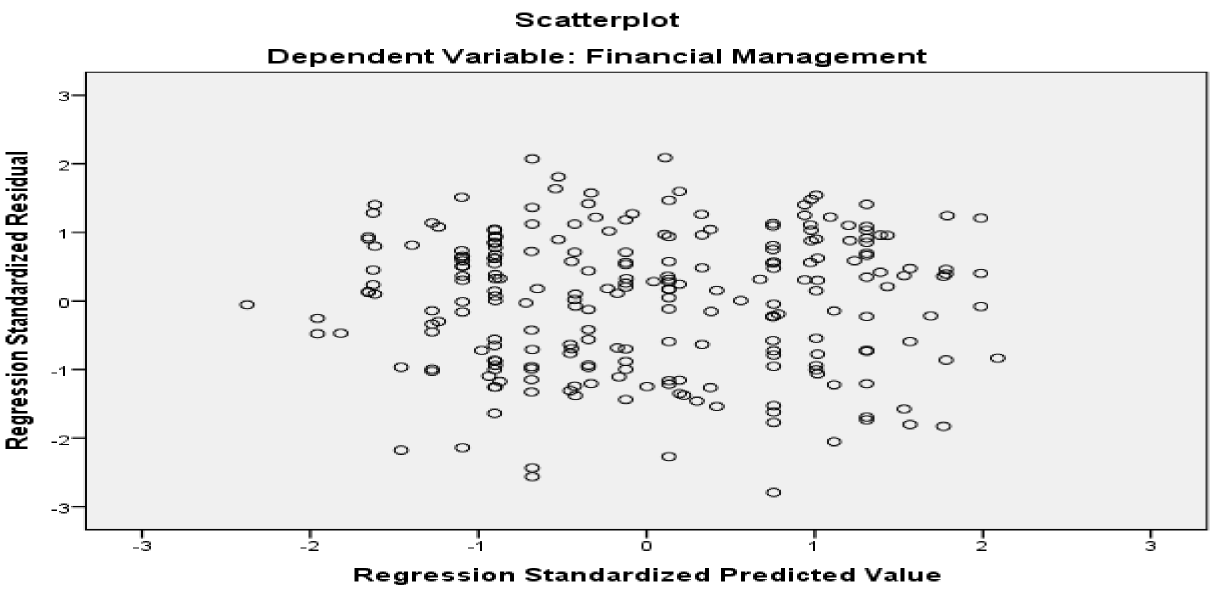

Figure 1: Heteroskedasticity Test

This was graphically determined through the scatter plot as summarized in this figure and the results noted a clearly established pattern as per the data points extracted. This is an indication of absence of Heteroskedasticity in the data which is a desirable condition.

Autocorrelation Test

Table 4: Autocorrelation Test

Model	Durbin-Watson
1	1.844

The presence of serial correlation in the data was determined through Durbin Watson statistic and Table 4 shows the results as 1.844, which is approximately 2 when rounded off. This is an indication of absence of serial correlation in the data and thus the suitability of the dataset towards regression analysis.

Inferential Statistics

The study conducted inferential statistics through analysis of correlation and regression to determine the relationship between the two variables.

Correlational Analysis

Table 5: Correlational Analysis

		Financial Management	Internal audit function
Financial Management	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	235	
Internal audit function	Pearson Correlation	.766	1
	Sig. (2-tailed)	.000	
	N	235	235

The findings in Table 5 indicate that internal audit function had positive and strong association with financial management.

This is based on these results where the r value was .766 and p-values at .000.

Regression Analysis

Table 6: Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	.802[a]	.643	.637	.11907

Table 6 in the study shows the correlational coefficient is 0.802 showing that the internal audit function has a strong and positive relationship with financial management of county governments in Kenya. The adjusted R Square (coefficient of determination) of 0.643 shows that 64.3% change in financial management of the 47 Kenyan counties can be traced to the elements of internal audit function. The results also indicate that 35.7% influence of financial management in counties is based on elements beyond the scope of this study.

Table 7: Variance Analysis

	Sum of Squares	**df**	**Mean Square**	**F**	**Sig.**
Regression	5.874	1	5.874	451.846	.000[b]
Residual	3.261	233	.013		
Total	**9.135**	**234**			

Table 7 shows the results from the ANOVA statistics as calculated at a 0.05 significance level. The $F_{Calculated}$ was 451.846 while the value of $F_{Critical}$ was 3.882. The model is fit and acceptable for use in the study since (451.846 > 3.882) and the p-values at 0.000 are less than the standard of 0.05 showing that internal audit function significantly impacted the financial management of the 47 County Governments in Kenya.

Table 9: Regression Analysis

	Unstandardized Coefficients		**Standardized Coefficients**		
	B	**Std. Error**	**Beta**	**t**	**Sig.**
(Constant)	2.021	.133		15.195	.000
Internal audit function	.966	.136	.651	7.103	.000

The resultant equation is:

$$\mathbf{Y = 2.021 + .966X_1}$$

Where Y = Financial Management, X_1 = Internal Audit Functions

On hypothesis H_0 there is no impact of internal audit work on monetary administration of Kenyan County Governments. Based on the regression results above, the variable internal audit functions (β = .966 and $p<0.05$) and indicated presence of a significant predictor of financial management. The researcher therefore discards the above hypothesis and writes that internal audit functions moderately and positively impact on the financial management of county governments in Kenya. Pimpong and Laryea (2016) echo the above findings by asserting that proper financial management depends on the elements of unbiased, free and dynamic audit committee, working internal audit department in the county, regular internal audit reports generated, county's internal auditing officers work diligently with high degrees of autonomy and void of management interference and the internal audit team provides relevant recommendations for implementation from management. Similarly, Simon and Muhamed (2017) observed that county governments with efforts to identify, eliminate and reduce wastages and inefficiencies, internal audit teams that provide relevant recommendations for implementation from management, internal audit department members that perform regular and in-depth auditing process and relegated duties regarding the ideal audit documents and goal involving any rebelliousness things as indicated in the above audit documentation perform well in terms of financial management.

VI. Conclusions

From regression results, the element on internal audit function significantly affects financial management in county government institutions. From the findings of regression analysis, the null hypothesis was rejected and alternative hypothesis was adopted where it was inferred that internal audit function significantly affects financial management among Counties in Kenya. The study thus concluded that internal audit function is an important factor that influences financial management of the counties in Kenya.

VII. Recommendations

As per regression analysis, internal audit function has a positive beta coefficient which was also significant. Hence, the study recommends that internal auditors and the audit committee members of the all the counties in Kenya should work together to safeguard the public interest. Further studies should be conducted to develop a framework and policy that guides the institutions' ability to determine value for money in county projects and associated compensation scheme. Similarly, a further research can cover how financial management systems affect county governments' income status, residents' poverty level and general living standards.

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