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The Examination of the Effectiveness of Internal Audit in County Government of Nakuru

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Abstract: *The new Kenyan constitution has created the two levels of government that is the national and the county government with a view of bringing more resources to the people on the ground. The new county governments have immense resources placed at their disposal in order to effectively deal with their constitutional mandate. In additional to the central government funding to the county governments, the county governments are mandated to collect revenues within the areas of their jurisdiction. There is therefore huge amounts of money that are at the control of the elected officials at the county government level. There is therefore need to ensure accountability from the government officials through advocating for value for money in the projects that are undertaken, adherence to the procurement laws, elimination of corruption and the enhancing of the county government's operational capacities. In this context, the county government officials are expected to maintain accurate and reliable accounting records for the purposes of auditing and future use. The need for internal audit within the county government is underscored by noted irregularities within the county government expenditure. There has been several noted cases of misuse of public funds in the county governments and the lack of adherence to laid down procedures in the utilization of the funds. There has been utilization for public funds without examining the value for public funds. Among the counties that have been mentioned to have misappropriation of public funds include Kirinyaga, Meru, Mombasa, Baringo, Homa Bay, Nyeri, Nairobi, Kajiado, Busia and Makueni counties amongst others. For example, in the 2013/2014 audit report for Nakuru County Government there were claims of irregularities in the utilization of county governments. This study examined the factors that influence the county government of Nakuru internal audit efficiency. The theoretical framework was based on the agency theory, shareholder's theory and the stewardship theory. The study utilized the descriptive research design. The information was collected using the structured questionnaires and analyzed through use of SPSS version 21. The study concluded that there was a significant statistical relationship between the independent variables and the dependent variables. The relationship between the organizational independence of the audit committee and the effectiveness of the internal audit was a positive relationship that was also significant .On the other hand, there was a significantly and strong positive correlation between professional efficiency of auditors and effectiveness of the internal audit. The relationship between management support to internal audit and effectiveness of the internal audit was statistically significant and positively correlated while the relationship between the size of the internal audit function and the effectiveness of the internal audit was statistically significant and positively correlated.*

.***Keywords:*** *Internal Audit, Organizational Independence, County Government*

I. Introduction

The need for internal audit within the county government is underscored by noted irregularities within the county government expenditure. There has been several noted cases of misuse of public funds in the county governments and the lack of adherence to laid down procedures in the utilization of the funds. There has been utilization for public funds without examining the value for public funds. Among the counties that have been mentioned to have misappropriation of public funds include Kirinyaga, Meru, Mombasa, Baringo, Homa Bay, Nyeri, Nairobi, Kajiado, Busia and Makueni counties amongst others. For example, in the 2013/2014 audit report for Nakuru County Government there were claims of irregularities in the utilization of county governments. Among the noted irregularities included payment of Ksh 28,999,926.34 to a construction company to refurbish county assembly offices which was paid before completion of work contrary to provisions of the public procurement and disposal act. The provisions of the act require the goods and services to be inspected by the Inspection and Acceptance Committee before payment. A further Ksh 1,861,200 was paid to a landscaping firm without a certificate of completion and before the completion of the work contrary to provisions of the public procurement and disposal act. The certificates of completions enable the county governments to confirm that the work has been undertaken within the required scope and there is value for money. Other noted issues included the payment for of Ksh 320,000 night out for members of the Nakuru County Assembly to attend a youth forum in which all the expenses had been catered for.

The wastefulness exhibited by the county government necessitates a critical need for an effective internal audit function. In this context, Alzeban & Sawan (2013) notes that the in the context of governance and control, increasing importance has been attached to the internal auditing function, and questions as to its effectiveness in discharging its responsibilities are being asked with greater frequency. Dawuda (2010) note that there are several reasons necessitating internal audit in government institution. There is need for the government officials to be held accountable for their use and stewardship of resources and the extent to which the public's objectives have been accomplished. The citizens on whose the money (through taxation) is being used may not have confidence with the information provided by the government officials and may need assurance from an independent function such as the internal audit function (Bediako-ahoto, 2011). This internal audit function introduces an element of credibility of the financial reporting, performance results, compliance, and other measures arises from the following factors inherent in the relationship between the government and its citizens (Hammad, Awan, Akhtar, & Imdadullah, 2012).This is due to the conflict of interests between the government officials and its citizens. The government officials may use their resources and authority to benefit their own interests rather than the citizen's interests due to several factors such as the complexity of running the government which the ordinary citizen may not appreciate (Othman, Othman, & Jusoff, 2009). The citizens in this context depended on the auditor to provide an independent, objective evaluation of the accuracy of the government officials' accounting and to report on whether the government officials, use the resources in accordance with the citizens' wishes (Ongeri, Okioga, & Okwena, 2005).

Several authors have conceptualized on what constitutes internal audit effectiveness. According to Roziani, (2011), there are several factors that constitute the internal audit effectiveness including the assurance that the management processes are adequate to identify and monitor significant risks and confirmation of the effective operation of the established internal control systems. Others include the credible processes for feedback on risks management and assurance, and the objective confirmation that the Board receives the right quality of assurance and information from management and this information is reliable (Ongeri et al., 2005). Murimi (2013) conceptualizes an internal audit to be effective if it adds value to the internal controls, governance, and risk management processes of an organization. In this context, the effectiveness of internal audit is how best internal audit accomplishes its objectives of adding value to an organization. On the other hand, Van Staden & Steyn, (2009) argues that the internal audit effectiveness is related with the quality of procedures, such as the level of compliance with audit standards or the ability to plan, execute and communicate audit findings as well as the ability to respond to auditees' needs. The internal audit effectiveness would therefore relate to the accomplishment of planned audits, issuing audit reports on time and carrying out follow up on audit recommendations to close the audits (Affum, 2011).Finally, Bediako-ahoto (2011) gives one of the most comprehensive conceptualization of the internal audit. In this context, Bediako-ahoto (2011) notes that the effectiveness of the internal audit is determined by the audit achieving the auditees' objectives and finds no problems, and no problems surface following the audit; or audits and finds problems, recommends solutions to the problems, and the solutions resolve the problems

The central and primary objective of the internal audit is to offer assistance to the management members to discharge their responsibilities effectively through furnishing them with analyses, appraisals, recommendations and pertinent comments concerning the activities reviewed (Tapiwa, 2013). There are four major benefits that the management gains from an effective internal audit function including the provision of a basis for judgement and action, exposing of the weaknesses in control and performance, recommending improvements, providing counsel to managers and boards of directors on the solutions of business problem's, and supplying information that is timely, reliable and useful to all levels of management (Nteziryayo, 2014). There are other functions that the internal audit should achieve the organization in achieving. The internal auditors should be in apposition to review and appraise the soundness and adequacy of the accounting, financial, and operating controls, and promote effective controls at reasonable costs (Van Staden & Steyn, 2009). The internal control function should also ascertain the extent of compliance with established policies, plans procedures, laws and regulations, which could have a significant impact on the company's operations (Ongeri et al., 2005). Sakalunda (2014) also note that the internal auditors also review the means of safeguarding assets and when appropriate, verify the existence of such assets and appraise the economy and efficiency with which resources are employed. Lastly, the internal auditors review operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned (Onyango, 2014). Reviewing and evaluating the adequacy and effectiveness of an organization's internal control system and the quality of performance in carrying out assigned responsibilities is representative of several primary core activities of internal audit work (Roziani, 2011).

Atuhire (2013) examines the effectiveness of the internal audit in the context of five dynamics; effective review of compliance, effective evaluation and examination of financial operations, effective financial audit, effective mitigation practices, and effective risk management practices. The compliance reviews are conducted to strictly test, adherence to laws, regulations, standards and policies and procedures with an aim of determining that an organization is adhering to a specified regulation and the results reported. On the other hand, evaluation and examination of the financial operations, means that the internal auditors are focusing on the accuracy of reported information through providing an attestation based on the Generally Accepted Auditing Standards (GAAS) and other internal audit frameworks. The effective financial audit is an appraisal activity established by management for the review of accounting and internal control systems as a service to the entity. Finally, the effective risk management practices ensures that the internal auditors play a major role in the entrenchment of the best practices at organizational levels and identify risks that may affect the organization's objectives.

Alzeban (2014) examined the effectiveness of the internal audit function within Saudi Arabia government. The study noted that there were factors that contributed to the perceived effectiveness of the internal audit function in Saudi Arabia including competence, independence, size of the function, the relationship between internal and external audit and the extent of management support for the internal audit function and also as to the role of management support for the internal audit function as a key driver of the effectiveness of the function. In the context of Malaysia, Hammad et al., (2012) the lack of qualified , skilled and experienced internal auditors greatly reduced the effectiveness of the internal audit function within the public sector in Malaysia. There were few internal auditors in the government with 10 years of experience.

The effectiveness of the internal audit function in Africa faces various challenges. In Ghana, Affum (2011) notes that the internal audit function is faced with challenges such as poor image, communication challenges, incompetent staff, and lack of independence from the management staff. In the context of the internal audit image, the internal auditors are often perceived as the enemies of the management as opposed to seeing the contribution that the internal audit function plays. On the other hand, Ogechi (2013) notes that the effectiveness of the internal audit function in Nigerian local government was curtailed by the lack of proper segregation and proper assignment of duties as well as shortage of qualified staff to carry internal audit and accounting duties. Other challenges included the lack of the implementation of routine audit reports by appropriate authorities and the inadequacy of the internal control systems.

In Kenya, Ongeri et al., (2005) studied the effectiveness of the internal audit function within the Kisii Local Government which established the function was not adequately discharging its mandates. On the other hand, Masika (2013) examined the effect of the risk based internal auditing on the effectiveness of the internal audit in regulatory state corporations in Kenya. The study concluded that the internal audit in RSCs in Kenya has strived and attained a good level of effectiveness. However, there were noted weaknesses in management support of the internal audit function, as well as the ability of the internal audit function to capture the needs of the management.

II. Literature Review

Theoretical Review

The theoretical framework was based on the agency theory, shareholder's theory and the stewardship theory. The agency theory was proposed by Ross and Barry (1973) and later developed by Jensen and Mecklings (1976) demonstrates the fundamental conflicts of interest between managers and owners of a firm. The theory examines the separation of the ownership of a firm, control and management motivation (Nteziryayo, 2014). The theory therefore examines the relationship between a business firm's owners and its managers who under the law are agents for the owners (Sakalunda, 2014). The agency theory argues that the principal who is the business owner passes the authority to an agent to conduct transactions and make decisions on the behalf of the principal with an effort to maximize the principal's utility preferences (Tapiwa, 2013).The agency relationship is described as a contract (implicit or explicit) in which one or more persons, the principal(s) engage another person, the agents, to take actions on their behalf and thus involves delegation of some decision making authority to the agent (Mawia, 2013). The agents musty have enough motivation and control mechanisms to always act in a manner that maximizes the profitability of the principal's business (Nyabenge, 2009). This theory is applicable in this context because the tax payer delegates their authority to the government officials with the view that the officials will use the given authority in accordance to the mandate given to them by the tax payers. The internal auditors thus play a critical role in assuring the tax payers that their funds are being prudently utilized.

The stakeholder's theory was originated by Freeman in 1984 and identifies and models the groups that are stakeholders of a corporation. The stakeholders are defined as all the interested parties for whom the firm's development and good health are of prime concern (Ranti, 2011). The stakeholders have also been defined as any group or individual that can affect or be affected by the realization of a company's objectives. The stakeholders are divided into the primary and secondary stakeholders. The primary stakeholders are those actors who entertain a direct and contractually determined relationship, as the name indicates, with the company and are sometimes called the contractual stakeholders (Kulundu, 2014).On the other hand, the secondary stakeholders are those actors who are impacted by a firm's actions without having any contractual connection to the firm.

The shareholder's theory indicates that the shareholders or stakeholders are the owners of the company, and the firm has a binding fiduciary duty to put their needs first, and to increase value for them (Mbuchi, 2013).The theory recognizes the importance of the shareholder or the stakeholder in the management of the firm. The effective organizations will seek to do what is important for its relationships with its key stakeholders. In this context, Kulundu (2014) argues that the stakeholder theory attempts to address the question of which groups of stakeholders deserve and require management's attention. The internal audit helps to raise issues in which requires the management's action from the operational aspect to the financial integrity of the systems (Atieno, 2013).

The stewardship theory in contrast to the agency theory argues that the firm's directors have interests that are consistent with those of the shareholders (Noah, 2013).In this context, Ngotho (2014) notes that the organizational role-holders are conceived as being motivated by a need to achieve and gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses. Ngenoh (2013) notes that managers carry their duty with a sense of duty. The stewardship perspective suggests that the attainment of organizational success also satisfies the personal needs of the steward (Gad, Shane, & Strong, 2010). The steward identifies greater utility accruing from satisfying organizational goals than through self- serving behaviour. Stewardship theory recognizes the importance of structures that empower the steward, offering maximum autonomy built upon trust (Oketch, 2013). This theory is applicable in this study in the context that the internal audit reports assists the management in making decisions that ultimately leads to the improvements of the shareholder's value.

Organizational Independence of the Audit Committee

The leadership of an organization plays a critical role in enhancing the effectiveness of the internal audit function (Baffour & Wittbom, 2009) . The leadership of the organization influences the effectiveness of the internal audit through impacting on its independence (Onyango, 2014). The independence of the internal auditor is examined within the context of freedom from conditions that threaten objectivity and appearance of objectivity (Tapiwa, 2013). The objectivity implies that the internal auditors are expected not to subordinate their judgment on audit matters to that of others, especially management (Kisoka, 2012).Therefore the internal auditor's independence means that internal auditors should not be placed in a position where their independence can be questioned and feel unable to make objective professional judgments (Beyanga, 2011). Ideally, internal auditors must be free to report matters they audit as they are and their reporting activities are not subject to any influences (Van Staden & Steyn, 2009).Hammad, Awan, Akhtar, & Imdadullah (2012) further notes that internal auditors should not develop and install procedures, prepare records or engage in any other activity, which they would normally review and appraise and which could reasonably be construed to compromise the independence of the internal auditor.

The independence of the internal auditor is critical in ensuring that the auditors carry an effective check. The leadership is also involved in the creation of the reporting structure of the internal auditors as well as the approval of the internal auditors budgets (Lenz, 2013). In the context of the reporting structure, the internal audit function should have direct access to the board and senior management by giving it the authority to access any records it deems fit, by allowing full access to all employees and departments, by placing strict conditions on the appointment and removal of the head of internal audit, and by not undertaking non-audit work (Madi, 2012). Ongeri, Okioga, & Okwena (2005) observe that the internal auditors are highly influenced by their reporting positions and hence a reporting structure that includes the senior management is inappropriate but rather the internal auditors should report to the audit committees. Jie (2013) further observe that where the internal auditors are subject to incentives-based compensation, which include reported earnings as one measure of performance, their objectivity and independence may well be hampered.

III. Objective of the Study

To examine the effect of organizational independence of the audit committee on internal audit effectiveness in Nakuru County Government

IV. Research Hypothesis

H_0: There is no significant relationship between organizational independence of the audit committee and the internal audit effectiveness of the Nakuru County Government

V. Methodology

The descriptive research design was used for the study. Descriptive research method is used when a researcher intends to describe a situation or a condition as it is. The target population for this study was internal auditors, and finance staff of the county government of Nakuru at different sub counties. The study used a total of 110 respondents drawn as 10 respondents per Sub County. This was in line with Cooper & Schindler (2003) who argued that a sample frame of more than 30 is sufficient to undertake the inferential statistics. This study had a sample size of 110 respondents necessitating distribution of 110 structured questionnaires to the potential respondents. However, not all the questionnaires were returned as only 97 questionnaires were returned making a response rate of 88.18%.This response rate is deemed sufficient using a minimum threshold of 80% as recommended by Mugenda (2003). A further 4 questionnaires were eliminated at the point of the data cleaning as they were incompletely filled.

VI. Findings And Discussions

In order to examine the effect of organizational independence of the audit committee on internal audit effectiveness in Nakuru County Government the following aspects were examined;

i. The reporting structure of the internal auditors does not present a conflict of interest with people they are meant to audit or areas of audit enquiry
ii. The internal auditors are able to produce audit reports without interference or pressure from external forces e.g. political considerations
iii. The internal auditors are not engaged in the preparation/development and installation of procedures, preparation of records or engagement in any other activity, which they would normally review and appraise
iv. The internal auditors are not subjected to incentives based compensation which may hamper their objectivity in audit report findings
v. The internal auditors are able to present their findings as they are without having undue bureaucracies in the organization

The likert scale of Strongly Agree (SA), Agree (A), Uncertain (U), Disagree (D), and Strongly Disagree (SD) was used.

The organizational independence of the audit committee was examined using lack of conflict of interest as a result of reporting structure of internal auditors, preparation of audit reports without external forces pressure, internal auditors not involved in review of processes and procedures they normally develop, internal auditors are not subject to incentive based compensation, and internal auditors are able to present findings without undue bureaucracies in the organization. The likert scale descriptors Strongly Disagree (SD), Disagree (D), Uncertain (U), Agree (A) and Strongly Agree (SA) were used. The lack of conflict of interest as a result of reporting structure of internal auditors results were 2.2% (SA), 20.4% (A), 26.9%(U), 33.3% (D), and 17.2% (SD). On the other hand, the results for preparation of audit reports without external forces pressure were 1.1% (SA), 20.4% (A), 26.9% (U), 33.3% (D),and 18.3% (SD).On the other hand, the results for internal auditors not involved in review of processes and procedures they normally develop were 2.2% (SA), 20.4% (A), 16.9% (U), 33.3% (D), and 17.2% (SD). The results for internal auditors are not subject to incentive based compensation were 3.2% (SA), 19.4 % (A), 25.8% (U), 34.4% (D), and 17.2% (SD). Finally, the results for internal auditors are able to present findings without undue bureaucracies in the organization were 0.0% (SA), 18.3% (A), 26.9% (U), 34.4%(D) and 20.4% (SD).

Table 1: Frequency Distributions on Organizational Independence

	SA	A	U	D	SD	TOTAL
The reporting structure of the internal auditors does not present a conflict of interest with people they are meant to audit or areas of audit enquiry	2.2%	20.4%	26.9%	33.3%	17.2%	
The internal auditors are able to produce audit reports without interference or pressure from external forces e.g. political considerations	1.1%	20.4%	26.9%	33.3%	18.3%	
The internal auditors are not engaged in the preparation/development and installation of procedures, preparation of records or engagement in any other activity, which they would normally review and appraise	2.2%	20.4%	16.9%	33.3%	17.2%	
The internal auditors are not subjected to incentives based compensation which may hamper their objectivity in audit report findings	3.2%	19.4%	25.8%	34.4%	17.2%	
The internal auditors are able to present their findings as they are without having undue bureaucracies in the organization	0.0%	18.3%	26.9%	34.4%	20.4%	

Table 4.7 shows the means and standard deviations of the organizational independence of the audit committee. The results indicated that in respect to three of the metrics of the study the respondents on average tended to disagree with the given metrics. These metrics included the internal auditors being not engaged in the preparation/development and installation of procedures, preparation of records or engagement in any other activity, which they would normally review and appraise with a mean of 2.0699. Others included the internal auditors being not subjected to incentives based compensation which may hamper their objectivity in audit report findings and the internal auditors being able to present their findings as they are without having undue bureaucracies in the organization with means of 2.4699 and 2.4301 respectively.

Table 2; Descriptive Statistics on Organizational Independence of Audit Committee

	N	Mean	Std. Dev
The reporting structure of the internal auditors does not present a conflict of interest with people they are meant to audit or areas of audit enquiry	93	2.5600	1.06728
The internal auditors are able to produce audit reports without interference or pressure from external forces e.g. political considerations	93	2.5269	1.04872
The internal auditors are not engaged in the preparation/development and installation of procedures, preparation of records or engagement in any other activity, which they would normally review and appraise	93	2.0699	1.06728
The internal auditors are not subjected to incentives based compensation which may hamper their objectivity in audit report findings	93	2.4699	1.08746
The internal auditors are able to present their findings as they are without having undue bureaucracies in the organization	93	2.4301	1.01508
Valid N (listwise)			

Source: Field Work

On the other hand, two of the metrics had the respondents tending to be uncertain with the measured metrics. These metrics included the reporting structure of the internal auditors not presenting a conflict of interest with people they are meant to audit or areas of audit enquiry, and the internal auditors being able to produce audit reports without interference or pressure from external forces e.g. political considerations with means of 2.5600 and 2.5269 respectively. There was a noted lack of consensus amongst the respondents as indicated by the standard deviation of above 1.000.

VII. Conclusion

The objective of the hypothesis testing was to check on whether there were significant statistical relationship between the independent variable and the dependent variable.

H_0: There is no significant relationship between organizational independence of the audit committee and the internal audit effectiveness of the Nakuru County Government

The relationship between the organizational independence of the audit committee and the effectiveness of the internal audit was a positive relationship that was also significant due to the results $r=0.871$, $p<0.05$. This led to the rejection of H_0.

Table 3; Hypothesis testing

Organizational Independence of Audit Committee		**Effectiveness of Internal Audit**
	Pearson Correlation	.871**
	Sig. (2-tailed)	.000

**. Correlation is significant at the 0.01 level (2-tailed).

VIII. Recommendations

The study recommends that the county government should place an emphasis on the organizational independence of audit committee in order to have an effective internal audit.

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