

**EFFECT OF INTERNAL AUDIT PRACTICES ON FINANCIAL
PERFORMANCE IN KENYA:
A CASE OF VIHIGA COUNTY GOVERNMENT**

BY

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DECLARATION

This research project is my original work and has not been presented for any award in any other university.

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DEDICATION

This work is dedicated to my father Daudi Ehaji Muhadi, the pillar of my hard work and vision in life, a father who embraced education and an icon in changing the young people's lives through dedication and love for Counselling, guidance and impacting knowledge, and to my wife Gladys for her continuous encouragement and support during the study.

ABSTRACT

Financial performance of County governments in Kenya has been rated to be below average, as is evidenced in the 2017/2018 Auditor General's report, on County governments' performance. Available information attests to the fact that Audit practices are an inherent function of the operations of all government activities. Audit provides unbiased, objective assessments of responsible and effective public resources management in an effort to achieve intended results, through accountability and integrity, improved operations, and instilling confidence among citizens and stakeholders. Public sector audit not only supports the governance responsibilities of oversight, insight, and foresight, but generally lends to increased performance measurements. Below average performance despite existence of audit functions is therefore an understatement.

The Purpose of this study is therefore to investigate the effect of internal audit Practices on financial performance of County governments in Kenya, with specific interest on Vihiga County Government. The study focused on Vihiga county because from the Summary of the report of the Auditor General on financial statements for county governments for the year 2017/2018, Vihiga County executive and the County assembly had had qualified and disclaimer opinions respectively, the county had total pending bills of ksh.1, 881,292,987 and 73 systemic issues affecting them. The specific objectives of the study were to establish the association between risk management practices and financial performance, the contribution of internal environment practices to financial performance; and analyse effect of monitoring and control practices on financial performance. The study was guided by stewardship and Agency theories; where stewardship explains that the executives and managers of an entity work to protect and make profits for the stakeholder and agency explain principal-agent's relationship. The Cross –sectional correlation design was applied because it has capacity to determine effect, and coefficient contribution of factors on single or aggregate dependent variables. The study targeted population 100 people consisting of Heads of departments, Directors, Chief Officers, Accountants, Internal auditors and Procurement Officers of Vihiga County government. The study employed Krejcie& Morgan (1970) table to determine a sample size of 80 respondents. The study used primary data collected using structured questionnaires. The SPSS version 20 was used in the statistical analysis. Reliability of data collection was realised through consistency measure known as Cronbach's alpha ($\alpha=0.767$). Data validity was achieved through liaison of research expert who validated the research tools. The collected data was analysed using correlation, regression, Descriptive Statistics, inferential statistic e.g. ANOVA, the results showed that internal audit practices affect financial performance significantly, evidenced by F-statistics of + 0.679 and therefore the null hypothesis (H_0) that there is no significant relationship between internal audit practices and finance performance is rejected at 0.05 (5 %) level of significance. The study has potential to researchers to understand why organizations perform poorly, despite internal audit practices in place; students and academicians may use this study as a basis of discussions on corporate governance practices and how these affect performance

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LIST OF ACCRONYMS AND ABBREVIATIONS

ANOVA:	Analysis of Variance
CAE:	Chief Audit Executive
IAD:	Internal Audit Department
ICPAK:	Institute of Certified Public Accountants of Kenya
IIA:	Institute of Internal Auditors
IT:	Information Technology
NSE:	Nairobi Securities Exchange
OECD:	Organization for Economic Cooperation and Development
PFM:	Public Financial Management
RBA:	Retirement Benefits Authority
SEC:	Security Exchange Commission
SOEs:	State Owned Enterprises
SOX:	Sarbanes-Oxley
SPSS:	Statistical Package for Social Science
UK:	United Kingdom

OPERATIONAL DEFINITION OF TERMS

Audit Practices: Are activities and processes that are carried out to successfully meet stakeholder expectations and drive exceptional business performance in their organizations.

Best practices: Commercial or professional procedures that are accepted or prescribed as being correct or most effective, „oxford dictionary (Barrier, 2003).

Business entity: A person, partnership, organization or business that has a legal and separate identity with specific purpose“ (Limited Liability Partnership Act, 2012)

Compliance: Conforming to a rule, such as a specification, policy, standard or law (Jackson, 2000).

Corporate governance: Most often viewed as both relationships which determine the structure and corporate direction and performance (Gatamah, 2008).

Internal audit: Refers to independent consulting activity and objective assurance structured to improve and add value to an organization operational performance (Pitt, 2014).

Internal Control: Internal controls are the mechanisms, rules, and procedures implemented by a company to ensure the integrity of financial and accounting information, promote accountability and prevent fraud.

Internal environment: Is the foundation on which an effective system of internal control is build and operated in an organization that strives to achieve strategic objectives, provide reliable financial reporting to internal and external stakeholders, operate its business efficiently and effectively, comply with all applicable laws and regulations and safeguard its assets.

Monitoring & control activities: Is a process of assessing risks linked to achieving operational objectives.

Risk Management Practices: These are processes and activities constantly carried out to assess risks and determine steps to be carried out to try to prevent these risks from negatively affecting an entity

Qualified Opinion -Where financial transactions recorded are to a large extent in agreement with the underlying records, except for cases where material misstatements or omissions in the financial statements are noted. The issues though material, are not widespread or persistent.

Disclaimer of Opinion -Where financial statements exhibit serious and significant misstatements that may arise from inadequate information, limitation of scope, inadequacy or lack of proper records such that an auditor is not able to form an opinion on the financial operations.

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Local government is a government at the grassroots level of administration, meant for meeting peculiar grassroots need of the people (Agagu, 1997). Lawal (2000) defines local government as that tier of government closest to the people, which is vested with certain powers to exercise control over the affairs of the people in its domain. Local government as a system of public administration at a local level, charged with the responsibility of bringing the people at the grassroots closer to the government. He however, regretted that a critical survey of local governments in Nigeria today shows at most the same scene; that is, they are living in the shadow of the federal government that have resulted to the abysmal failure of the system (Usman, 2010).

Local government is a politico-administrative arrangement which entails the devolution of authority to plan, make decisions and manage public functions from the central government to subordinate organizations, agencies or units of government, either geographically or structurally ((Anyanwu 1999) Emezi (1984) on the other hand perceived local government as “system of local administration under local communities that are organized to maintain law and order, provide some limited range of social amenities, and encourage cooperation and participation of inhabitants towards the improvement of their conditions of living. It provides the community with formal organizational framework which enables them to conduct their affairs effectively for the general good. Local government is one of man’s oldest institutions. The earliest form of local government existed in the form of clan and village meetings. In fact, democracy itself originated and developed along the lines of local government initiatives in the ancient Greek city states (Agbakoba & Ogbonna, 2004). Globally, devolution became a major political issue in the United Kingdom in the beginning of the early 1970s (Charles, 2012). Many people in Scotland and Wales began demanding greater control over their own affairs, a trend reflected in a rise in support for the Scottish National Party (SNP) and Plaid Cymru (Party of Wales). In 1979 the Labor Party government, supported by the SNP and Plaid Cymru as well as the Liberal Party, held referenda that would have devolved power, but they were

rejected by voters in both Wales and Scotland. It is notable that the majority of voters in Scotland actually favored devolution.

Due to the requirement that such projects should exceed the two-fifths of the electorate for passage, it was not passed into law. The project was however passed during the 1980s and 90s, arising from increased support for devolution in both countries. France and the United Kingdom for instance serve as notable instances where devolution was applied in the late 1990s. This was despite of the fact that France was one of the most centralized states in the world (Jackson, 2013). Back then, the public at all levels had to solely rely on the central government based in Paris, the capital city, to give approval for all major decisions made by the regions, departments, and communes. This encompassed any major decision touching the populace in any major way. However, the size and responsibility of the national government grew making it necessary to devolve power.

In Africa, Burugu (2010) avers that governance systems employed by many developing countries have borrowed heavily from their colonizers. This may implicate that their style of devolution may not be compatible with the situation on the ground due to socio-cultural, political and economic sub-systems in the local states. Kauzya (2007) asserts that in terms of Public administration, historically African countries have experienced fused, personalized and at best highly centralized governance systems and practices. According to Korir (2013), devolution is one among several forms of decentralization, which is a characteristic of all governments globally. Vertical decentralization offers a vote, while horizontal decentralization, and offers a voice (Kauzya, 2007). This therefore implies the how and why governments decentralize are key considerations significant for the choice between alternative modes of decentralization. A study of decentralization in 30 African countries established that no country preferred the model of centralization. The study further posted that decentralization was not considered undesirable rather it was found to be difficult to effect and sustain (Ndegwa, 2012).

In Kenya, Ndulo (2013), states that the first phase of devolution involved the *Majimbo* system immediately after independence, the local authorities system, the Constituency development fund and the current County government system. The Constitution of Kenya ,2010 spells out the objects of devolution as; to promote democratic and accountable exercise of power; to foster national unity by recognizing

diversity; to give powers of self-governance to the people and enhance the participation of the people in the exercise of the powers of the state and in making decisions affecting them; to recognize the right of communities to manage their own affairs and to further their development; to protect and promote the interests and rights of minorities and marginalized communities; to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya; to ensure equitable sharing of national and local resources throughout Kenya ; to facilitate the decentralization of State organs, their functions and services, from the capital of Kenya; and to enhance checks and balances and the separation of powers. Principles of devolved government shall be based on democratic principles and the Separation of powers; County governments shall have reliable sources of revenue to enable them to govern and deliver services effectively; and no more than two-thirds of the members of representative bodies in each county government shall be of the same gender.

The Constitution of Kenya (2010, Article 189) spells out the relationship between the County government and Central government. It indicates that Government at either level shall—(a) perform its functions, and exercise its powers, in a manner that respects the functional and institutional integrity of government at the other level, and respects the constitutional status and institutions of government at the other level and, in the case of county government, within the county level;(b) assist, support and consult and, as appropriate, implement the legislation of the other level of government; and(c) liaise with government at the other level for the purpose of exchanging information, coordinating policies and administration and enhancing capacity. Government at each level, and different governments at the county level, shall co-operate in the performance of functions and exercise of powers and, for that purpose, may set up joint committees and joint authorities. In any dispute between governments, the governments shall make every reasonable effort to settle the dispute, including by means of procedures provided under national legislation. National legislation shall provide procedures for settling intergovernmental disputes by alternative dispute resolution mechanisms, including negotiation, mediation and arbitration. The Kenyan Constitution (2010, Article 190) gives the Parliament powers to legislate and ensure that county governments have adequate support to enable them

to perform their functions. County governments are required to operate financial management systems that comply with any requirements prescribed by national legislation. It is evident that County governments employ audit practices as part of their control function to improve resource application and productivity.

The Kenya Gazette notice number 2690 (15th April 2016), The Public Finance Management Regulations 2015, spells out clearly the Audit committee guidelines for County governments. The PFM regulation (2015) requires that each public entity establish an Audit committee. The Audit Committee form a key element in the governance process by providing and independent expert assessment of the activities of top management, the quality of management, financial reporting, financial management and internal audit, to the board or executive management.

Despite of favorable attributes of audit practice to institutional performance, Counties inclusive of Vihiga County has continued to present or demonstrate poor performance as reflected by Transparency International-Kenya status report of 2016 on the Kenya County governance where it was found that forty percent of citizens agreed that there was increased corruption/ fund embezzlement while third of MCAs noted that there was misuse of funds and poor implementation of projects. Forty per cent of Speakers/Clerks also noted that corruption had increased and there was lack of proper accountability. A quarter of the executive felt that the national government was not releasing devolved functions fully.

According to a summary of financial performance report of the Auditor-General for the county governments in Kenya for the financial year 2017/2018, the auditor revealed the following issues relating to governance and compliance in the County Assemblies; Management override of internal controls; Inadequate checks and balances, lack of Audit Committees and absence of internal audit departments were noted in 24 County Assemblies; Lack of approved ICT policies and inadequate governance structures to strengthen IT controls; Lack of compliance with procurement practices and processes as laid down in the Public Procurement and Asset Disposal Act, 2015 and irregular payments to County Assembly Members for meetings that were doubtful, not held at all, or were held outside the precincts of the Assembly.

Following the promulgation of the new constitution and the establishment of county governments, expectations of Kenyans have been raised. Kenyans now look upon development projects delivered by county government the hope from historically skewed development. Service delivery at county governments is hoped to address the inefficiency in public service. Consequently, Kenyans everywhere more than ever before, expect their county governments to design and implement high impact development projects that have the capacity to make a real difference in their lives, since development projects have become the principal means through which public services are being delivered in the counties. As a result, county governments must design and implement projects that not only make a difference in the lives of their county residents, but must execute development projects and interventions that deliver public value (Kayonde et al., 2013). Prior to the new constitution in Kenya, development projects were perceived as favours from political godfathers. However, there has been a paradigm shift occasioned by the new constitution. Actually, the spirit of devolution has so excitingly infected the nation to the extent that Kenyans now see development projects as a right. Kenyans irrespective of their levels of education, have become increasing aware that development projects are not favours brought to them by some benevolent county leaders, but are their constitutional rights. This has put to task the role of county governments to implement development projects (Waweru, 2015).

While devolution has had its pros, Kenyans have also witnessed its shortcomings. Kenya has forty seven (47) County Governments and since their establishment they have faced numerous administrative, financial accountability challenges ranging from poor services delivery and non- accountability of the taxpayers' money. The Office of the Auditor General has occasionally qualified financial accountability of over 40 county Governments. It is expensive in the sense that, the introduction of more seats (67 senators, 47 governors and 2,526 members of assemblies) means that the taxpayer is at a loss since the wage budget has increased significantly. There is non-uniform development whereby some counties such as Nairobi, Nakuru, and Mombasa, already had a head start development wise. These counties have better infrastructure and public utilities as well as opportunities for employment and investment. It will take extra efforts and some years for other counties to catch up. There is duplication of roles where, more people are doing the same job, hence, the chances of misusing

powers and wasting resources are higher. Some county governments have been in the spotlight for misappropriating funds while most counties cannot account for the money allocated. Kenyans have been spectators in the pull-and-push between the National and county governments regarding the mandates of both and allocation of resources. Sometime back, the Council of Governors pointed an accusing finger at the state for derailing the transition process. As the two lock horns, service delivery at county level becomes affected. When the counties took over health docket, there has been a go-slow in the services offered and strikes lasting months. The hiring process of county executives and other officials is questionable. Some county governments seem to be rewarding allies, rather than appointing professionals to get the job done. Lack of resources and capacity for efficient service delivery is another challenge; the county governments have a problem in the management of current resources. As it is, salaries and wages account for a significant portion of the county budgets, therefore, compromising other development efforts. We also have fiscal Challenges; while the National and county legislature oversees the budgeting process, the National Treasury still has a lot of power and control over the fiscal policy. The county governments have not yet come up with systems or measures to handle county treasury operations. The 15% of National revenue allocated to counties may not be enough to enable them to discharge all their duties. While some counties such as Nairobi and Kiambu collect a lot of revenues, the resources are still not enough for efficient service delivery. However, the counties need to be more accountable before they receive extra funding from the government. Kenyans look to county governments to drive the desired change in the country. In light of these, the Kenyan Government has come up with strategies like formation of Audit Committees at County Government levels and at National level , the enactment of Public Finance Management Act, 2012, Public Audit Act, 2015, County Governments Act,2012 so as to oversight on issues of accountability.

1.2 Statement of the Problem

Recent corporate bookkeeping embarrassments and the resultant objection for straightforwardness and genuineness in reporting have offered ascend to two divergent yet sensible results. These call for investigation on the effect of internal

audit practices on organization financial performance. Internal auditing abilities have ended up critical in unwinding the convoluted bookkeeping moves that have muddled budgetary articulations. Studies conducted show that there is collateral effect of financial management practices on financial performance of county governments , there exist a relationship between internal controls and financial performance of county governments in Kenya and efficiency of internal control system in Parastatals in Kenya affect financial performance. However, the reviewed studies did not focus on how the general internal audit function relates to the financial performance of county governments in Kenya. Besides, the findings of these studies did not focus specifically on the connection among internal audit and financial performance of county governments in Kenya. Previous studies that have been carried out focused in different sectors and were carried out in different environments. It is for this reason that the current study will determine the effects of internal audit practices on the financial performance of Vihiga County government. The research question is: What is the effect of internal audit practices on the financial performance of Vihiga County government?

1.3 Objective of the Study

The general objective of the study is to determine the effect of internal audit practices on the financial performance of Vihiga County Government. The following are the specific research objectives;

- i. To establish the association between risk management audit practices and financial performance factors of Vihiga County government.
- ii. To determine the contribution of internal environment audit practices on financial performance for Vihiga County government.
- iii. To analyse the effect of monitoring and control audit practices on financial performance of Vihiga County government.

1.4 Research hypotheses

H01 There is no significant association between Risk management Audit activities and financial Performance.

H02 Internal environment audit practices do not have significant effect on financial performance.

H03 Monitoring and Control activities do not have significant effect on financial performance

1.5 Significance of the Study

The results and recommendations of the study may help the policy makers in decision making and enable them put in place policies guiding operation of the County Governments. The management in National Government and the Judiciary may also understand the anomalies in their operations. This study may help in enhancing the role of internal audit in management of staff to make them more successful and expedient. It may help the shareholders welcome the role of the internal audit as a standout amongst the most essential administrative control frameworks in an organization required to shield their interests.

The County Governments in Kenya may have the capacity to identify for methods of making Internal Audit a totally independent function from the management alongside making it more successful. By executing suggestions given on the internal audit reports, administration may have the capacity to upgrade execution of County Governments in Kenya. The findings may help the government in particular to learn a lot about accountability, efficiency and effectiveness of service delivery. For researchers it may help them acknowledge and upgrade their insight into deeper review to hold fast the expert morals as required by the International Accounting Standards. The finding may also help researchers understand why organizations perform poorly, despite internal controls in place. The students and academicians would use this study as a basis for discussions on the corporate governance practices and how these affect performances.

Internal auditing assumes a basic part in the administration and operation of an association. At the point when it's viably executed and worked, it is considered as a vital component in helping an association accomplish its goals. Associations that adequately utilize inside evaluation can recognize business dangers, process and framework wasteful aspects and make fitting remedial move and at last foster ceaseless change. As such most of the organizations have considered as a monitoring function, organizational policeman and watchdog. Internal audit function has helped keep bad things from happening, assure good things can happen and help management understand where their risks are, whether the risks are under control and whether the risks are worth taking. It is against this background that the current study

aims to investigate effect of internal audit practices on the performance of County Governments with focus to Vihiga County Government.

1.6 Scope of the Study

The research sought to determine the effectiveness of internal audit practices on the financial performance of Vihiga County government. The study targets the top management in the audit and accounting departments of the County Government of Vihiga. The study has been designed to cover the period from the year 2018-2019 (i.e. the period for two years).

1.7 Conceptual Framework

.Figure 1.1 represents the research structure of internal audit practices as the independent variables and their interplay with financial performance as the dependent variable. The frame shows how county governments internal audit practices affect financial performance.

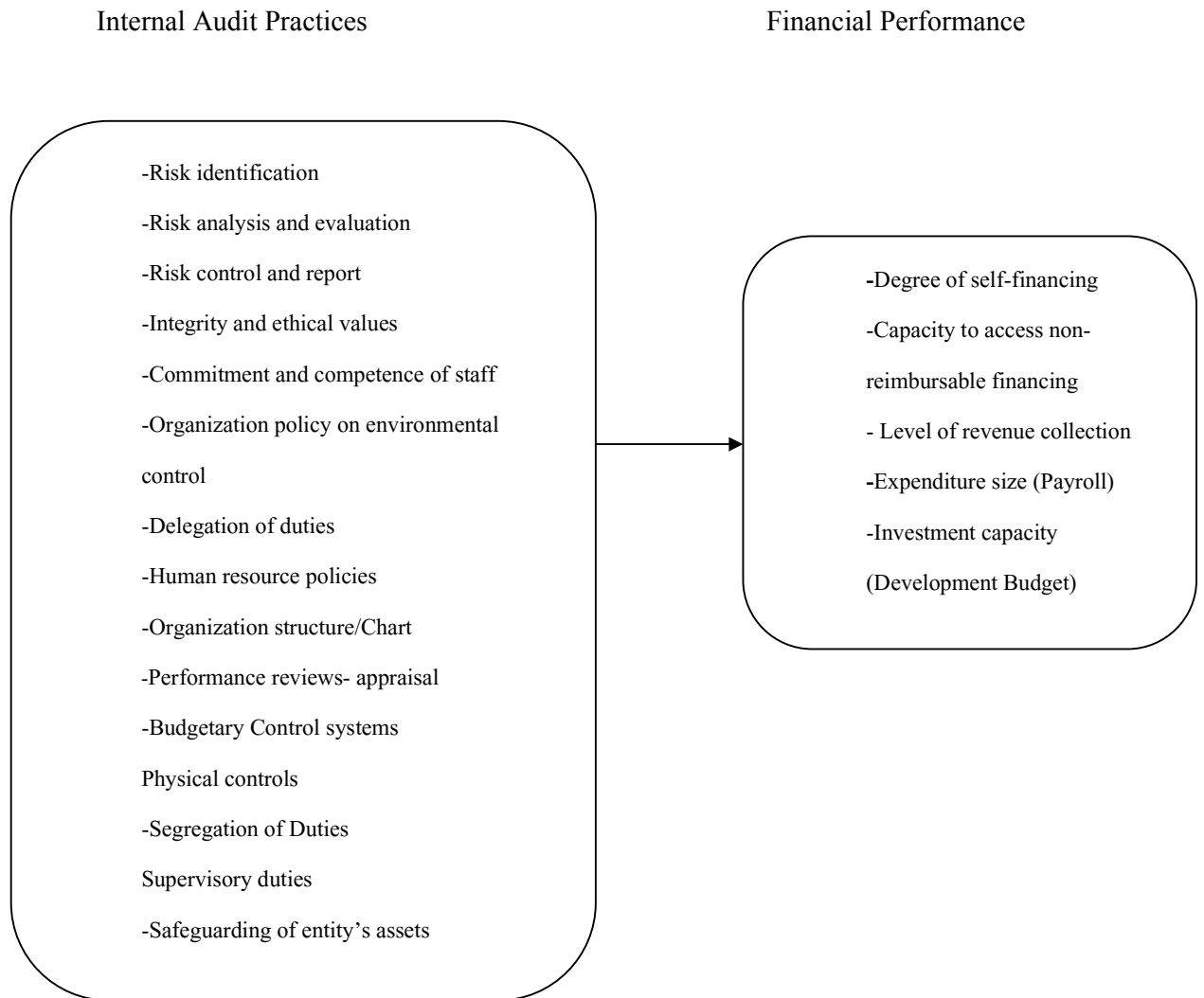


Figure 1.1 Conceptual Framework.

CHAPTER TWO

LITERATURE REVIEW

This section analyses a spectrum of empirical literature on internal audit practices on County Government financial performance. The specific areas dealt with include the theoretical framework, internal audit and corporate governance and the empirical studies.

2.1 Theoretical Framework

A theoretical framework is an edge of reference that forms the foundation for observations, meanings of ideas, research plans, presentation, and analysis, much as the casing that lays on an establishment that characterizes the general outline of a house (LoBiondo & Haber, 1998).

2.1.1 Stewardship Theory

The roots of the stewardship theory are psychology and sociology. Davis and Donaldson (1997) stated that theory protects steward and maximize the wealth of shareholders through firm performance, in light of the fact that by so doing, the steward's utility cut-off points are expanded. Based on their definition, stewards are executives and managers of the firm working, protecting and making profits for the shareholders. Contrary to the agency theory that focuses on the perspective of individualism (Donaldson and Davis, 1991), the stewardship theory weights on the top administration's part as stewards who coordinate their objectives as a major aspect of the organization. The hypothesis recommends that stewards are persuaded and fulfilled when hierarchical achievement is accomplished.

While Agyris (1973) argues that the theory of agency identifies employees or people as material beings, Donaldson and Davis (1991) observe that the theory of stewardship recognizes the value of structures that empower the steward and offers full autonomy built on trust. Additionally, the approach focuses on the rank of staff or the management to be more independently to maximize the investors' returns. In addition, Fama (1980) contends that the directors and administrators also manage

their careers so as to portray themselves as active stewards of the organization. Besides, Shleifer and Vishny (1997) state that managers return finance to shareholders so as to establish a good reputation which will enhance their re-entry in the market for future finance. Davis (1997) and Tosi (2003) contend that the participative management and involvement-oriented philosophy adopted by the theory of stewardship is beneficial to the firm. The Philosophy reduces the need for austere internal control methods to curb agency costs and governance challenges, part of which involves the work of internal audit in a company.

According to Meckling and Jensen (1994), when owners directly manage their firms costs incurred in controlling agency problems such as reducing moral hazards, and information asymmetries are reduced. Besides, when owners manage their companies, they are more likely to align their interests with growth opportunities and risk. Therefore, stewardship theory differs from agency theory in that it does not emphasize the need to incur agency or monitoring cost which incorporates setting up internal audit function. However, Donaldson and Davis (1991) argue that amalgamation, rather than separation, of the two theories, enhances the proceeds of a company. Therefore, managers must seek ways to strike a balance between agency theory and stewardship theory.

In this study stewardship theory assumes that managers keep their best interests in mind to the detriment of shareholders. It determines certain components which risks that are associated with auditing practices in the organization. The theory aims to motivate managers and auditing committee to be keen in identifying any risk that may arise on failure by the accounting and auditors to give clear position of an organization. The key presumption underlying the solutions of Stewardship Theory is that the practices of the chief are adjusted to the interests of the principals.

The stewardship theory supports this study by embracing the fact that those bestowed the opportunity to serve Kenyans in difference accountable positions should institute proper internal audit practices for our counties to perform well in financial matters.

2.1.2 Agency Theory

This theory is also referred to as the Principal-Agency Theory. This theory was pioneered by Stephen Ross and Barry in 1973 (Ross and Barry 2012). The theory was

adopted by Batley (2004) and Kayode et al (2013) who examined organizational relationship as tension between the” Principal” who demand a service and the “Agent” who provides it. The model assumes that actors are motivated by rational self-interest. According to Arwoti (2012), the thrust of the “principal- agency theory is about the relationship between the principal agent and its effect on services on the demand-side”. The theory is seen as problematic since it is particularly salient on the demand-side of public service delivery, “which arises from the fact that clients, politicians and frontline providers have divergent interests compounded by the fact that multiple principal-agent problems result in the delivery chain” (Hyden and Olowu, 2010). Critics however argue that the agency-theory model is one-sided because it negatively characterizes an agent’s behaviour as self-seeking, and ignores agent loyalty, pride, and professionalism in aligning with the principal’s goals (Davis, Donaldson and Schoolman, 2007). They argue that some agents are not overwhelmingly motivated by self-interests, and may well place value on collective goals for example community based organizations. The steward does not have to be altruistic – merely recognize that mutual benefit ultimately delivers greater personal benefit.

Another criticism of the agency theory is that it omits opportunistic behavior by principals (Waterman and Meier, 2008). This is especially so in public services where politicians and bureaucrats stand to gain personally from colluding with private agents. The Principal-Agency Theory however provides a good basis to understand the relationship in which one party (the principal) delegates work to another (the agent), who performs the task (Jensen and Meckling, 2006). Even though the principal is dependent upon an agent whose interest differs from his own, Collier (2007) argues that the principal is not powerless to the extent that he is in charge of remuneration. Various mechanisms can be used by the principal to align the interest of the agents to his own. Thus, the primary control mechanisms for the principal are dependent on: i) the performance measurement and evaluation system, ii) the reward and punishment system, and iii) the system for assigning decision rights to client – voice and accountability. The theory in connection with this study shows how the Principal (Kenyans) can manage the self-interest of those empowered to act on their

behalf (i.e. the Agents: county government officials, politicians, legislator, and staff) so that it will be aligned with the purposes that they (the principal) wish to achieve. There is a problem in Vihiga County Government on issues of financial performance. This problem arises not just from conflict of interest but also from the privilege access of the agents to information and resources. The agent who has been employed to provide services to the electorate have tended to use their superior knowledge and access to resources to divert benefits in their own direction. This theory describes the situation and is relevant since it shows that the electorate (principal) is not powerless as is the public opinion but can indeed dictate the way the services are delivered. The legal avenues like the PFM Act 2012 can be applied to enhance accountability of resources allocated to county government by instilling better audit practices and control. This theory supports the study by indicating clearly that the County governments are merely agents of Kenyan electorate and therefore, they should embrace accountability at all levels to achieve prudent financial performance and management

2.2. Empirical Literature Review

This section reviews the existing empirical studies on internal audit practices on financial performance. Internal audit practices helps an organization to achieve its objective by bringing a composed, restrained approach with a specific end goal to survey and build up the viability of hazard administration, control and administration forms.

2.2.1 Concept of County Government Financial Performance

Financial performance is the degree of a firm's overall health over a specified duration. It underscores the role of a firm's financial stability as to quality of services offered and reduced creditors turnover enhanced throughout and risk management. Maphalla (2015) indicated that financial performance is measured using financial statement analysis. This analysis measures the revenue, operating income and profit after tax, financial position, cash flow, the level of financial leverage and the ability to meet financial commitments.

In the case of county government the allocation from the national government, the efficiency in collection of local revenue and the expenditure allocation of expenditure into development expenditure and recurrent expenditure. Measurement of financial performance in county governments is different from measurement of other business and sometimes poses a great challenge. This is because other factors tend to affect financial performance in county government like political influence, interested parties and bureaucracy which are difficult in measuring due to their nature of being qualitative and subjective (Zakaria, 2014).

2.2.2 Factors that affect financial performance

2.2.2.1 Liquidity

One of the most common measure of working capital is the current ratio. “Current ratio is a measure of relative liquidity that takes into account differences in absolute size. It is used to compare companies with different total assets and liabilities” (Louderback et al.. 2000) Binti and Binti (2010) found that current ratio is negatively significant to financial performance of 172 listed Malaysian firms. Eljely (2004) empirically examined the relationship of liquidity and profitability as measured by current ratio and case gap on a sample of 29 joint stock companies in Saudi Arabia and found significant negative relation between the firm’s profitability and its liquidity level, as measured by current ratio using correlation and regression analysis.

2.2.2.2. Asset Utilization

According to Ellis (1998) asset utilization measures which assets are capable of producing and what they actually produce. Conversely, asset dis-utilization represents losses in revenue in relation to the investment that may be attributable to the inefficient use of assets. Fleming Heaney and McCosker (2005) pointed out that asset dis-utilization may increase agency costs because managers do not act in the best interest of the owners

2.2.2.3. Firm Size

Vijayakumar and Tamizhselvan (2010) found a positive relationship between firm size and profitability. Papadognas (2007) conducted analysis on a sample of 3035 greek manufacturing firms and revealed that for all size classes firms' probability is positively influenced by firm size. Lee (2009) examined the role that firm size plays in profitability. Results showed that absolute firm size plays an important role in explaining profitability.

2.2.2.4. Internal Audit Practices.

Institute of Internal Auditors (IIA) (2009) referred internal auditing as an independent, goals and consulting activities that is intended to add imperative value and build up the operations of an organization. It assists any firm to complete its targets through bringing a composed, restrained approach that is to build up the adequacy of hazard administration, control and administration forms. In this way, interior evaluating is being performed by experts with a careful comprehension of the business culture, frameworks and procedures, the inner review movement which offers ensure that inside controls set up are adequate keeping in mind the end goal to ease the dangers, administration procedures are useful and equipped, and authoritative objectives and targets are being met (IIA, 2004). This pronouncement recommends internal control as system that bring a unique experience to organizations and an outlook change from an accentuation on responsibility about the past to enhancing future result which help evaluators work in more compelling and effective way (Nagy & Cenker, 2002).

Internal Audit is a target and independent appraisal benefit in risk management, control and administration by measuring and assessing their viability in accomplishing the organization concurred goals (Committee, 2002). Likewise, internal audits results are basic to the Board of Directors and line administration in the inspected units. The administration applies the master capacities of inward examining through exact and controlled evaluation of the techniques, strategies and operations that administration set up to ensure the achievement of the association's objectives and through proposals for development (Dumitrescu, 2004).

According to Institute of Internal Auditors (2009) internal auditing is a self-overseeing, objective and consulting function that is intended to add value and

develop operations in organizations. Internal audit practices help organizations to accomplish their objectives by setting up a sorted out and taught way to deal with surveying the adequacy of risk control and management and in addition processes within organizations. As a result, internal auditing should be performed by professionals with a proper comprehension of the business culture, systems, and procedures. According to IIA (2004) internal audit is an activity that guarantees that interior controls of an organization are sufficient to alleviate risks. It also ensures that governance process are helpful and competent and that the organization' goals and objectives are met.

Internal auditing is a profession that involves prompting organization on the most proficient method to accomplish their objectives through overseeing risks and upgrading internal control (Nagy & Cenker, 2002). It additionally includes using a deliberate technique to dissect business methods or issues and recommending solutions. The essential part of the interior auditing activity is to guarantee effective application of official management controls. The internal audit function, despite the fact that not obligatory, exists in most private or corporate agencies, and in public sector including national and county governments. The quality and quality of an internal audit functions varies according to organizations and sectors depending on traditions of companies and the approach of top managers. Cai (2007) suggests that by accessing and evaluating the ability of definitive controls, internal looking at shapes a key managerial control mechanical assembly that is clearly associated with the structure and general standards of an affiliation. Internal audit function has a few points and standards which is vital to adhere to. It is the top managerial staff of any organization, however which bears last obligation that the organizations management applies a proper and viable arrangement of internal audit. Internal audit offers a system of evaluating banking activity risk and risks concerning organization capital, appropriate strategies for checking consistence with laws, measures and internal methods. Internal audit is a part of the monotonous checking of the internal control frameworks of the organization and its methodology for assessing internal capital. In that capacity, it helps administrators and board of directors in the viable execution of their obligation as outlined in organization missions (Gramling, 1997). Internal control involves five parts; the internal environment audit practices, the risk assessment, advanced information communication systems, control activities and

audit monitoring controls (Hayes, 2005). Internal auditing is a professional and movement required in prompting associations with respect to how to better accomplish their goals through overseeing dangers and enhancing internal control. Internal auditing involves the utilization of a systematic methodology for analyzing business processes or organizational problems and recommending solutions. The main role of the internal audit practices is to ensure that administration official controls are being connected in successful way. Internal audit function, although it is not compulsory, subsists in majority of private venture or firms substances, and in public sector are not excluded, state, and national and county governments. The errand, quality and solid purpose of an inward review capacity might be distinctive broadly inside the approach of top officials and conventions of organizations and associations. By measuring and assessing the viability of firm controls, internal auditing, itself, is an essential administrative control gadget, which is specifically connected to the authoritative structure and the general principles of the business (Cai, 1997).

Internal audit practices are designed to assist organization accomplish its objectives through systematic and discipline approach to appraise and improve effectiveness of governance, processes, internal control, risk management and employees efficiency (Ramamoorti, 2003). The importance of the internal audit function (IAF) as a key component of good corporate governance practice has increased as a result of repeated financial scandals and the extensive focus by governance regulations worldwide on the concepts of internal control and risk management (Spira & Page, 2003; Gamling et al., 2004; Selim et al, 2009; Sarens, 2009).

The lack of sound internal control systems is considered one of the major causes of corporate failure (Lewington, 1996), and corporate governance codes worldwide not explicitly require companies to disclose information about the effectiveness of their internal control systems (Hass et al; 2006). For instance, the UK corporate governance code requires companies to maintain a sound system of internal control and to review at least annually the effectiveness of their internal controls (Financial Reporting Council, 2008). The definition further shows that the role of internal audit has shifted from compliance assurance and assets safeguarding to value added assurance and consulting services which are critical to augmenting stakeholders value (Ebaid,2011; Bou-Raad, 2000). The presence of assurance and consulting in the definition of internal audit is becoming a practice, consumer focused activity concerned with the

important issues of control, risk management and governance (Hass et al., 2006; Chapman & Anderson, 2002).

Internal audit seeks to identify system controls designed to prevent and disclose irregularities that may lead to poor decision making. The internal auditing is an independent objective assurance and consulting activity designed to add value and improve the company's operations (Hass, Abdolmohammadi & Burnaby, 2006; Nagy & Cenker, 2002) its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management control and governance and governance processes.

2.2.3. Concept of Financial Performance

Financial performance is an extent to which a company's financial health over a period of time is

Measured. In other words, it is a financial action used in order to generate higher sales, profitability and worth of a business entity for its shareholders through managing its current and non-current assets, financing, equity, revenues and expenses. Its main purpose is to provide complete to the point information to shareholders and stakeholders to encourage them in making decisions. It can be used to evaluate similar companies from the same industry or to compare industries in aggregation (Farrukh & Faizan, 2016).

Financial performance is the achievement of the company's financial performance for a certain period covering the collection and allocation of finance measured by capital adequacy, liquidity, solvency, efficiency, leverage and profitability. It is the company's ability to manage and control its own resources. Cash flow, balance sheet, profit-loss, capital change can be the basis of information for corporate managers to make decisions (Didin, Fatihudin, Jusni & Mochamad Mochklas, 2018).

2.2.4. County Governments in Kenya

A county government is an administrative body for a small geographic area, such as a city, town, county, or state. A local government will typically only have control over their specific geographical region, and cannot pass or enforce laws that will affect a wider area. Local governments can elect officials, enact taxes, and do many other

things that a national government would do, just on a smaller scale (Business Dictionary).

County government was described by the United Nation as a political subdivision of a nation or state which is constituted by law and has sub-national control of local affairs including the power to impose taxes or to extract labour forces for prescribed purposes. The governing of such an identity is elected or otherwise locally selected (Tomori, 2008). According to Laleye (2008) county government (local government) is defined as a government at the level established by law to perform specific function within defined areas.

The Kenyan Constitution 2010 is the mother of devolution which has created the county governments. The Kenyan governance system is divided into two, the national government headed by the president and the county government headed by the governor. The constitution spells out the objects of devolution of government being to promote democratic and accountable exercise of power; to foster national unity by recognising diversity; to give powers of self-governance to the people and enhance the participation of the people in the exercise of the powers of the State and in making decisions affecting them; to recognise the right of communities to manage their own affairs and to further their development; to protect and promote the interests and rights of minorities and marginalized communities; to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya and to ensure equitable sharing of national and local resources throughout Kenya.

In Kenya, we have forty seven (47) County governments and since their establishment they have faced numerous administrative, financial and accountability challenges ranging from poor services delivery and non- accountability of the taxpayers money. The Office of the Auditor General has occasionally qualified financial accountability of over 40 county governments. The mandate of the Internal Audit function has been stipulated in the Public Financial Management Act (2012), Section 150 and encompasses; evaluating the effectiveness of internal control systems and ascertaining whether they are functioning effectively and provide reasonable assurance that the County Assembly's financial management objectives are being met consistently, efficiently and in a cost effective manner, reviewing and evaluating the reliability and integrity of record keeping and reporting on financial and operating

information and the means used to identify measure, classify and report such information to ensure accuracy and timeliness, verifying and certifying periodical financial returns that are required to be submitted from time to time such as pending bill returns, expenditure returns, imprest returns, staff returns and vehicle returns etc., carrying out a pre-audit of all documents used in initiating commitment and expenditure and in effecting payments such LPOs and contract agreements and reviewing budgetary reallocation process to ensure legislative and administrative compliance and advise the Clerk to the County Assembly where commitments are entered into when there is no budgetary provision and/or adequate cash. Other functions include carrying out investigations on irregularities identified or reported and report on any wastage of public funds resulting from (a) decisions which may not have been well-planned; (b) decisions made without being cost conscious; and/or (c) general misuse or misappropriation of financial resources and Government property; Report on the results of audit work to the Clerk, County Assembly and/or Heads of Departments after discussing inclusions and recommendations with them, following up on outstanding issues to ensure that appropriate corrective action is promptly taken on reported audit findings, and ensuring that the County Assembly's physical assets, plant and equipment, supplies, stores etc., are appropriately recorded in the relevant registers, and are kept under safe custody.

The Kenyan Government has come up with strategies like formation of Audit Committees at County Government levels and at National level so as to oversight in issues of accountability. Local government managements are entrusted with public resources and saddled with the responsibility of managing these resources effectively and efficiently. It is expected that, the local government officials entrusted with the management of public resources at local government level will give account of how these resources are being managed under their care. In order to ensure proper utilization of these resources entrusted to the local government officials, laws are enacted to control the local government revenues and expenditures (Modibbo, 2015). However, the process of accountability is not complete without auditing, which presently remains one of the most neglected and misunderstood area of the financial management cycle, especially in the public sector (Maru, 2002). For an audit to be meaningful the audit unit must be seen to be truly independent and the report produced by internal auditor will assist in providing information for planning,

decision making and performance evaluation. The establishing of internal audit function is important as an essential internal assurance mechanism in public financial controls and as a tool for monitoring and evaluating financial management activities in government agencies. Besides, it will assist government organizations to achieve accountability and integrity, improve the implementation of government programs and develop confidence among citizens and stakeholders as well as to lead to use public fund efficiently and cater any risk of mismanagement of public fund. Audit services also can help organization for the success of better financial management in public service by playing the effective and efficient roles to promote better governance in managing public money. In local government administrative this audit function has a special importance.

The objective of auditing is to review and evaluate the activities of the organization with a view to express an opinion on the efficiency and effectiveness of management, as well as the adequacy of internal control within an organization. Therefore, internal auditor is charged with the responsibility of safeguarding the assets and liabilities of an organization and other constructive services that will enhance the efficiency and effectiveness of the operations of the organization, through the review of accounting systems, internal control systems, implementation of the corporate policies, and carrying out special investigations assigned by the management (Modibbo, 2015). However, due to different factors IA become ineffective in conducting an audit function. Thus, this ineffectiveness leads them not to prevent and detect frauds. So this fraud negatively affects an economy as a whole, by causing huge financial losses, weakening social stability, threatening democratic structures, leading to a loss of trust in the economic system, or corrupting and compromising economic and social institutions (Nicolescu, 2007).

Internal audit effectiveness is arguably a result of the interplay among different factors: internal audit quality, management support, organizational setting, attributes of the auditee, and the competence of the audit team and the independence of internal audit (Mihret & Yismaw, 2007; George, Theofanis & Konstantinos, 2015). An internal audit function's capability to provide useful audit findings and recommendations would help raise management's interest in its recommendations.

2.2.5 Auditing Function and Financial Performance

Internal Audit has turned into a key administration instrument for accomplishing powerful control in both open and private associations (Udu, 2006). Internal auditing serves as a vital connection in the business and budgetary reporting procedures of partnerships and not-revenue driven associations. The point of inner inspecting is to enhance hierarchical proficiency and adequacy through useful feedback. Inner Auditing has four primary segments: viz; check of composed records, investigation of approach, assessment of the rationale and fulfillment of methods, interior administrations and staffing to guarantee they are proficient and proper for the association's strategies; and reporting suggestions for enhancements to administration. Most internal audit experts contend that a compelling inner review work connects with enhanced money related execution. As indicated by Beyanga (2011), a viable inside review administration can, specifically, decrease overhead, distinguish approaches to enhance effectiveness and expand introduction to conceivable misfortunes from deficiently defended organization resources all of which can significantly affect the execution of an organization. Saren and De Belde (2006) pointed that when an organization seeks respectability and clear moral qualities reflected in a formal set of principles/morals, the internal audit capacity will take a more noteworthy significance. Inside control frameworks add to administrative adequacy as well as vital obligations of corporate directorate. Bookkeeping writing in like manner underlines the significance of an association's respectability and moral values in keeping up a powerful control.

Fadzil et al (2005) noticed that internal auditors run an organization all the more proficiently and adequately to expand shareholders esteem. At long last Hermanson and Rittenberg (2005) contended that the presence of a viable internal auditor's capacity is connected with predominant authoritative execution. At the observational level, a study directed by KPMG (1999) indicated that the internal auditors work in associations where it exists, contributes significantly to execution change and help with recognizing benefit confirm in corporate catastrophes, especially budgetary misrepresentation reliably archives a relationship between feeble administrations. Subsequently interior review by going about as a guard dog could spare the association from acts of neglect and inconsistencies in this manner empowering the

association to accomplish its targets of guaranteeing abnormal state of efficiency and benefit.

2.2.6 Risk Management and Organizational Financial Performance

An organization management of internal control has a key part in the administration of dangers that are noteworthy to the satisfaction of its business targets. A sound arrangement of inward control adds to protecting the shareholders venture and the organization's advantages. Inside control encourages the adequacy and effectiveness of operations, guarantees the dependability of interior and outside reporting and helps consistence with laws and directions (Whittington and Pany, 2010). An organization arrangement of inward control has a key part in the administration of dangers that are noteworthy to the satisfaction of its business targets. A sound arrangement of internal control adds to shielding the shareholders venture and the organization's advantages. Inner control encourages the viability and productivity of operations, guarantees the unwavering quality of inward and outer reporting and helps consistence with laws and directions (Whittington & Pany, 2010).

Organizations understand risk and need valuing the significance of hazard administration to an association. Great corporate administration codes require the board to introduce an arrangement of hazard administration and educate their shareholders regarding this framework (Pickett, 2003). An organization cannot get smaller its way to approach its extent. It must create, and one of the keys to fruitful development is compelling danger administration. Chance affects an association's capacity to contend and to keep up its money related quality and the nature of its items and administrations. It is the interior examiner's business to recognize all auditable exercises and important hazard figures and to evaluate their noteworthiness.

An effective internal control structure requires that the material perils that could unfavorably impact the achievement of the bank's destinations are being perceived and constantly surveyed. As indicated by Beyanga (2011) this evaluation ought to cover all dangers confronting the bank and the combined keeping money association (that is, credit hazard, nation and exchange chance, showcase chance, financing cost chance, liquidity chance, operational hazard, legitimate hazard, and reputational chance). Inward controls should be modified to fittingly address any new or

beforehand uncontrolled dangers (Radu and Ramona, 2013). Subsequently it is basic that, as a major aspect of an inner control framework these dangers are being perceived and ceaselessly surveyed. From an inside control point of view, a hazard appraisal ought to recognize and assess the inward and outer components that could antagonistically influence the accomplishment of the administrative bodies' execution, data and consistence objective.

Effective risk assessment identifies and perceives and considers internal parts, (for instance, the multifaceted way of the affiliation's structure, the nature of the bank's activities, the nature of the work constrain, various levelled changes and agent turnover) and what's more outside components, (for instance, fluctuating fiscal conditions, changes in the business and mechanical advances) that could inimically impact the achievement of the firm's objectives. This hazard evaluation ought to be led at the level of individual organizations and over the wide range of exercises and backups of the combined managing an account association. This can be refined through different strategies (Pickett, 2010). Successful hazard appraisal addresses both quantifiable and non-quantifiable parts of dangers and measures expenses of controls against the advantages they give.

The risk assessment process also figures out risks which are controllable by the firm and which are most certainly not. For those dangers that are controllable, the bank must survey whether to acknowledge those dangers or the degree to which it wishes to relieve the dangers through control techniques. For those dangers that can't be controlled, the bank must choose whether to acknowledge these dangers or to pull back from or lessen the level of business action concerned. According to Birkett (2009) risk refers to the probability that an occasion, condition, or activity may unfavorably influence an association or its activities. Certain factors in events, conditions, or actions may be seen as posing risks for an organization or its activities.

In order for risk assessment, and in this manner the arrangement of internal control, to stay viable, senior administration needs constantly to assess the dangers influencing the accomplishment of its objectives and respond to changing conditions and conditions. Internal audit controls may be amended to suitably address any new or beforehand uncontrolled dangers. For instance, as money related development happens, a bank needs to assess new budgetary instruments and market exchanges and consider the dangers connected with these exercises. Frequently these dangers can be

best comprehended while considering how different situations (monetary and something else) influence the money streams and profit of budgetary instruments and exchanges.

Adverse effects can take a number of forms, depending upon operative risk factors. The meaning of a risk is seen as the product of the degree of its adverse effect and the probability of its occurrence. In assessing the significance of adverse effects identified with risk factors, ultimate reference will be made to a “failure to accomplish established objectives and goals; indeed, the actual process of establishing goals and objectives should explicitly recognize the risks associated with not achieving them. As an outcome, different risks may be assigned relative significance.

Risk assessment system is divided into three steps: risk identification, risk analysis and evaluation, risk control and report. Risk identification deals with finding out how the enterprise judges and analyzes risks, including its nature, types and reasons of the occurrence. On the other hand risk analysis and evaluation needs quantitative analysis of digital information collected by mathematical method in order to make the risk management based on scientific basis. The result of risk analysis and risk evaluation is the probability of occurrence and size of the risk so as to provide a dependable basis for decision-making. When dealing with risk control and report management is required to consider how to control risk. The method of controlling risk usually is to transfer risk, adverse risk and disperse risk.

2.2.7. Internal Environment Audit Practices and Organizational Performance

Whittington and Pany (2001) characterized internal environment audit practices as the tone of the association by impacting the control awareness of individuals. They encourage and affirm that control environment is the establishment for the various segments of inner control. Internal environment audit practices hones variables incorporate; trustworthiness and moral estimations of work force in charge of making, managing, and checking the controls, duty and skill of people performing doled out obligations, top managerial staff or review panels, management philosophy and operating style and authoritative structure (which might be an all-round sorted out

structure that accommodates appropriate arranging, coordinating and controlling operations or a disordered structure that may just serve to befuddle the key players by making misty parts).

Administration state of mind ought to be focused on moral business honours and to taking after the set up control techniques (Fish, 2001). This is the establishment for each other piece of internal control, giving request and structure. Inside environment control sharpens components include: Integrity and good values; the devotion to wellness; organization hypothesis and working style; and the way organization distributes power and commitment, deals with and develops its family. The Internal environment control practices are the establishment of the five components in the inner control system. Its assignment and operation influence the venture's general action, as well as the other four components. In this way control environment specifically influences the impact of execution of interior control system and the advanced ventures ought to build up a reasonable internal environment control (Eden, 2006).

Internal environment audit practices has a few components, nonetheless, for reasons for this exploration, the survey will concentrate on administration rationality and working style, the trustworthiness and moral estimations of staff that make and regulate controls, and review councils and directorate. For motivations behind the study, governing body will be spoken to by the Board of Management and the different advisory groups of the Board (Verschoor, 1999). Whittington and Pany (2001) likewise trust that these variables set a premise whereupon the other inward control parts can be manufactured. They additionally give a structure inside which alternate segments work. Be that as it may, these attestations have not generally remained constant, since administration in associations has dependably superseded these controls, the absence of tutoring.

The internal environment audit practices usually include the following context. To begin with, there is personnel integrity and quality. The staffs assume a double part: on one hand, they are the subjects of inward control in the association and control the execution of their task; then again, they are the objects of interior control in the association and regulated and controlled by the other. Anything of inner control framework might not go past the staffs' trustworthiness and quality that makes, oversees, actualizes and administers the framework. Besides, there is the

administration style and administration thought (Eden, 2006). The leadership administration style and administration thought impact the method for overseeing of the undertakings, particularly the supervisor singular marvelousness and the capacity to settle on choice. Directors control the endeavour principally by planning the association and administration component, approving and outlining the framework. What's more, in conclusion there is the association structure. Organization structure including association structure settings, duties portion, what position of the individual in the association is and what power and obligation he has. Association structure is the grantee for the undertaking to accomplish generally speaking.

2.2.8. Monitoring and Control Activities and Financial Performance

Ray and Pany (2010) referred control exercises as another part of inner controls. They observe that control activities are methodologies and frameworks that ensure the organization commands are finished. Controls exercises in an association essentially involve; execution surveys (contrasting genuine execution and spending plans, gauges and earlier period execution), data preparing (important to check exactness, culmination and approval of exchanges), physical controls (important to give security over both records and different resources), and isolation of obligations (where nobody individual ought to handle all parts of an exchange from the earliest starting point to the end). Internal control ought to be successful when looking at outline can amazingly helpful and is as a rule for association administration and broadly to budgetary articulations at present, an extensive variety of business firms have used internal controls through the advancement of ways to deal with certification a protecting assets and profitable business environment especially accounting course of action, organization procedure, and operational approach (Ogneva, Subramanyam & Raghunandan, 2010). Thus, internal control ought to be all the time survey in all parts of their organization and embed inside controls that will reinforce the organization and increment benefit (Skaife, 2009).

Control activities are the inside control structures ought to be watched - a system that assesses the way of the structure's execution after some time. Constant watching happens in the ordinary course of operations, and joins reliable organization and supervisory activities, and diverse moves staff make in playing out their commitments that assess the way of inside control system execution (Colbert and Bowen, 1996).

The expansion and repeat of specific evaluations depend basically on an examination of perils and the feasibility of advancing checking systems (Anduuru, 2005). Internal control insufficiencies should be represented upstream, with bona fide matters reported quickly to top association and regulating sheets. Internal control systems change after some time (Dumitrescu, 2004). The way controls are associated may progress once suitable frameworks can end up being less convincing a direct result of the arrival of new staff, fluctuating sufficiency of planning and supervision, time and resources necessities, or additional weights. Also, conditions for which within control structure was at first sketched out furthermore may change. In light of advancing conditions, organization needs to make sense of if the inside control system continues being correlated and prepared to address new dangers (Roth, 1997).

2.3 Research Gap

Most of the literature reviewed is from developed nations with different political arrangements, socio-economic backgrounds and environments and whose financial footing and strategic approach is different from that of Kenya. The legal systems all over the world are different and unique in nature. The literature reviewed again has historical outlook which may be different from the current technological dynamisms. Hence, there is a research gap on the subject matter in the Kenyan situation. Therefore, the study sought to fill this gap by investigating internal audit practices on financial performance of County Governments in Kenya A case of Vihiga County government.

CHAPTER THREE

RESEARCH METHODOLOGY

This section shows the procedure, which will be utilized to do the study. The chapter also shows the type and source of information that the study will seek to target populace and data sampling method that will be used. It additionally portrays how information that will be gathered and analysed. The appropriate philosophy in this study illustrates the rules for data assembling and handling.

3.1 Research Design

Research design is fundamental arrangement that demonstrates a diagram of the exercises that are important to execute the examination extend. The flow of research will concentrate on thorough utilization of illustrative research outline. As indicated by Cooper and Schindler (2003) a descriptive study is concerned with finding out the what, where and how of a wonder. In this study, the primary centre of this study will be quantitative. The underlining idea is to choose a few focused situations where a serious examination recognized by conceivable choices for unravelling the exploration will be addressed on the premise of the current arrangement. This study will use a descriptive survey design and more so cross-sectional surveys design that will interrogate officers across various sections in the County government. The cross sections can be departments, sections and units in the County government. The technique is used to allow an examination of a smaller sample selected and generalization of the results to a smaller population from which the whole group is chosen (Neuman, 2000). The study will investigate the effect of internal audit practices on the performance of Vihiga County government.

3.2 Study Area

Target population is the particular populace about which data is covered. As per Kombo and Tromp (2006) a population is especially described as a set of people, organizations, segments, events, social occasion of things or families that are being

inspected entirety up the results. This definition expects that the populace is not homogeneous. The study targets County Government of Vihiga which is found in Western part of Kenya and among the 47 counties of the Republic of Kenya, its County code 38 . The County constitutes employees of different job descriptions i.e. Heads of Departments, Subordinates, Directors, Chief Officers, Accountants, Internal Auditors and Procurement staff. The researcher will visit and collect data during working days in October 2019

3.3 Sampling and Sample Size

A sample is a subset of a given population unit. It is the procedure of selecting a representative sample from the target population. The study will use census method as a sampling technique given the small number of target group. A census requires you to survey all of your population. Where you have a small potential population it is often feasible to undertake a census. Where you have known small groups of individuals within your population you may wish to undertake a census of these groups of individuals within your population you may wish to undertake a census of these groups to ensure that their views are represented where other techniques for selection may overlook them completely or under-represent them (Mugenda & Mugenda, 2003). The study will use proportionate random sampling for subordinates from the various departments and

purposive sampling for Heads of Departments and Chief officers..Therefore, the Krejcie and Morgan (1970) table deals with definite populations .As such the population intended for the study must be known.If the target population is finite, the following formula (Krejcie & Morgan, 1970) will be used to determine the sample size.

$$S = \frac{X^2NP(1-P)}{d^2(N-1) + X^2P(1-P)}$$

Where

S = Required Sample size

X = Z value (e.g. 1.96 for 95% confidence level)

N = Population Size

P = Population proportion (expressed as decimal) (assumed to be 0.5 (50%))

d = Degree of accuracy (5%), expressed as a proportion (.05); It is margin of error

3.4 Table for determining sample size for finite population

To simplify the process of determining the sample size for a finite population, Krejcie & Morgan (1970), came up with a table using sample size formula for finite population.

Table 3.1
Table for Determining Sample Size of a Known Population

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	346
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	354
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	191	1200	291	6000	361
45	40	170	118	400	196	1300	297	7000	364
50	44	180	123	420	201	1400	302	8000	367
55	48	190	127	440	205	1500	306	9000	368
60	52	200	132	460	210	1600	310	10000	370
65	56	210	136	480	214	1700	313	15000	375
70	59	220	140	500	217	1800	317	20000	377
75	63	230	144	550	226	1900	320	30000	379
80	66	240	148	600	234	2000	322	40000	380
85	70	250	152	650	242	2200	327	50000	381
90	73	260	155	700	248	2400	331	75000	382
95	76	270	159	750	254	2600	335	1000000	384

Note: N is Population Size; S is Sample Size *Source: Krejcie & Morgan, 1970*

Note: There is no need of using sample size determination formula for ‘known’ population since the table has all the provisions one requires to arrive at the required sample size. For a population which is equal to or greater than 1,000,000, the required sample size is 384.

3.5 Instrument and Data Collection

This study utilized a questionnaire for the subordinate employees and interview guide conducted a few key informant interviews to gather essential information. Questionnaires are important for studies since they gather data that is not straightforwardly discernible as they ask about sentiments, inspirations, mentalities, achievements and also encounters of people (Mellenbergh, 2008). The questionnaire will contain both open and close-finished inquiries. The study will use Likert scale to generate the questions in the questionnaire. The questionnaire will have structured questions. The close-ended questions give more organized reactions to encourage substantial suggestions. The questionnaire will address the three research objectives therefore it will be sub-divided into five sections. The first section of the questionnaire will collect demographic data of the respondents, while the next sections answer the three objectives of the study, that is, risk management, internal control environment, Monitoring and control activities and financial performance.

Before conducting interviews, you need an interview guide that you can use to help you direct the conversation toward the topics and issues you want to learn about. Interview guides vary from highly scripted to relatively loose, but they all share certain features: They help you know what to ask about, in what sequence, how to pose your questions, and how to pose follow-ups. They provide guidance about what to do or say next, after your interviewee has answered the last question. (Mary Kennedy, 2006). The research will therefore strictly adhere to these features.

3.5.1 Data Collection

The researcher first obtained ethical approval from an institutional review board, then research authorization from NACOSTI, finally seek permission from the County Secretary before administering the data collection. The researcher then engaged three research assistants to assist in conveyance of questionnaires to the focused respondents. The researcher and research assistants administered the questionnaires to the respondents face to face. The questionnaires will be distributed through drop and pick later method. However, where the respondents had little time to fill the

questionnaire the research assistant waited and accorded assistance and clarification that he or she wanted.

3.5.2 Validity and Reliability

Cozby (2001) Validity encompasses the entire experimental concept and establishes whether the results obtained meet all of the requirements of the scientific research method. Reliability is the degree to which an assessment tool produces stable and consistent results. To measure the validity of the research instruments, the researchers will liaise with the research supervisor who will validate the research tools. To ensure reliability, the researcher will pre-test questionnaires on four respondents, on a separate group. These respondents will not be included in the study. Corrections will then be made before the distribution of these questionnaires.

The motivation behind the pilot test was to set up the legitimacy and unwavering quality of the exploration instruments and thus upgrade confronts legitimacy. The dependable guideline is that 1% to 10% of the specimen ought to constitute the pilot test (Cooper & Schilder, 2011). The proposed pilot test is within the recommendation. The study utilized both face and substance legitimacy to find out the legitimacy of the surveys. Content validity draws a derivation from test scores to a vast space of things like those on the test. Content validity is concerned with test populace representativeness. Response options would be given to the majority of the inquiries to guarantee that the answers given are in accordance with the examination questions they are intended to gauge.

Reliability is based with the subject of whether the after-effects of a study are repeatable. The researcher will use the most widely recognized interior consistency measure known as Cronbach's alpha (α). It demonstrates the degree to which an arrangement of test things can be dealt with as measuring a solitary dormant variable. The suggested estimation of 0.6 or more will be utilized as a cut-off of reliabilities (Rousson, Gasser & Seifer, 2002). The pilot testing will re-run until the researcher is satisfied with the data collection instruments.

3.6 Data Analysis and Presentation

Before processing, data was cleaned, coded, entered and analyzed using Statistical Package for Social Science (Version 20) also, presented percentages, means, standard deviations and frequencies. The researcher intends to use Partial Correlation analysis, multiple regression analysis and statistical tests like t-test, Z-test, F-test and ANOVA. The data will be shown by utilization of bar diagrams and pie outlines and in exposition shape. This will be finished by tallying up responses, processing rates of varieties accordingly and also portraying and deciphering the information in accordance with the study destinations and suppositions through utilization of SPSS (Version 20) to convey look into discoveries. The analyst will utilize multiple regression analysis to determine the quality of the relationship between the dependent and independent factors. The researcher will use multiple regression analysis to establish the strength of the relationship between the dependent and independent variables.

The regression equation will be: $Y = \beta_0 + \beta_1 RM_1 + \beta_2 IC_2 + \beta_3 CA_3 + \alpha$

Where: **Y** is dependent variable (organization performance), β_0 is the regression coefficient/constant/Y-intercept,

$\beta_1, \beta_2, \beta_3$ and β_4 are the slopes of the regression equation,

RM₁ is the risk management Practices

IA₂ is the internal environmental audit practices,

CA₃ is the monitoring control activities,

α Is an error term normally distributed about a mean of 0 and for purpose of computation, α is assumed to be 0.

3.7. Description of respondents

From the target population of 100 respondents a sample of 80 was used by the researcher and achieved 100% response this is because the researcher himself administered the questionnaires.

3.8 Gender:

	Frequency	Percent	Valid percent	Cum.percent
Male	47	58.8	58.8	58.8
Valid	33	41.2	41.2	41.2
Female	80	100.0	100.0	100.0
Total				

Table 4.1

Source: (Research data, 2019)

From the findings on table 4.1, majority of the respondents (58.8%) were male while (41.2) were female as further demonstrated on figure 2 below.

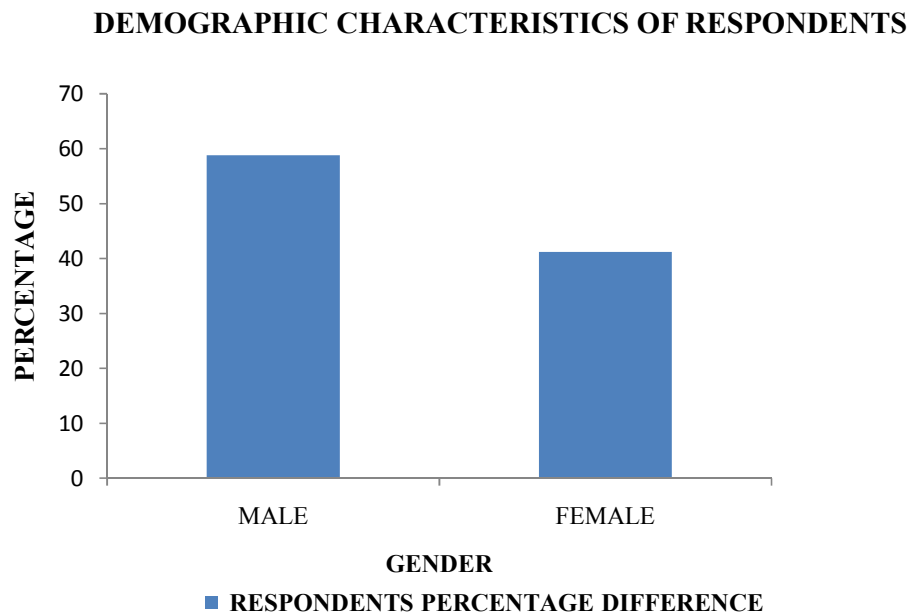


Figure 2.1

3.9. Educational level

The study sought to investigate the effects of level of education of the respondents. From the findings, 2.5% were primary graduates, 1.3% were secondary school graduates, 3.8% college certificate graduates, 31.3% diploma graduates, 43.8% degree graduates, 13.8% masters degree graduates and 3.8% were doctorate level graduates. Few employees with doctorate were based in strategic management position.

Table 4.2. Level of education

	Frequency	Percent	Valid Percent	Cumulative Percent
Primary Level	2	2.5	2.5	2.5
Secondary Level	1	1.3	1.3	3.8
Certificate Level	3	3.8	3.8	7.5
Valid Diploma Level	25	31.3	31.3	38.8
Degree Level	35	43.8	43.8	82.5
Masters Level	11	13.8	13.8	96.3
Doctorate Level	3	3.8	3.8	100.0
Total	80	100.0	100.0	

Source: (Research data, 2019)

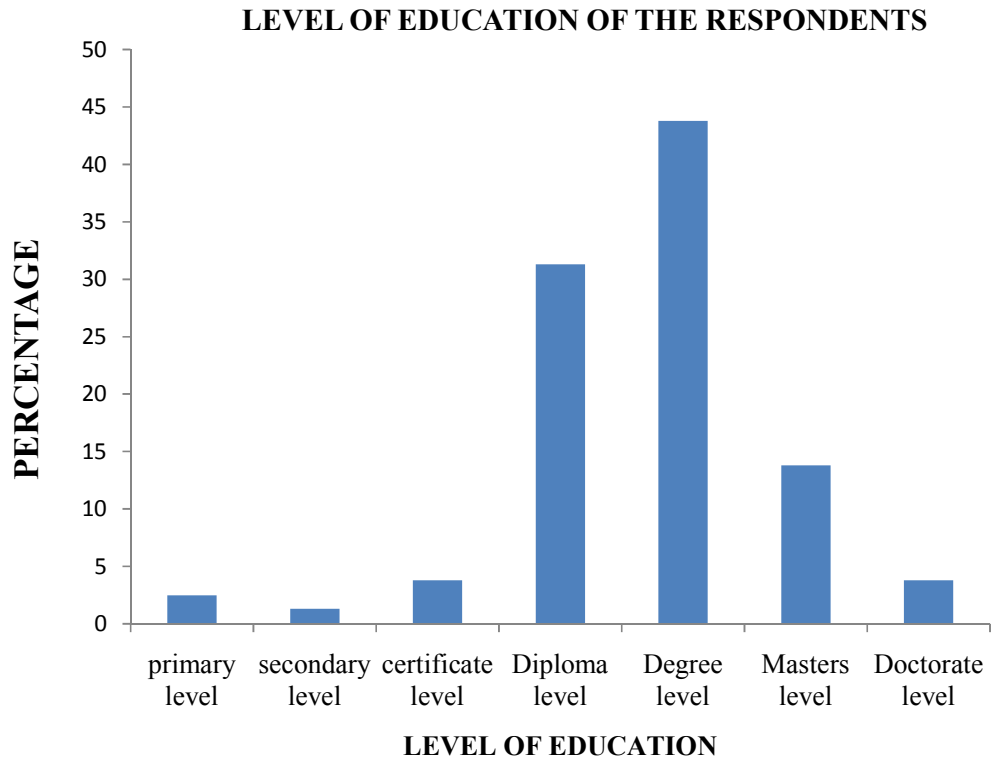


Figure 3.

3.10. Work Experience

The study sought to investigate the effects of work experience of the respondents. The findings revealed that 53 respondents had work experience of utmost 5years representing 66.3% while 27 respondents had work experience of utmost 10years representing 33.8%.

Table 4.3

		Frequency	Percent	Valid Percent	Cumulative percent
Valid	0-5 years	53	66.3	66.3	66.3
	6-10 years	27	33.8	33.8	100.00
Total		80	100.0	100.0	

3.11 Age Bracket

The findings in table 6 below shows that the majority of the respondents, 50% were aged between 18-30 years an evident factor of the young employees who served in various departments within the county. From the findings majority of the respondents are middle aged, and they argued that such employees are able to perform their duties because they are active and conversant with their duties

Table 4.4

		Frequency	Percent	Valid Percent	Cumulative perc
Valid	Age 18-30	40	50.0	50.0	50.0
	Age 31-40	20	25.0	25.0	75.0
		14	17.5	17.5	92.5
	Age 41-50	5	6.3	6.3	98.8
	Age 51-60	1	1.3	1.3	100.00
	Age 60-70				
	Total	80	100.0	100.0	

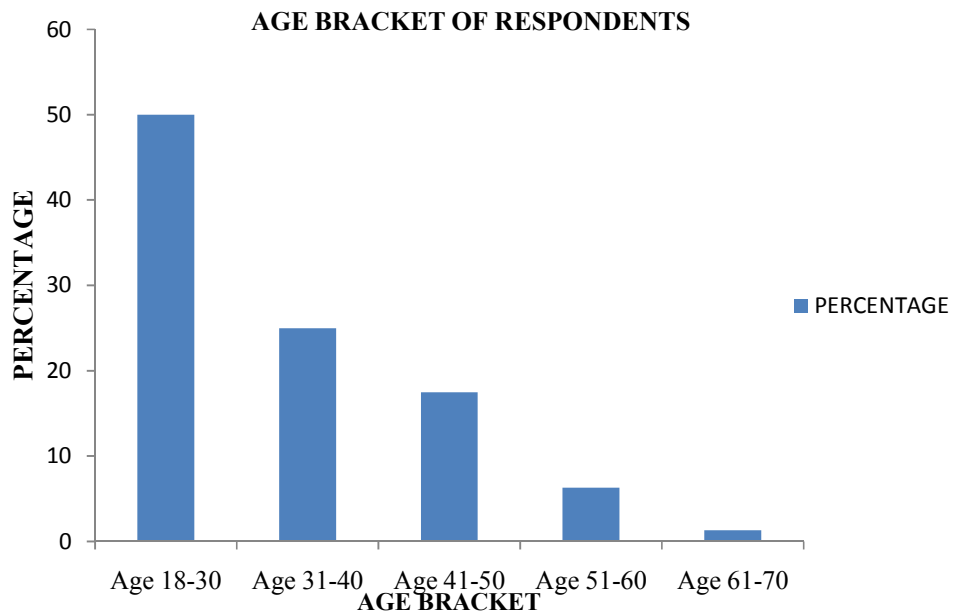


FIGURE 4.1

CHAPTER FOUR

RESULTS AND DISCUSSIONS.

This chapter postulates the presentation, description, explanation and discussion of the research results. The purpose of the study was to analyze effect of internal audit practices on financial performance in Kenya, a case of Vihiga County Government. The study presents the findings by use of frequency tables and figures.

4.1. Descriptive Statistical Findings.

4.1.1 Descriptive Statistics on Risk Management Audit Practices.

Table.4.5

	N	Min	Max	Mean	Std. Dev
Risk identification	80	2.00	5.00	4.000	.76266
Risk analysis	80	1.00	5.00	4.000	.84793
Risk control	80	1.00	5.00	4.000	.84933
Risk reporting	80	2.00	5.00	4.000	.83855
Valid N	80				

Source: Research data 2019

In the table 4.5, are details of the measures of effectiveness of the Internal Audit Practices from different key statements received from the respondents. The responses were ranked in terms of their Means and Standard Deviations for analysis of the results .According to this study Internal Audit Practices influence financial performance as The Highest Mean Value is 4.000 and the maximum rank of 5 and a corresponding standard deviation of 0.76266 revealing that there is significant effect. This shows that internal audit practices affect financial performance of Vihiga county government because they are ≥ 3 . These findings are in agreement with (Whittington and Pany,2010), who found out that a sound arrangement of inward control adds to protecting the shareholders venture and organizations advantages, inside control encourages effectiveness of operations, guarantees the dependability of interior and outside reporting and helps consistence with laws and directions

4.1.2 Descriptive Statistics on Internal Environmental Audit

Practices

Table 4.6

	N	Min imu m	Maxi mum	Mean	Std. Deviation
Integrity	80	1.00	5.00	3.4500	1.26191
Segre. Of duties	80	1.00	5.00	3.7625	1.08200
Enviro.audit	80	1.00	5.00	3.6125	1.01250
Operating cycle	80	1.00	5.00	3.5000	.99365
Valid N =	80				

Source: Research data 2019

This table 4.2 are details of the measures of effectiveness of internal audit practices from key statements received from the respondents. The respondents provided their views on Internal Environmental Audit and its extent of effect on financial performance of Vihiga County government .The responses were ranked in terms of their Means and Standard Deviations for analysis of results. According to the study Internal audit practices influence financial performance as the highest Mean value is 3.76525.The study findings reveal that Segregation of duties with a mean of 3.7625 has a greater influence on financial performance in the category of Internal environment audit practices while integrity practices with mean of 3.4500 was perceived to have the lowest impact. This suggests that segregation of duties is vital in auditing for achieving good financial performance, however efforts should be made to instil integrity in the system by coming up with vibrant policies.

The study findings concur with (Eden,2006) who found that internal environment control practices influences the ventures general action and impact of execution of interior control system and the advanced ventures ought to build up a reasonable internal environment control.

4.1.3 Descriptive Statistics on Monitoring and Control practices.

Table 4.7

	N	Min	Max	Mean	Std. Deviation
Performance Review	80	1.00	5.00	3.6875	.83581
Physical Controls	80	1.00	5.00	3.7625	.83049
Supervision	80	1.00	5.00	3.7750	.84156
Monitoring Procedures	80	1.00	5.00	3.8500	.82830
Valid N =	80				

Source: Research data 2019

This table 4.3 represents details of the measures of effectiveness of internal audit practices from key statements received from the respondents. The respondents provided their views Monitoring and Control audit practices and its extent of effect on financial performance of Vihiga County government .The responses were ranked in terms of their Means and Standard Deviations for analysis of results. According to the study Internal audit practices influence financial performance as the highest Mean value is 3.8500.The study findings reveal that Monitoring procedures has a greater influence(3.8500) on financial performance in the category of Monitoring and Control audit practices while performance reviews with mean of 3.6875 was perceived to have the lowest impact. This suggests that monitoring procedures are core in auditing for achieving good financial performance, however the County government should carry out periodical appraisals in order to catch up with a competitive economy where employees are paid for good work done and satisfactorily. This can be done through setting of targets i.e performance contracting. This is in an agreement with (Colbert and Bowen, 1996) who found that constant watching happens in the ordinary course of operations, and joins reliable organization and supervisory activities, and diverse moves make staff to be committed.

4.1.4 Descriptive Statistics on Financial Performance

	N	Min	Max	Mean	Std. Dev
Degree of Self financing	80	1.00	5.00	3.5375	1.00560
Access to non-reimbursable funds.	80	1.00	5.00	3.7625	.87502
Revenue collection	80	1.00	5.00	3.7375	1.08784
Manageable Expenditure size	80	1.00	5.00	2.4250	1.28058
High invest capacity/Dev.Budget.	80	1.00	5.00	3.6750	1.11122

N=7

Source: Research data2019

From Table 4.4 above, it is clear that, respondents were of the opinion that the county government of Vihiga had a moderate Degree of Self-financing activities as revealed by Mean of 3.7375 This means that the County can not sustain itself financially, this is critical because incase of any slight delay of financing from National government, then operations of the county would stall. The study also revealed that the County government has a high opportunity to access non- reimbursable funds with a Mean of 3.7625 and a standard deviation of 0.87502; this informs us that the county government can approach Development partners who can offer non reimbursable grants to undertake development projects. The Revenue collection activity is crucial according to the respondents; this can be obtained from the results revealed by Mean of 3.7375 and of 1.08784, the respondents noted that the County has great potential of Revenue collection which is a key Component of financial performance. The County government has a high Expenditure size in its financial operations, the payroll management of the County and recurrent expenditure on local and international travels and sitting allowances take a major share of the county financial resources, as revealed by Mean of 2.4250 and a standard deviation of 1.28058 .It also shows that the respondents are of the opinion that the County government has higher expenditure size than the revenues that it can generate for its operations. Finally the study revealed that the County government of Vihiga has high investment opportunities and the respondents confirmed this through the mean of 3.6750 and a standard deviation of 1.11122, the county can attract foreign and local investment by putting in place appropriate policies and legal frameworks which are investor friendly.

The findings of this study is in agreement with the studies carried out by (Didin, Fatihudin, Jusni and Mochamad Mochklas,2018), who found that financial performance is the achievement of the company’s financial performance covering the collection and allocation of finance measured by capital adequacy, liquidity, solvency, efficiency, leverage and profitability. It is the company’s ability to manage and control its own resources. Cash flow, balance sheet, profit and loss, capital changes can also be a basis of information for corporate managers to make decisions.

4.2. Correlation

4.2.1. Effect of Risk Management audit Practices on financial performance

Table 4.9

Control Variables		Risk identification	Risk analysis	Risk control	Risk reporting	
Self-financing	Risk identification	Correlation	1.000			
		Significance (2-tailed)				
	Risk Analysis	Correlation	-.108	1.000		
		Significance (2-tailed)	.342			
	Risk control	Correlation	.064	.109	1.000	
		Significance (2-tailed)	.573	.340		
	Risk reporting	Correlation	.090	.028	.030	1.000
		Significance (2-tailed)	.430	.808	.794	

N=77

Source: Research data 2019

From the above table 4.5, it is evident that risk control has high positive correlation coefficient (0.573) over other risk management practices. Risk identification practice has negative correlation coefficient of -0.108. This implies the County in an effort of managing risks pegs its focus on controlling risks other than risk identification, risk analysis and risk reporting. Risks affect operations of the county if they are not identified, analysed, reported and controlled. Failure to adhere to risk management policies by the county government has a negative impact on financial performance. The Respondents noted that the county government had done little in issues of risk management, this is revealed by corresponding correlations in the above table i.e

1.000, -.108 0.64 and 0.90 for risk identification, analysis, control and reporting respectively.

4.2.2. One-Way Analysis of Variance (ANOVA) for Risk

Management Audit practices

Table 4.10

		Sum of Squares	df	Mean Square	F	Sig.
Self-Financing	Between Groups	8.736	4	2.184	2.302	.066
	Within Groups	71.152	75	.949		
	Total	79.888	79			
Access to reimbursable funds	Between Groups	5.522	4	1.380	1.884	.122
	Within Groups	54.966	75	.733		
	Total	60.487	79			
Revenue collection	Between Groups	9.949	4	2.487	2.233	.073
	Within Groups	83.538	75	1.114		
	Total	93.488	79			
Manageable Expenditure size	Between Groups	21.364	4	5.341	3.703	.008
	Within Groups	108.186	75	1.442		
	Total	129.550	79			
High investment capacity	Between Groups	7.071	4	1.768	1.465	.221
	Within Groups	90.479	75	1.206		
	Total	97.550	79			

Source: Research data2019

From the above table 4.10 ANOVA table, it is clear that there a high risk in management of expenditure size as depicted by F-statistic of 3.703, whereas there is lower risk in investment and development capacity as depicted by F= statistic of 1.465. This implies that the there is unforeseen consequences in the management of expenditure size, the expenditure size is risky because it constitute payroll management and other recurrent expenditures which can in most case be violated by the county responsible payroll managers and those responsible of incurring

expenditure. High investment capacity is not actually risky because the funding is not usually accessed by everyone and therefore those investing would put in stringent terms and conditions for its absorption.

The findings of the study are in agreement with (Beyanga , 2011) who noted that evaluation ought to cover all dangers confronting the bank and the combined keeping money association (that is , credit hazard, nation and exchange chance, showcase chance, financing cost chance, liquidity chance, operational hazard, legitimate hazard, and reputation chance.

4.2.3. Correlation Analysis report of Internal Environmental Audit

Practices on Financial Performance.

Table 4.11

Control Variables			Integrity Practices	Segregation duties	Environment control	Operating cycle
Revenue collection	Integrity	Correlation	1.000	.474	.402	.225
		Significance (2-tailed)	.	.000	.000	.046
	Segregation of duties	Correlation	.474	1.000	.710	.422
		Significance (2-tailed)	.000	.	.000	.000
	Environmental audit	Correlation	.402	.710	1.000	.657
		Significance (2-tailed)	.000	.000	.	.000
	Operating cycle	Correlation	.225	.422	.657	1.000
		Significance (2-tailed)	.046	.000	.000	.

Source: Research data2019

From table 4.11 above, integrity practices has a high positive correlation coefficient of 1.000 compared to other internal environment audit practices. On the other hand, operating cycle practices has a lower positive correlation coefficient of 0.225. This implies integrity issues affect revenue collection activity in the county. It is therefore imperative that all the officers involved in revenue collection should undertake integrity tests for the county to realise greater financial performance. The County should again embrace operating cycle practices eg clear responsibilities, duties and roles should be outlined to ensure smooth flow of operations.

4.2.4 .One-Way Analysis of Variance of Internal Environmental Audit on Financial Performance

Table 4.12

		Sum of Squares	df	Mean Square	F	Sig.
Self financing	Between Groups	10.810	4	2.703	2.934	.026
	Within Groups	69.077	75	.921		
	Total	79.888	79			
Access to non-reimbursable Expenditures	Between Groups	13.967	4	3.492	5.630	.001
	Within Groups	46.520	75	.620		
	Total	60.488	79			
Revenue collection	Between Groups	18.804	4	4.701	4.721	.002
	Within Groups	74.684	75	.996		
	Total	93.487	79			
Manageable Expenditure size	Between Groups	10.696	4	2.674	1.687	.162
	Within Groups	118.854	75	1.585		
	Total	129.550	79			
High investment capacity	Between Groups	11.232	4	2.808	2.440	.054
	Within Groups	86.318	75	1.151		
	Total	97.550	79			

Source: Research data2019

From table 4.8 above, Internal audit environment practices have high positive correlation coefficient of 5.630 on accessible to non-reimbursable expenditures compared to other financial performance indicators. On the other hand, internal audit environment practices have a lower positive correlation coefficient of 1.687 on managing expenditure size as a dependent variable. This implies that integrity and ethical issues, commitment and competence of staff, organization policy on environment control, delegation of duties, Human resource policies and operating cycle are major internal environment practices which propels financial performance of the Vihiga County government.

This finding concurs with the finding of (Fish, 2001) who noted that administration state of mind ought to be focused on moral business hones and to taking after the set up control techniques. This is the establishment of each piece of internal control, giving request and structure and that inside environment sharpens components

including integrity and good values, the devotion of wellness, organization hypothesis and working style, and the way organization distributes power and commitment, deals with and develops its family.

4.2.5. Correlation Analysis report of Monitoring and Control on Financial Performance

Control Variables			Performance review	Physical Control	Supervision
Manageable Expenditure size	Performance review	Correlation	1.00	.732	.497
		Significance (2-tailed)		.000	.000
	Physical Control	Correlation	.732	1.000	.718
		Significance (2-tailed)	.000		.000
	Supervision	Correlation	.497	.718	1.000
		Significance (2-tailed)	.000	.000	

Source: Research data2019

It is evident from table 4.13 above that physical control has a highest correlation coefficient of positive 2.45 depicting the fact that physical control is significant component of Monitoring and control audit practice. On the other hand Performance reviews has less correlation coefficient of 2.1 meaning that performance reviews play a lesser role as a contributor of monitoring and control audit practices.

The findings of this study concurs with (Skaife, 2009) who said internal control ought to be all time survey in all parts of the organization and embed inside controls that will reinforce the organization and increment benefit.

4.2.6. One-Way Analysis of Variance of Monitoring and control activities on Financial Performance.

		Sum of Squares	df	Mean Square	F	Sig.
Self-Financing	Between Groups	10.810	4	2.703	2.934	.026
	Within Groups	69.077	75	.921		
	Total	79.888	79			
Access to reimbursable funds	Between Groups	13.967	4	3.492	5.630	.001
	Within Groups	46.520	75	.620		
	Total	60.488	79			
Revenue collection	Between Groups	18.804	4	4.701	4.721	.002
	Within Groups	74.684	75	.996		
	Total	93.487	79			
Manageable Expenditure size	Between Groups	10.696	4	2.674	1.687	.162
	Within Groups	118.854	75	1.585		
	Total	129.550	79			
High investment capacity /Development budget	Between Groups	11.232	4	2.808	2.440	.054
	Within Groups	86.318	75	1.151		
	Total	97.550	79			

Source: Research data2019

The researcher requested the respondents to indicate the effect of internal environment audit practices on financial performance. From study results most of respondents agreed and pointed out integrity and ethical values, Organization policy on environmental control, delegation of duties and the operating cycles processes influence financial performance effectiveness as depicted by mean score of 3.5375, 3.7625, 3.7375 and 2.4250 and standard Deviations of 1.00560, 0.87502, 1.08784, 1.28058 and 1.11122 in the above analysis. The researcher requested the respondents to indicate effect of monitoring and control audit practices on financial performance. Most of the respondents pointed that performance reviews (appraisals , Budgetary control, physical controls, segregation of duties, and supervisory duties influence financial performance as depicted by mean score of 3.5375, 3.7625, 3.7375 and 2.4250 and standard Deviations of 1.00560, 0.87502, 1.08784, 1.28058 and 1.11122 in the above analysis .

4.3. Validity and Reliability Testing

The researcher carried out a pilot study to pre-test the validity and reliability of data collected using the questionnaire. The reliability of the questionnaire was evaluated through Cronbach's Alpha which measures the internal consistency. The Alpha measures internal consistency by building up if certain item measures a similar construct. Cronbach's Alpha was set up for each independent variable with a specific end goal to figure out whether every scale (goal) would deliver steady results ought to the examination to be done later on. The findings of the pilot study shows that all questionnaire control activities had the highest reliability ($\alpha=0.767$). This illustrates that all the five scales were reliable as their reliability values exceeded the prescribed threshold of 0.7 (Nunnally, 1978).

Case Processing Summary			
		N	%
Cases	Valid	80	100.0
	Excluded ^a	0	.0
Total		80	100.0

Reliability Statistics	
Cronbach's Alpha	N of Items
.767	17

Table 4.15

Source: Research data2019

4.4 Regression Analysis

Regression analysis is a powerful statistical method that allows one to examine the relationship between two or more variables of interest. While there are many types of regression analysis, at their core they all examine the influence of one or more independent variables on a dependent variable. Regression analysis is a reliable method of identifying which variables have impact on a topic of interest. The process of performing a regression allows you to confidently determine which factors matter most, which factors can be ignored, and how these factors influence each other.

The study conducted regression analysis to show the relationship between internal audit practices (Independent variable) and financial performance (dependent variable). Before the regression analysis, the data was subjected to assumptions of regression analysis, with no violation observed. The regression model was

$$Y = \beta_0 + \beta_1 RM_1 + \beta_2 IE_2 + \beta_3 MC_3 + \alpha$$

Where Y represents financial performance, RM1 is Risk management audit Practices, IE2 is internal environment practices and MC3 is the Monitoring and control audit practices. B0 is the model's constant and β_1 - β_2 are the regression coefficients while α is the model's significance from f-significance results obtained from analysis of Variance (ANOVA)

4.4.1 Model Summary

The coefficient of determination also known as model summary was carried out to measure how well the statistical model was likely to predict future outcomes. The coefficient of determination, r^2 is the square of the sample correlation coefficient between outcomes and predicted values.

Table 4.16

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.468 ^a	.219	.163	.92311

a. Predictors: (Constant), Risk management, Internal environment, Monitoring and control

In Table 4.8, R is the square root of R-squared and is the correlation between the observed and predicted values of dependent variable (financial performance). R-square is the proportion of variance in the dependent variable (financial performance) which can be predicted from the independent variables (Risk management, Internal environment and Monitoring and control) the model had a coefficient of determination (R^2) = 0.219, indicating that 21.9% of the variation in financial performance and leaving 78.1 % which can be predicted from the variables Risk management, internal environment and monitoring and control. Adjusted R^2 expounds that as predictors are added to the model, each predictor will explain some of the variance in the dependent variable simply due to

chance. Predictors can be added to the model which would continue to improve the ability of the predictors to explain the dependent variable, although some of this increase in R-square would be simply due to chance variation in that particular sample.

The adjusted value of R-squared was .219, while the value of adjusted R-square was .163. Standard Error of the estimate; this is also called the root mean square error, is the standard deviation of the error term, and is the square root of the mean square

Residual

ANOVA on Model Summary.

	Sum of Squares	df	Mean square	F	Significance
Regression	.842	1	.842	.679	.413 ^a
Residual	96.708	78	1.240		
Total	97.550	79			

Table 4.17

a. Independent variables: Risk Management, internal environment and Monitoring and control

b. Dependent variable: Financial performance

The above table 4.13 shows that there's a good linear association between the dependent and independent variables used in the study. This is shown by correlation coefficient as measured by the adjusted R-square presents a moderately strong relationship linking dependent and independent variables with a f-Statistic value of 0.679. This depicts that the model accounts for 67.9 % of the total observations while 32.1% remain unexplained by the regression model.

The findings indicate the true behaviour of R₂ dependent variable (financial performance) varies in accordance with the changes in independent variables (Risk Management, internal environment and monitoring and evaluation). These findings support the findings of as indicated by Beyanga (2011) that a viable interior review administration can,

specifically, lessen overhead, recognize approaches to enhance effectiveness and boost introduction to conceivable misfortunes from insufficiently protected organization resources all of which can significantly affect the execution of an association.

From the estimated regression equation;

$$Y = \beta_0 + \beta_1 RM_1 + \beta_2 IE_2 + \beta_3 MC_3 + \alpha$$

Where β_0 is the constant =1.66, $\beta_1 = -.122$, $\beta_2 = .262$ $\beta_3 = .639$. The fitted regression equation of the model becomes;

$$Y = 1.66 + (-0.122) + 0.262 + 0.639 + \alpha$$

It is evident from the above regression model that if all factors were to be held constant then a unit of change predictor variables would result in a 1.66 change in financial performance.

The regression coefficient of risk management was not significant in predicting the county's financial performance. This implies that a unit increase in risk management will lead to -0.122 which will consequently lead to decrease in financial performance. Thus the study rejects the null hypothesis that there is no significant association between Risk management audit practices and financial performance. The findings of the study are consistent with Saunders and Cornett (2006) study that current organizations are in the hazard administration business as they embrace the elements of bearing and overseeing dangers in the interest of their clients through the pooling of dangers and the offer of their administrations as hazards authorities.

4.4.2. Regression

Table 4.18

	Un-standardized coefficients		Standardized coefficients	Signi
	B	Std Error	Beta	
(Constant)	1.666	.723		0.27
Risk Management.	-.122	.148	.93	.413
Internal	.262	.547	.238	.242
Environment Monitoring	.639	.234	.578	0.09

Predictor: (Constant) Risk management audit practices, (Risk control)

Dependent variable: Financial performance

The regression coefficient of internal environment was positive and significant in predicting financial performance of the county government. This implies that a unit increase in internal environment audit practice would increase the financial performance of the county government by 0.262. Thus the study rejects the null hypothesis that internal environment audit practices do not have significant effect on financial performance. The regression coefficient of monitoring and control audit practices is positive and significant in predicting the financial performance of county governments. This implies that a unit increase in monitoring and control practices will lead to 0.639 increases in financial performance. From the study results the null hypothesis which states that monitoring and control practices do not have significant effect on financial performance, is hereby rejected. The findings concur with the results of Anduuru (2005) those organizations that have control activities in place out do the one without in their performance

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

This chapter gives summary of the data findings on the effect of internal audit practices on financial performance with focus Vihiga County government in Kenya, the conclusions and recommendations are drawn there to. The chapter is therefore broken down into summary of findings, conclusions, recommendations and area for further research study.

5.1 Summary of the Findings

The objectives of this study were to establish the association between risk management audit practices and financial performance factors of Vihiga County government, to determine the contribution of internal environment audit practices on financial performance for Vihiga County government and to analyze the effect of monitoring and control audit practices on financial performance of Vihiga County government. From the study findings most of the respondents indicated risk identification, risk analysis and evaluation and risk control and reporting provide assurance that the risks are being appropriately managed and they influence financial performance effectiveness. A sound system of internal control contributes to safeguarding the shareholders investment and the County's assets. Internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists compliance with laws and regulations. From coefficient correlation, risk management had a moderate significance in predicting the financial performance of Vihiga County government with a p-value=+0.677. The regression coefficient of risk management is positive and significant in predicting financial performance. This implies that a unit decrease in risk management will lead to -0.322 will lead to decrease in financial performance.

On internal environment audit practice and financial performance, the study established that integrity and ethical values, commitment and competence of staff, organization policy on environmental control, delegation of duties, Human resource policies and operating cycle influence financial performance effectiveness of vihiga county government. Further the study found that internal audit environment has a

significant coefficient with p-value =+0.1462. The regression coefficient of internal audit environment was positive and significant in predicting financial performance. This implies that decrease in the internal audit environment practices leads to decrease in financial performance to -0.8538. Thus the study will reject the null hypothesis that there is no significant relationship between internal audit environment and county's financial performance.

In regard to the effect of Monitoring and control audit practices on finance performance, the study found that monitoring procedures, that is, Performance reviews, budgetary control systems, physical controls, segregation of duties, supervision and safeguarding of county's assets significantly affect the financial performance of Vihiga County government.

5.2 Recommendations of the Study.

Based on the study findings, the following recommendations were made:-

The study recommended that risk assessment should be carried out at the level of individual departments within the county administration and over the wide range of exercises and auxiliaries of the solidified function of the county government. This includes evaluating the risks to determine which are controllable by the County and which are not. This can be accomplished through various methods. This addresses both measurable and non-measurable aspects of risks and weighs costs of controls against the benefits they provide. In order for risk assessment to remain effective, senior management needs continually to evaluate the risks affecting the achievement of its goals and react to changing circumstances and conditions. Internal controls should also be revised to appropriately address any new or previously uncontrolled risks.

On Internal audit environment, the study recommends that management should be committed to ethical business practices and follow the established control procedures. The study also observes that where an enterprise has internal audit environmental considerations as some of their objectives it is entirely necessary and appropriate that internal control should facilitate the assured achievement of those objectives. Additionally, the study concluded that Counties should have separate environmental audits conducted by someone other than internal audit; but internal audit should be in

a position to provide this service to the County, and to take account of work done by others that contributes to meeting this objective.

Subsequently, Internal audit ought to be all the time survey in all parts of the county and embed inward controls that will reinforce the increased public benefit. An effective internal control system requires that an appropriate control structure is set up, with control activities defined at every business level. These should include: top level reviews; appropriate activity controls for different departments or divisions; physical controls; checking for compliance with exposure limits and follow-up on non-compliance; a system of approvals and authorizations; and, a system of verification on reconciliation.

5.3 Area for Further Study

The research recommended that a study be done on the role of external auditing on the financial performance in Kenya with focus to County governments in order to depict real and offer independent opinion. The research also recommends that a study be done on challenges that are affecting internal auditing practices in both public and private sectors organization performance effectiveness.

5.4 Limitations of the Study

Due to inadequate funds the researcher conducted this research under serious financial constraints. This made it hard for an in-depth study to be conducted. Some respondents were biased while giving information due to reasons such as victimization as such the research findings was skewed. Secondly the limitation of time was much evident since the sources of the data operate on working days and the researcher was equivalently an employee. Respondents were naturally skeptical and uneasy when asked to contribute to a study in which they were not aware of its ramifications. The research process was expensive and tiresome exercise since the researcher had to commute frequently to where the respondents were and also had to communicate frequently to follow up with the respondents.

5.5 Conclusion

Based on the study findings, on effect of risk management on financial performance, the study found that County governments have appropriate risk based strategies which

can lead to viable and productive internal audit review. The findings conforms to Bromilow and Berlin (2008) organizations set up internal control framework as an administrative necessity that helps in guaranteeing that all management practices are fittingly completed. From the discoveries, the study presumed that hazard based evaluating through hazard appraisal, chance administration, yearly hazard based arranging, interior examining models and inner inspecting staffing ought to be upgraded. Internal audit practices helps an organization to achieve its goals by bringing an orderly, trained way to deal with assess and enhance the adequacy of hazard administration, control, and administration forms. The internal audit action assesses chance exposures identifying with the association's administration, operations and data frameworks. The interior evaluators are relied upon to give proposals to change in those territories where openings or insufficiencies are distinguished. Cohen (2002) pointed that internal auditing practices is a crucial part of an organization performance in both private and public sectors. On internal control practices, the study concluded that a company's internal control practices is widely believed to be crucial to the success of an enterprise since it acts as a powerful brake on the possible deviations from the predetermined objectives and policies. Hayes (2005) internal controls provide sensible yet not outright confirmation to a firm management and board of directors that the organization targets will be accomplished. This implies that an organization that set up a suitable and sufficient arrangement of internal controls is outdoing it is competitors and player that do not have such systems. Thus inadequate control systems may have negatively affected an organization's success and that successful internal control practices is connected with prudent organizational performance. Organizations develop some procedures to ensure it goals and objectives are attained effectively which help them accomplish execution and hierarchical objectives, avoid loss of assets, empower creation of dependable reports and guarantee consistence with laws and directions (Dunjia, 1997). Internal audit practices in organization can fundamentally influence the operations of the business and may affect the capacity of the firm to remain competitive.

The study established that internal auditing is regularly considered as a general checking action with obligation to management for surveying the viability of control techniques which are the duties of functional managers. Internal audit helps an

organization to complete its targets by bringing a composed, restrained approach that to build up the adequacy of hazard administration, control and administration forms (IIA, 2004). The internal audit function is not limited to the operation of any particular function within an organization. Rather, it is all-embracing and accordingly is structured in the organization as a separate entity responsible only to a high level of management. An effective internal audit service help to reduce overhead, distinguish approaches to enhance proficiency and boost introduction to conceivable misfortunes from deficiently shielded organization resources all of which can significantly affect the main issue. Cai (2007) internal auditing shapes a key managerial control mechanical assembly that is clearly associated with the structure and general standards of an affiliation.

Internal audit function in organizations where it exists, contributes considerably to execution change and help with distinguishing benefit prove in corporate calamities, especially money related extortion reliably archives a relationship between feeble administration. Venables and Impey (2010) expressed that internal audit is a significant instrument of administration for enhancing organization performance. Along these lines inner review by going about as a guard dog could spare the association from acts of neglect and anomalies in this manner empowering the association to accomplish its targets of guaranteeing abnormal state of efficiency and benefit. Hermanson and Rittenberg (2008) pointed that the existence.

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APPENDICES:

APPENDIX I

Objective	Variable	Indicators	Measurement scale	Question in questionnaire
To establish the association between the audit practices and financial performance factors of Vihiga County Government.	Independent : Risk Management	<ul style="list-style-type: none"> • Risk identification • Risk analysis and evaluation • Risk control and report 	Nominal/ Ordinal	Part B Question 1-3
To determine the contribution of audit practices to revenue based financial performance for Vihiga County Government	Independent : Internal environment audit practices	<ul style="list-style-type: none"> • Integrity and ethical values • Commitment and competence of staff • Organization policy on environmental control • Delegation of duties 	Nominal/ Ordinal	Part C Question 1-2
To analyse the effect of audit practices on expenditure based financial performance of Vihiga County Government	Independent : Monitoring and Control activities	<ul style="list-style-type: none"> • Performance reviews - appraisals • Physical controls • Segregation of duties • Supervisory activities • Assessment of risks • Monitoring procedures 	Nominal/ Ordinal	Part B Question 1-3

Operationalization of the Study Variables

APPENDIX II

QUESTIONNAIRE ON THE EFFECT OF INTERNAL AUDIT PRACTICES ON FINANCIAL PERFORMANCE OF VIHIGA COUNTY GOVERNMENT.

SECTION A:

DEMOGRAGHC INFORMATION

I would like to ask you questions about yourself. Please answer as truthfully as possible..Tick only one appropriate statement (response) in each question.

1. **Select your appropriate gender.**

Male Female

2. **Kindly choose the age bracket you belong to (tick one) :**

18-30 years 31-40 years 41-50 years 51-60 years
 61-70 years

3. **What is your marital status?**

Married Widowed Divorced Not married

4. **What position do you hold in the County?**

Manager Accounts clerk Auditor Procurement
Officer project Leader supervisor Local Administrator
Accountant Director

5. **For how long have you worked with the Vihiga County Government?**

0-5 years 6-10 years 11-15 years 16-20 years
 21 years and above

6. **What is your level of Education?**

PhD Masters Bachelor Degree Diploma
 Certificate Secondary School Certificate primary school certificate

SECTION B

This section contains five items on Internal Audit Practices. The statements are on a scale of a Likert Scale Rating of 1-5 Where (5)-Strongly Agree (4)- Agree (3) - Neutral (2)- Disagree and (1) Strongly Disagree

Items	Statement on Risk Management Audit activities	SA(5)	A(4)	N(3)	D(2)	S.D (1)
1	Risk identification activities properly organized					
2	Risk analysis and evaluation properly conducted.					
3	Risk Control well performed.					
4	Risk Control process properly done					
5	Risk reporting conducted					

SECTION C

This section contains five items on Internal Audit Practices. The statements are on a scale of a Likert Scale Rating of 1-5 Where (5)-Strongly Agree (4)- Agree (3) - Neutral (2)- Disagree and (1) Strongly Disagree

Items	Statement on Internal Environment Audit Activities.	SA(5)	A(4)	N(3)	D(2)	S.D (1)
1	Integrity practices carried out properly					
3	Segregation of duties well done.					
2	Environmental audits are properly conducted.					
4	Operating cycle Control exists					
5	Internal controls performed.					

SECTION. D

This section contains five items on Internal Audit Practices. The statements are on a scale of a Likert Scale Rating of 1-5 Where (5)-Strongly Agree (4)- Agree (3) - Neutral (2)- Disagree and (1) Strongly Disagree

Items	Statement on Monitoring and Control activities	SA(5)	A(4)	N(3)	D(2)	S.D(1)
1	Performance reviews and appraisals done to satisfaction.					
2	Physical controls instituted well					
3	Segregation of duties performed properly					
4	Supervision done well					
5	Monitoring procedures done well					

SECTION E

This section contains five items on Internal Audit Practices. The statements are on a scale of a Likert Scale Rating of 1-5 Where (5)-Strongly Agree (4)- Agree (3) - Neutral (2)- Disagree and (1) Strongly Disagree

Items	Financial Performance	SA(5)	A(4)	N(3)	D(2)	S.D (1)
1	Degree high of self-financing exist					
2	Existence of capacity to access to non-reimbursable financing.					
3	High level of revenue collection					
4	Manageable expenditure size.					
5	High investment capacity (development budget)					

APPENDIX III

REQUEST LETTER TO COLLECT DATA

HESBORN LUMWAJI EHAJI
PO BOX 150-50309
TIRIKI
1ST OCTOBER 2019

THE COUNTY SECRETARY,
VIHIGA COUNTY GOVERNMENT,
PO BOX 146
MARAGOLI

Dear sir/ Madam

RE: REQUEST TO COLLECT DATA

I am a student at Maseno University studying Master of Business Administration (Accounting Option) Reg. NO. MBA/BE/00029/017. An undertaking a research Project on “EFFECT OF INTERNAL AUDIT PRACTICES ON FINANCIAL PERFORMANCE. A CASE OF VIHIGA COUNTY”

It is on this basis that I request you to permit me to access County offices and its jurisdictions to collect data that will facilitate my research.

I wish to assure you that all the information collected will be treated with utmost confidentiality and it will only be used for the purpose of this research.

Yours faithfully,

HESBORN EHAJI LUMWAJI

0725792093