

**EFFECT OF INTERNAL AUDIT PRACTICES ON ORGANIZATION  
PERFORMANCE: A CASE OF REGULATORY BODIES IN KENYA**

**HARRIETTE IGONANGA CHIGGAI**

**REG NO: 13/01858**

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## DECLARATION

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

Students Name:

Reg, No: **13 / 01858**

**Harriette Chiggai**

Sign: \_\_\_\_\_

Date: \_\_\_\_\_

This research project has been submitted for examination with my approval as the candidate's supervisor.

Dr. Brigitte Okonga

Sign: \_\_\_\_\_

Date: \_\_\_\_\_

## ABSTRACT

For a large portion of its history internal control has served as a straightforward managerial strategy involved primarily of checking archives, numbering resources, and answering to Board of Directors, Management or External Auditors. As of late, be that as it may, a blend of various powers has prompted to a calm upset of the calling. Associations need to show responsibility in the utilization of shareholders cash and effectiveness in the conveyance of administrations. Associations now request awesome competency and polished methodology from interior review, and rare assets must be conveyed all the more proficiently to minimize and oversee dangers. An internal control framework includes the entire system of frameworks set up in an association to give sensible certification that hierarchical targets will be accomplished. The study aimed to investigate the effect of internal audit system on organization performance with focus to regulatory bodies in Kenya. The study investigated whether control environment, risk evaluation, internal auditing and control activities influence performance of regulatory bodies in Kenya. The study aimed to analyze the effect of internal audit system on organization performance with focus to regulatory bodies in Kenya. The target population of the study was employees of from 265 regulatory Bodies. The study employed stratified sampling technique in coming up with a sample size of 53 respondents where one respondent was targeted in each organization. The primary data collection method was used in collecting information through use of a questionnaire. The collected data was analyzed using regression analysis and descriptive statistics using SPSS version 20 and presented through percentages, means, standards deviations and frequencies. The findings were presented in form of frequency tables and figures while data was presented in prose. Multiple regression analysis was also used to establish the relationship between the dependent and independent variables. The study found that risk management was not significant in predicting the organization performance in regulatory bodies with p-value = -0.007. The regression coefficient of risk management is negative and insignificant in predicting the organization performance. This implies that a unit increase in risk management with lead to -0.752 will lead to decrease in organization performance. Further the study found that control environment had a significant co-efficient with a p-value of 0.242. The regression coefficient of control environment was positive and significant in predicting organization performance. This implies increase in control activities by a unit leads to increase in organization performance by 0.262. the study further found that Control activities had significant correlation with organization performance with p-values greater than 0.005 with a p-value of 0.009. The regression coefficient of control environment was significant in predicting organization performance. The study recommends risk assessment appraisal ought to be directed at the level of individual organizations and over the wide range of exercises and auxiliaries of the merged association. The concentrate additionally suggests that where an endeavor has ecological contemplations as some of their destinations it is totally vital and fitting that inside control ought to encourage the guaranteed accomplishment of those goals. Finally, the study recommends that internal control ought to be viable when analyzing outline can to a great degree valuable to guarantee a shielding assets and favorable exchanging climate particularly bookkeeping approach, administration arrangement, and operational strategy.

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## **DEDICATION**

This work is dedicated to my late mother Margaret, the pillar of my hard work and vision in life, a teacher who embraced education and an icon in changing the young people's lives through dedication and love for teaching and impacting knowledge, , my children Basil and Timmon and my sister Nelly for their continuous encouragement and support during the study.

## **ABBREVIATIONS AND ACRONYMS:**

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

## **TERMS AND DEFINATION**

<b>Best practices</b>	Commercial or professional procedures that are accepted or prescribed as being correct or most effective, ‘oxford dictionary (Barrier, 2003).
<b>Business entity:</b>	A person, partnership, organization or business that has a legal and separate identity with specific purpose’ (Limited Liability Partnership Act’, 2012)
<b>Compliance</b>	Conforming to a rule, such as a specification, policy, standard or law (Jackson, 2000).
<b>Corporate governance</b>	Most often viewed as both the structure and the relationships which determine corporate direction and performance (Gatamah, 2008)

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background to the Study**

The world over, it is acknowledged that the Internal Audit practices can possibly provide unparalleled administrations to management in the behavior of their obligations. There has been advance in achieving accord on what audit standards, governments and government offices ought to apply (Spencer, 2008). It is basic to note that both the International Organization of Supreme Audit Institutions (INTOSAI) and the Institute of Internal Auditors (IIA) have issued guidelines to manage inspecting in the general population area. On account of inside review and Audit Committees, rules must be in conformance with the Institute of Internal Auditors'- International Standards for the Professional Practice of Internal Auditing (Sayag, 2010).

This potential has been transformed into a test and typified in the new meaning of Internal Auditing from the Institute of Internal Auditors (IIA). For the greater part of its history internal audit review has served as a straightforward authoritative methodology contained essentially of checking records, tallying resources, and answering to Board of Directors, Management and External Auditors (Ramamoorti, 2003). However, as of late, a mix of various forces has prompted a peaceful transformation of the process. According to Gramling (2004) organizations need to exhibit responsibility in the utilization of shareholders' money and productivity in service delivery and reporting.

Globally, financial scandals have been witnessed triggering reaction for tighter regulation and enhanced standards for accounting and corporate governance (Sarbanes & Oxley,

2002). In America, scandals such World.com and Enron in year 2002 where investors lost over \$180 billion led to enactment of Corporate and Auditing Accountability and Responsibility Act (Sarbanes & Oxley, 2002). These major financial scandals were caused by poor internal control systems including weak corporate governance which the Sarbanes Oxley Act of 2002, tried to address. In South Africa, the effects and implementation of the King II Report on audit practices on organization performance have not been clearly measured or the results reported. However, this is contributed by failure of regulatory bodies providing little guidance on how these evaluations should be performed. He suggests that this process should be customized for individual companies and that it cannot be a case of one size fits all (Mahadeva, 2009).

According to Bromilow and Berlin (2008) across the world, organizations no longer set up internal control framework as an administrative necessity additionally in light of the fact that it helps in guaranteeing that all administration exercises are fittingly completed. Kenyon and Tilton (2006) firms are making it a state of obligation to prepare, instruct, and sharpen their workers on the most proficient method to utilize these internal control frameworks since its adequacy relies on upon the competency and constancy of the general population utilizing it. All these control activities guarantee that any dangers that may influence the organization's capacity to accomplish its objectives are fittingly maintained a strategic distance from and ought to happen at all levels and in all elements of the association.

In journey for more grounded responsibility environment, Kenya keeps on creating solid bookkeeping and evaluating frameworks (Rutto, 2011). For instance, it embraced a

globally perceived reporting system. In 1999 it embraced the International Financial Reporting Standards (IFRSs) and International Standards on Auditing (ISAs) for the Private Sector and generally, the International Public Sector Accounting Standards (IPSASs) in 2014. The Country rebuilt the general population segment and embraced execution contracting, organized screening of State Officers, set up Independent Commissions and Offices and different changes that keep on strengthening corporate administration and with current talks with the World bank to establish a Financial Oversight Authority to monitor Public Interest Entities (Sayag, 2010).

Organizations now demands for incredible competency and polished methodology from internal audit, and uncommon resources must be sent all the more capably to minimize and regulate risks (Ramamoorti, 2003). Mechanical progression makes it conceivable to track and examine information with consistently expanding speed therefore making it key for organizations to be very much prompted by the internal audit department (Fish, 2012). Internal audit differs starting with one association then onto the next, and rolling out improvement in modern environment can be a generous undertaking. The move from simply guaranteeing consistence with tenets and directions to really conveying included worth requires more than simply organizational changes.

A viable internal audit functions is one of the most grounded devices to screen and improve organization performance. Cohen (2002) pointed that internal auditing practices is a crucial part of an organization performance in both private and public sectors. Internal control refers to the measures founded by an association in order to guarantee achievement of the substance's targets, goals and operations. These are terms and

conditions employed by a firm in guaranteeing that organizations exchanges are prepared in the suitable way to maintain a strategic distance from waste, burglary and abuse of organization assets. Internal Controls are procedures composed and influenced by those accused of governance, management, administration, and other staff to give sensible certification about the accomplishment of an element's targets as to unwavering quality of the money related reporting, viability and effectiveness of operations and consistence with pertinent laws and directions (Mwindi, 2008).

As indicated by 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. The probability of accomplishment is influenced by constraints intrinsic in all frameworks of internal control practices. 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) views internal control practices involve the entire system of frameworks built up in an organization to give sensible confirmation that hierarchical targets will be accomplished.

### **1.1.1 Internal Auditing Practices**

Institute of Internal Auditors (IIA) (2009) referred internal auditing as a 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 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 audit's 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 helps 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 nation and city 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).

### **1.1.2 Concept of Organization Performance**

The term performance is frequently discussed but rarely defined. Organizational performance to a great extent contains the real yield or aftereffects of an association as measured against its proposed yields (or goals and objectives) (Dunjia, 1997). An effective organization is the one that is performing admirably and that is accomplishing its objectives and is adequately executing appropriate procedures.

Most internal audit specialists' points that successful internal audit practices relate with enhanced organization performance. As indicated by Bejide (2009) an internal audit administration can, particularly, decrease overhead, distinguish approaches to enhance proficiency and increase presentation to conceivable misfortunes from minimal defended organization resources all of which can significantly affect achievement of the organization goal. Additionally, Venables and Impey (2010) expressed that internal audit is a significant instrument of administration for enhancing organization performance. Fadzil (2005) likewise noticed that internal auditors run an organization proficiently and viably to maximize shareholders' expectations. Hermanson and Rittenberg (2008) pointed that the presence of a viable internal audit capacity is connected with effective firm performance.

Empirically, a study directed by KPMG (2011) established that internal audit review in a firm, contributes impressively to execution change and help in distinguishing benefit prove in corporate fiascos, especially monetary extortion reliably reports a relationship between powerless administration (fewer independent boards or nonattendance of an internal audit system) and the incidence of problems (Beasley, 2000). As such internal

audit works as a guard dog and prevent an organization to have a misconduct and anomalies subsequently empowering the association to accomplish its destinations of guaranteeing abnormal state of profitability and benefit. Greenlay and Foxall (2012) pointed that despite the fact that studies have found a relationship between bookkeeping control frameworks and performance hypothesis, predicts that these organizations will be impacted by external environmental impacts.

### **1.1.3 Regulatory Bodies in Kenya**

Regulatory bodies are public entities that were formed following introduction an act of parliament. The mandate of these institutions is direct specific sectors of the economy for the benefit of the Government (Belay, 2007). In Kenya, regulatory bodies have experienced thorough changes to enhance corporate governance. Recent research has shown that the assurance, compliance and consultant functions of internal auditing are considered as valuable contributors to governance practices in many organizations.

According to the 2013 presidential task force report, there are 265 state corporations in Kenya that are classified into 17 sectors of government (Presidential Task Force 2013). Each sector has regulatory bodies. The public sectors are as listed as: Banking sector; Actuarial Society; Education sector; Research and Innovation; Medical sector; Finance Sector; Business sector; Construction sector; Service industry sector; Alcohol and drug abuse; Agricultural sector and the Insurance sector.

Regulatory bodies in Kenya play a key role in promoting or accelerating market development and advancement. These entities are basic to enhancing the ability and specialized limit of the state in encouraging as well as advancing national advancement

(Presidential Task Force 2013). They are likewise vital instruments in enhancing the conveyance of open administrations, and achieving the essential desires of natives. They are differently connected to production of good as well as broad business openings in different locales. Regulatory bodies are helpful for focused and reasonable working of international organizations. In enhancing states to accomplish the above objectives; regulatory bodies' assume a noteworthy part in empowering social and financial change of the economies in which they operate in (RSA, 2013). In Kenya, these bodies have been built up and assumed these parts in various ways. The experience has been at times effective and in others not really. In the last ten years Kenya has been aiming to achieve economical growth, however achievable improvement plan are reflected in the adopted Vision 2030 plan.

## **1.2 Statement of the Problem**

Internal Audit is referred intention and self-governing appraisal benefits in an organization that deals with risk management, control and governance by accessing and evaluating their viability in accomplishing the organizations set objectives. Amid the most recent two decades evaluating capacities have risen as key systems in fortifying corporate administration universally. It was at first connected as non-compulsory practices to upgrade responsibility. As of late, various expert and administrative foundations in numerous nations have suggested the general utilization of inner practices and pushed for the extension of their part. The occurrence of prominent corporate disappointments, highlighted grave shortcomings in corporate administration structures exemplified by misrepresentation, poor bookkeeping and the disappointment of inner controls (Turner, 2007). This gave episodic confirmation supporting discernments on the

insufficient evaluating hones in observing danger and controls in enterprises and their compelling commitment to administration.

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 performance. Internal auditing abilities have ended up critical in unwinding the convoluted bookkeeping moves that have muddled budgetary articulations. Furthermore, the general population interest for change and resulting administrative activity has changed corporate administration. Progressively, organization officers and executives are under moral and lawful examination. Both patterns have the shared objective of dependably tending to speculators' worries about the money related reporting framework. However there has been laxity in implementation of internal audit findings and recommendations. Organizations should establish frameworks of internal control to help them accomplish execution and authoritative objectives, anticipate loss of assets, empower creation of dependable reports and guarantee consistence with laws and directions.

Following the complexity of the internal audit function, there are conflicting findings on the different roles played by internal audit in enhancing organization performance. Some scholars have found positive effects while others have established minimum or adverse effects of the internal audit function on corporate governance. Kibet (2008) established positive results of conducting an internal audit of state-owned enterprises and identified bureaucracies as the impediments. Similarly, Kibara (2007) conducted a survey of the

risk management practices of internal auditors in banking sector in Kenya and found that there is a positive effect facilitated by the implementation of risk and compliance policies. Herdman (2002) also found out positive association while Davidson (2005) established a minimal effect. Mutua (2012) researched on relationship between risk based audit on financial improvement of commercial banks in Kenya. He found that hazard based auditing through hazard evaluation, risk management, yearly hazard based arranging, internal auditing norms and internal auditing staffing should be overhauled.

Otieno (2012) researched on impacts of corporate governance and financial performance of commercial banks in Kenya. He concluded that corporate governance elements represent 22.4 % of the budgetary execution of commercial banks

This means that the audit committee should be informed of such irregularities through internal audit reports. From the above studies, no study has looked at the effect of internal audit practices on organization performance. It is against this realization that the current study aims to investigate effect of internal audit practices on organization performance with focus to regulatory bodies in Kenya.

### **1.3 Objective of the Study**

The overall research goal was to establish the effect of internal audit practices on organization performance with focus to regulatory bodies in Kenya. The following are the specific research objectives;

- i. To determine the effect of risk management practice on performance of regulatory bodies in Kenya.

- ii. To establish the effect of internal environment audit practices on performance of regulatory bodies in Kenya.
- iii. To establish the effect of monitoring and control activities on performance of regulatory bodies in Kenya.

#### **1.4 Research Questions**

The research aimed to answer the questions below:

- i. How does risk management affect performance of regulatory bodies in Kenya?
- ii. Do internal environment audit practices affect performance of regulatory bodies in Kenya?
- iii. Does monitoring and control activities affect performance of regulatory bodies in Kenya?

#### **1.5 Significant of the Study**

The results and recommendations of the study will help the policy maker in decision making and enable them put in place policies guiding operation of the public organizations. The management in both public and private sectors will also understand the anomalies in their operations.

This study will help in enhancing the role of internal audit in management staff to make them more successful and expert. It will 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 regulatory bodies in Kenya will have the capacity to search for methods for making Internal Audit a totally free capacity from the management along these lines making it more successful. By executing suggestions given on the internal audit reports administration will have the capacity to upgrade execution of regulatory bodies in Kenya. The findings will help the government in particular to learn a lot about accountability, efficiency and effectiveness of service delivery.

For researchers it will help them to acknowledge and upgrade their insight into inside review to hold fast to the expert morals as required by the IAS. The finding will also help the researcher to understand why organizations perform the way they do, despite internal controls put in place. The students and academics would use this study as a basis for discussions on the corporate governance practices and how these affect performances.

### **1.6 Justification of the Study**

Internal auditing assumes a basic part in the administration and operation of an association. At the point when viably executed, worked and oversaw, it is considered as a vital component in helping an association accomplishes its goals. Associations that adequately utilize inside evaluating can recognize business dangers, process and framework wasteful aspects and make fitting remedial move and at last bolster 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 organization performance with focus to regulatory bodies in Kenya.

### **1.7 Scope of the Study**

The research sought to determine the effectiveness of internal audit practices on organization performance with focus to regulatory bodies in Kenya. The study targeted the top management in the audit department of the 265 regulatory bodies in their head offices located in Nairobi.

### **1.8 Time Scope**

The study was designed to cover the period from the year 2013-2015, the period for three years.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

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

#### **2.2 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 characterizes the general outline of a house (LoBiondo & Haber, 1998).

##### **2.2.1 Control Theory**

Control theory is considered as an interdisciplinary source of illustrating and science that game plans with the lead of dynamical system with data sources. The outside duty of a framework is known as the reference. At the point when no less than one yield components of a structure need to take after a specific reference over the long haul, a controller controls the commitments to a system to gained needed effect on the yield of the system.

The goal of a control hypothesis is to ascertain answers for the best possible collective activity from the controller that outcome in system steadiness that is, the system will hold the set point and not waver around it. Frameworks have inputs and yields to bring an item

in the wake of preparing thus inputs and yields of a control framework are by and large related by differential conditions.

Setting objectives, spending arrangements, masterminds and distinctive goals develop criteria for control. Control itself exists to keep execution or a circumstance inside what is routine, allowed or saw. Control worked inside a theory is inside in nature. It happens with a blend of interrelated parts, for instance, social environment affecting behavior of pros, information essential in control, and strategies and methodology. Inside control structure is a procedure picking how inside control contains these parts.

From control point of view, the significance of inward evaluating hones comes from the need to adjust the interests of administration with different partners in the firm keeping in mind the end goal to make the administration responsible on the additions of the firm and expand the inner review division viability. Different interior reviewing systems can be utilized to screen the administration's conduct and these incorporate having a powerful review board of trustees and both outside and inner review. Davidson et al., (2005) depict the mind boggling collaborations between these inner examining systems as the corporate administration mosaic.

The theory control theory applies in businesses today, as it is turned out to be essential for their operation and accomplishing the goal of associations. The part of inward reviewing is to survey the viability of the inside control framework and to see if the framework is working as planned.

### **2.2.2 Institutional Theory**

Institutional theory is an aspect of social structure. It regards strategies by which structures, including plans; guidelines, measures, and schedules, get to be set up as legitimate rules for social conduct (Scott, 2004). Fogarty (1997) states that the institutional theory designs an organization in such a way that its functions meet the social expectations and the operations are obvious to public in general. Subsequently, the inward operations of an association, which are frequently mind boggling and hard to perceive, are secondary while external legitimacy is the primary focus. In addition, the operation process of a company and the technology it adopts determines the external image of the organization.

Fogarty (1997) asserted that the primary contribution of the theory of institution is in the understanding of the real achievements of an organization. In any case, the genuine accomplishment of an association and the normal achievements are regularly extraordinary. While structures kept up for correspondence with outcasts don't altogether add to the organization's profits, most associations work with inside procedures that are not generally unmistakable to untouchables.

Fogarty (1996) stated that organizations' can avoid scrutiny by outsiders by adopting the right structures. However, loose technological coupling allows organizations to demonstrate success in external problems even as they allow flexibility in operational processes. Therefore, institutions should be prepared to meet the high cost of espousing various technologies in the internal audit department and ensure that the staff is qualified so that the department can operate efficiently. From the internal auditing practices,

organisation works with inward procedures that are not ordinarily noticeable to those outer to it, while different structures kept up for pariahs don't altogether add to yield. Investigation by outcasts can maintained a strategic distance from if the right structures are received by associations. Thus the organization should embrace internal auditing practices to enhance its performance. In this study, institutional theory highlights its relationship with economic resources dependency perspective to provide a more comprehensive conceptual framework for understanding need for auditing practices in the public sector. It considers the methods by which structures, including plans, standards, measures, and timetables, get the opportunity to be developed as authoritative guidelines in evaluating hone.

### **2.2.3 Stewardship Theory**

The roots of the stewardship theory are psychology and sociology. Davis, Schoorman 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 cutoff 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.

### **2.3 Empirical Review**

This section reviews the existing empirical studies on internal audit practices on organization 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.

#### **2.3.1 Auditing Function and Organizational 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 after 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 auditors 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 administration. 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.

### **2.3.2 Risk Management and Organizational 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 to 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 may 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 leveled 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 figure 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.

### **2.3.3 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 affirm that control environment is seen as 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 around 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 hones 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' 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. Any thing 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 endeavor 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 have. Association structure is the grantee for the undertaking to accomplish generally speaking.

#### **2.3.4 Control Activities and Organizational Performance**

Ray and Pany (2010) referred control exercises as another part of inner controls. They observe that control activities are methodologies and frameworks that certification that

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 and 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).

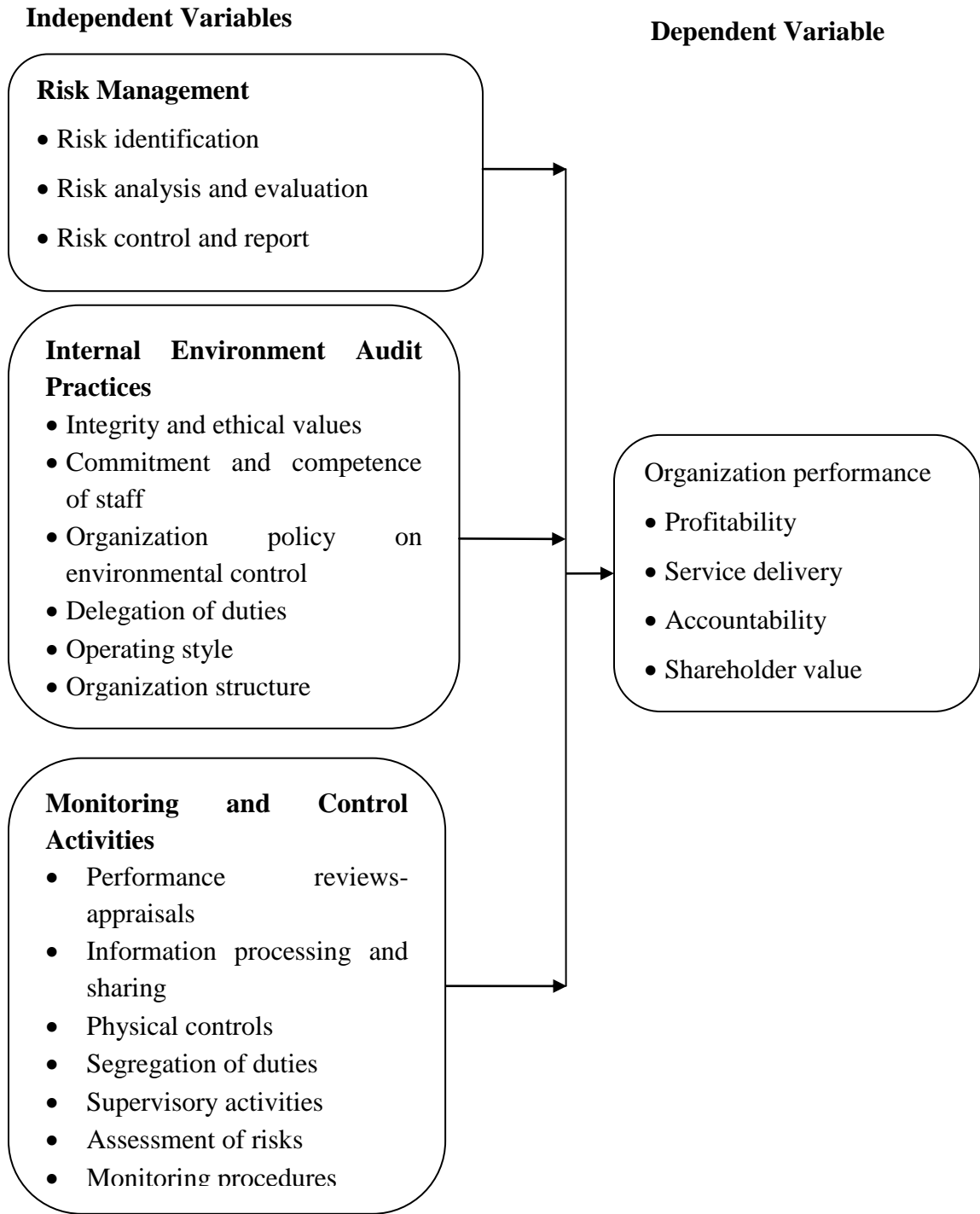
Control activities are the Inside control structures ought to be watched - a system that assesses the way of the structure's execution after some time. Constant watching happens in the ordinary course of operations, and joins reliable organization and supervisory activities, and diverse moves staff make 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).

#### **2.4 Conceptual Framework**

Mugenda and Mugenda (2008) define a conceptual framework as a system of variables operationalized by the researcher in an attempt to realize the set objectives. The independent variables in this research are risk management, internal environment audit practices and monitoring and control activities while the dependent variable is organization performance. Figure 2.1 represents the research structure of internal audit controls as the independent variables and their interplay with the independent variable.



**Figure 2.1: Conceptual Framework**

## 2.5 Research Gap

Most of the literature reviewed is from developed nations whose financial footing and strategic approach is different from that of Kenya. 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 organization performance with focus to regulatory bodies in Kenya.

## 2.6 Operationalization of the Variables

The study operationalized the effect of internal audit practices on organization performance. The independent variables are risk management, control environment, control activities and monitoring of control. The dependent variable is organizational performance. The following operationalization table gives the insight on how the various variables will be measured, analyzed and conclusions drawn thereafter.

**Table 2.1: Operationalization of the Study Variables**

<b>Objective</b>	<b>Variable</b>	<b>Indicators</b>	<b>Measure ment scale</b>	<b>Question in Questionnaire</b>
To examine the effect of risk management practice on performance of regulatory bodies in Kenya	<b>Independent</b> Risk Management	<ul style="list-style-type: none"><li>• Risk identification</li><li>• Risk analysis and evaluation</li><li>• Risk control and report</li></ul>	Nominal/ Ordinal	Part B Question 1-3
To establish the effect of internal	<b>Independent</b> Internal	<ul style="list-style-type: none"><li>• Integrity and ethical values</li></ul>	Nominal/ Ordinal	Part C Question1-2

audit environment on performance of regulatory bodies in Kenya	environment audit practices	<ul style="list-style-type: none"> <li>• Commitment and competence of staff</li> <li>• Organization policy on environmental control</li> <li>• Delegation of duties</li> </ul>		
To assess the effect of monitoring and control activities on performance of regulatory bodies in Kenya	<b>Independent</b> Monitoring and Control activities	Performance reviews-appraisals Information processing and sharing Physical controls Segregation of duties	Nominal/ Ordinal	Part D Question 1-3
		<ul style="list-style-type: none"> <li>• Supervisory activities</li> <li>• Assessment of risks</li> <li>• Monitoring procedures</li> </ul>	Nominal/ Ordinal	

## 2.7 Research Hypothesis

The following hypothesis will be used to test the regression model that will be adopted for data analysis.

H<sub>01</sub> Risk management practices have no significant effect on organization performance in regulatory bodies.

H<sub>02</sub> Control environment has no significant effect on organization performance in regulatory bodies.

H<sub>03</sub> Monitoring and control activities have no significant effect on organization performance in regulatory bodies.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

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

#### **3.2 Research Design**

Research design is fundamental arrangement that demonstrates a diagram of the exercises that are important to execute the examination extend. The ebb and flow research was concentrated on through 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 center of this study was quantitative. The underlining idea is to choose a few focused on situations where a serious examination recognized the conceivable choices for unraveling the exploration addresses on the premise of the current arrangement.

#### **3.3 Target Population**

Target population is the particular populace about which data is coveted. As per Kombo and Tromp (2006) a population is an especially described or set of people, organizations, segments, events, social occasion of things or families that are being inspected entirety up the results. This definition expected that the populace is not homogeneous. The

population of this study comprised of all regulatory bodies in Kenya. According to the Presidential Task Force report (2013) there are 265 regulatory bodies in Kenya distributed across the government ministries. The mandate of regulatory bodies is direct specific sectors of the economy for the benefit of the Government.

### **3.4 Sampling and Sample Size**

In this study, simple random sampling technique was used to select the sample to be included in the study. The method was chosen because every element in the population had an equal chance of being selected as the sample. According to Sekaran (2011) simple random sampling has the least bias and offered the most generalization and hence for the study to be more representative, it was important that the right method was chosen. Mugenda and Mugenda (2003) states that the descriptive studies 10-40% of the accessible population is a representative sample. Out of the 265 regulatory bodies, the study focused on a sample size of 53 regulatory bodies where the heads of internal audit function in each organization targeted.

### **3.5 Instrument and Data Collection**

This study utilized a questionnaire 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 involved both open and close-finished inquiries. The study used likert scale to generate the questions in the questionnaire. The questionnaire had structured questions. The close-ended questions gives more organized reactions to encourage substantial suggestions. The questionnaire addressed the three

research objectives therefore it was sub-divided into two sections. The first section of the questionnaire collected demographic data of the respondents, while the next sections answered the three objectives of the study, that is, risk management, control environment, control activities.

### **3.6 Data Collection**

The researcher engaged three research assistance to assist in conveyance of questionnaires to the focused on respondents. The researcher and research assistants administered the questionnaires to the respondents face to face. The questionnaires were distributed through drop and pick later method. However, where the respondents had time to fill the questionnaire as the research assistant waits were accorded any assistance and clarification that he or she wants.

### **3.7 Validity and Reliability**

The study conducted a pilot study to pre test and validates the data instrument. The pilot testing was conducted using the questionnaire on 14 management staff from ICPAK. The pilot group was done through random sampling.

The motivation behind the pilot test is 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 were 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 aftereffects of a study are repeatable. The researcher used the most widely recognized interior consistency measure known as Cronbach's alpha ( $\alpha$ ). 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 was utilized as a cut-off of reliabilities (Rousson, Gasser & Seifer, 2002). The pilot testing was re-run until the researcher is satisfied with the data collection instruments.

### **3.8 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 data was shown by utilization of bar diagrams, diagrams and pie outlines and in exposition shape. This was 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 utilized multiple regression analysis to determine the quality of the relationship between the dependent and independent factors.



The researcher used multiple regression analysis to establish the strength of the relationship between the dependent and independent variables.

The regression equation is:

$$Y = \beta_0 + \beta_1 RM_1 + \beta_2 IC_2 + \beta_3 C_3 + \epsilon$$

Where: **Y** is dependent variable (organization performance),

$\beta_0$  is the regression coefficient/constant/Y-intercept,

$\beta_1$ ,  $\beta_2$ ,  $\beta_3$  and  $\beta_4$  are the slopes of the regression equation,

**RM<sub>1</sub>** is the risk management

**IA<sub>2</sub>** is the internal environmental audit,

**CA<sub>3</sub>** is the control activities,

**$\alpha$**  is an error term normally distributed about a mean of 0 and for purpose of computation,

the  **$\alpha$**  is assumed to be 0.

## **CHAPTER FOUR**

### **DATA ANALYSIS AND INTERPRETATION OF FINDINGS**

#### **4.1 Introduction**

This chapter discusses the interpretation and presentation of the findings. The purpose of the study was to analyze effect of internal audit practices on organization performance with focus to selected regulatory bodies in Kenya. The study presents the finding of the study by use of frequency tables and figures. The finding intended on answering the study's research questions. Data collected were reported and summarized in form of tables and figures and qualitative analysis done in prose.

#### **4.2 Response Rate**

The study targeted a sample of 56 respondents. However, out of 56 questionnaires distributed 46 respondents completely filled in and returned the questionnaires, this represented a 87% response rate. This is a reliable response rate for analysis as Mugenda and Mugenda (2003) showed that 50% of response rate is sufficient for analysis and presentation of the data, 60% is reliable and 70% of response rate and over is excellent. However, 13% of the respondent were reluctant to responded to fill the questionnaire this was due to reasons like, the respondent were not available to fill them in at the required time and even after subsequent follow-up there were no positive reactions from them.

**Table 4. 1 Response Rate**

<b>Response</b>	<b>Frequency</b>	<b>Percentage (%)</b>
Filled in questionnaires	46	87
Non response	7	13
<b>Total</b>	<b>53</b>	<b>100.0</b>

### **4.3 General Information**

The study aimed to establish the general information about the respondent. The study used this information to base the study finding on the experience of the respondents and familiarity of the respondent to the information that the study sought.

#### **4.3.1 Gender of the Respondent**

Further the study aimed to establish the distribution of respondents gender. According to the study findings most (56.5%) of the respondents were female while the rest 43.5% were male. This implies that majority of most of the employees in regulatory bodies are male while their counterpart occupies only small portion.

#### **4.3.2 Age Category of the Respondent**

The study further aimed to establish the age category of the respondent. Table 4.2 shows the results of the study.

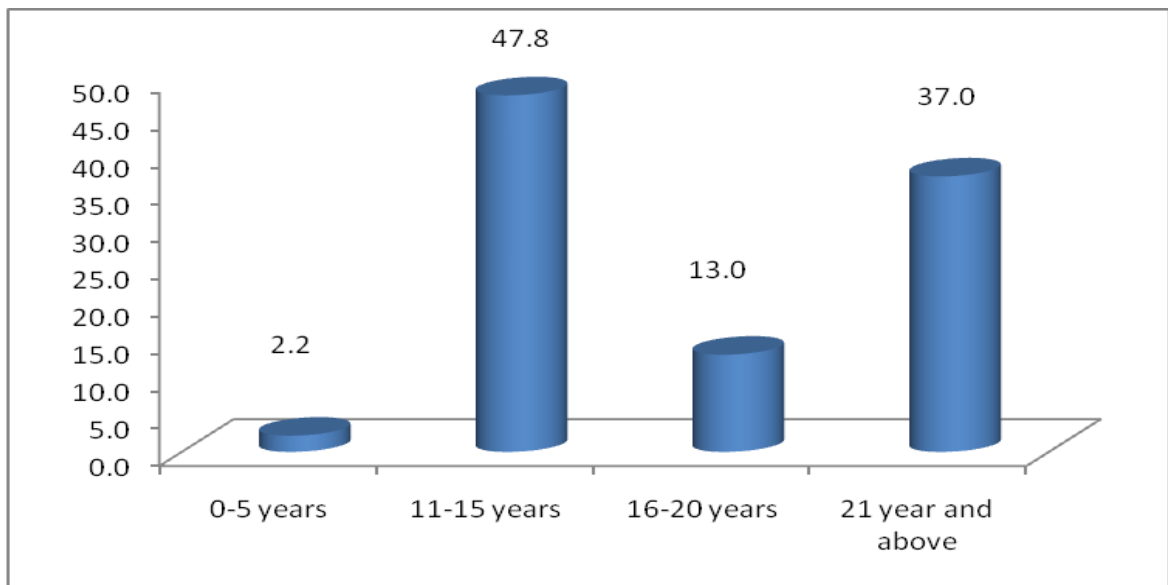
**Table 4. 2 Age Category of the Respondent**

	<b>Frequency</b>	<b>Percentage</b>
21-29	5	10.9
30-39	9	19.6
40-49	26	56.5
50 years and above	6	13.0
<b>Total</b>	<b>46</b>	<b>100.0</b>

From the study 56.5% of the respondents aged 40-49 years, 19.6% of aged 30-39 years, 13% aged above 50 years while 10.9% were aged between 21-29 years. This depicts that majority of the regulatory bodies employees were aged between 21-39 years as shown by a total of 76.1% within the categories.

### **4.3.3 Working Duration**

Table 4.3 illustrates working duration of the respondents in their respective organization.



**Figure 4. 1 Working Duration**

From the findings most (47.8%) of the respondents had worked in the organization for a period of 11-5 years, 37% had worked for a period of above 21 years, 13% had worked for a period of 16-20 years while the rest (2.1%) had served in the organization for a period less than 5 years. This suggests that most of the respondents of this study had worked for an abundant time inside the association therefore they were familiar of the data that the study looked for relating to the association.

#### **4.4 Effect of Risk Management on Organization Performance**

The study further aimed to investigate effect of risk management and how it affects organization performance. From the findings, most of the respondent pointed that risk assessment, risk management strategies, risk mitigation, risk monitoring, assess ethics and values within the organization, risk management provide guarantee to the management that risks are appropriately managed, risk identification and that assessment performance management effectiveness influence organization performance as depicted by mean score of 4.43, 4.41, 4.37, 4.30, 4.28, 4.26, 4.11 and 4.00 respectively. Further respondent agreed that unplanned and informal reviews of other areas of concern, including unacceptable levels of risk and assess communication of risk enhance organization performance effectiveness as shown by mean score of 3.89 and 3.85 respectively.

**Table 4. 3 Effect of Risk Management on Organization Performance**

	<b>Mean</b>	<b>STDev</b>
Risk identification	4.11	0.526
Risk assessment	4.43	0.544
Risk mitigation	4.37	0.532
Risk monitoring	4.30	0.511
Risk management strategies	4.41	0.541
Risk management provide assurance that the risks are being appropriately managed	4.26	0.535
Assess ethics and values within the organization	4.28	0.502
Assess performance management	4.00	0.789
Assess communication of risk	3.85	0.666
Unplanned and informal reviews of other areas of concern, including unacceptable levels of risk	3.89	0.737

#### **4.5 Effect of Internal Control on Organization Performance**

The researchers requested the respondent to indicate the effect of internal control on organization performance. From study results most of respondents agreed pointed that accounting information and communication, provide financial controls, managerial controls and reviews of individual systems and processes influence organization performance effectiveness as shown by mean score of 4.26, 4.17, 4.14 and 4.13 respectively. Respondents also indicated that provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision making process, Operational policies controls, Ongoing and independent reconciliation of all balances, Methodical examination of business processes and connected controls and control

information within the organization influence organization performance effectiveness as depicted by mean score of 3.93, 3.91, 3.89 respectively.

**Table 4. 4 Effect of Internal Control on Organization Performance**

	<b>Mean</b>	<b>STDev</b>
Reviews of individual systems and processes	4.13	0.341
Provide Financial controls	4.17	0.437
Managerial controls	4.14	0.859
Operational policies controls	3.93	0.533
Control information within the organization	3.85	0.788
Accounting Information and communication	4.26	0.681
Assessment of internal control framework	4.04	0.631
Methodical examination of business processes and connected controls	3.89	0.706
Provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision making process	4.00	0.816
Ongoing and independent reconciliation of all balances	3.91	0.661

#### **4.6 Effect of Monitoring and Control Activities on Organization Performance**

The researcher requested the respondents to indicate effect of monitoring and control activities on organization performance. Most of the respondents pointed that monitoring procedures, checking for compliance with exposure limits, physical controls, supervisory activities, environmental monitoring, system of verification on reconciliation, assessment of risks and that segregation of duties influence organization performance effectiveness 4.43, 4.17, 4.13, 4.10, 4.10, 4.07, 4.02 and 4.01 respectively. Follow-up on non-

compliance, information processing and sharing, system of approvals and authorizations, performance reviews and that environmental management influence organization effective as depicted by mean score of 3.98, 3.96, 3.87 and 3.67, 3.65 respectively.

**Table 4. 5 Effect of Monitoring and Control Activities on Organization Performance**

	<b>Mean</b>	<b>STDev</b>
Performance reviews	3.67	0.560
Information processing and sharing	3.96	0.698
Physical controls	4.13	0.718
Segregation of duties	4.01	0.745
System of approvals and authorizations	3.87	0.749
Follow-up on non- compliance	3.98	0.665
Checking for compliance with exposure limits	4.17	0.677
System of verification on reconciliation	4.07	0.772
Supervisory activities	4.10	0.680
Assessment of risks	4.02	0.715
Monitoring procedures	4.43	0.655
Environmental management	3.65	0.674
Environmental monitoring	4.09	0.725

#### **4.7 Aspects of Corporate Governance**

Table 4.6 illustrates the study finding on effect of corporate governance on organization performance. Respondents pointed that Independence, Fairness, Responsibility and that accountability has improved organization performance as indicated in a mean score of 4.65, 4.43 and 4.39 respectively. Social responsibility, discipline and that transparency has improved organization performance as shown by a mean score of 4.33, 4.26 and 4.17 respectively.



**Table 4. 6 Aspects of Corporate Governance**

	<b>Mean</b>	<b>STDev</b>
Discipline	4.26	0.491
Transparency	4.17	0.486
Independence	4.65	0.482
Accountability	4.35	0.482
Responsibility	4.39	0.537
Fairness	4.43	0.544
Social responsibility	4.33	0.519

**4.8 Pilot 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 be done later on. The findings of the pilot study shows that questions control activity had the highest reliability ( $\alpha=0.751$ ) followed by internal environment audit ( $\alpha = 0.723$ ) then risk management ( $\alpha=0.713$ ). This illustrates that all the four scales were reliable as their reliability values exceeded the prescribed threshold of 0.7 (Nunnally, 1978).

**Table 4. 7 Reliability Coefficients**

<b>Scale</b>	<b>Cronbach's Alpha</b>	<b>Number of Items</b>
Risk management	0.713	12
Internal environment audit	0.723	11
Control activities	0751	19

## 4.9 Regression Analysis

The study conducted regression analysis to show the relationship between internal audit practices and organization performance. Before the regression analysis, the data was subjected to assumptions of regression analysis, with no violation observed.

### 4.9.1 Relationship between Internal Audit Practices and organization Performance

An analysis was performed on the relationship between internal audit practices and organization performance. The study used multiple linear regression model and before the regression analysis, the data was subjected to assumptions of regression analysis with no assumptions violated

**Table 4. 8 ANOVA**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.037	3	3.346	3.926	.015 <sup>b</sup>
	Residual	35.79	42	0.852		
	<b>Total</b>	<b>45.826</b>	<b>45</b>			

b. Predictors: (Constant), TOTALMC, TOTALAUDIT, TOTALRISK

From the table above, the model was significant (p-value = 0.015) at 0.05 level in explaining the linear relationship between internal audit practices and organization performance. Additionally, the F-statistic is significantly greater than 1 thus indicating the appropriateness of the model in testing the relationship between independent and dependent variable. This means that the model is appropriate for use running a factor analysis.

#### 4.9.2 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. 9 Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.468 <sup>a</sup>	.219	.163	.92311

a. Predictors: (Constant), TOTALMC, TOTALAUDIT, TOTALRISK

In Table 4.8, the model had a coefficient of determination ( $R^2$ ) = 0.219, indicating that 21.9% of the variation in organization performance was explained by the variables in the model leaving 78.1% of the variations in organization performance to be explained by variables not in the model. Adjusted  $R^2$  indicates the true behavior of  $R^2$  that varies in accordance with the changes in independent variables. 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.

### 4.9.3 Coefficient of Correlation

An interpretation of the coefficients in Table above shows control activity had a significant coefficient with p-value = 0.242, control environment had a significant coefficient with a p-value of 0.009 risk management had no significant with p-values greater than 0.007.

From the estimated regression equation;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon$$

Where  $\beta_0$  is the constant = 1.665,  $\beta_1 = -0.752$ ,  $\beta_2 = 0.262$ ,  $\beta_3 = 0.639$ . The fitted regression equation of the model becomes;

$$Y = 0.89 + -0.752X_1 + 0.262X_2 + 0.639X_3 + \epsilon$$

It is evident from the above regression model that if all factors were to be held constant then a unit change predictor variables would result in a 1.665 change in organization performance.

The regression coefficient of risk management was not significant in predicting in predicting the organization performance in regulatory bodies. This implies that a unit increase in risk management with lead to -0.752 will lead to decrease in organization performance. The study thus accepts the null hypothesis that risk management has no significant effect on organization 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 hazard authorities.

The regression coefficient of control environment was positive and significant in predicting organization performance. This implies that a unit increase in internal environment audit will result in a unit increase in organization performance by 0.264. Thus the study rejects the null hypothesis that states that there is no significant effect between control environment and organization performance. These findings are consistent to the findings of Whittington and Pany (2001)

The regression coefficient of control activity is positive and significant in predicting the organization performance in regulatory bodies. This implies that a unit increase in control activity will lead to 0.639 increases in organization performance. From the study results the null hypothesis which states that control activity has no significant effect on organization performance. The findings of the study are consistent with the results of Anduuru (2005) that organizations that have control activities in place outdo the one without in their performance.

**Table 4. 10 Coefficient of Correlation**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.665	.723		2.303	.026
TOTAL RISK	-.752	.264	-.633	-2.849	.007
TOTAL IEA	.262	.221	.238	1.187	.242
TOTAL CA	.639	.233	.565	2.740	.009

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Introduction**

This chapter depicts the summary of the data findings on the effect of internal audit practices on organization performance with focus regulatory bodies in Kenya, the conclusions and recommendations are drawn there to. The chapter is therefore structured into summary of findings, conclusions, recommendations and area for further research.

#### **5.2 Summary of the Findings**

The objectives of this study were to ascertain the effect of risk management, internal audit environment and monitoring control activities on performance of regulatory bodies in Kenya.

From the study findings most of the respondent indicated that risk assessment, risk management strategies, risk mitigation, risk monitoring, assess ethics and values within the organization, risk management provide assurance that the risks are being appropriately managed and risk identification influence organization performance effectiveness. A sound system of internal control contributes to safeguarding the shareholders investment and the company'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 was not significant in predicting in predicting the organization performance in regulatory bodies with  $p\text{-value} = -0.007$ . The regression coefficient of risk management is negative and insignificant in predicting the

organization performance. This implies that a unit increase in risk management will lead to -0.752 will lead to decrease in organization performance.

On control environment and organization performance, the study established that accounting information and communication provide financial controls, managerial controls and reviews of individual systems and processes influence organization performance effectiveness. Provision of autonomous confirmation of an adequate specimen of exchanges to guarantee uprightness of the basic leadership handle, operational strategies controls, Ongoing and free compromise of all parities influence organization performance effectiveness. Risk impacts an organization's capacity to contend and to keep up its financial strength and the nature of its products and services. An effective internal control system requires that the material risks that could adversely affect the achievement of the bank's goals are being recognized and continually assessed. Further the study found that control environment had a significant co-efficient with a p-value of 0.242. The regression coefficient of control environment was positive and significant in predicting organization performance. This implies that increase in control activities leads to increase in organization performance by 0.262. Thus the study will accept the alternative hypothesis that there is significant relationship between control environment and organization performance.

To the effect of monitoring and control activities on organization performance, the study found that monitoring procedures, checking for compliance with exposure limits, physical controls, supervisory activities, environmental monitoring, system of verification on reconciliation, assessment of risks and that segregation of duties influence

organization performance effectiveness. Control activities had significant correlation with organization performance with p-values greater than 0.005 with a p-value of 0.009. The regression coefficient of control environment was significant in predicting organization performance. This implies that an increase in control activities leads to decrease in organization performance by 0.639.

### **5.3 Conclusion**

Based on the study findings, on effect of risk management on organization performance the study found that organization have appropriate risk based hence 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 its 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 its 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 of an effective internal audit capacity is connected with effective firm performance.

#### **5.4 Recommendation of the Study**

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

The study recommended that risk assessment should be led at the level of individual organizations and over the wide range of exercises and auxiliaries of the solidified association. This includes evaluating the risks to determine which are controllable by the bank 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 control environment, the study concludes that management attitude should be committed to ethical business practices and follows the established control procedures. This is the establishment for every other segment of inside control, giving order and structure. The study also concludes that where an enterprise has 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 organizations 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 business, and to take account of work done by others that contributes to meeting this objective.

To the effect of control activities on organization performance, the study recommends that internal control ought to be viable when looking at outline can amazingly gainful and is as a rule for association administration and broadly to monetary proclamations at present, a wide range of business firms have utilized interior controls through the development of strategies to guarantee a shielding resources and beneficial business environment particularly bookkeeping arrangement, administration approach, and

operational strategy. Subsequently, inner control ought to be all the time survey in all parts of their organization and embed inward controls that will reinforce the organization and increment 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.

### **5.5 Area for Further Study**

The study recommended that a study be done on the role of internal auditing in the organizational performance with focus to private sectors in order to depict real situation across the sectors. The study also recommends that a study be done on challenges that affecting internal auditing practices in both public and private sectors.

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## APPENDICES

### Appendix I: Introductory Letter

Dear Sir/Madam,

#### **REF: REQUEST TO CARRY OUT DATA COLLECTION.**

I am a student at KCA University pursuing a Master's degree in Business Administration (Corporate Management). As a requirement in fulfillment of this degree, am carrying out a study on the **'EFFECT OF INTERNAL AUDIT PRACTICES ON ORGANIZATION PERFORMANCE: A CASE OF REGULATORY BODIES IN KENYA.'**

You have been chosen as you are well positioned to provide reliable information that will enable the study achieve its objectives. I intend to research the above through the use of questionnaires.

Any assistance accorded to me in my noble cause and information given shall be treated as confidential and will be used purely for the purpose of this research and a final copy of the document shall be availed to you upon request. Your cooperation will be highly appreciated and thank you in anticipation.

Yours Faithfully,

Harriete Chiggai

## Appendix II: Questionnaire

### SECTION A: DEMOGRAPHIC INFORMATION

1. Gender of the respondent :

Male  [ ]

Female  [ ]

2. Age of the respondent

Below 20 years  [ ]

21-29 years  [ ]

30-39 years  [ ]

40-49 years  [ ]

50 years and above  [ ]

3. length of service in the organization

0-5 years  [ ]

6-10 years  [ ]

11-15 years  [ ]

16-20 years  [ ]

21 years and above  [ ]

### SECTION B: INTERNAL AUDIT IN ENHANCING ORGANIZATION PERFORMANCE

4. How effective are the following functions of internal audit through risk management, enhancing organization performance? Use a scale of 1-5 where 5= very effective, 4= effective, 3 = moderately effective, 2= slightly effective and 1= ineffective

<b>Risk management</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Risk identification					
Risk assessment					
Risk mitigation					
Risk monitoring					

Suggest risk management strategies					
provide assurance that the risks are being appropriately managed					
Assess ethics and values within the organization					
Assess performance management					
Assess communication of risk					
Unplanned and informal reviews of other areas of concern, including unacceptable levels of risk					

5. How effective are the following functions of internal audit through internal environment audit practices enhancing organization performance? Use a scale of 1-5 where 5= very effective, 4= effective, 3 = moderately effective, 2= slightly effective and 1= ineffective

<b>Internal Control</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Reviews of individual systems and processes					
Provide Financial controls					
Managerial controls					
Operational policies controls					
Control information within the organization					
Accounting Information and communication					
Assessment of internal control framework					
Methodical examination of business processes and connected controls					
Provision of independent verification of a sufficient sample of transactions to ensure integrity of the decision making process					
Ongoing and independent reconciliation of all balances					

6. How effective are the following functions of internal audit through monitoring and control activities enhance organization performance? Use a scale of 1-5 where 5= very effective, 4= effective, 3 = moderately effective, 2= slightly effective and 1= ineffective

<b>Control activities</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
Performance reviews					
Information processing and sharing					
Physical controls					
Segregation of duties					
System of approvals and authorizations					
Follow-up on non- compliance					
Checking for compliance with exposure limits					
System of verification on reconciliation					
Supervisory activities					
Assessment of risks					
Monitoring procedures					
Environmental management					
Environmental monitoring					

7. How would you rate the following attributes of corporate governance in the last 3 years? Use a scale of 1-5 where 1 is greatly decreased, 5 greatly improved.

	<b>Greatly decreased</b>	<b>Decreasing</b>	<b>Constant</b>	<b>Improved</b>	<b>Greatly improved</b>
Discipline					
Transparency					
Independence					
Accountability					
Responsibility					
Fairness					
Social responsibility					

8. What would you suggest to be done to enhance organization performance in area of internal auditing?

.....

.....

.....

Thank you for your participation



**Appendix III: Work Plan**

	<b>May</b>	<b>June</b>	<b>July</b>	<b>Aug</b>	<b>Sep</b>
• Identification of the supervisor					
• Development of concept paper					
• Proposal writing					
• Correction of proposal					
• Submission and presentation of proposal					

#### Appendix IV: Budget Estimates

<b>ITEMS</b>	<b>QUANTITY</b>	<b>UNIT COST(KSHS)</b>	<b>TOTAL COST(KSHS)</b>
Stationary	5 reams	500	2,500
Typing services	80	20	1,600
Binding	16 copies	60	
Photocopying	800 pages	1.50	1,200
Data analysis			30,000
Lunch	5 lunches	400	2,000
Supervision			20,000
<b>Total</b>			<b>57,300</b>