

**EFFECT OF INTERNAL AUDIT REPORTING QUALITY ON FINANCIAL
PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVE SOCIETIES
A CASE STUDY IN MURANG'A COUNTY IN KENYA**

**BY
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**A RESEARCH DISSERTATION SUBMITTED TO THE SCHOOL OF GRADUATE
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DECLARATION

I declare that this dissertation is my original work and has not been previously published or submitted elsewhere for award of a degree. I also declare that this contains no material written or published by other people except where due reference is made and author duly acknowledged.

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ABSTRACT

The cooperative movement in Kenya now boasts of an annual turnover of Ksh 43.6 billion which is equivalent to 4.5% of the country's Gross Domestic Product. SACCOs globally continue to perform poorly financially due to poor management and fraud. An inspection report compiled by the SACCO Societies Regulatory Authority showed that many SACCOs in Kenya have been involved in mismanagement, fraud and corrupt practices. SACCO regulations (2008) stipulated that every SACCO shall establish an internal audit function which shall be responsible for reviewing and reporting on the adequacy of the internal audit system and the financial matters of the SACCO. The general objective of this study was to determine the effect of internal audit reporting on financial performance of SACCOs. The specific objectives were to: determine the effect of objectivity of the internal audit reports on financial performance of SACCOs in Kenya; establish the effect of internal audit reporting channels on financial performance of SACCOs in Kenya; examine how internal audit report completeness affects financial performance of SACCOs in Kenya, and; determine the effect of internal audit report timeliness on the financial performance of SACCOs in Kenya. The researcher employed descriptive survey design. The target population of this study was all the SACCOs in Murang'a County which are estimated to be 400. Stratified sampling was utilized to select a sample of 120 SACCOs. A questionnaire was used to collect data. Descriptive statistics such as mean scores, percentages and frequency distributions were applied to data in nominal, ordinal and interval scales. Inferential statistics including regression and correlation analysis were applied to establish whether there was any significant relationship between audit reporting and financial performance of SACCOs. The study findings reveal that objectivity of financial reporting in SACCOs, internal audit report completeness and timeliness of internal audit reporting all had significant effect on financial performance of SACCOs. However, internal audit reporting channels did not have a significant influence on financial performance of SACCOs. The following recommendations are made. First, SACCOs should ensure that internal audit reports in the SACCO are not based on hearsay, subjective judgment or witch-hunting. Second, the internal audit departments should be independent and should report to the highest office in the SACCO to ensure that this department carries its function effectively and competently without any fear or favor. Third, the SACCOs should ensure that internal audit department provides comprehensive reports with an assessment of the entire effectiveness of risk, governance and controls that the organization has put in place. Lastly, SACCOs should ensure that internal audit reports on high risk areas are done regularly so that to make sure risk from these areas is managed effectively.

Key words: Auditing, Completeness, Reporting, objectivity, timelines, Financial performance, SACCOs.

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ACRONYMS AND ABBREVIATIONS

SACCO	Savings and Credit Cooperative Organization
GDP	Gross Domestic Product
SASRA	SACCO Societies Regulatory Authority
WOCCU	World Council of Credit Unions
USAID	United States Aid for International Development
IAF	Internal Audit Function
IIA	Institute of Internal Auditors
CEO	Chief Executive Officer
CFO	Chief Financial Officer
SPSS	Statistical Package for Social Sciences

TERMS AND DEFINITIONS

Internal audit report- The report issued by the internal audit function after an examination, monitoring and analysis of activities related to a company's operation (Johnson, 2006).

Objectivity - This covers the comments and opinions expressed in the report indicating that they should be objective and unbiased (Stewart and Subramaniam, 2010).

Clarity - having clear channels of reporting in the internal audit that is simple and straightforward (Johnson, 2006)

Adequacy - having enough information contained in the internal audit report to enable management make informed decisions on internal controls (Swanson, 2006).

Brevity - having an internal audit report which is concise and to the point (Soh and Martinov-Bennie, 2011).

Timeliness -having an internal audit report which is released promptly and immediately after the audit is concluded (Sparks, 2011).

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The cooperative movement in Kenya now boasts of an annual turnover of Ksh 43.6 billion which is equivalent to 4.5% of the country's Gross Domestic Product (GDP) (SASRA, 2013). This is a huge impact as the movement plays an important role in financial deepening and intermediation in the financial industry. In their operations, cooperatives have mobilized savings of over Ksh 350 billion and provided affordable credit facilities of over Ksh 180 billion to their members. Savings and credit cooperative organizations (SACCOs) control over Ksh 250 billion with over 1.8 million members. Indeed, the government took cognizance of this key sector in financial deepening and provided a legal framework to govern this sector called the SACCO societies regulatory authority (SASRA).

USAID (2011) established that SACCOs globally continue to perform poorly financially due to poor management and fraud. Agrawal and Cooper (2007) observe that key governance characteristics such as independence of boards and audit committees, and the provision of audit services by internal auditors are important factors that affect performance. Audit reporting is valuable in providing oversight of a firm's operations and financial reporting. However, the quality of the audit reports and who the internal audit function reports to are as important. Nair and Kloppinger-Todd (2012) established that poor management and corporate governance in SACCOs continue to hamper their performance and growth.

There have been various governance scandals that have affected various entities. SACCOs have not been untainted by these scandals as they have been subject of many financial and corporate governance issues. SACCO governance is the system in which SACCOs as is the

case with other organizations are led. Governance enables a SACCO to be managed effectively and to ensure that leaders of the SACCO are held accountable for their management actions and to ensure that they manage the SACCOs in the members' interests (Ssemwanga, 2009). In Kenya, an inspection report compiled by the SACCO Societies Regulatory Authority (SASRA) showed that many SACCOs in Kenya have been involved in mismanagement, fraud and corrupt practices (SASRA, 2012). A case in point was Elimu SACCO which was reported to have used creative accounting tactics to cover up fraud and non-payment of loans by some members (Okoth, 2013).

1.1.1 Saving and credit cooperative societies

Savings and credit cooperative societies (SACCOs) play a very important role the world over in enhancing financial deepening and improving access to financial services for the low income segment (WOCCU, 2005). As players in financial intermediation, SACCOs remain sparsely understood members in the financial intermediation sectors in many economies (Cuevas and Fisher, 2006). SACCOs are member owned and their major objective is to encourage savings culture in their members at the same time offering efficient access to loan for their members. Members pull resources together in form of savings, and the SACCO uses the mobilized savings to extend small credit facilities to them (Were, 2009). They are user owned financial cooperatives that offers savings, credit and other financial services to their members.

SACCOs in the developing world form one of the major building blocks of the financial system, and indeed of the economy of a nation (James, 2012). At the heart of any financial institution is the audit function which is evident by the fact that all other departments are linked with the internal audit department. It is mandatory for any SACCO in Kenya to provide audited

financial statements at the end of every accounting period. However, not many SACCOs in Kenya have internal audit function (SASRA, 2013). This study seeks to establish the role played by the internal audit reporting in financial performance of the SACCOs that have the internal audit function.

To be able to regulate SACCOs so that member savings and interests are well taken care of, the SACCO regulations (2008) stipulated that every SACCO shall establish an internal audit function which shall be responsible for reviewing and reporting on the adequacy of the internal audit system and the financial matters of the SACCO. The internal audit function so established is expected to offer assurance and reports on the operations and dealing of the SACCO to ensure that member deposits are safeguarded. The emergence of SASRA was the effect of the inaugurated SACCO Societies Act 2008 which came to effect in 2009. SASRA was given the mandate to license and supervise SACCOs that are formed in Kenya.

Many organizations the world over are putting more emphasis on corporate governance and internal controls. This has led to the increasing attention on the internal audit function (IAF), its expanding roles, its establishment in a growing number of organizations and an increase in its size have been observed over recent years (Arena & Azzone, 2007). Studies have also empirically provided evidence of the importance of IAF and its ability to provide oversight in the internal operations and functions of the organization. IAF has been indicated to play significant roles in improving quality of corporate governance, improvement of the internal control and monitoring environment of the organization and its ability to prevent corruption and fraud in the entity (Castanheira, Rodrigues & Craig, 2010). In an organization, internal auditors are usually the ones that disclose misrepresentation, weaknesses, mistakes and errors in the firm.

1.1.2 Internal audit report

At the end of any internal audit is the internal audit report. Internal auditors are expected to provide a report to management of the organization soon after their audit. This report is expected to provide the summarized findings of the audit and recommendations that are made the internal audit department. The internal audit report typically has an executive summary, body and an appendix. The body has the major findings and recommendations while the appendix that may have charts, graphs or any other information that is deemed relevant in the report but it is too detailed to be included in the body of the report. However, every audit finding in the body of the report has to include the "5 C's". These Cs are the cause, criteria, condition, cause, consequence and corrective action (Johnson, 2006). Condition entails the identification of the particular problem while criteria indicate the standard that was used to identify the anomaly. The cause explains the reasons behind the problem occurring consequence provide the loss or risk that emanates from the finding. Lastly, corrective action provides the recommended solution to the problem or the action that management should take.

The recommendations in an internal audit report are designed to help the organization achieve effective and efficient governance (Sarens, De Beelde & Everaert, 2009). The recommendations contained in the internal audit report inform the management on the operational and control procedures that should be undertaken to ensure that the organization complies with operational, risk, management and financial compliance objectives. Audit findings and recommendations are strong statements about transactions, operations and dealings of the organization. The audit report provides information on validity, valuation, authorization, accuracy and disclosure of the firm's activities.

Under the Institute of Internal Auditors (IIA) standards, a critical component of the audit process is the preparation of a balanced report that provides executives and the board with the opportunity to evaluate and weigh the issues being reported in the proper context and perspective (Soh & Martinov-Bennie, 2011). In providing perspective, analysis and workable recommendations for business improvements in critical areas, auditors help the organization meet its objectives including financial performance. The quality of internal audit report is measured through its objectivity, its clarity, accuracy, and timeliness. These four factors are expected to influence how the audit reports affect the operational and control effectiveness of the company. This study will seek to establish the effect of audit reporting on the financial performance of SACCOs in Kenya.

1.1.3 Quality of report

Audit quality is, in essence, a complex and multi-faceted concept (Soh and Martinov-Bennie, 2011). It is subject to many direct and indirect influences. Various stakeholders have differing interpretation of audit quality due to their direct or indirect involvement in the process of internal auditing or how they perceive quality of an audit. This observation leads to the assertion that non single variable should be taken as an objective measure of audit quality. The complexities and dynamism of the concept of internal audit quality therefore requires a deeper and wholesome understanding which can only be received from study or research.

Conceptually, one can view audit quality in terms of three fundamental aspects: inputs, outputs, and context factors (Bou-Raad, 2010). There are many inputs to audit quality apart from auditing standards. Some of the important attributes for any internal audit include the skills of the auditor, his/her experience, the values of the auditor and the mindset of the auditor during the

auditing exercise. The audit process is also important in determining the quality of the process. The effectiveness of the methodology used in auditing, the appropriateness of the tools used in the audit and technical support provided to the auditing staff determine whether the audit will be quality or not.

Most stakeholders consider the output of the audit process to determine whether the audit was quality or not (Soh and Martinov-Bennie, 2011). When the audit report is clear and conveys audit outcome well, this will make stakeholders to perceive a positive influence on the audit quality. Further, how well the auditor communicates with the management responsible for internal control, financial reporting and governance have a strong positive influence on the audit quality.

Further, the corporate governance practices in the organization also influence the audit quality in that firm. When a company has a culture of good ethical behaviour and transparency, for example, this can positively influence the quality of its internal audit (Gramling et al, 2004). Further, regulatory and legal forces can have an influence on audit quality. This emanates from the fact that a framework of effective auditing is created. Moreover, the effectiveness of financial reporting procedures in the industry has an effect on audit quality. This is indicated by the presence of financial reporting procedures that focus on transparency.

1.1.4 Financial performance of savings and credit cooperative societies

In any modern economy, the financial sector plays a very crucial role in the economy due to its financial intermediation role. SACCOs are a very significant player in the financial sector of growing economies. They source funds from surplus units and channel the funds to deficit units' thus increasing productivity and investment in the economy. Recent introduction of new financial services laws have seen SACCOs being embraced as formal financial institutions. This

has not only been done to facilitate financial inclusion and promote growth of financial services but also in recognition of the fact that SACCOs like other financial institutions need to receive great scrutiny in order to protect depositors and maintain financial stability.

1.1.5 Context of study

This study was a case study of SACCOs in Kenya, in Murang'a County. In Kenya, although assets of SACCOs have grown overtime, financial performance in terms of profitability remains weak. The financial performance of SACCOs is indicated by net surplus which is revenues less costs. The report by SASRA evaluated the performance of the SACCO sub-sector based on the financial data and information extracted from audited financial statements and reports for the period 2006 to 2012. It is a legal requirement that the audited accounts of a SACCO be registered with the Commissioner for Cooperatives Development before presentation to members at the annual general meeting. However, not all active SACCO societies comply with this requirement (SASRA Report, 2012).

1.2 Problem Statement

Most of the registered SACCOs in Kenya have functional internal audit departments with well qualified staff charged with responsibilities of re-assuring that internal control systems are adequate and quality processes and systems are in place (Olando, Jagongo and Mbewa, 2013). However, there is continued poor financial performance, incidences of fraud, incidences of budgets not being followed and cases of non-conformance to rules and regulations on usage of finance. This has put member savings at risk despite investing in the internal audit department (Olando et al, 2013).

There have been several studies carried out which demonstrate the importance of internal audit reporting on the effectiveness of the organization. Hutchinson and Zain (2009) studied the role of internal audit quality and the independence of the audit committee on firm performance and growth opportunities in UK companies. The study established that report should be in a format that is prescribed by the organization and meet completeness standards as per the organization's guidelines. Sparks (2011) assessed the value of timely internal audit reporting to SACCOs in Canada. According to Sparks the audit report should have insight into the changes that are taking place and the effect these changes can have on the organization. This then should be timely communicated to the management for action to be taken. Clikeman (2003) studied the role of internal auditors in educating management on finance and corporate governance in Brazil. He observed that for an audit report to comprehensively and completely provide insight to management about the internal controls in operation, it has to reasonably cover all areas of operations and be reasonably complete. Further, Stewart and Subramaniam (2010) studied the role played by internal audit independence and objectivity on firm effectiveness in India. They observed that objectivity in the audit function is critical in all the functions including in reporting. Johnson (2006) examined the role played by internal audit reporting channels on internal audit effectiveness. He observed that having proper reporting channels is important in ensuring independence of the audit departments and at the same ensuring that the internal audit reporting is not influenced by management. Few studies have been done on the role of internal audit in SACCOs in Kenya. A study by Olando et al. (2013) assessed the contribution of SACCO financial stewardship to growth of SACCOs in Kenya. In this study, internal audit was just a variable among various other variables. This study sought to explain how internal audit reporting quality affects SACCO's financial performance.

The internal audit department is mandated to provide reports on the processes and systems in the organization to ensure that SACCO objectives are followed, financial reporting is reliable, and the operations are effective and efficient. The internal audit department is also expected to report on whether the SACCO complies with the different rules and regulations. However, in Kenya, the internal audit function in the SACCO sub-sector has not been fully tapped. This could be seen in the numerous cases of poor management, fraud and poor governance reported by SACCOs (Olando et al., 2013).

Though having an internal audit function is important, the quality of the reports from the internal audit is of utmost importance. The completeness of the report, the objectivity of the advice, the timeliness of the report and the clarity of where the report is directed to are important characteristics that quality reporting should have. It is important to ensure that internal audit reports are quality and the reporting is made to the right people in the organization. As SACCO's continue to be affected by poor governance and poor performance, a question arises as to what effect the internal audit reporting quality may have on their financial performance. As observed from previous empirical studies, there are few studies that focus on internal audit reporting quality. It is against this background that this study sought to evaluate the role of internal audit reporting on financial performance of SACCO's in Kenya.

1.3 Objectives of the Study

1.3.1 General objective

The general objective of the study was to determine the effect of internal audit reporting quality on financial performance of SACCOs.

1.3.1 Specific objectives

The specific objectives of the study were to;

- i) Determine the effect of objectivity of internal audit reports on financial performance of SACCOs in Kenya
- ii) Establish the effect of internal audit reporting channels on financial performance of SACCOs in Kenya.
- iii) Examine how completeness of internal audit report affects financial performance of SACCOs in Kenya
- iv) Establish the effect of internal audit report timeliness on the financial performance of SACCOs in Kenya

1.4 Hypothesis

The study sought to test the following hypothesis;

- i) There is no significant effect of objectivity of internal audit reports on financial performance of SACCOs in Kenya.
- ii) There is no significant effect of internal audit reporting channel on financial performance of SACCOs in Kenya.
- iii) There is no significant effect of completeness of internal audit reports on financial performance of SACCOs in Kenya.
- iv) There is no significant effect of timeliness of internal audit reports on financial performance of SACCOs in Kenya.

1.5 Justification of the Study

The study findings will be of immense importance in the sense that they will assist management of SACCO's to realize how audit reporting can affect its operations and financial performance. The study established how objectivity of reports, the reporting channels,

completeness of audit reports and timeliness of internal audit reporting are related to financial performance of the SACCO. This will be able to inform management of these SACCOs on the way forward in relation to internal audit reporting.

The study findings will also be of importance to government in that it will give regulatory agencies of the government like SASRA deeper insight on the role of internal audit reporting on financial performance. This will go a long way in informing policy and regulations on internal audit reporting of SACCO operations. SACCOs have been established as one of the most important financial institutions towards financial deepening and their financial performance is important for the growth and advancement thus steering economic growth. The findings therefore will affect policies on how internal audit reporting in these institutions is performed.

Members of a SACCO are the ones who are directly affected if the financial performance of a SACCO is poor. The findings from this study will inform SACCO members on the role played by internal audit reporting in influencing financial performance of these SACCOs. Members therefore can use their voting rights to ensure that top management of their SACCOs who are elected ensure that internal audit reporting plays its rightful role and it has the desired effect on financial performance.

Finally, the current research study will be important to researchers for theoretical purposes in that it will add to the empirical and theoretical literature available in the field of internal audit reporting and financial performance of SACCOs. This can be used by scholars and students interested in the area of study. The limitations and gaps in the study and suggestions for further research that will be provided by this study can be used by future researchers.

1.6 Scope of the Study

The scope of this study covered 400 SACCOs in Murang'a County. The financial statements of the selected SACCOs were examined and values of internal audit and performance proxies were extracted for investigation. The focus of the study was on the effect of internal audit reporting on financial performance of SACCOs. Audit reporting factors that were included in the study were objectivity, audit reporting channels, timeliness and completeness.

1.7 Limitations of the Study

Internal audit reporting is a very sensitive area. The researcher encountered some challenges in conducting this study. First, employees who were the subjects of the study were reluctant to respond to the questions as they involved answering sensitive questions about internal audit reporting and financial performance of the SACCOs. This could have made some of the respondents to be reluctant in providing the requisite information for the study purposes. To counter this challenge, confidentiality and anonymity of responses was assured to the responding subjects.

Secondly, there could have been bias in the responses provided in the various questions. Subjects could be tempted to provide positive responses or negative responses to portray the situation as they would want it to be without a strong basis on the facts underlying internal audit reporting and financial performance. To counter the risk of bias, respondents were provided with an introductory letter that informed them of the need to provide accurate and objective responses. They were also informed of the need for providing objective responses as the study could be used to inform policy and practice on internal audit reporting in future.

Another limitation that was encountered is the lack of criteria for measuring quality and effectiveness of internal audit reporting. Respondents could have been not conversant with the

internal audit reporting and hence would not be in a position to rate the reporting as per the scales that were provided. However, respondents were briefed on the purpose of the study before administration of questionnaires and those respondents who felt that they did not have relevant information to provide were provided with the opportunity to opt out. Further, the questionnaires were well structured to have the minimum effort and time and at the same time collect all relevant information.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the review of literature on audit reporting and the effect it can have on firm performance. The various factors relating to audit reporting include objectivity of the audit reports, completeness of the audit reports, timeliness of the audit reports and the reporting channels used when providing the audit reports.

2.2 Theoretical Review

This section provides the theoretical perspective that guides the study. The theories that guided this study were agency theory and capture theory.

2.2.1 Agency theory

An agency relationship arises when one or more principals (such as SACCO members) engage another person as their agent (such as management) to perform a service on their behalf. Agency Theory explains how to best organize relationships in which one party determines the work while another party does the work (Gibbons, 1998). In this relationship, the principal hires an agent to do the work, or to perform a task the principal is unable or unwilling to do. For example, in corporations, the principals are the shareholders of a company, delegating to the agent, that is, the management of the company, to perform tasks on their behalf. The major assumption in the agency theory is that both the agent and the principal are directed by self interest in their operations. This assumption therefore presumes conflict between the agent and the principal when they work together. Thus, if both parties are motivated by self-interest,

agents are likely to pursue self-interested objectives that deviate and even conflict with the goals of the principal. Yet, agents are supposed to act in the sole interest of their principals.

One way to deal with agency conflicts is through auditing (Mills, 2009). The auditing function ensures that management is focused on the common interests of the shareholders and other stakeholders, the agency theory was used in this study to explain how internal audit reporting is done to quell the agency conflicts between management and SACCO members.

2.2.2 Capture theory

Capture theory is associated with George Stigler, a Nobel laureate economist (Spiller, 1996). It is the process by which regulatory agencies eventually come to be dominated by the very industries they were charged with regulating. Regulatory capture happens when a regulatory agency, formed to act in the public's interest, eventually acts in ways that benefit the industry it is supposed to be regulating, rather than the public.

In this study, this theory was applied to illustrate how internal auditing, formed to ensure that management is well regulated, informed and advised, eventually acts in ways that benefits the management it was supposed to regulate and monitor. This can be seen when internal audit department is not independent and the reporting channels devised are conducive to internal audit reporting. This capture can make the internal audit department unable to perform its activities effectively and competently (Hutchinson and Zain, 2009).

2.3 Empirical Review

This part discusses the effects of the internal audit reporting on performance. The internal audit reporting factors considered include objectivity, timeliness, completeness and reporting

channels of the internal audit. Firm performance in this study was the financial performance measured through the net operating surplus or deficit by the SACCO.

2.3.1 Objectivity of the internal audit reports

Holt and DeZoort (2009) did a study that sought to establish the effects of internal audit reporting on corporate governance and performance of the organizational functions. The study established that since internal auditors are expected to check all the organizational controls and report on them, objectivity in the reporting should not be compromised. The reports should not be based on hearsay, subjective judgment or witch-hunting. Reports that are not objective would raise disputes and discontent among the organizational members which would affect the performance of the organization as a whole. The reports of the internal audit department should be factual and authenticate which would increase the chance of action being taken by top management in regard to the report.

Gramling, Maletta, Schneider and Church (2004) analyzed the role of the internal audit reporting function on performance of firms and also on their corporate governance. The study revealed that the objectivity of reports is important to ensure that positive change is performed in the different organizational processes to improve corporate governance and organizational repute. Objective reports are not biased which even make many organizational members to unanimously accept the report and take positive steps towards acting on the report and making the recommended changes. This positive effect of internal audit objective reporting creates strong controls and processes that are a catalyst for improved organizational performance.

Stewart and Subramaniam (2010) studied the effect of internal audit objectivity and independence and the effects these can have on the organization. They observed that objectivity

in the audit function is critical in all the functions including in reporting. Having reports with verifiable and supporting documents is important in ensuring that the credibility of internal audit is not compromised. This ensures that the internal audit function provides reports that are not questioned by any organizational unit and thus effectively playing its role of advisory. On the other hand, reports that are filled with innuendo, allegations and bias may brew discontent and chaos in the organization which may adversely affect the overall organizational performance (Aid, 2010).

Goodwin (2004) did a comparative analysis of the internal audit in the public and the private sectors. The analysis revealed that though internal auditing is an assurance activity that is expected to be unbiased and independent, many internal auditors participate in activities that cloud their independence and objectivity and hence the reports they compile are seen as biased and of little use. Rather than being seen as advisors, they are seen as consultants whose reports may or may not be used. This state of affairs does not help in enabling the internal audit to play its rightful role in ensuring that the company's operations are done competently and transparently. If internal audit reports are expected to play its role in accomplishing organizational objectives, their reporting must be objective, factual and unbiased (Stewart & Subramaniam, 2010).

2.3.2 Internal audit reporting channels

A study by Holt (2012) in USA assessed the influence of the internal audit reporting relationships on the credibility and subsequent performance of the organization in the stock market. The study established that investor based performance was better in companies whose internal audit reports were provided to the audit committee and the Chief Executive Officer (CEO) compared to those organizations that the internal auditor gave reports to the chief

financial officer (CFO). Stock exchange performance of the companies that had internal auditors reporting to the CEO were due to the fact that investors perceived the assurance role of the internal audit department as being more pronounced as opposed to those organizations that had internal audit reporting to the CFO.

The IIA's standards on independence of internal audit stipulate that a company's internal audit department should have a reporting relationship to a high level in the organization to ensure that it plays its assurance role properly. Having the audit reports channeled to a high level office is important to ensure that the reports are acted upon and ensure that there is no conflict of interest to other offices. For instance, Johnson (2006) observed that having proper reporting channels is important in ensuring independence of the audit departments and at the same ensuring that the internal audit reporting is not influenced by management. The internal audit department reports can contribute to the positive health of the company if they report to either the CEO or any other high office apart from the CFO. This is because the CFO has the responsibility for financial reporting whereas the audit reporting is concerned on assurance about the financial reports and other controls. Having the audit department to report to the CFO would therefore create a conflict and this would negatively affect the company performance both in the near and long term (Bou-Raad, 2010).

A study by James (2003) established that a firm that has internal audit department reporting to lower or perceived inferior levels of management may find it problematic in finding willing lenders. This may affect capital investments decisions of the firm which may in turn affect the future revenues and financial performance of the organization. Providers of capital, whether lenders or investors, have a dislike of organizations that have their internal audit departments reporting to the accounting head or other lower levels besides the CEO or the audit

committee. Soh and Martinov-Bennie (2011) also had similar findings when they established that the preferred reporting channel for the internal audit is the CEO and the audit committee. This implies that the internal audit should report administratively to the CEO but functionally to the audit committee. This reporting relationship can create confidence on external investors and lenders who are providers of investing capital to the firm. This in turn would affect the financial performance of the organization in question. Having the internal audit reporting to any lower functional level would make capital providers to negatively rate the organization in credit worthiness. This would mean the organization having access to credit on high interest rates on having limited access to credit.

Stefaniak and Robertson (2010) observed that the reporting channels are important not only in who the internal audit reports to but also in relation to relationship between the internal audit and whoever the departments reports to. Having a good reporting relationship makes it easier for the internal audit department to report on forecasted risks and opportunities that may not be evident based on current happenings. Having a bad relationship however, creates an environment of distrust between the internal audit and where the department reports which is not good for the role they have to report any issue that arises. An environment of trust between the internal audit department and where the department reports create a good working relationship where the reporting can be insightful for the whole organization.

2.3.3 Internal audit report completeness

The comprehensiveness of the internal audit reports was found by Whittington & Pany (2001) positively influence the financial performance of an organization through its effect on adherence to ethics, regulations and corporate governance. Completeness in reporting enables the various departments in the organization to effectively have operations that add value to the

organization and thus influence the organizations' accountability, use of resources and performance.

Comprehensive reports and assurances that the internal audit department provides to the management of the organization are expected to assure management and provide them with confidence that the internal controls and operational processes in the organization are sound and effective (Arena and Azzone, 2007). For an audit report to comprehensively and completely provide insight to management about the internal controls in operation, it has to reasonably cover all areas of operations and be reasonably complete. Internal audit reporting involves disclosing facts about the organization to the management so that management can take corrective action. The nature of these facts could be financial, operational, regulatory or operational. If the report does not cover all the areas comprehensively, the report will not be very useful to management which could be detrimental to the organization's financial performance (Clikeman, 2003). Incomplete internal audit reports could lead to loss of resources, reduced creditability of the audit department on the eyes of all other departments and occurrences that can lead to loss.

Hutchinson and Zain (2009) studied internal audit quality and the prospects of the firm growth and financial performance. The study established that, the function of the internal audit function is to investigate and assess the internal operations of the company and compile a comprehensive report that would inform management of how effective the internal controls of the company are. The report should be in a format that is prescribed by the organization and meet completeness standards as per the organization's guidelines. A comprehensive report is important to educate management on what is happening internally in the organization and thus work on improving the company so that it can achieve its objectives (Hutchinson & Zain, 2009). Further, the report should adequately offer insights on the risks that face the organization and

how well the organization adheres to regulations. This helps in ensuring that the company will be in a better position to manage its risks comprehensively.

For an audit report to be considered complete and adequate, it needs to have the following. First, the internal audit report should have an analysis of the control weaknesses that are significant with an assessment of what could have caused the weaknesses (Coram et al., 2008). This should be followed by an analysis of the factors that could have contributed much or exacerbated the weaknesses. Secondly, an audit report should have an analysis of any thematic issues that have been unearthed by the audit in the entire organization. Further, the report should provide an independent view of reporting by management on risk, and an assessment of the risk management plans that the management has (Aid, 2010). Lastly, the report may be required to provide an assessment of the entire effectiveness of risk, governance and controls that the organization has put in place in an annual basis (Clikeman, 2003). An audit report that lacks one aspect of the above mentioned factors may be deficient and may not contribute towards performance objectives of the organization.

2.3.4 Internal audit report timeliness

Timeliness according to Al Matarneh (2011) refers to the ability of internal audit reporting meeting the set deadlines of report issuance to the relevant organizational units. When the audit department does not issue timely reports, there could be avoidable inefficiencies, perceived risk could materialize and the internal organization processes could be negatively impacted. These could lead to poor performance of the affected organizational units which may have an impact on the overall organizational performance. In a study on factors that affect audit quality in banks, Al Matarneh (2011) observed that timeliness of reports is important as the timely information could be usable to management to prevent risk and losses.

Though internal auditors are having an ever increasing set of responsibilities, they are expected to provide timely reports so that management can take action against risks and weakness before loss occurs. Audit reports should be timely and as per risk category to ensure that management has time to action on the recommendations that have been put forward. Reports on high risk areas should be done regularly so that management can keep abreast with the happenings on the areas hence ensuring that risk management at the company is current. Timely reports support quick and timely actions and controls which are linked to good financial performance.

Breakspear (2008) observed that internal audit reports should be timely compiled and circulated to all respective units after completion of the audit. Delay in reporting may worsen an already bad situation or make an opportunity that could have been taken pass. If there is any expected delay in internal audit reporting, this should be communicated to the relevant authorities and the effect of this delay assessed. Delaying of audit reports may have a negative effect on operations and activities in the organization which may in turn adversely affect the firm's financial performance.

Sparks (2011) analyzed the importance of timely audit reporting in enabling the organization to perform its duties effectively. The audit reports according to Sparks should have insight into the changes that are taking place and the effect these changes can have on the organization. This then should be timely communicated to the management for action to be taken. When audit reports are provided to top management in a timely manner, they can serve as an effective communication tool which is critical in enabling the organization achieve its performance goals. Further, Soh and Martinov-Bennie (2011) adds that when audit reports are released late, they are of little value and their contributions towards organizational goals are

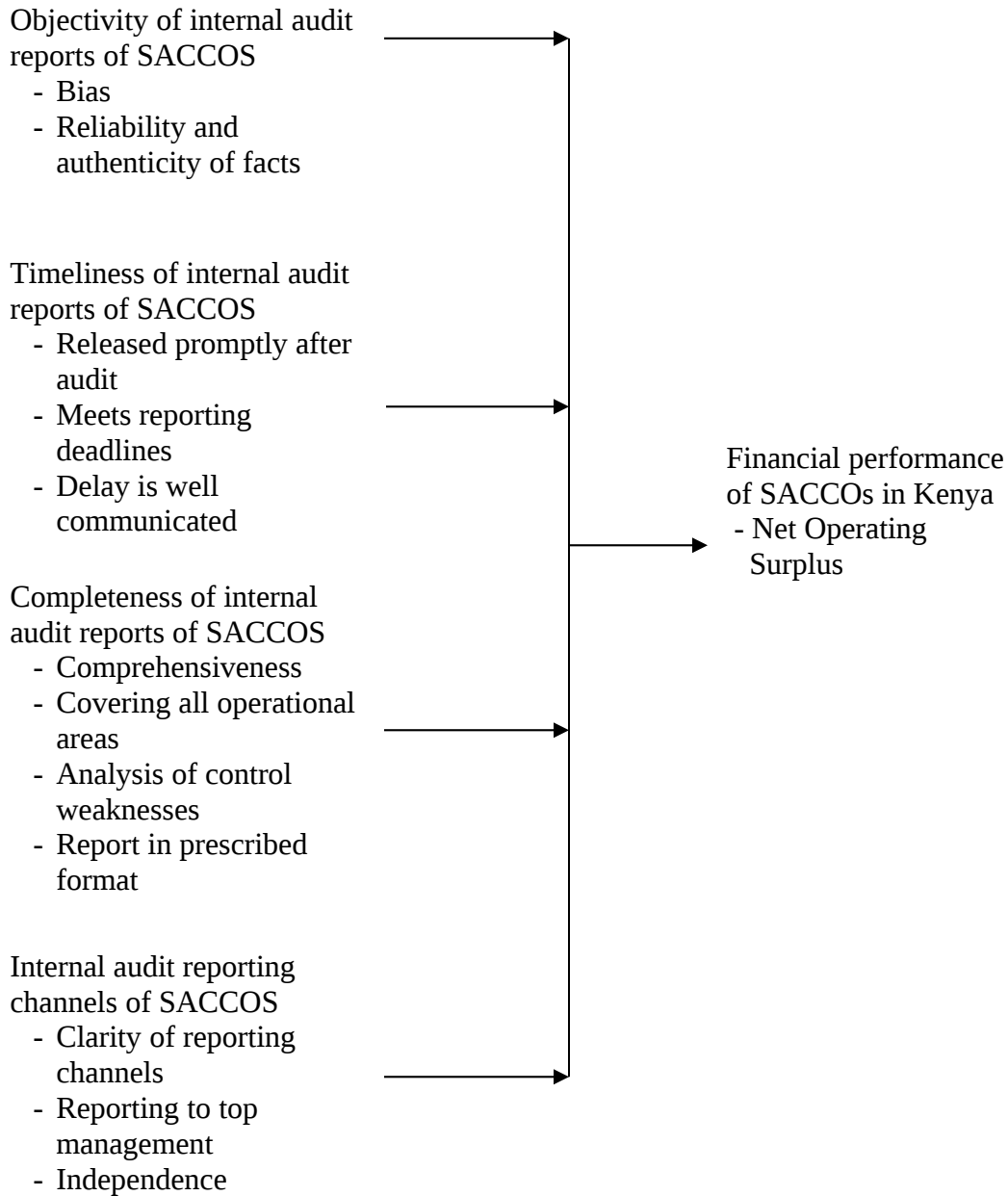
affected negatively. , he adds that late reports can be of little value, especially if it becomes a regular occurrence.

In audit reporting, Castanheira et al. (2010) observed that the reporting time should follow the policies and guidelines set up in the organization. Once the audit exercise is complete, the internal audit department should issue a report as soon as possible. The audit report so provided should be a summary of the findings the recommended actions and an analysis of any management action already in place. The audit reporting should be continually timely to be able to help management in controlling the different operations and tasks and managing risk. However, timeliness of the audit report should not be focused upon such that completeness is compromised. The most critical issues in the organization should be reported to the relevant authority in the organization regularly and timely to ensure that effective monitoring is done. Timely reports creates an environment where management is current on the various issues and risks and hence are in a better position to take action that can contribute positively to organizational performance (Archambeault et al., 2008).

2.4 Conceptual Framework

This study conceptualized that objectivity of internal audit reports, timeliness of the reports, the reporting channels established and the completeness of internal audit reports can all have an influence of the effectiveness of internal auditing in a SACCO. This in turn can have an effect on SACCO operations and eventually affect the financial performance of the SACCO. The conceptual framework is depicted in Figure 1.

**FIGURE 1
Conceptual Framework**



Independent variables

Dependent variable

Objectivity in the reporting indicates the verifiability and authenticity in the facts incorporated in the reports, and lack of bias or witch hunting in the reporting. The reports should

not be based on hearsay, subjective judgment or witch-hunting. Reports that are not objective would raise disputes and discontent among the organizational members which would affect the performance of the organization as a whole. The reports of the internal audit department should be factual and authenticate which would increase the chance of action being taken by top management in regard to the report.

Timeliness according to Al Matarneh (2011) refers to the ability of internal audit reporting meeting the set deadlines of report issuance to the relevant organizational units. When the audit department does not issue timely reports, there could be avoidable inefficiencies, perceived risk could materialize and the internal organization processes could be negatively impacted.

Completeness of a report indicates its comprehensiveness, coverage of all the operational areas and indicative of all control areas. Comprehensive reports and assurances that the internal audit department provides to the management of the organization are expected to assure management and provide them with confidence that the internal controls and operational processes in the organization are sound and effective. For an audit report to comprehensively and completely provide insight to management about the internal controls in operation, it has to reasonably cover all areas of operations and be reasonably complete. If the report does not cover all the areas comprehensively, the report will not be very useful to management which could be detrimental to the organization's financial performance.

Internal audit reporting channels indicate whether the audit function reports to a position higher up in the hierarchy. The IIA's standards on independence of internal audit stipulate that a company's internal audit department should have a reporting relationship to a high level in the organization to ensure that it plays its assurance role properly. Having the audit reports

channeled to a high level office is important to ensure that the reports are acted upon and ensure that there is no conflict of interest to other offices. Having proper reporting channels is important in ensuring independence of the audit departments and at the same ensuring that the internal audit reporting is not influenced by management.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter outlines the overall methodology that the researcher used to carry out the study. This includes the research design, target population, sample design, and data collection procedure. Data analysis procedure and presentation is also presented in this chapter.

3.2 Research Design

The researcher employed descriptive research design. Mugenda and Mugenda (2003) define descriptive study as the type of research where a researcher does an inquiry into a problem and reports as it is without interfering in any way. Descriptive studies are usually carried out to answer research questions or test research hypothesis. In this study, data was collected from a cross section of SACCOs in Murang'a County which was used to answer the research questions. The study entailed studying auditing practices in the SACCOs and relating these to performance of these SACCOs. The study did not interfere with the situation and only reported the situation as it was.

3.3 Target Population

The target population of this study was all the SACCOs in Murang'a County which were 400 (KUSCO, 2014). The SACCOs that were included are the SACCOs that had been duly registered as per the Cooperatives Act.

3.4 Sampling Design and Sample Size

Stratified sampling was utilized to ensure that the sample selected was representative of the population. The study location was Murang'a County. A selected group of respondents from the larger population make up a sample and a selection of the sample is called the sampling technique (Kothari, 2004). One respondent (The secretary to audit committee) from each sampled SACCO was the sample unit. The sample selected which is a representative of the population, should also be large enough to minimize the sampling error. According to Mugenda and Mugenda (2003), a 30% sample is sufficient. This formed a sample of 120 SACCOs as presented in Table 1.

TABLE 1
Sampling Design

Size	Population	%	Sample
Large	24	30%	7
Medium	166	30%	50
Small	210	30%	63
Total	400		120

3.5 Reliability and Validity

A pilot study on the research questionnaires was done to test for reliability and validity. A pilot test according to Robson (2002) is a try out of the questionnaires to establish the reliability and validity of the constructs. A pilot test was done with 10 respondents from Unaitas SACCO in Muranga who were issued with the draft questionnaire and asked to give their recommendations on the format and clarity of the questions. The pilot respondents were requested to comment on the clarity, readability and how comprehensive the questionnaire items were. Their recommendations were used to make amendments to the final questionnaire. On reliability,

Cronbach alpha was utilized which indicated the reliability of the items to be 0.835 which was an indicator that the rating scales were reliable. Unaitas SACCO was excluded from the main study.

3.6 Measurement of Variables

Performance of SACCOs was measured through net operating surplus. This was enquired in the questionnaire and also counter checked through financial statements. The four independent variables: objectivity of the internal audit reports; internal audit reporting channels; internal audit report completeness, and; timeliness of internal audit reporting were measured using a five point likert scale. Variables that related to the four variables were listed on a 5 point likert scale and respondents were required to indicate their level of agreement on how these related to their SACCOs.

The research instrument was a questionnaire which was directed to top management of the SACCOs. The questionnaire contained items designed to elicit facts on performance of the SACCO and also on the four independent variables (objectivity of the internal audit reports, internal audit reporting channels, internal audit report completeness and timeliness of internal audit reporting). The questionnaire included only closed ended items. This made it easy to elicit the information required and also enabled receipt of standard answers. The closed items were also important as they made analysis easier and clear.

3.7 Data Collection Instrument

Data was collected using both secondary and primary means. Primary data was collected by use of questionnaire which had closed questions with some having likert scales for ease of analysis. Secondary data was collected through financial statements of the SACCOs. The study respondents were first briefed of the study purpose, rationale and the importance of their input

before administering the questionnaires to them. They were left with the questionnaires to respond to the items where the date of collection was agreed. The researcher then collected the questionnaires from respondents after the agreed duration of time. Follow up was done until all or a reasonable number of questionnaires had been collected.

3.8 Data Analysis

Analysis of data started with sorting out the questionnaires and establishing that they were correctly filled. Only correctly filled questionnaires were considered for analysis. After sorting, data from the questionnaires was coded into Statistical package for social sciences (SPSS) which aided in analysis. Bivariate data analysis technique was applied where associations between the various variables was sought. Analysis of data was through both descriptive and inferential statistics.

Descriptive statistics such as mean scores, percentages and frequency distributions were applied to data in nominal, ordinal and interval scales. This was data on age, gender, experience and educational qualifications. Ratings on the four independent variables were analyzed through mean scores. Inferential statistics that were utilized included multiple regression analysis and correlation analysis. Regression analysis is expected to establish the effect of the four audit reporting independent variables on the dependent variable (financial performance of SACCOs).

The regression model was of the form;

$$\text{Equation I..... } Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4$$

Where,

Y= Financial performance of SACCO's

B_0 = Constant

β_i = Beta or Regression Coefficients

X₁ = Objectivity of the internal audit reports

X₂ = Internal audit reporting channels

X₃ = Internal audit report completeness

X₄ = Timeliness of internal audit reporting

Beta and regression coefficients were computed to indicate the magnitude or strength of effect of the independent variables on the dependent variable. Coefficient of determination (r^2) in the regression model showed the level of contribution of the independent variables to the dependent variable. The f-test and the t-test were performed to test the significance of the whole model and the significance of each of the independent variables in influencing the dependent variable. Correlation analysis was used to compute correlation coefficients (r) which were used to assess the relationship between the study variables which included the direction of the relationship and the strength of that relationship.

The findings from the study were then presented using tables showing frequencies, percentages, means and standard deviations to illustrate the distribution of response on all the variables. The ANOVA, correlation coefficients and significance of all the independent variables were presented in tabular form.

CHAPTER FOUR

FINDINGS AND DISCUSSION

4.1 Introduction

Presented in this chapter is the analysis of data and its presentation which is in tables and charts. Presented first is the response rate and the demographic characteristics. The presentation of results is then made of the research results based on the research objectives. These findings are presented based on descriptive and inferential analysis.

4.2 Response Rate

A sample of 120 respondents from 120 SACCOs in Murang'a County was selected to participate in the study. This sample consisted of senior level employees. Out of these 120 sampled respondents, 76 returned their responses which was a 63% response rate. Babbie (2011) suggested that a response rate of 60% is good while a response rate of 70% is very good. The response rate for this study was good and the findings presented relate to the 76 responses received. All these received questionnaires were found to be fit for analysis.

4.3 Demographic Characteristics

Demographic information of respondents was enquired. Information sought included age, gender and education level of the respondents. Further, the years of service the respondents had in the SACCO were investigated.

4.3.1 Age of respondents

First, respondents were required to indicate their age. Results are presented in Table 2. The results indicate that 31% of the respondents were aged between 35 – 45 years whereas 5% of the respondents were aged above 55 years.

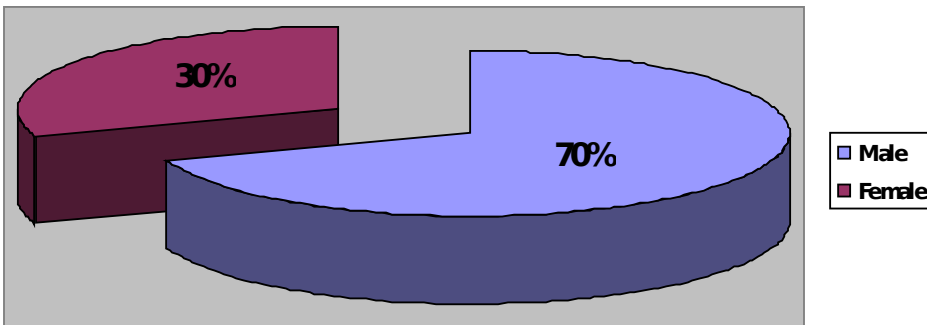
TABLE 2
Age of respondents

Age	Frequency	Percent
Below 25 years	9	12
26 – 35 years	23	30
35 – 45 years	31	41
46 – 55 years	9	12
Above 55 years	4	5
Total	76	100

4.3.2 Gender of respondents

Respondents were asked to indicate their gender. Results are presented in Figure 2. The results indicate that 70% of the respondents were male while 30% were female.

FIGURE 2
Gender of Respondents



4.3.3 Educational qualifications of respondents

Further, highest educational qualifications attained by the respondents was enquired. Results are presented in Table 3. The results indicate that 40% had diploma level of education while only 8% had masters' degree level of education.

TABLE 3
Education Qualifications of Respondents

Education level	Frequency	Percent
Certificate	12	16
Diploma	30	40
Bachelors degree	28	36
Masters degree	6	8
Total	76	100

4.3.4 Years of service in the SACCO

The number of years that the respondents had been working in the SACCOs was also established. Results are presented in Table 4. The results reveal that 40% of the respondents had been serving the organization for less than five years while 4% had served the SACCO for over 15 years.

TABLE 4
Years of Service in the SACCO

Years of Service	Frequency	Percent
Below 5 years	40	53
5 – 10 years	22	29
11 – 15 years	11	14
Above 15 years	3	4
Total	76	100

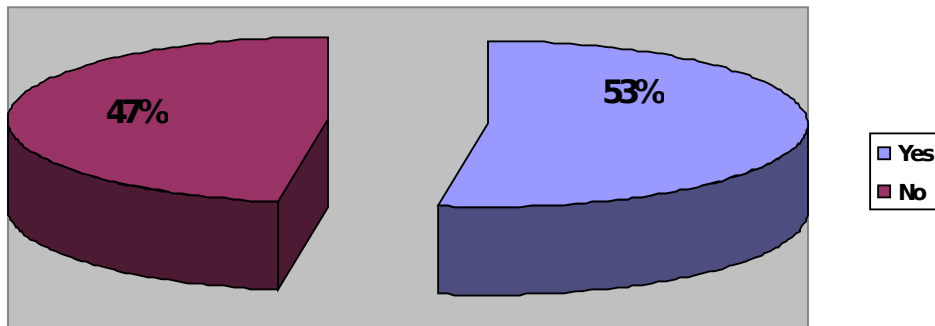
4.4 Data Analysis and Presentation

4.4.1 Objectivity of the internal audit reports

The first objective of the study was to establish the effect of objectivity of internal audit reports on financial performance of SACCOs. To achieve this objective, various questions were posed to respondents. First, respondents were asked to indicate whether the audit reports by the internal audit department of the SACCO were objective or not. Results are presented in Figure 3.

The results indicate that 53% of the respondents indicated that audit reports in their SACCOs were objective while 47% indicated that audit reports in their SACCOs were not objective.

FIGURE 3
Whether audit reports were objective



To establish further the objectivity of audit reports in the SACCOs, various statements concerning objectivity were listed and the respondents were required to indicate their level of agreement on how those statements related to their SACCOs. The rating was as follows: 1- Strongly disagree, 2 – Disagree, 3 – Neutral, 4 – Agree and 5 – Strongly agree. Mean scores were used to analyze the responses. Mean scores of less than 1.5 meant strongly disagree, 1.5 – 2.5 meant disagree, 2.5 – 3.5 meant neutral, 3.5 – 4.5 meant agree, while above 4.5 meant strongly agree. Results are presented in Table 5.

The study results revealed that respondents agreed to the statement that ‘Internal audit in this SACCO provides reports with verifiable and supporting documents’ (3.73) and also that ‘the reports of the internal audit department are based on facts and can be authenticated’ (3.61). Further results indicate that respondents were neutral on all other statements. These included the statement that ‘Organizational members unanimously accept internal audit reports and take positive steps towards acting on the reports’ (3.31), ‘Internal audit reports raise disputes and

discontent among the organizational members’ (2.71), ‘Internal audit reports in this SACCO are based on hearsay, subjective judgment or witch-hunting’ (2.66) and also neutral on the statement that ‘The comments and views expressed in internal audit report are biased’ (2.63).

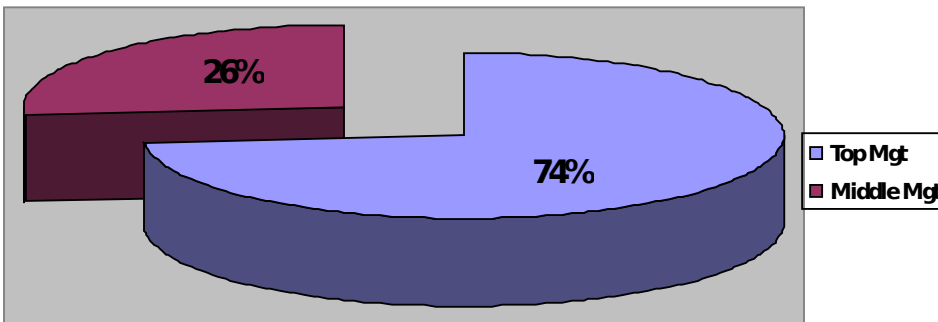
TABLE 5
Objectivity of Audit Reports

Statement	Mean score
The comments and views expressed in internal audit report are biased	2.63
Internal audit reports in this SACCO are based on hearsay, subjective judgment or witch-hunting	2.66
Internal audit reports raise disputes and discontent among the organizational members	2.71
The reports of the internal audit department are based on facts and can be authenticated	3.61
Organizational members unanimously accept internal audit reports and take positive steps towards acting on the reports	3.31
Internal audit in this SACCO provides reports with verifiable and supporting documents	3.73

4.4.2 Internal audit reporting channels

The second objective of the study was to determine how internal audit reporting channels influence financial performance of SACCOs. First, respondents were required to indicate where the internal auditor in the SACCO reports to. Results are presented in Figure 4. Study results indicate that 74% of internal auditors in the surveyed SACCOs reported to the CEO or top management while in 26% of the SACCOs, the internal auditor reported to middle management.

FIGURE 4
Who Internal Auditor Reports to



The study sought to establish reporting channels of internal audit by listing statements on audit reporting channels and respondents were required to indicate how these applied to their SACCO. Results are presented in Table 6. The results indicate that respondents agree to all the statements on internal audit reporting channels. Respondents agree to the statement that ‘The internal audit department reports openly without any fear in this SACCO’ (3.88), and also agreed to the statement that ‘Internal audit reports are provided to the highest office in the SACCO’ (3.72). Further results indicated that respondents agreed to the statement that ‘There is a good relationship between Internal audit department and who they report to in this SACCO’ (3.65) and also agreed to the statement that ‘There are clear channels of reporting for internal audit that are simple and straightforward’ (3.61). Respondents also agreed to the statement that ‘The internal audit department shows independence in their reporting’ (3.54).

TABLE 6
Internal Audit Reporting Channels

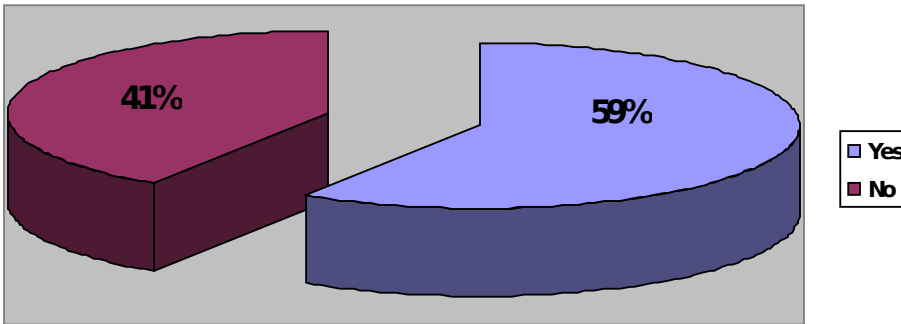
Statement	Mean score
There are clear channels of reporting for internal audit that are simple and straightforward	3.61
Internal audit reports are provided to the highest office in the SACCO	3.72
There is a good relationship between Internal audit department and who they report to in this SACCO	3.65
The internal audit department reports openly without any fear in this SACCO	3.88
The internal audit department shows independence in their reporting	3.54

4.4.3 Internal audit report completeness

The third objective of the study was to investigate the effect of internal audit report completeness on financial performance of SACCOs. Respondents were asked to indicate whether the internal audit reports of the SACCO presented display the qualitative aspect of completeness. Findings are presented in Figure 5. The findings revealed that 59% of the respondents felt that

internal audit reports in their SACCOs displayed completeness while 41% thought that internal audit reports in their SACCOs did not display completeness.

FIGURE 5
Whether Internal Audit Reports Display Completeness



The research further sought to assess how completeness was observed in internal audit reporting using likert scales. Statements on completeness of internal audit reports were listed and respondents were required to indicate their level of agreement to those statements as they related to their SACCO. The results are presented in Table 7. The study results indicate that respondents agreed to the statements that ‘Internal audit reports adequately offer insights on the risks that face the SACCO’ (3.94), that ‘Internal audit reports have an analysis of the control weaknesses that are significant’ (3.77) and also agreed to the statement that ‘The internal audit reports are in a format that is prescribed by the SACCO’ (3.73). Study findings also revealed that respondents agreed that ‘Internal audit reports have an analysis of any thematic issues that have been unearthed by the audit in the entire SACCO’ (3.72) and also that ‘Internal audit reports reasonably cover all areas of operations and are reasonably complete’ (3.62). There was also agreement to the statement that ‘Internal audit reports have enough information to enable management make informed decisions on internal controls’ (3.57).

TABLE 7

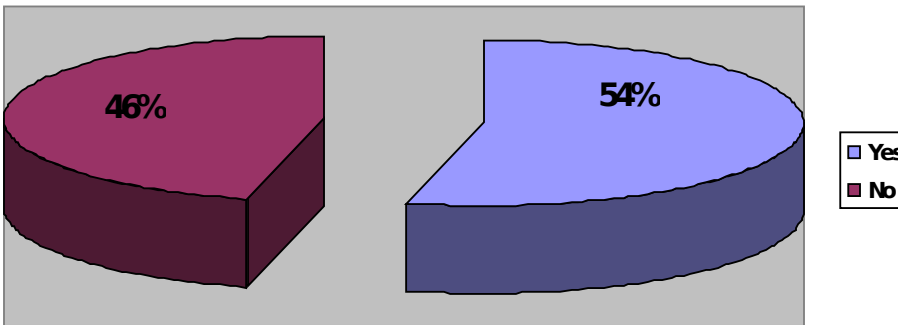
Completeness of Internal Audit Reports

Statement	Mean score
Internal audit reports have enough information to enable management make informed decisions on internal controls	3.57
The internal audit reports in this SACCO are comprehensive	3.30
Internal audit department provides comprehensive reports and assurances to the management of the SACCO	3.46
Internal audit reports reasonably cover all areas of operations and are reasonably complete	3.62
The internal audit reports are in a format that is prescribed by the SACCO	3.73
Internal audit reports adequately offer insights on the risks that face the SACCO	3.94
Internal audit reports have an analysis of the control weaknesses that are significant	3.77
Internal audit reports have an analysis of any thematic issues that have been unearthed by the audit in the entire SACCO	3.72
Internal audit reports have an assessment of the risk management plans that the management has	3.36
Internal audit reports provide an assessment of the entire effectiveness of risk, governance and controls that the organization has put in place	3.43

4.4.4 Timeliness of internal audit reports

The fourth objective of the study was to establish how timeliness of internal audit reports influenced performance of SACCOs. Respondents were required to indicate whether internal audit reports in their SACCOs were timely or not. Results are presented in Figure 6. The results reveal that 54% of the respondents indicated that internal audit reports in their SACCOs were timely while 46% indicated that internal audit reports in their SACCO did not observed timeliness.

FIGURE 6
Whether Internal Audit Reporting Observe Timeliness



Further, likert type statements were listed and respondents were required to indicate their level of agreement or disagreement with the listed statements in relation to timeliness of internal audit reports in their SACCO. The results are presented in Table 8. The findings reveal that indicate that respondents agreed to the statement that ‘Internal audit reports have insight into the changes that are taking place in this SACCO and the effect these changes can have on the SACCO’ (3.74) and also agreed to the statement that ‘If there is any expected delay in internal audit reporting, this is communicated to the relevant authorities and the effect of this delay assessed’ (3.72). Further results revealed that respondents agreed to the statements that ‘Internal audit reports are timely compiled and circulated to all respective units after completion of the audit’ (3.65), ‘Internal audit reports are released promptly and immediately after the audit is concluded’ (3.58) and also to the statement that ‘Internal audit reporting meets the set deadlines of report issuance to the relevant SACCO units’ (3.54).

TABLE 8
Timeliness of Internal Audit Reporting

Statement	Mean score
Internal audit reports are released promptly and immediately after the audit is concluded	3.58
Internal audit reporting meets the set deadlines of report issuance to the relevant SACCO units	3.54
Internal audit reports are timely which enables management to prevent risk and losses	3.31
Audit reports on high risk areas are done regularly	3.14
Internal audit reports are timely compiled and circulated to all respective units after completion of the audit	3.65
If there is any expected delay in internal audit reporting, this is communicated to the relevant authorities and the effect of this delay assessed	3.72
Internal audit reports have insight into the changes that are taking place in this SACCO and the effect these changes can have on the SACCO	3.74

4.5 Correlation and Regression Results

4.5.1 Correlation results

A correlation analysis was performed to establish the relationship between the variables under study. Assets owned by the SACCO were used to control for size. Pearson bivariate correlation coefficients were established for all the variables with findings as indicated in Table 9. The study results indicate that there was significant positive correlation between objectivity ($r = 0.675$; $p < 0.05$), completeness ($r = 0.714$; $p < 0.05$) and timeliness ($r = 0.699$; $p < 0.05$) on one hand and net operating surplus on the other. These findings reveal that objectivity, completeness and timeliness of internal audit reports is positively related to net operating surplus indicating that an improvements in one or all of these variables would results to an improvement of the net operating surplus. However, the relationship between internal audit reporting channels and net operating surplus was negligible and insignificant ($r = 0.053$; $p > 0.05$). This indicates that reporting channels do not have a significant relationship with net operating surplus.

TABLE 9
Correlation Matrix

		1	2	3	4	5
1. Objectivity	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	74				
2. Reporting Channels	Pearson Correlation	.041	1			
	Sig. (2-tailed)	.724				
	N	74	74			
3. Completeness	Pearson Correlation	.797**	.068	1		
	Sig. (2-tailed)	.000	.562			
	N	74	74	74		
4. Timeliness	Pearson Correlation	.661**	.033	.690**	1	
	Sig. (2-tailed)	.000	.678	.000		
	N	74	76	74	76	
5. Net Operating Surplus	Pearson Correlation	.675**	.053	.714**	.699**	1
	Sig. (2-tailed)	.000	.649	.000	.000	
	N	74	76	74	76	76

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

4.5.2 Regression results

Regression analysis was performed with the independent variables being objectivity, reporting channels, completeness and timeliness. The ratings on the independent variables (1- Strongly disagree, 2 – Disagree, 3 – Neutral, 4 – Agree and 5 – Strongly agree) were used as parameters in the regression analysis. The dependent variable was financial performance of SACCOs measured using net operating surplus. Size of the SACCOs was controlled using value of assets owned by the SACCO.

The r-squared for the regression model was 0.71 as indicated in Table 10. The model therefore is explaining 71% of the change in net operating surplus of SACCOs using the four independent variables. These findings indicate that the four independent variables selected

(objectivity, reporting channels, completeness and timeliness) can explain 71% of the change in net operating surplus of SACCOs.

TABLE 10
Coefficient of Determination – Combined R²

R	R Square	Adjusted R Square	Std. Error of the Estimate
.843	.710	.694	5.678

The significance of the overall model in providing any predictive value was assessed using the f-test. Results from the analysis of variance are provided in Table 11. The results reveal that the overall regression model was significant and have some predictive value ($f = 43.455$; $p < 0.05$). These findings reveal that the four independent variables used in the regression have a predictive value on the net operating surplus of SACCOs. This implies that knowledge about a SACCO's internal audit reporting quality can be used to predict the financial performance of that SACCO as measured through net operating surplus.

TABLE 11
Significance of the Regression Model

Source of variance	Sum of Squares	df	Mean Square	F	Sig.
Regression	5604.648	4	1401.162	43.455	.000
Residual	2289.299	71	32.244		
Total	7893.947	75			

The test of the statistical significance of the independent variables in the model was done using t-tests. Results are presented in Table 12 which indicates that objectivity of internal audit reports has a positive coefficient when used as a predictor of performance of SACCOs in the regression model ($\beta = 2.202$; $t = 2.226$; $p < 0.05$) indicating that rise in objectivity of internal audit reports would have a positive effect on performance of SACCOs as measured through net operating surplus. The t-test also revealed that objectivity of internal audit reports is a significant predictor of financial performance of SACCOs.

Reporting channels were not a significant predictor of financial performance of SACCOs ($\beta = 0.042$; $t = 0.9$; $p > 0.05$). These findings reveal that where the internal audit department reports to does not have a significant effect on financial performance of the SACCO.

Completeness of internal audit reports had a significant effect on financial performance of the SACCOs ($\beta = 3.507$; $t = 3.19$; $p < 0.05$). This finding indicates that improvement on completeness and comprehensiveness of internal audit reporting would significantly lead to improvement of financial performance of the SACCO and vice versa.

Further findings reveal that timeliness of internal audit reports has a significant influence on the financial performance of the SACCO ($\beta = 2.253$; $t = 2.575$; $p < 0.05$). This indicates that timeliness of internal audit reporting has a positive and significant effect on financial performance of SACCOs. This implies that an improvement on timeliness will positively influence a rise on financial performance and vice versa.

TABLE 12
Test of Significance of Independent variables

Variables	Unstandardized		Standardized	t	Sig.
	Coefficients		Coefficients		
	β	Std. Error	Beta		
(Constant)	7.760	6.143		1.263	.211
Objectivity	2.202	.989	.282	2.226	.029
Reporting Channels	.042	.467	.006	.090	.928
Completeness	3.507	1.099	.452	3.190	.002
Timeliness	2.253	.875	.153	2.575	.017

4.6 Discussion of Results

On objectivity of audit reporting, the study established that internal audit in the surveyed SACCOs provided reports with verifiable and supporting documents. This agrees with a study

done by Holt and DeZoort (2009) which observed that since internal auditors are expected to check all the organizational controls and report on them, objectivity in the reporting should not be compromised. The reports should not be based on hearsay, subjective judgment or witch-hunting for them to have the desired effect on performance of the organization. Correlation results indicated that there was a significant positive correlation between objectivity of internal audit reports and financial performance of SACCOs. Further results indicated that objectivity of internal audit reports has a significant positive effect on performance of SACCOs. These findings agree with findings from a study by Gramling et al. (2004) which established that objectivity of reports is important to ensure that positive change is performed in the different organizational processes to improve corporate governance and organizational repute. This positive effect of internal audit objective reporting creates strong controls and processes that are a catalyst for improved organizational performance. The study findings also agree with a study by Aid (2010) which revealed that reports that are filled with innuendo, allegations and bias may brew discontent and chaos in the organization which may adversely affect the overall organizational performance.

On how internal audit reporting channels influence financial performance of SACCOs, study results indicate that internal audit reporting channels did not have a significant relationship with financial performance of SACCOs. Further, internal audit reporting channels did not have a significant effect on financial performance of SACCOs. These study findings are contrary to findings in a study by Holt (2012). Holt had established in the study that financial performance of firms was better in companies whose internal audit reports were provided to the audit committee and the Chief Executive Officer (CEO) compared to those organizations that the internal auditor gave reports to the chief financial officer (CFO). Further, the study results

disagree with findings by Johnson (2006) who observed that the internal audit department reports can contribute to the positive health of the company if they report to either the CEO or any other high office apart from the CFO. The current study findings also disagree with findings by James (2003) who established that a firm that has internal audit department reporting to lower or perceived inferior levels of management may find it problematic in finding willing lenders. This may affect capital investments decisions of the firm which may in turn affect the future revenues and financial performance of the organization.

On completeness of the internal audit reports, the study established that internal audit reports in the surveyed SACCOs adequately offer insights on the risks that face the SACCO. This finding agrees with the capture theory (Spiller, 1996) which indicates that internal auditing is formed to ensure that management is well regulated, informed and advised. Internal auditing therefore should act in ways that benefits the management it is supposed to regulate and monitor. This indicates that many of the internal audit departments of the SACCOs were performing their activities effectively and competently. Completeness of internal audit reports in this study had a significant positive linear relationship with financial performance of SACCOs. Further, completeness of internal audit reports had a significant positive effect on financial performance of SACCOs. This concurs with findings of a study by Whittington and Pany (2001) who established that completeness of internal audit positively influence the financial performance of an organization through its effect on adherence to ethics, regulations and corporate governance. Arena and Azzone (2007) had similar findings to the current study as they observed that comprehensive reports and assurances that the internal audit department provides to the management of the organization are expected to assure management and provide them with confidence that the internal controls and operational processes in the organization are sound and

effective and hence contribute to financial performance. Another study with similar findings to the current study was by Hutchinson and Zain (2009) who observed that comprehensive and complete audit reports contribute positively to firm growth and financial performance.

On the effect of timeliness of internal audit reports on performance of SACCOs, the study established that timeliness of internal audit reports had a significant positive linear relationship with financial performance of SACCOs. The study further determined that timeliness of internal audit reports has a significant positive effect on the financial performance of SACCOs. These results agree with a study by Al Matarneh (2011) which established that timeliness of reports is important as the timely information could be usable to management to prevent risk and losses which in turn enhances financial performance. The current study also established that audit reports are timely compiled and distributed to respective departments. This concurs with findings by Breakspear (2008) who established that internal audit reports should be timely compiled and circulated to all respective units after completion of the audit for them to contribute positively to the organization's bottom line. This is because delay in reporting may worsen an already bad situation or make an opportunity that could have been taken pass. Sparks (2011) also had similar findings to the findings in the current study. Sparks established the importance of timely audit reporting in enabling the organization to perform its duties effectively. The audit reports according to Sparks should have insight into the changes that are taking place and the effect these changes can have on the organization. This then should be timely communicated to the management for action to be taken. As such, this positively affects organizational performance. The current study further established that audit reporting guidelines in the surveyed SACCOs were generally adhered to. This concurs with a study by Castanheira et al. (2010) which established that in audit reporting, the reporting time should follow the policies

and guidelines set up in the organization for the reporting to be well coordinated and assists other functions in the organization.

CHAPTER FIVE

CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The aim of the study was to establish the effect of internal audit reporting quality on financial performance of SACCOs. The study had the following objectives: To establish the effect of objectivity of internal audit reporting on financial performance of SACCOs; To determine how internal audit reporting channels affect financial performance of SACCOs; To investigate the effect of internal audit report completeness on the financial performance of SACCOs, and; To establish how timeliness of internal audit reporting affects financial performance of SACCOs. This chapter presents the summary of findings and discussion of the findings.

5.2 Summary of Findings

The first objective of the study was to determine the effect of objectivity of the internal audit reports on financial performance of SACCO's in Kenya. The results reveal that 53% of the respondents indicated that audit reports in their SACCOs were objective while 47% indicated that audit reports in their SACCOs were not objective. The study results further indicated that respondents agreed to the statement that 'Internal audit in this SACCO provides reports with verifiable and supporting documents' (3.73) and also that 'The reports of the internal audit department are based on facts and can be authenticated' (3.61). Further results indicate that respondents were neutral on all other statements. These included the statement that 'Organizational members unanimously accept internal audit reports and take positive steps towards acting on the reports' (3.31), 'Internal audit reports raise disputes and discontent among

the organizational members' (2.71), 'Internal audit reports in this SACCO are based on hearsay, subjective judgment or witch-hunting' (2.66) and also neutral on the statement that 'The comments and views expressed in internal audit report are biased' (2.63). Correlation results indicated that there was a significant positive correlation between objectivity of internal audit reports and financial performance of SACCOs. ($r = 0.675$; $p < 0.05$). Test of hypothesis indicated that objectivity of internal audit reports has a significant positive effect on performance of SACCOs ($t = 2.226$; $p < 0.05$).

The second objective of the study was to determine how internal audit reporting channels influence financial performance of SACCOs. Study results indicate that 74% of internal auditors in the surveyed SACCOs reported to the CEO or top management while in 26% of the SACCOs, the internal auditor reported to middle management. Further results revealed that respondents agreed to the statement that 'The internal audit department reports openly without any fear in this SACCO' (3.88), and also agreed to the statement that 'Internal audit reports are provided to the highest office in the SACCO' (3.72). Further results indicated that respondents agreed to the statement that 'There is a good relationship between Internal audit department and who they report to in this SACCO' (3.65) and also agreed to the statement that 'There are clear channels of reporting for internal audit that are simple and straightforward' (3.61). Respondents also agreed to the statement that 'The internal audit department shows independence in their reporting' (3.54). Correlation results indicated that internal audit reporting channels did not have a significant relationship with financial performance of SACCOs ($r = 0.053$; $p > 0.05$). Test of hypothesis in regard to effect of internal audit reporting channels on financial performance indicated that internal audit reporting channels do not have a significant effect on financial performance of SACCOs ($t = 0.9$; $p > 0.05$).

The third objective of the study was to investigate the effect of internal audit report completeness on financial performance of SACCOs. The findings indicate that 59% of the respondents indicated that internal audit reports in their SACCOs exhibited completeness while 41% indicated that internal audit reports in their SACCOs did not display completeness. Further results indicate that respondents agreed to the statements that 'Internal audit reports adequately offer insights on the risks that face the SACCO' (3.94), that 'Internal audit reports have an analysis of the control weaknesses that are significant' (3.77) and also agreed to the statement that 'The internal audit reports are in a format that is prescribed by the SACCO' (3.73). Study findings also revealed that respondents agreed that 'Internal audit reports have an analysis of any thematic issues that have been unearthed by the audit in the entire SACCO' (3.72) and also that 'Internal audit reports reasonably cover all areas of operations and are reasonably complete' (3.62). There was also agreement to the statement that 'Internal audit reports have enough information to enable management make informed decisions on internal controls' (3.57). Completeness of internal audit reports had a significant positive linear relationship with financial performance of SACCOs ($r = 0.714$; $p < 0.05$). Completeness of internal audit reports had a significant positive effect on financial performance of SACCOs ($\beta = 3.507$; $t = 3.19$; $p < 0.05$).

The fourth objective of the study was to establish how timeliness of internal audit reports influenced performance of SACCOs. The results revealed that 54% of the respondents indicated that internal audit reports in their SACCOs were timely while 46% indicated that internal audit reports in their SACCO did not observed timeliness. Further findings indicate that respondents agreed to the statement that 'Internal audit reports have insight into the changes that are taking place in this SACCO and the effect these changes can have on the SACCO' (3.74) and also agreed to the statement that 'If there is any expected delay in internal audit reporting, this is

communicated to the relevant authorities and the effect of this delay assessed' (3.72). Further results revealed that respondents agreed to the statements that 'Internal audit reports are timely compiled and circulated to all respective units after completion of the audit' (3.65), 'Internal audit reports are released promptly and immediately after the audit is concluded' (3.58) and also to the statement that 'Internal audit reporting meets the set deadlines of report issuance to the relevant SACCO units' (3.54). Timeliness of internal audit reports had a significant positive linear relationship with financial performance of SACCOs ($r = 0.699$; $p < 0.05$). The study further established that timeliness of internal audit reports has a significant positive effect on the financial performance of SACCOs ($\beta = 2.253$; $t = 2.575$; $p < 0.05$).

5.3 Study Conclusions

The study makes the following conclusions. First, objectivity of financial reporting in SACCOs significantly affects the SACCO's financial performance. Most of the SACCOs surveyed in this study had objective reporting by their internal audit departments but still there were a sizeable percentage which indicated that internal audit reporting in the SACCOs was not objective.

Secondly, internal audit reporting channels do not have a significant influence on financial performance of SACCOs. Most of the SACCOs surveyed had internal auditors reporting to the CEO or top management while a few had internal auditors reporting to middle management. This however, did not have any effect on financial performance of the SACCOs. The internal audit department of the surveyed SACCOs reported openly without any fear.

Thirdly, internal audit report completeness has a significant positive effect on financial performance of SACCOs. The SACCOs surveyed had internal audit departments that displayed

completeness in audit reporting. The internal audit reports so provided in the surveyed SACCOs have an analysis of the control weaknesses that are significant and are in a format prescribed by management.

On timeliness of internal audit reporting, the study concludes that timeliness of internal audit reports had a significant positive effect on financial performance of SACCOs. The study also concludes that most of the SACCOs had their internal audit departments providing timely audit reports. The internal audit reports had insight into the changes that are taking place in the SACCO and the effect these changes can have on the SACCO. Internal audit reports in the surveyed SACCOs were generally timely compiled and circulated to all respective units after completion of the audit.

5.4 Implications of the Study

The study has implications for SACCO management, SACCO committees SASRA and other regulatory authorities like the CBK who regulate deposit taking SACCOs. For SASRA and other regulatory authorities, the study reveals that internal audit reporting has an effect on financial performance of SACCOs. This therefore calls on them to ensure that internal auditing in SACCOs conform to standards of objectivity, completeness, timeliness and reliability.

For the SACCO management, the study results calls on management to ensure that internal auditing departments is let to perform its oversight and advisory role in all the affairs of the SACCO. This therefore indicates that SACCOs who will be able to have effective internal audit reporting systems will be able to perform better financially.

5.5 Recommendations of the Study

5.5.1 Recommendations for practice

The study makes the following recommendations. First, SACCOs should improve on objectivity of their audit reports and ensure that internal audit reports do not raise disputes and discontent among the organizational members. Further internal audit reports in the SACCO should not be based on hearsay, subjective judgment or witch-hunting.

Second, the internal audit departments should be independent and should report to the highest office in the SACCO to ensure that this department carries its function effectively and competently without any fear or favor.

Third, the SACCOs should ensure that internal audit department provides comprehensive reports and assurances to the management of the SACCO. These reports should have an assessment of the risk management plans that the management has and also provide an assessment of the entire effectiveness of risk, governance and controls that the organization has put in place

Lastly, SACCOs should ensure that internal audit reports on high risk areas are done regularly so that to make sure risk from these areas is managed effectively. Further internal audit reports should be timely which enables management to prevent risk and losses even a long time before the risks and losses are realized.

5.5.2 Recommendations for further research

This study was a survey of SACCOs in Murang'a County and sought to establish the effect of audit reporting quality on financial performance of SACCOs. A recommendation is made for any future research to focus on other SACCOs in other counties of the republic and establish how audit reporting influences financial performance of the SACCOs. This is because

this survey of Murang'a County has limited generalization to other counties in Kenya due to the different contextual factors in these other counties. Further a future study should also be conducted in other sectors beyond the SACCO sector. This could be in micro finance institutions, NGOs and other such organizations whose activities affect the majority poor.

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APPENDICES

APPENDIX I

Questionnaire to SACCO employees

Kindly answer the following questions as accurately as possible. The questions are intended for research purposes only. Whatever you write will be used for the intended purpose only and will remain confidential. Do not write your name on this questionnaire. Put a tick (✓) where relevant.

SECTION A: DEMOGRAPHIC INFORMATION

1. Please indicate your age category

Below 25 years []

26 – 35 years []

35 – 45 years []

46 – 55 years []

Above 55 years []

2. Please indicate your gender

Male []

Female []

3. What is your highest professional qualification?

Certificate []

Diploma []

Bachelors degree []

Masters degree []

Doctorate []

5. How many years have you worked in this SACCO?

Below 5 years []

5 – 10 years []

11 – 15 years []

Above 15 years []

SECTION B: OBJECTIVITY OF THE INTERNAL AUDIT REPORTS

1. Are audit reports in this SACCO objective?

Yes []

No []

2. The table below presents statements about objectivity of audit reports in this SACCO and how that has affected financial performance. Please indicate your level of agreement on the statements below. Use the following scale:

1 - Strongly Disagree
4 – Agree

2 - Disagree
5 - Strongly agree

3 - Undecided

Statement	1	2	3	4	5
The comments and views expressed in internal audit report are biased					
Internal audit reports in this SACCO are based on hearsay, subjective judgment or witch-hunting					
Internal audit reports raise disputes and discontent among the organizational members					
The reports of the internal audit department are based on facts and can be authenticated					
Organizational members unanimously accept internal audit reports and take positive steps towards acting on the reports					
Internal audit in this SACCO provides reports with verifiable and supporting documents					

SECTION C: INTERNAL AUDIT REPORTING CHANNELS

1. Who does the internal audit department report to?

CEO/Top Management []

Middle management []

Lower management []

2. The table below presents statements about internal audit reporting channels in this SACCO and how that has affected financial performance. Please indicate your level of agreement on the statements below. Use the following scale:

1 - Strongly Disagree
4 – Agree

2 - Disagree
5 - Strongly agree

3 - Undecided

Statement	1	2	3	4	5
There are clear channels of reporting for internal audit that are simple and straightforward					

Internal audit reports are provided to the highest office in the SACCO					
There is a good relationship between Internal audit department and who they report to in this SACCO					
The internal audit department reports openly without any fear in this SACCO					
The internal audit department shows independence in their reporting					

SECTION D: INTERNAL AUDIT REPORT COMPLETENESS

1. Are internal audit reports in this SACCO usually complete?

Yes []

No []

2. The table below presents statements about completeness of internal audit reports in this SACCO and how that has affected financial performance. Please indicate your level of agreement on the statements below. Use the following scale:

1 - Strongly Disagree

2 - Disagree

3 - Undecided

4 - Agree

5 - Strongly agree

Statement	1	2	3	4	5
Internal audit reports have enough information to enable management make informed decisions on internal controls					
The internal audit reports in this SACCO are comprehensive					
Internal audit department provides comprehensive reports and assurances to the management of the SACCO					
Internal audit reports reasonably cover all areas of operations and are reasonably complete					
The internal audit reports are in a format that is prescribed by the SACCO					
Internal audit reports adequately offer insights on the risks that face the SACCO					
Internal audit reports have an analysis of the control weaknesses that are significant					
Internal audit reports have an analysis of any thematic issues that have been unearthed by the audit in the entire SACCO					
Internal audit reports have an assessment of the risk management plans that the management has					
Internal audit reports provide an assessment of the entire effectiveness of risk, governance and controls that the organization has put in place					

SECTION E: INTERNAL AUDIT REPORT TIMELINESS

1. Are internal audit reports in this SACCO on time?

Yes []

No []

2. The table below presents statements about internal audit reports timeliness in this SACCO and how that has affected financial performance. Please indicate your level of agreement on the statements below. Use the following scale:

1 - Strongly Disagree

2 - Disagree

3 - Undecided

4 - Agree

5 - Strongly agree

Statement	1	2	3	4	5
Internal audit reports are released promptly and immediately after the audit is concluded					
Internal audit reporting meets the set deadlines of report issuance to the relevant SACCO units					
Internal audit reports are timely which enables management to prevent risk and losses					
Audit reports on high risk areas are done regularly					
Internal audit reports are timely compiled and circulated to all respective units after completion of the audit					
If there is any expected delay in internal audit reporting, this is communicated to the relevant authorities and the effect of this delay assessed					
Internal audit reports have insight into the changes that are taking place in this SACCO and the effect these changes can have on the SACCO					

SECTION F: FINANCIAL PERFORMANCE

1. Indicate financial performance of the SACCO in the last financial year

Net Operating Surplus Ksh _____

2. Indicate the assets owned by the SACCO at the end of the last financial year.

Assets worth in Ksh _____

THANK YOU FOR PARTICIPATING