EFFECT OF INTERNAL AUDIT FUNCTIONS ON FINANCIAL ACCOUNTABILITY OF COMMERCIAL ENTERPRISES IN KENYA

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DECLARATION

I declare that this research project is my original work and has never been presented in any other university for the award of any degree.

Signed---Date--

CHANUA EDNA

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This research project has been submitted for examination with my approval as the University supervisor.

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DEDICATION

I dedicate this research project to my lovely husband Geoffrey Ongaga, my children Marion Ongaga and Brayden Chinua, my parents, brothers and sisters for their patience to stand with me during desperate moments. May God bless you abundantly for your encouragement and cooperation while I was preparing this research project.

ACKNOWLEGEMENTS

Thank you Lord for giving me good health, peace and protection while I was preparing this research project. Was it not for the dedication and commitment of my supervisor Dr. Angela Kithinji and Dr. Winnie Nyamutte, this research project was to be an impossibility. I thank you for your academic insights and positive critique of this research work. I appreciate my workmates and colleagues for their moral support and encouragement while I was preparing this research work. May the almighty God bless you and reward you accordingly for standing with me from the beginning of the MBA pursuit to this far.

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ABBREVIATIONS AND ACRONYMS

GoK	Government of Kenya
KAM	Kenya Association of Manufacturers
KIPPRA	Kenya Institute of Public Policy Research and Analysis
KNA	Kenya National Audit
KRA	Kenya Revenue Authority
SPSS	Statistical Package of Social Sciences
IAS	International Accounting Standards
UNDP	United Nations Development Programme

ABSTRACT

Despite extensive studies on internal audit functions and financial accountability from one context to another, there is no clear understanding on internal audit functions and financial accountability. The study sought to examine the effect of internal audit functions on financial accountability of commercial enterprises in Kenya. The specific objectives were to determine the effect of proactive audit, policy compliance and control of operations. This study was anchored on agency theory, finance theory and stewardship theory as discussed. The study adopted cross-sectional research. A census approach was adopted to collect information from all the 5 commercial enterprises in the textile manufacturing sector in Kenya. Questionnaires comprising open and closed ended questions were used to collect primary data. Employees from commercial enterprises in Kenya and scholars at the University of Nairobi were used to test validity of the research instrument while reliability was tested using Cronbach Alpha coefficients. Descriptive statistic and inferential statistics such as correlation and linear regression were used to analyze data. The findings revealed a significant positive relationship between internal audit functions and financial accountability of commercial enterprises in Kenya. Proactive audit was significant (β=0.467, $p < 0.000$), policy compliance (β=0.389, $p < 0.000$) and control of operations (β=0.318, $p < 0.000$). The study concluded that unless management of commercial enterprises in Kenya appreciate the role of internal audit functions achieving financial accountability would be an uphill task. For effective financial accountability among commercial enterprises in Kenya, top leaders should develop and implement policies that promote internal audit functions such as proactive audit, policy compliance and control of operations.

CHPTER ONE

INTRODUCTION

1.1 Background of the Study

Internal audit is conceptualized to be a function of financial accountability of financially competitive organizations (Fajar & Mulyasari, 2018). As organizations seek to enhance their financial soundness from time to time, embracing best internal audit practices is viewed to be a driver of organizational efficiency and effectiveness in terms of financial resource management (Vinnari & Skaerbaek, 2014). As organizations expand their operations, internal administrative procedures such as examinations of financial documents (Tunji, 2013). Counting assets and providing timely feedback to organizational stakeholders such as board members, managers and external auditors are considered to be activities that can enhance financial accountability (Sylvester, 2018). Organizational ability to demonstrate high level of financial accountability is considered to be influenced by proactive audits, compliance to policies and control of operations (Fajar, & Mulyasari, 2018).

This study was informed by agency theory founded by Ross and Stephen (1973), finance theory established by Modigliani and Miller (1958) and stewardship theory established by Davis, (1997). Agency theory argues that financial accountability can be influenced in any organizations if the employer and employee act for the interest of each other. Finance theory opines that entities are likely to enhance financial accountability if internal audits systems are effectively embraced while stewardship theory contends that financial accountability is only enhanced if stewards who are in charge of resources have high level of integrity and professionalism to serve the interests of the majority.

Deteriorating financial performance of commercial entities is not only influenced by competition and change of regulations but also by weak control internal systems. Inability of the commercial enterprises to innovate new products, diversify and embrace appropriate technology is associated with poor financial management practices. Inappropriate financial risk management and internal audit practices can have a negative impact on financial accountability from one entity to another (Kenya Institute of Public Policy Research and Analysis, 2018). This study is motivated on the premise that financial accountability in commercial entities in Kenya will result to attainment of Vision of the economic pillar of Vision 2030 thereby industrialization and globalization of the economy.

1.1.1 Internal Audit Functions

Internal audit function is a set of systematic activities which are objectively carried out by professionals in any organization with an aim of improving organization's value (Fajar, & Mulyasari, 2018). Similarly, Ewa and Udoayang (2012) regard internal audit function as a framework manager in an organization put in place to enhance financial soundness of the entity. Dieter and Lause (2011) describe internal audit function as a systematic exercise conducted by professionals based on scientific principles that seek to ascertain reality of information provided in financial records. Financial accountability is viewed by Muhammad (2015) as the responsibility of the organization to effectively update and provide accurate financial information to key stakeholders.

Nawhera (2012) also regards financial accountability as the ability of the organization to provide accurate information to key stakeholders on the expenditure of money allocated for accountability purposes. Financial accountability is described as the capacity of the organization to openly be evaluated by internal and external stakeholders on how money allocated was spent (Sarens & Abdolmohammadi, 2011). Internal audit functions conceptualized in this study to influence financial accountability are proactive audits, policy compliance and control of operations. Proactive audits are a set of procedures or activities performance by organizations with an aim of preventing an organization from experiencing financial misappropriation cases or financial fraud (Bett, 2014).

Policy compliance is the ability of the entity to adhere to existing policies with an aim of minimizing cases attributed to financial mismanagement or fraud (Adel, 2011) while control of operation is described as the ability of managers in the organization to develop clear plans or frameworks that will facilitate implementation and evaluation of the plans based on the set standards (Adegbite, 2010). Effective and efficient internal audit functions are considered to positively influence financial accountability of private and public organizations (Agburu, 2012). High level of competency and professionalism expressed by internal auditors in any organization not only enhance stakeholder value but also results to minimal wastage of financial resources through fraudulent ways or intentional misappropriation of funds allocated for development activities (Bett, 2014).

As organizations continue to exist in an environment characterized by unethical behaviours among workers such as theft, internal audit function is considered to be one of the competitive practices which can maximize the stakeholder value and at the same time lead to minimal conflicts between the employers and worker (Sarens & Abdolmohammadi, 2011). Tunji, (2013) ascertains that metrics such as customers and employees' satisfaction can be used to measure financial accountability whereas Kilika (2013) opines that financial accountability can be measured using metrics such as accessibility of financial information to members of the public, budget credibility, employee accountability on expenditures and high level of integrity among workers. Whilst, Jokipii (2010) acknowledges that financial accountability is viewed and a function of internal audit functions is effectively embraced.

1.1.2 Financial Accountability

Financial accountability is the responsibility of the organization to effectively and efficiently use funds or money allocated in a more transparent manner which enhances stakeholder confidence (Dogui, Boiral & Gendron, 2013). Good stewardship of resources by public servants for the benefit of the majority is described to be the best practice of financial accountability (Nyakundi et al. 2014). Fajar and Mulyasari (2018) ascertain that preparation of accurate and up to date accounts and adherence to financial standards can enhance organizational productivity in terms of improved customer service delivery. Violation of financial regulations and inability of employees in any organization to keep accurate and up to date accounts not only results to misappropriation of money but also promotes interests of individual's employees rather than collective interests of stakeholders (Tunji, 2013).

Adel (2011) contends that effectiveness of internal control structures not only make organizations to utilize resource effectively but also facilitates implementation of policies that address collective interests. Despite differences amid internal control structures and performance of organizations from one context to another, it is viewed that element of internal control can have a significant impact on financial accountability among private and public organization (Al Matarneh, 2011).

Irregularities and fraud cases in organizations is not only attributed to weaknesses of internal control systems but also failure of good-will among employees to embrace ethical values such as honest, integrity and openness. Dieter and Lause (2011) argue that misappropriation of funds by workers, inability to keep up to date records, manipulation of accounts records, lack of individual accountability on expenditure and failure to provide information on expenditure are all issues that hinder effective financial accountability in commercials enterprises (Nawhera, 2012).

Abdolmohammadi (2011) in Madagascar, Tunji (2013) in Nigeria, Vinnari and Skaerbaek (2014), Sylvester (2018) in Kenya, Nyakundi et al. (2014) in Kenya revealed that, despite the fact that internal audit functions had a significant impact on financial performance of firms, to some extent there exist differences between internal audit functions and financial accountability from one context to another. Inefficiently managed organization not only experience financial problems but also issues of corporate governance (Otieno, Mugo, Njeje& Kimathi, 2015). Similarly, Tan (2012) on the other hand, observed that financial difficulties experienced in both commercial enterprises are attributed to weaknesses of internal control systems (Ewa, &Udoayang,2012).

1.1.3 Commercial Enterprises in Kenya

Commercial enterprises are entities operating in multiple sectors in Kenya and registered by the registrar of companies to provide goods and services as per the provisions of the Companies Act (GoK, 2012). The major objective of any commercial enterprise in any economy is to establish viable business ventures with high rates of return thereby maximizing stakeholder value and wealth (Kenya Bureau of Statistics, 2018). For sustainable economic stability, effective performance of all sectors is considered to be a predominant factor of economic growth. Favorable government regulation, political and economic stability not only promote enterprise growth but also economic stability (KAM, 2018).

Performance of the manufacturing sector and more specifically the textile sector is viewed to contribute significant to Gross National Product from one country to another if internal factors and external factors are favourable (KBS, 2018). Effective management of internal audit functions by manufacturing firms in the textile sector in Kenya can result to improved financial performance of the entities and in turn result to improved economic stability (KIPPRA, 2018). Deteriorating financial performance of commercial enterprises in the textile manufacturing sector in Kenya is attributed to a range of issues such as internal audit, competition, change of regulations and influence of technology (KAM, 2018) thus pertinence of this study to unearth the research gaps.

1.2 Research Problem

Internal audit is considered to be a function of financial accountability among organizations. Organizations with appropriate audit mechanisms are likely to enhance financial accountability (Kilika, 2013). Whilst, Muhammad (2015) contend that accountability to expenditure, transparency and budget credibility are parameters that are attributed to organizations to embrace internal audit in managing financial resources. On the other hand, Nawhera (2012) opines that corporate governance can have a significant impact on financial accountability from one organization to another if effectively embraced. Poor corporate government can make organizations realize financial distress thus failure to meet stakeholder interests (Kamau, 2013). Constraints of conceptualizing and operationalizing variables of this study from context to another will form the basis of this study.

Financial inefficiencies in commercial enterprises in Kenya not only contributes to slow economic growth but also made them to rethink on effective internal audit functions (Karuthi, 2015). Further, the author pointed out that inability to pay suppliers on time and late remittance of dividends to the reassure and other statutory deductions are issues of concern in commercial enterprises. Increased cases of misappropriation of funds and lack of individual accountability are identified to issues of concern in commercial enterprises from one country to another (United Nations Development Programme, 2018). Globally, In Adel (2011), Vinnari and Skaerbaek (2014) in Malaysia identified that there existed a significant effect between internal audit practices and financial performance of organizations from context to context.

Regionally, Vinnari and Skaerbaer (2014) in South Africa noted that there existed differences between internal audit functions and organizational performance of municipalities. According to UNDP (2018) and KIPPRA (2018), inability of any organization to meet its financial obligation is attributed with weaknesses of internal audit systems. Kamau (2013) noted that failure of commercial entities to expand and diversify was attributed to lack of financial accountability from one enterprise to another. In this regard, despite that extensive studies have been undertaken by scholars, it is viewed these commercial enterprises in the textile sector have been given little attention by scholars thus the basis of this study.

Locally Nyakundi, Nyamita and Tinega (2014) in Kenya revealed that there existed a significant impact between internal control systems and financial performance of small and medium scale business enterprises in Kenya. A study by Kamau (2013) established that there exists a significant positive effect between internal controls financial performance of manufacturing firms in Kenya. Kilika (2013) in Kenya noted that there existed a difference between internal control practices on financial performance of commercial banks from one context to another.

Mugo (2013) established that internal controls had a significant impact on financial performance of technical training institutions in Kenya. Based on the findings of the empirical studies by Nyakundi et al. (2014), Kamau (2013), Kilika (2013) and Mugo (2013), it is noted that each study examined variables of this study partially and in isolation and at the same time each study was confined to a different context. In this regard, it is concluded that there exist deficiencies in evidence on the link between internal audit functions and financial accountability of organizations thus pertinence of this study. Therefore, it was on this premise this study sought to answer the question: what was the effect of internal audit functions on financial accountability of commercial enterprises in Kenya?

1.3 Objective of the Study

To determine the effect of internal audit functions on financial accountability of commercial enterprises in Kenya.

1.4 Value of the Study

The information of this study would be of help to managerial practice, policy makers, researchers and scholars. Management of commercial enterprises would use this information to articulate on new ways of enhancing financial accountability. This information would assist management to redefine internal audit models thus improved financial accountability through proactive audits, policy compliance and control of operations. Policy makers such as the government and development partners would use this information to formulate policies that would promote financial accountability among commercial enterprises in Kenya. Decisions that would discourage embezzlement of funds would be formulated and implemented. Scholars and researchers would identify research gaps from this study thereby replicating the study in other areas.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents theoretical and empirical literature review in relationship variables of this study. Finally, a conceptual framework showing the relationship between variables of the study is illustrated.

2.2 Theoretical Foundation

This study was anchored on agency theory, finance theory and stewardship theory as discussed.

2.2.1 Agency Theory

The theory was founded by Ross (1973). The theory argues that in any firm with more than one party conflicts and coordination problems can arise. As a result, regulations formulated can provide an opportunity to minimize the conflicts between the agent (employee) and the principal (employer) (Mugo, 2013). This theory argues that firms may have corporate governance issues if interests of each part are not addressed appropriately. Managers of firms may seek to satisfy their self-interest and violate the interests of shareholders who have major investments in the firm (Sarens & Abdolmohammadi, 2011).

This theory argues that agents are expected to express high level of integrity and professionalism while discharging duties and responsibilities allocated to them and on the other hand shareholders of the firm should ensure ownership structures are stables to facilitate maximization of profits (Muhammad, 2015).This theory opines that firms with corporate governance issues may experience losses in form of stock returns

(Jokipii, 2010). This theory suggests that management capital structure can enhance shareholder value.

The theory suggests that firms can realize gains on stock returns if managers of firm are dedicated in protecting interests of employees and vice versa (Kaplan, Pope & Samuels, 2010). Even though this theory has been applied in by Nyakundi, Nyamita and Tinega (2014), Fajar and Mulyasari (2018), it is viewed that constraints of operationalization and conceptualizing constructs of this theory from one context to another are uncertain thus the need to retest it in this study. The theory underpins this study on the assumption that commercial enterprises can enhance their financial accountability if they embrace proactive audits.

2.2.2 Finance Theory

Finance theory was established by Modigliani and Miller (1958). It is founded on behavioural finance which seeks to assess behaviour of investors and borrowers from the rational perspective (Adegbite, 2010). This theory observes that individual behaviour and market phenomena are interrelated and cannot be separated in any context. Investors and borrowers can behave differently based on the knowledge they have on the economy. The theory opines that investors are likely to invest in stable economies (Agburu, 2012).

Borrowers can invest in securities if the economy is performing well in terms of exchange rates. Further, the theory contends that that investors are always rational in making investments decisions. This theory argues that foreign and local investors are more likely to invest in terms of shares in companies that have good performance records (Adegbite, 2010). This theory opines that shareholders are likely to invest more in companies that are attributed to high dividend earnings and vice versa. Subsequently, well established shareholders are likely to reduce the level of stock investments in companies with poor track records.

Despite the fact that this theory has been extensively used in studies conducted by Agburu (2012), Adegbite, (2010), Ewa and Udoayang (2012), it is observed that universality and operationalization of its constructs are uncertain from one context to another thus pertinence to retest it in this study. This theory is retested in this study on the premise that commercial enterprises can enhance their financial accountability if they are in a position to comply with regulations of institutions such as International Accounting Standards and that of Kenya Revenue Authority.

2.2.3 Stewardship Theory

The theory was founded by Davis (1997). It argues that employees in any organization should not only act as strategic stewards but also act for the interest of shareholders (Dogui, Boiral & Gendron, 2013). Organizational performance is considered to be a function of corporate stewardship. To maximize stakeholder values, employees or agents or stewards should utilize resources more efficiently and effectively. Good management practices in any organization can translate into employee commitment and efficient resource utilization (Fajar & Mulyasari, 2018). Lack or management skills among workers can negatively affect organizational performance in terms of financial resource management (Ewa, & Udoayang, 2012).

The theory holds that, for any organization to maximize shareholder value, employees should be given the freedom and support in order to develop strategies that can maximize enterprise performance (Hironori, Theodore & Arnold, 2011). As organizations expand, good stewardship is viewed to be a function of financial excellence (Jokipii, 2010). Kamau (2013) contends that good stewardship can stimulate organizational growth in terms of financial performance. This theory is retested in this study as it will shed more light on how commercial enterprises can influence financial accountability through internal audit functions which is viewed to be a practice institutionalized by stewards of good-will.

2.3 Determinants of Financial Accountability

This section discusses the three variables that are considered to influence financial accountability in relation to empirical studies conducted globally, regionally and locally thereby pointing out the research gaps which were addressed by this study.

2.3.1 Proactive Audit and Financial Accountability

In Nigeria, Agburu (2012) and Adegbite (2010) established that financial accountability among local government institutions was attributed to accountability, integrity and transparence among workers. The studies concluded that despite that internal control practices had a significant impact on financial accountability, there existed a difference between internal audit functions and financial accountability among local government institutions thus the need for this study in commercial enterprises in Kenya. In Malaysia, Adel (2011) noted that there existed differences between internal audits and financial performance of microfinance institutions but failed to examine the effect of proactive audits, policy compliance and control of operation on financial accountability of commercial State corporations thus the need of this study in Kenya to bridge the conceptual and contextual research gaps.

In Jordan, Al Matarneh (2011) noted a significant impact between internal audit and financial performance of banks. The author noted that financial risk was minimized through employee training on forensic audit functions though is existed differences in evidence from one organizations to another. Tan (2012) in Asia also concurs that the ability of any organizations to enhance its financial soundness was determined by effective internal initiatives such as employee training, effective scrutiny of financial records and engagement of external auditors in auditing activities. However, it is pointed out that the study examined variables of this study partially and focused in different contexts thus conceptual and contextual gaps to be addressed by this study.

Agburu (2012), Adegbite, (2010) and Engel et al. (2010) concluded that proactive audits were more effective strategies of minimizing financial fraud in organizations contrary to reactive audits. Whilst in Kenya, Bett (2014), Kamau (2013), Karuthi (2015), Kilika (2013) acknowledged despite proactive audits, employee ethical standards had a significant effect on financial accountability and vice versa. Ewa and Udoayang (2012) also established a positive between internal audit functions and financial performance of organization from one context to another though variables of this study were examined in isolation thus non-generalizability of the findings the studies in this study. On the other hand, it was concluded by these authors concluded that there existed moderate differences between internal control practices or systems from one organization to another.

2.3.2 Policy Compliance and Financial Accountability

Nyakundi et al. (2014) in Kenya, Sarens and Abdolmohammadi (2011) in Madagascar, Sylvester (2018) in Kenya, Tunji (2013) in Nigeria, Vinnari and Skaerbaek (2014) in Malaysia ascertained that compliance to policies by organizations such as adherence to statutory regulations was a parameter of financial accountability. Hironori et al. (2011) also noted that non-adherence to regulations by organizations did not only contribute to organizational inefficiency in terms of legal cost but also made organizations to be subjected to high levels of financial risks.

Whilst, these results are acknowledged by Muhammad (2015) in Pakistan, Kyalo et al. (2016) in Kenya, Fajarand Mulyasari (2018) in Malawi, Dogui et al. (2013) in Canada who concluded that weaknesses in the internal audit systems such as non-adherence to policies had negative impact on organizational performance. The authors pointed out the embezzlement of funds by individual's workers and manipulation of financial records not only undermined financial viability of firms but also reflected how individual transparency, honest, accountability and integrity can significantly influence organizational image thus stakeholder value. Compliance to statutory regulations not only enhances financial accountability of firms but also promotes stakeholder confidence (Jokipii, 2010 & Khamis, 2013).

2.3.3 Control of Operations and Financial Accountability

In Kenya, Otieno, Mugo, Njeje and Kimathi (2015) concluded that Sacco's were likely to perform effectively if they embraced sound corporate governance structures and managed their financial plans. These findings are consistent with that of Mugo (2013), Muhammad (2015), Nawhera (2012), Nyakundi et all. (2014), Ongore and Kusa (2013) who identified that financial accountability of any firm was determined by the ability to firm to develop contingent financial plans, develop financial risk management practices, provide timely information to stakeholders and embrace financial management systems to minimize financial misappropriation.

The studies concluded that control of operations was not only the sole factor that influenced financial performance of organizations but also other factors such as proactive audits. These findings are supported by Khamis (2013) in Tanzania who identified that financial performance was not influenced by control of operations.

Subsequently, in Uganda, Nawhera (2012) pointed out that internal control had a significant influence on financial performance of Social Security Fund. Though, it was observed that this study adopted a case study approach which cannot be generalized in this study.

Tunji (2013) in Nigeria and Otieno et al. (2015) in Kenya also concluded that board characteristics, stakeholder rights, internal controls, transparency and disclosure had a significant impact on financial performance of firms although there existed conflicting views among scholars from context to another. Further, in Nigeria, Ewa and Udoayang (2012) postulated performance of commercial banks was determined by ability of management to control financial fraud through strict compliance to international accounting standards. Further, it was noted that corporate governance had a positive impact on performance as the mediating variable. Despite extensive studies by Mugo (2013), Muhammad (2015), Nawhera (2012), Nyakundi et al. (2014), Ongore and Kusa (2013), it is viewed that the studies examined variables of this study in isolation. This study will examine the variables in a consolidated manner.

2.4 Summary of Literature Review and Research Gaps

Despite extensive studies conducted internally, regionally and locally by scholars such as Dogui et al. (2013) in Canada, In Malaysia Adel (2011), Sarens and Abdolmohammadi (2011) in Madagascar, Tunji (2013) in Nigeria, Vinnari and Skaerbaek (2014), Sylvester (2018) in Kenya, Nyakundi et al. (2014) in Kenya, it is viewed that there is no clear understanding on the link between internal audit functions and financial performance of commercial enterprises from one context to another. Further, the context of each study was different geographically and contextually thus the need for this study to bridge contextual research gaps. Methodologies adopted by each study was different in terms of research design, instruments and data analysis methods thus the basis for this study. Constraints of operationalizing and conceptualizing variables of this study from one context to another will form the basis of this study.

2.5 Conceptual Framework

As depicted in Figure 2.1, the independent variable which was the internal audit function which was conceptualized to comprise a sub-set of three independent variables (proactive audit, policy compliance and control of operations). Board characteristics is the indicator that measured corporate governance while the selected metrics to measure proactive audits employee training and claim procedures. Policy compliance was measured using selected indicators such as accounting standards and statutory remittance and control of operations variable was considered to be measured using indicators such ad financial plans and communication. Financial accountability was also conceptualized to be measured using selected metrics such as budget credibility, transparency, and employee accountability on expenditure.

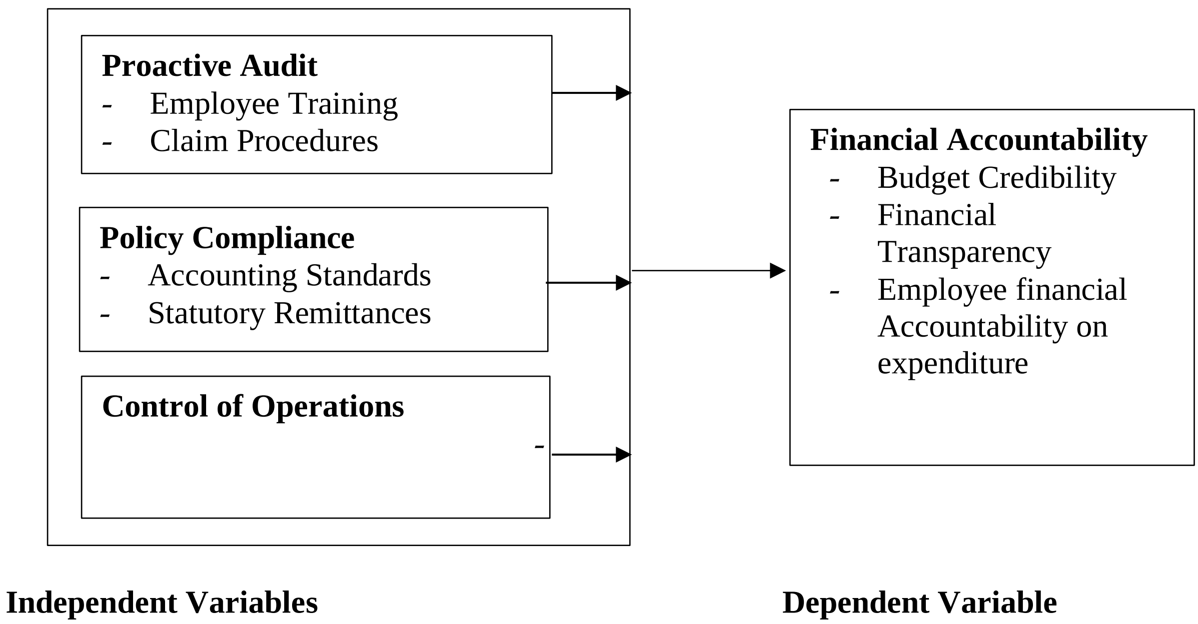

Figure 2.1: Conceptual Framework

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents research design, target population, research design, data collection procedures, validity and reliability of the research instrument and data analysis methods.

3.2 Research Design

Novikov and Novikov (2013) regards a research design as the overall plan of collecting, analyzing and interpreting data. The study adopted cross-sectional research. Cross-sectional research design would help the research collect data at a particular point in time and analyze it without manipulation. It would help the researcher determine the statistical association between variables of the study. It facilitates collection of data from a sizeable population with common characteristics.

Moreover, it provides the opportunity of analysis and presenting data using both quantitative and qualitative approach. It facilitates discovery of new knowledge thus prediction and control of the problem under investigation. Furthermore, this design is preferred because it enables the researcher to verify findings of the current study by using findings of previous empirical studies and existing theories (Collis & Hussey, 2014).

3.3 Population

Novikov and Novikov (2013) define a population as the total number of units targeted in an inquiry. A census approach was adopted to collect information from all the 5 commercial enterprises in the textile manufacturing sector in Kenya as at August 2019 as shown in appendix (3). Given that there are limited number of commercial enterprises in the textile manufacturing sector in Kenya, data was collected from all the 5 commercial enterprises. The unit of analysis was commercial enterprises in the textile manufacturing sector in Kenya while unit of observation was the employees.

3.4 Data Collection Procedure

Structured questionnaires with open and closed ended questions were used to collect primary data. The respondents of this study included employees from top, middle and lower level of management. Questionnaires were considered appropriate based on their flexibility to collect data systematically for objective analysis. The questionnaires were sub-divided according to the study variables and items were measured using a Likert scale type where 5 denotes strongly while 1 denotes strongly disagree. To facilitate high response rate, trained researchers were used in conducting follow-ups through phone calls.

3.5 Validity of the Research Instrument

3.5.1 Validity Testing

The capability of the research instrument to measure exactly what is supposed to be measured is termed as validity (Novikov & Novikov, 2013). For accuracy of the research instrument, the researcher selected 2 employees from commercial enterprises in the manufacturing sector in Kenya and scholars at University of Nairobi to measure face and content validity. A pilot sample of 5% was considered appropriate in testing validity as acknowledged by Mertler and Vannatta (2010). Feedback obtained from the pilot sample was used to refine items of the questionnaire. The pilot sample of this study was excluded from the final sample size for precision of the results.

3.5.2 Reliability Testing

Reliability is regarded as the capacity of the research instrument to yield similar results by subjecting the instrument more than once to respondents with common features (Guest,2012). Cronbach Alpha coefficients as used to measure internal consistency of the instrument.Alpha values more than 0.7 were used to determine reliability of the instruments recommended by Mertler and Vannatta (2010) while those values less than 0.7 were assumed not to be reliable.

3.6 Data Analysis

Data collected was cleaned for completeness to eliminate any inconsistencies. Data was analysed quantitatively with the help of Statistical Package of Social Sciences (SPSS). Descriptive statistics such as mean scores, percentages, frequency distribution tables and standard deviations was used to describe the general behaviour of data while inferential statistics such as Pearson Product Moment was used to describe the predictive of independent variables on the dependent. The analyzed data was presented in form of Tables and Figures. Linear regression method was used and it is of the form: $\mathbf{Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon}$**,** Where;

Y= Financial Accountability of Commercial Enterprises in Kenya, β_0= Y intercept, β_1 to β_4 = regression coefficients, X_1 = Proactive Audits, X_2 =Policy Compliance, X_3 = Control of Operations and ε= Error term

CHAPTER FOUR

DATA ANALYSIS, FINDINGS AND DISCUSSION

4.1 Introduction

This chapter discusses research findings in relation to research objectives. The effect of proactive audit, policy compliance and control of operations on financial accountability of commercial enterprises in Kenya. The research findings of this study are discussed in relations to findings of previous empirical studies.

4.2 Response Rate

Data was obtained from all the 5 commercial enterprises in the textile manufacturing sector in Kenya. The unit of analysis was textile manufacturing sector in Kenya. Out of the 100% questionnaires distributed, only 83% were successfully filled and returned. 11% of them were not returned while 6% of them were wrongly filled. The response rate of 83% was considered appropriate as recommended by Fisher (2010) who argues that a response rate above 50% is fair for a scientific study, while above 60% is good and that of 70% and above is excellent. The findings are summarized as shown in Figure 4.1.

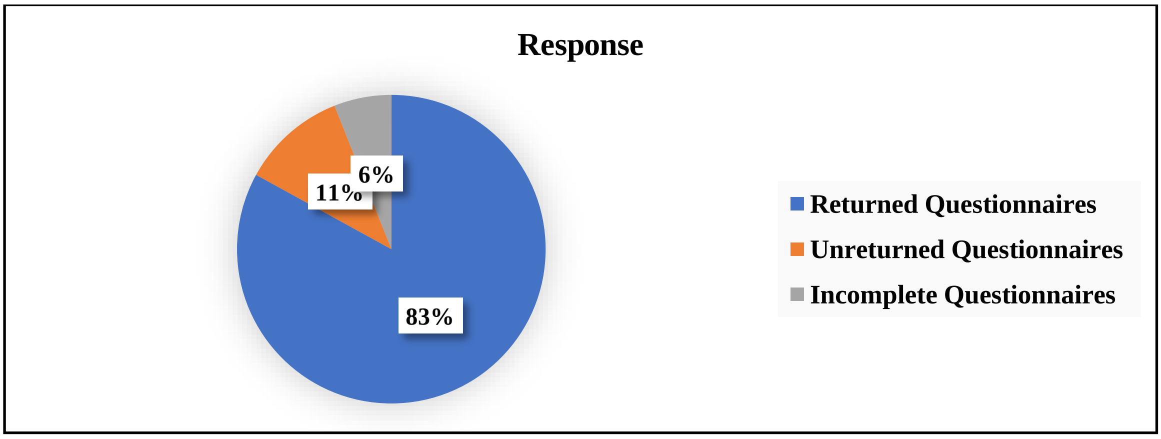

Figure 4.1 Response Rate

Primary Data.

4.3 Reliability Coefficients

To test the internal reliability of the research instrument, Cronbach Alpha coefficients were used as shown in Table 4.1.

Table 4.1: Reliability Coefficients

Variables	**No. of Items**	**Cronbach Alpha**	**Conclusion**
Proactive Audit	1	0.702	Reliable
Policy Compliance	1	0.721	Reliable
Control of Operations	1	0.821	Reliable
Financial Accountability	1	0.732	Reliable

Source: Primary Data

4.4 Proactive Fraud Audit

The study sought to examine the extent to which respondents agreed proactive audits influenced financial accountability and the findings are presented in Table 4.2:

Table 4.2: Proactive Audits

Statements	**Mean**	**S.D**
My corporation has a record of all payment claims	4.56	.123
Employees are trained on effective record management systems	4.48	.312
My corporation has a system of verifying all payment claims	4.32	.156
Payment claims are verified by multiple officers before approval	4.12	.214
My corporation has an audit committee that approves any financial claim made	3.92	.382
Employees of my organization are conversant with financial regulations	3.67	.409
Internal audits are trained on International Accounting Standards	3.00	.456
My corporation hires highly trained and experienced internal auditors	2.92	.572
My corporation has functions financial management systems	2.34	.589
Internal auditors are allowed to make independent reports	2.08	.502
Overall Mean Score	**3.54**	**0.371**

Source: Research data

Table 4.2 results show an overall mean score of 3.54 indicating that respondents agreed on average that proactive audits had an influence on financial accountability. The mean score for 4 statements of the 10 had a mean score of more than 4.00, 3 statements of the 10 had a mean score of less than 3.00 indicating that respondents averagely agreed while 3 of the statement had a mean score of less than 2.00 indicating that some respondents had disagreed.

Proactive audits such as record keeping, training employees on record management systems and verification of payments before approval were considered to influence financial accountability, to some extent commercial enterprises in Kenya did not embrace some proactive audits effectively. Issues of hiring highly trained and experienced auditors, availability of financial management systems and freedom of internal auditors to make independent decisions were aspects that influenced financial performance directly and indirectly.

These findings are consistent with that of Agburu (2012), Adegbite (2010), Al Matarneh (2011), Tan (2012), Kamau (2013), Karuthi (2015) and Kilika (2013) who revealed that, despite internal issues from one organization to another, proactive audits such as employee training on ethical issues and establishment of systems to monitor income and expenditure can have significant impact on financial accountability if effectively managed.

4.5 Policy Compliance

The study sought to ascertain how policy compliance influenced financial accountability and the findings are presented in Table 4.3:

Table 4.3. Policy Compliance

Statements	Mean	S.D
My corporation strictly adhere to KRA regulations	4.91	.345
My corporation has policies that regulate payment	4.78	.214
My corporation is a member of Legal Institutions	4.11	.672
Employees of my organization are training on money laundering regulations	3.56	.418
Officers who violate financial regulation are subjected to legal procedures	2.94	.569
My organization strictly adhere to procurement policies	2.18	.670
My corporation strictly adhere to International Accounting Standards	2.00	.672
Overall Mean Score	**3.5**	**0.508**

Source: Research Data

Table 4.3 results shows an overall mean score of 3.5 indicating that generally respondents averagely agreed that policy compliance had an influence on financial accountability. The mean score for 3 statement of the 7 was more than 4.00 indicating that commercial enterprises in Kenya strictly adhered to KRA regulations, had policies of regulating payments and the corporations were legal institutions. 1 statement of the 7 had a mean score less than 3.00 indicating that employees were averagely trained on money laundering regulations. 3 of the statements also had a mean score of less than 2.00 indicating that commercial enterprises in Kenya did not take legal action against those employees who violated financial regulations. Procurement policies were not adhered to nor international accounting standards.

These findings are consistent with those of Sarens and Abdolmohammadi (2011) in Madagascar, Sylvester (2018) in Kenya, Tunji (2013) in Nigeria, Vinnari and Skaerbaek (2014) who found out that policy compliance had an influence on financial performance of organizations from one firm to another. The authors concluded that adherence to statutory regulations and financial standards, organizations can tremendously influence their productivity in terms of return on investment and profits generated.

4.6 Control of Operations

The study sought to examine the extent to which respondents were in agreement that control of operations had an influence on financial accountability and the findings are presented in Table 4.4:

Table 4.4: Control of Operations

Statements	Mean	S.D
External auditors are involved in auditing process	4.94	.124
My corporation has financial plans or budgets	4.79	.290
Comprehensive reports are prepared by my corporation of money spent	4.71	.489
Employees are effective informed on the expenditure	2.68	.678
Timely and up to date information is given to all employees on money spent	2.42	.468
Financial reports prepared by my corporation are reliable	2.33	.234
Employees are involved in budget preparation	2.18	.527
Overall Mean Score	**3.43**	**0.401**

Source: Research Data

Table 4.4 results shows an overall mean score of 3.43 indicating that most of the respondents averagely agreed that control of operations had an influence on financial accountability. The mean score for 3 statement of the 7 had a mean score of more than 4.00 indicating that external auditors were involved in the auditing process, there was financial plans or budgets and comprehensive reports were prepared showing how money was spent. 4 statement of the 7 statements had a mean score of less than 2.00 indicating that most of the respondents said that employees were not informed on the expenditure, timely information was not given to employees on expenditure, financial reports prepared were not reliable and employees were not involved in budget preparation.

These findings are in line with those of Mugo (2013), Muhammad (2015), Nawhera (2012), Nyakundi et all. (2014), Ongore and Kusa (2013) who established that control of operations practices such as preparation of financial budgets, involvement of external auditors and timely provision of information to organizational stakeholders had a significant effect on financial performance of organizations.

4.7 Financial Accountability

The respondents were required to indicate the extent to which financial accountability was measured in their respective enterprises and the findings are presented in Table 4.5:

Table 4.5: Financial Accountability

Statements	**Mean**	**S.D**
Employees are paid on time	4.90	.456
Employees of my organizations have high level integrity	3.83	.346
Suppliers are paid without delay	2.84	.624
There is open access of financial information by members of the public	2.79	.691
Projects initiated are completed within timelines	2.68	.693
External audit reports are shared among workers	2.46	.634
Employees are involved in budget preparation	2.21	.623
Internal audit reports are shared among workers	2.12	.567
My corporation strictly adheres to procurement policies	2.08	.670
Employees are held accountable for any financial matter	2.08	.649
Statutory remittances are paid on time	2.02	.671
Budgets developed by my corporation are credible	2.03	.601
Overall Mean Score	**2.50**	**0.602**

Source: Research Data

The results in Table 4.5 indicate an overall mean of 2.50 indicating that most of the respondents disagreed that financial accountability was measured using the indicators measured. 2 of the 12 statements had a mean score of more than 3.00 indicating that some respondents had agreed that employees were paid on time and high level of integrity was observed by workers. 10 of the 12 statements had mean score of less than 2.00 indicating that most of the respondents were in disagreement.

Despite the fact that financial accountability was measured using multiple indicators, it was reported that commercial enterprises in Kenya to a larger extent did not pay suppliers on time, provide access of financial information to members of the public nor completed the projects within timelines given. It was reported that internal and external audit reports were not shared among worker. Employees were not involved in budget preparation nor were they held accountable for financial matters. Procurement regulations were violated, budgets prepared were incredible and statutory remittances were not paid on time.

Although financial accountability was measured by multiple indicators, to a larger extent commercial enterprises in Kenya were not financially accountable due to issues such as non-adherence to financial regulations, procurement regulations. Non-involvement of employees in budget preparation and lack of sharing audit reports among workers all are aspects that affected financial accountability of firms. These findings corresponds with those of Sarens and Abdolmohammadi (2011) in Madagascar, Tunji (2013) in Nigeria, Vinnari and Skaerbaek (2014) who noted that financial accountability can be measured using multiple parameters such as information transparency, involvement of employees in budget development, adherence to accounting standards and procurement regulations.

4.8 Correlation Analysis

To ascertain whether there existed a correlation between independent and dependent variable of the study, correlation analysis was conducted using R-square at 95% confidence interval as shown in table 4.6.

Table 4.6: Correlations Results Analysis

Variable	Pearson Statistics	1	Proactive Audits	Policy Compliance	Controls of Operations	Financial Accountability
Proactive Audits	Pearson Correlation	173**				
	Significance (2-tailed)	0.000				
	Sample size	5				
Policy Compliance	Pearson Correlation	167**	1			
	Significance (2-tailed)	0.023				
	Sample size	5				
Control of Operations	Pearson Correlation	189**		1		
	Significance (2-tailed)	0.0000				
	Sample size	5				
Financial Accountability	Pearson Correlation	0.232	.739**	.616**	.519**	.1
	Significance (2-tailed)	0.000	0.012	0.001	0.000	0.000
	Sample size	5				5
****p< 0.05**						

Source: Research Data

The result in Table 4.6 shows a significant correlation between internal audit functions and financial accountability. Proactive audits were significant (r=0.739, p < 0.011), policy compliance was significant (r=0.616, p < 0.001) and control of operations (r=0.119, p < 0.000). The results imply that a unit increase of proactive audit, policy compliance and control of operations can result to an increase in financial accountability of commercial enterprises in Kenya.

4.9 Regression Analysis

To determine the statistical effect of predictor variables on the dependent, linear regression was conducted as shown in Table 4.7.

Table 4.7: Regression Results Analysis

Dependent Variable	**Independent Variables**	**Beta Value**	**T-Value**	**P-Values**
Financial Accountability	Proactive Audits	0.317	4.327	0.011
Financial Accountability	Policy Compliance	0.298	3.451	0.000
Financial Accountability	Control of Operations	0.219	3.318	0.000

Source: Research Data

The results in Table 4.7 shows a significant statistical effect of proactive audit, policy compliance and control of operations on financial accountability of commercial enterprises in Kenya. Proactive audits were significant (β=0.317, $p < 0.011$), policy compliance (β=0.298, $p < 0.000$) and control of operations (β=0.219, $p < 0.05$).

Table 4.8: Regression Coefficient

Model		**Unstandardized Coefficients**		**Standardized Coefficients**	**T**	**Sig.**
		B	**Std. Error**	**Beta**		
1	**(Constant)**	1.273	1.217		0.389	0.000
	Proactive Audits	0. 467	0.198	0.113	2.418	0.000
	Policy Compliance	0. 389	0.175	0.137	2.309	0.000
	Control of Operations	0.318	0.210	0.172	2.218	0.000

Source: Research Data

The results in Table 4.8 indicates that taking all factors at a constant zero, a unit increase of proactive audit, policy compliance and control of operations would result to an increase in financial accountability of commercial enterprises in Kenya by a magnitude of 1.123 units. At 95% confident interval and 5% significance level, proactive audits is significant (β=0.467, $p < 0.000$), policy compliance (β=0.389, $p < 0.000$) and control of operations (β=0.318, $p < 0.000$). The original multiple regression equation ($Y = \beta 0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$)) was transformed into: Y= 1.123+ 0.467X1+ 0.389X2+ 0.318X3

4.10 Summary Model

Table 4.9: Summary Model[a]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.89	0.79	0.789	0.6273

Table results in 4.9 indicate that proactive audit, policy compliance and control of operations explained only 79.0% on financial accountability among commercial enterprises in Kenya as shown by R^2. This results therefore imply that only 21% of the internal audit functions were not studied to influence financial accountability.

Table 4.10: ANOVA[b]

Model	Sum of Squares	df	Mean Square	F	Sig
Regression	0.334	1	.043	3.453	.000
Residual	0.123	4	.076		
Total	0.457	5			

As depicted in Table 4.10, findings imply that the processed data was ideal for making conclusions about this study. The population's parameter had a significance vale of less than 0.05 indicating and F value of 3.453. The findings confirm that all the proactive audit, policy compliance and control of operations consolidative had a significant effect on financial accountability since the significance values was less than 0.05 the critical value.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter discusses a summary of findings thereby providing conclusions, recommendations and finally presenting suggestions for further research

5.2 Summary of Findings

This section presents a summary of findings as per the research objectives which include: proactive audits, policy compliance and control of operations.

5.2.1 Proactive Audits

Proactive audits a significant influence on financial accountability of commercial enterprises in Kenya. However, it was noted that despite the positive influence of proactive audits on financial accountability, most of the commercial enterprises in Kenya did not embrace proactive audits such as hiring and training auditors. Further, it was noted that freedom of internal auditors to make independent decision was curtailed thus affecting financial accountability. Non-availability of financial management systems and inadequate employee trainings on International financial standards were also issues that affected financial accountability.

5.2.2 Policy Compliance

Policy compliance and positive influence on financial accountability of commercial enterprises in Kenya. It was noted that to some extent, most of the commercial enterprises in Kenya did not embrace compliance practices such as taking legal action against employees who violated financial regulations. Procurement policies were not adhered to nor international accounting standards. Violation of regulatory policies and procurement policies were also other aspects that affected financial accountability.

5.2.3 Control of Operations

This study identified a significant relationship between control of operations and financial accountability of commercial enterprises in Kenya. Although, it was noted that despite the positive influence of control of operations on financial accountability, most commercial enterprises did not adopt control practices such as providing timely information of expenditure to employees, involvement of workers in budget development and reliability of financial information provided was questionable.

5.3 Conclusions

This study concluded that despite the positive influence of proactive audits on financial accountability of commercial enterprises in Kenya. Most of the commercial enterprises were not financially accountable due to failure to embrace proactive audits such as hire and train auditors, give auditors freedom to make independent decisions. It was concluded that non-existence of financial systems not only affected financial accountability but also hindered the entities from conforming to International financial standards.

Even though policy compliance had significant impact on financial accountability of commercial enterprises in Kenya. It can be noted that financial accountability was affected by inability of the commercial enterprises to take legal action against employees who violated financial regulation. Further, non-adherence to procurement regulations and non-conformity to international accounting standards were also issued that influenced financial accountability.

It was concluded by the study that, despite the fact that control of operations had a significant impact on financial accountability of commercial enterprises in Kenya, most of the entities did not embrace control practices such as providing timely information of expenditure to employees, involvement of workers in budget development and reliability of financial information provided was questionable.

5.4 Recommendations

For effective financial accountability among commercial enterprises in Kenya, this study recommends that top managers of commercial enterprises in Kenya should take develop and implement proactive policies that promote financial accountability. Training employees on financial regulations and international financial standards will not only minimize financial risks.

Top financial managers in commercial enterprises in Kenya should develop and implement policies that promote compliance to internal and external regulations. The government of Kenya through parliament should enact policies that discourage entities from non-adherence to statutory regulations and accounting standards.

This study recommends that top financial managers should develop and implement strategies that enhance communication among stakeholders thus facilitate participatory decisions during budget preparation. Managers should involve all workers in financial decisions in order to find sustainable solutions on regulations of financial resources.

5.5 Limitations of the Study

Lack of cooperation from some of the respondents during data collection process was the limitation of this study. However, this limitation was managed by the researcher providing clarity to respondents on the aim of the study. A research permit was provided thus assuring respondents on the data provided. Confidentiality of the information provided was assured to respondents and voluntary participation was encouraged. Limitations of relying of existing literature which was biased on one way or the other were managed by the current study using a different methodology of data collection.

Cross-sectional research design and a census approach were adopted. Correlation and regression methods were adopted to determine the relationship between variables.

5.6 Suggestion for Further Studies

This study was limited to proactive audit, policy compliance and control of operations. However, future studies should seek to identify other independent variables that can influence financial accountability apart from the three variables. Studies can be replicated in other sectors and countries to confirm consistency of findings. Further researchers and scholars can also use different data analysis methods such as hierarchical regression methods by introducing moderators or intervening variables in the relationship.

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APPENDICES

Appendix 1: Introductory Letter

C/O

EDINA CHANUA

D61/5380/2017

UNIVERSITY OF NAIROBI

Dear Respondents

MBA Research Study

I am Edina Chanua, I request you for your participation in my research titled ***"Internal Audit Functions on Financial Accountability of Commercial Enterprises in Kenya.*** As a requirement of the award of a postgraduate degree in Business Administration at the University of Nairobi, I am required to undertake a research and present a final report to facilitate my graduation. I request to spare an approximate of 15 minutes to provide the intended information by filling the questionnaire attached herein. The information collected will be used for academic purposes only and utmost good faith and confidentiality is assured. Thank you for your assistance in this important endeavor.

Your Faithfully

Appendix 2: Questionnaire

Please supply the required data by filling in the blanks where space is provided or by ticking [√] against the most appropriate answer.

SECTION B: INTERNAL AUDIT FUNCTIONS AND FINANCIAL ACCOUNTABILITY

PART A: PROACTIVE AUDITS

1. Rank the following statements by using a Tick (√) to indicate the extent to which you agree or disagree on the effect of proactive audits on financial accountability of your corporation **(scale 5= Strongly agree (SA), 4= Agree (A), 3 = Not Sure (NS), 2= Disagree (D), 1 = Strongly disagree(SD)**

S/N	Statements	Strongly Agree 5	Agree 4	Not Sure 3	Disagree 2	Strongly Disagree 1
1.	My corporation has functions financial management systems					
2.	My corporation hires highly trained and experienced internal auditors					
3.	Employees are trained on effective record management systems					
4.	Internal auditors are allowed to make independent reports					
5.	Internal audits are trained on International Accounting Standards					
6.	My corporation has a record of all payment claims					
7.	My corporation has a system of verifying all payment claims					
8.	Payment claims are verified by multiple officers before approval					
9.	My corporation has an audit committee that approves any financial claim made					
10.	Employees of my organization are conversant with financial regulations					

PART B: POLICY COMPLIANCE

2. Rank the following statements by using a Tick (√) to indicate the extent to which you agree or disagree on the effect of policy compliance on financial accountability of your corporation **(scale 5= Strongly agree (SA), 4= Agree (A), 3 = Not Sure (NS), 2= Disagree (D), 1 = Strongly disagree(SD)**

S/N	Statements	Strongly Agree 5	Agree 4	Not Sure 3	Disagree 2	Strongly Disagree 1
11.	My corporation has policies that regulate payment					
12.	My corporation strictly adhere to International Accounting Standards					
13.	My corporation strictly adhere to KRA regulations					
14.	Employees of my organization are training on money laundering regulations					
15.	My organization strictly adhere to procurement policies					
16.	My corporation is a member of Legal Institutions					
17.	Officers who violate financial regulation are subjected to legal procedures					

PART C: CONTROL OF OPERATIONS

3. Rank the following statements by using a Tick (√) to indicate the extent to which you agree or disagree on the effect of control of operations on financial accountability of your corporation **(scale 5= Strongly agree (SA), 4= Agree (A), 3 = Not Sure (NS), 2= Disagree (D), 1 = Strongly disagree(SD)**

S/N	Statements	Strongly Agree 5	Agree 4	Not Sure 3	Disagree 2	Strongly Disagree 1
18.	My corporation has financial plans or budgets					
19.	Employees are involved in budget preparation					
20.	External auditors are involved in auditing process					
21.	Employees are effective informed on the expenditure					
22.	Timely and up to date information is given to all employees on money spent					
23.	Comprehensive reports are prepared by my corporation of money spent					
24.	Financial reports prepared by my corporation are reliable					

PART D: MEASURMENT OF FINANCIAL ACCOUNTABILITY

4. Rank the following statements by using a Tick (√) to indicate the extent to which you agree or disagree on parameters used to measure financial accountability of

Appendix 3: List of Commercial Enterprises in the Textile Industry in Kenya

1. Oriental Mills Ltd
2. Zig-Zag Furnishings
3. Riera-Tex Ltd
4. Alliance Garment Industries Ltd
5. New Utiithi Upholstery
6. Sai Sports Wear & Uniforms Ltd

Source: Kenya Association of Manufacturers (2018)