

**EMPIRICAL STUDY ON EFFECTIVENESS OF AUDIT
COMMITTEE IN PUBLIC SECTOR: A CASE STUDY OF
GOVERNMENT MINISTRIES IN KENYA.**

BY

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DECLARATION

This is to declare that this research project is my original work that has not been presented to any other University or Institution of Higher Learning for examination.

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This is to declare that this project has been submitted for examination with my approval as the university supervisor

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This research study is dedicated to my wife Dorah , Mum Elizabeth , my brothers and sisters for their moral support throughout the entire MBA program and especially during this research project.

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ABBREVIATION

AICPA	-	American Institute of Certified Public Accountants
CEO	-	Chief Executive Officer
CFOs	-	Chief Finance Officers
CG	-	Corporate Governance
CPAs	-	Certified Public Accountants
IIA	-	Institute of Internal Auditors
SAS	-	Statements of Auditing Standards
SOX	-	Sarbanes–Oxley Act
HIA	-	Head of Internal Audit
OECD	-	Organisation for Economic Cooperation and Development
COSO	-	Committee of Sponsoring Organizations for Tradeway Commission
IAF	-	International Accreditation Forum (IAF)
CSR	-	Corporate Social Responsibility
CG	-	Corporate Gorvance

ABSTRACT

Like any other organization public sector audit committee is a vital mechanisms the government need to use to monitor management's behaviour in the sector is to enhance proactive oversight of financial, compliance reporting and disclosure process. The audit committee plays a monitoring role of the ministries providing vital information to the legislature, political parties, the media, the citizens, and other organizations to control the government and its bureaucracy, and points to its value in serving the public interest. Therefore the study sought to carry out a research on effectiveness of audit committee on public sector governance.

The study used a descriptive survey approach in collecting data from the respondents. Study population was 42 staff working in the department of Finance and Accounting in the government ministries. The primary data for this study was collected using the questionnaires and complemented by interview hence ensuring that detailed and relevant information on the subject of study was collected. The data was then analyzed using descriptive analysis which included; frequency, percentages, means and standard deviation.

From the findings, the study concluded that government ministries need to enhance the effectiveness of audit committee through creating awareness of audit committee to the concerned departments and having an administrative procedure in which checking documents, counting assets, and reporting on past events to various types of management for the purpose of internal auditing. From the findings, the study concluded that government ministries need to set audit standards which provides a framework so as to promote quality audit work that is systematic, objective, and based on evidence. The study finally concluded that audit independence, formal mandate, unlimited access and competent leadership should be improved to enhance the effectiveness of Audit committee in the government ministries.

CHAPTER ONE

INTRODUCTION

Background of the Study

Good governance in an organization is a tool to achieve organizational strategy (Hung and Han, 1998). According to the professional guidance of the Institute of Internal Auditors (IIA), public sector governance encompasses the policies and procedures used to direct an organization's activities to provide reasonable assurance that objectives are met and that operations are carried out in an ethical and accountable manner (Brown,1983). Governance in the public sector relates to the means by which goals are established and accomplished to address the needs and expectations of several stakeholders. It also includes activities that ensure a government's credibility, establish equitable provision of services, and assure appropriate behavior of government officials to reduce the risk of public corruption (IIA, 2006).

Over the past years, there has been a loud call for “good governance” of organizations. This call began with a focus on major public companies and has expanded to cover a broad range of organizations. Internal Auditing is defined by Institute of Internal Auditors (IIA) as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations (Goodwin, 2004). It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (IIA, 2004). According to Davidson (2005), an auditor's duty is to give a fair and truthful view of a client's set of company accounts, but auditors cannot guarantee that the company accounts are entirely free of errors and irregularities. Therefore, in their audit planning, auditors must identify and assess the risk that they need to discover. If an item is discovered, auditors must consider the context and presentation of the item and then decide whether it affects the true and fair view of the company accounts. The Statements of Auditing Standards, SAS 220, states that 'Auditors should consider materiality and its relationship with audit risk when conducting an audit' (Scarbrough, Rama, and Raghunandan, 1998).

More recently, Imhoff (2003) reviewed historical developments of accounting, auditing, and corporate governance and proposed changes with the goal of stimulating debate. Epstein and Roy (2004) applied the balanced scorecard to boards of directors enabling interested parties to more fully evaluate board performance. Klein (2003) described many stock exchange proposals, put them in historical context, presented the likely effects of the new corporate governance proposals on future boards of directors, and assessed their impact on the financial reporting system. Lin, Pizzini, Vargus and Bardhan, (2007) provided evidence that ownership structure and board composition are related to voluntary disclosure. They found that lower marginal ownership and significant government ownership are associated with increased disclosure. They also found that larger firms and firms with lower debt had greater disclosure and that an increase in outside directors reduces corporate disclosure (Van-Gansberghe, 2005).

Other studies have looked at the interaction of audit committees and external auditors. For instance, Margheim, (1986) and Lawrence et al. (2003) looked at that interaction in terms of fees and auditor dismissals. DeZoort (2003) found that more experienced audit committee members are more supportive of the external auditor. Millichamp (2002) suggests, in order to avoid materiality, it should be taken into account at the planning stage of an audit and re-evaluated if the outcomes of tests, enquiries or examinations differ from expectations. Millichamp (2002) also suggests that materiality is fundamental to accounting and is a matter of professional judgement with both quality and quantity dimensions.

1.1.1 Audit Committee

In general, for regulators, the desired effect or goal of the Audit committee (AC) is to strengthen the quality of financial information and to maintain or strengthen investor confidence in the quality of financial reporting and financial markets (Blue Ribbon Committee Report, 1999; Canadian Securities Administrators 2004). Audit Committee can improve the quality of information directly, by overseeing the financial reporting process, and indirectly through the oversight of internal and external auditing. In the end, improved information quality as well as strengthened controls may result in investors being more confident about the quality of financial reporting and the functioning of financial markets (Bedard, Gendron, 2009). By analysing the

perspective of two authors, Berdard and Gendron, the activity of Audit Committees and dimensions of Effectiveness in the public sector, think that in the end those who benefit from the quality of the information and from the recommendations of the authors are the taxpayers.

From an agency perspective, the importance of strong governance stems from the need to align the interests of management with other stakeholders in the firm in order to reduce agency costs (Cohen et al., 2002). Various corporate governance mechanisms can be used to monitor management's behaviour and these include independent directors on the board (Messier and Schneider, 1988). an independent board chair, an effective audit committee and both external and internal audit (Davidson et al., 2005 describe the complex interactions between these governance mechanisms as the “corporate governance mosaic. The role of audit committee in public sector is to enhance proactive oversight of financial and compliance reporting and disclosure process and results of that process (Ministry of Finance, Kenya, 2006)

Anderson et al. (1993) argue that internal audit is a substitute mechanism for monitoring by directors. However, information asymmetry problems between executive and independent directors suggest that internal audit is more likely to be a complementary mechanism. This is supported by research evidence examining the relationship between internal audit and audit committees (Carcello et al., 2005) and is also consistent with the IIA view that internal auditing helps an organization to evaluate and improve other governance processes (IIA, 2004). Hence, we expect a positive association between the use of internal audit and both an independent board chair and the proportion of independent directors on the board. We also expect a positive association between the internal audit function and a strong audit committee because the goals of both are “closely intertwined” (Scarborough et al., 1998). While a strong internal audit function can enhance the effectiveness of the audit committee (Bishop et al. 2000), an effective audit committee in turn strengthens the position of the internal audit function (Braiotta, 1999; Verschoor, 1992). Following prior research, an effective committee is assumed to be the one that meets frequently and is comprised of independent and appropriately experienced directors (DeZoort et al., 2002).

1.1.2 Effectiveness of Audit Coimmittee

Audit committee is a mechanism of corporate governance so as to ensure the quality, credibility and objectivity of the financial reporting (Lindsell, 1992). They have a role of oversight responsibility and assist a board to monitor responsibilities of firm. Audit committee oversights many duties as a review vision of the business, review financial reporting process, review internal control and audit, consider external auditors. Moreover, they review all business risks management and review practice all rule a relevant to business. Thus, a role of audit committee is the most important to achieve corporate governance of listed firms. Prior research presents an audit committee more influence effective corporate governance mechanisms. The Blue Ribbon Committee (BRC, 1999) suggests audit committee has a strengthening both the independence and expertise. Various researches of characteristics as board and audit committee influence of responsibilities included other issues as composition, independence, knowledge and expertise, effectiveness, power duties and responsibilities (Cohen et al., 2002). Hence, audit committee has the most qualifications that can increase effectiveness.

The BRC (1999) describes a role of audit committee's oversight as ensuring the quality accounting policies, internal controls, and independent and objective outside auditors are in place to deter fraud, anticipate financial risks and promote accurate, high quality and timely disclosure of financial and other material information to the board, to the public markets, and to shareholders. Moreover, DeZoort et al., (2002) defined as an effective audit committee who has qualified members with the authority and resources to protect stakeholder interests ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts. Therefore, the audit committee plays a monitoring role or oversight activities of firm that supports to a board of director. Similarly, Kalbers and Fogarty (1993) defined audit committee effectiveness as the competency of the audit committee to specified oversight responsibilities in firm. This study focuses on responsibilities of audit committee that refers to the audit committee effectiveness as a means to the achievement of audit committee to play a role of duties and responsibilities in the firm.

Public auditing institutions aim to reduce the agency problem between citizens and government. In the limited literature available auditors serve as “watchdogs” of the executive and the bureaucracy to improve transparency, fight misappropriation, fraud, corruption, wasteful usage of public funds, and general inefficiencies. (Schelker, 2008) The scarce economic literature unanimously underlines the importance of Audit Committees of the public institutions in providing vital information to the legislature, political parties, the media, the citizens, and other organizations to control the government and its bureaucracy, and points to its value in serving the public interest. The evidence suggests that the existence of independent review by an auditing institution significantly reduces corruption and wasteful spending (Olken 2007, Ferraz and Finan 2005).

In the public sector, entities create their image upon the quality of provided services and their capacities of satisfying the public. This image becomes difficult to create in terms of lack of resources and the constantly growing needs of various and qualitative services (Țurlea, Ștefănescu, Dumitru, 2008). Starting from the premise that the entities in the public sector, including Health Care Providers (HCPs) must be more transparent, must improve the quality of the provided services, reduce bureaucracy and minimize risks, we think that PIACs can contribute to the fulfillment of these desiderata. Internal audit quality, which is determined by the internal audit department's capability to provide useful findings and recommendations, is central to audit effectiveness. Internal audit has to prove that it is of value to the organization and earn a reputation in the organization. Internal audit has to evaluate its performance and continually improve its service. According to Zamzulaila, Zarina and Dalila, (2007) audit quality is a function of the level of staff expertise, the scope of services provided and the extent to which audits are properly planned, executed and communicated. Prior researches by Arens and Loebbeckd (2000) defined the purpose of an organization's accounting information and communication systems as a means to identify, analyze, record, and report an entity's transactions supporting accountability for the associated assets. That is principle of accounting process created to the financial reporting correctness. Moreover, the issues of accounting process related to earning quality are the most important for financial reporting quality which ensures the firms' financial reporting reliability. Also, the other issues of accounting process consider as accounting policy, accounting estimates and adjustments of accounting. That is factors having an

effect on financial reporting process correctness. Furthermore, prior research by DeZoort, Hermanson, and Houston (2003) suggested to regulators that they should require external auditors and audit committee to discuss several issues as qualitative aspects of materiality, unrecorded auditor proposed adjustments and enhance auditor testing of accounting estimates and consider requiring greater disclosure of estimate ranges enhancing financial reporting quality. The activity of the Public Internal Audit Committee must be based on the CHARTER of the Committee, which includes current practices, new rules, the frequency of meetings, their duration, the reporting system to the Board of Administration, as well as other necessary activities (Ghiță, 2005).

1.1.3 Kenya Government Ministries

The government ministries derive their mandate from the Constitution of Kenya, which provides for proper budgetary and expenditure management of government financial resources. As a main function, the Ministries are charged with the responsibility of formulating financial and economic policies. The ministries are responsible for developing and maintaining sound fiscal and monetary policies that facilitate socio-economic development in all the government sub sectors. The government ministries coordinates government departments in the preparation of the annual national budget. It is the responsibility of the Ministry to initiate and guide all departments to prepare their ministerial budgets.

The purpose of setting up a Government is to gain much more economic benefits and social order. However, it is argued that the only way to increase economic benefits is to raise the level of productivity and improve management quality. Raising the level of productivity requires governments to tap potential manpower, material and financial resources, making full use of now available resources for production and operation (Guoming, 2007).

Kenya's internal audit system was abolished in 1962. Over the next few years it became apparent that lack of internal audit contributed greatly to laxity in the management of public resources; in compliance with the relevant laws, regulations, procedures; and in internal controls; and the system was reintroduced in 1984. With limited institutional support and an outdated focus on pre-audit activities, Kenya's internal audit function was neither efficient nor effective

.Being an independent department, Risk based audit is an important means for the public sector to strengthen operational management (Papas, 2009). The effectiveness of the Internal Audit Department in the Ministries should be improved by extending its scope and work practices to include. Assessing, advising and providing assurance to the Accounting Officer or other relevant officers on the management of key business risks. Obtaining an understanding of the processes and functions in the Ministries, Departments, and Districts by working with the relevant Accounting Officers and other Senior Officers to document the risk and control framework. This is a vital pre-requisite to the subsequent examination and evaluation of the effectiveness of internal controls systems. If there are strong internal controls, the system will have its own checks and balances and reduce the scope for errors, irregularities, and fraudulent manipulations.

1.2 Research Problem

For many years, internal auditing was confined to assisting organizations safeguard assets and check established control procedures. The aim of an audit committee in public sector is to improve public governance. As a subcommittee of the governing body, an audit committee aims to provide assurance on financial and compliance issues through increased scrutiny, accountability, and the efficient use of resources. An audit committee may also serve an advisory function aimed at performance improvement within the organisation. Audits serve a vital economic purpose and play an important role in serving the public interest to strengthen accountability and reinforce trust and confidence in financial reporting. As such, audits help enhance economic prosperity, expanding the variety, number and value of transactions that people are prepared to enter into. However, in recent years, and in the light of corporate scandals, we have witnessed ongoing global demands for improvements in audit quality. Over the past decade, the role of audit committees has become increasingly relevant, as high-profile corporate scandals such as Enron and WorldCom have intensified corporate governance requirements and expectations.

According to Millichamp (2002) for audit committee to be effective, they should have organizational independence, existence of approved mandate in the form of charter, unrestricted access to any forms of audit evidences and availability of defined audit standards to be adhered

and unlimited scope to ensure the committee achieve the objective set. The public reform, the financing of the public service system necessary to satisfy the needs of the population, as well as the current financial constraints have proved to be a major challenge in Kenya. Recent scandals that faced the Ministry of agriculture and education revealed huge gaps between boards of directors, executive management, internal control and organizational performance. In these conditions, the role of the Public Audit Committee (PIAC) within the public system becomes a major necessity. It is known that compulsoriness of sending proposals to the general management, as well as granting the needed support to implement them has lead to the building up of these structures. Public auditing institutions aim to reduce the agency problem between citizens and government. In the limited literature available auditors serve as “watchdogs” of the executive and the bureaucracy to improve transparency, fight misappropriation, fraud, corruption, wasteful usage of public funds, and general inefficiencies (Schelker, 2008)

Locally, studies focusing on auditing have also been carried out. Kimani (2006) contended that Uchumi supermarkets shareholders raised questions when the supermarket was declared insolvent and management was required to justify the retention of PWC as the auditors. Kibet (2008) carried out a survey on the role of internal audit in promoting good corporate governance in SOEs, Kibara (2007) similarly carried out a survey of internal auditors risk management practices in the banking industry in Kenya; Keitany (2000) studied the internal audit control function and its implication for risk assessment by the external auditor, Kariuki (2002) carried out a survey of the use of assessment centers in multinational auditing firms in Nairobi and Chepkorir (2009) carried out a study on the roles and challenges of internal auditing in the banking industry in Kenya. According to the ISAs the role of the external auditor is not to unearth frauds and irregularities in organizations but to carry out his work with a skepticism mind and report any if they encounter. They rely on information provided by the management of which internal auditors are part of. The internal auditor should be aware of any irregularities even before the external auditor finds out. This means that the audit committee would have been made aware also through the internal audit reports. There is no local study that has been carried out on empirical study on effectiveness of Audit committee in the government Ministries ensure the quality, credibility and objectivity of the financial reporting. There is no known local studies that had focused on the determining effectiveness of audit committee in the public sector and particularly in government Ministries. The study seek to fill to

existing knowledge gap by carrying out a research on effectiveness of audit committee on public sector governance and answer the questions to what extent has audit committee been effective in the government ministries?

1.3 Objectives of the Study

The objective of this study was to establish effectiveness of audit committee in government ministries.

1.4 Value of the Study

Government auditing is a cornerstone of good public sector governance. Enquiries on effectiveness of audit committee in the government ministries help to assess the extent to which the laws, policies and procedures promulgated in the public sector will be implemented and identifying causes related to implementation of those laws and regulations and creating awareness in this regard and contribute an input for legislators in improving those laws policies and procedures too. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. The government auditor's role supports the governance responsibilities of oversight, insight, and foresight. Oversight addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption. Insight assists decision-makers by providing an independent assessment of government programs, policies, operations, and results. Foresight identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, and investigation and advisory services to fulfil each of these roles.

The management of different business organizations also benefit from the study through the understanding of effectiveness of the audit committee in their organization in promoting corporate governance through adopting skilled and qualified manpower; properly delineated authority and responsibilities; and a reporting status that permits the maintenance of integrity, objectivity, and professional independence to enhance internal auditing and improve corporate

governance. They are also in a position to institute stringent audit practices and timely act on cases of corporate malpractices.

The study was significant to scholars and researchers as it provided contribution to existing body of knowledge on effectiveness of audit committee and provide a foundation for further researcher

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviewed the information from other researchers who have carried out their research in the same field of study. Specific emphasis were put on the major issues effectiveness of audit committee in public sector. The specific areas covered here were theoretical orientation, empirical review and factors that hinders effectiveness of audit committee.

2.2 Theoretical Review

This section outlines two theoretical approaches for the appreciation of audit committees. Since agency theory is well represented in the accounting and finance literature, more attention will be devoted to the description of institutional theory.

2.2.1 Agency Theory

Agency theory explains how to best organize relationships in which one party determines the work, which another party undertakes (Schneider, 1984). The theory argues that under conditions of incomplete information and uncertainty, which characterize most business settings, two agency problems arise: adverse selection and moral hazard, (Lin, Vargus and Bardhan, 2007). The agency theory is concerned with so-called agency conflicts, or conflicts of interest between agents and principals on financial reporting and management practices. This has implications for, among other things, corporate governance and business ethics. When agency occurs it also tends to give rise to agency costs, which are expenses incurred in order to sustain an effective agency relationship. Accordingly, agency theory has emerged as a dominant model in the financial economics literature which widely discusses the financial reporting and management practices in the public institutions.

The separation of management from ownership in the modern corporation provides an ideal context for the operation of agency theory. Shareholders (and debtholders) act as the principal with interests in deriving maximum utility from the actions of management, serving as the agent.

Problems arise because of the separation of ownership and management and the resulting inability of the owners to observe the actions of management . Owners and agents have incentives to invest in various information systems and control devices to reduce agency costs associated with information asymmetry .These control devices might offer Pareto optimality (maximum gains for all parties) since the agent would otherwise bear agency costs that occur when principals discount the value of the firm, based on the likelihood of adverse selection, shirking, and moral hazard .

Management may use various means to indicate to others the quality of the information they are providing. Demands for monitoring may result in external audits, the use of outside directors and audit committees (Menon and Williams, 1994). The use of audit committees can be considered an important part of the decision control system for internal monitoring by boards of directors . Agency theory suggests some firms will have incentives to incur costs to differentiate themselves from others. For example, in order to assert their higher quality, companies would submit to audits (Bar-Yosef and Livnat, 1984). Additional private information can be signaled through the selection of higher quality audits .However, when information is difficult to verify, an agent may attempt to mimic quality messages, which may lead to adverse selection . In a realistic multi-period world, agents have to be concerned about their human capital in the labor market. False communications may therefore have negative consequences for the agent as well as the principal (Fama, 1980).

Most public owned institutions now employ financial reporting and management practices given to executives on the basis of performances. If corporate performance is above the performance targets, the firm's managers earn more shares. If performance is below the target, however, they receive less than 100 percent of the shares. Incentive-based compensation plans, such as performance shares, are designed to satisfy two objectives. First, they offer executives incentives to take actions that will enhance shareholder wealth. Second, these plans help companies attract and retain managers who have the confidence to risk their financial future on their own abilities which should lead to better performance. Information transfer in a non-hierarchical setting is problematic because of the agency problem of moral hazard. If the principal has imperfect information about the agent's ability to perform the task that is demanded of the agent, the

principal will have difficulty ensuring that the agent has performed that task (Dittenhofer, 2001). This lack of measurement ability will provide the agent with an incentive to shirk on the proper performance of that task (Goodwin, 2004). In the context of franchising, this means that if the franchiser cannot be sure that the franchisee is performing the job of managing a local retail outlet, the franchisee will have an incentive to shirk on his efforts to manage the outlet.

Internal auditing focuses on strategic analysis and business process evaluation and on assessing the goals, risks and controls that must be considered for an organization's success. Brown, 1983), stated that by identifying, assessing, and monitoring a company's risk, internal auditing helps assure that resources are adequate and focused on priorities. Risk-based auditing assesses areas of heightened risk and, importantly, conducts continuous risk assessments (Goodwin, 2004). The knowledge gained from a comprehensive annual risk assessment as well as from risk assessments undertaken at the outset of every internal audit engagement should be shared with management and the board (Hung and Han, 1998).

Since its adoption by the American Institute of Certified Public Accountants (AICPA) in the early 1980s, the audit risk model has been warmly received in the professional literature (Sterck and Bouckaert, 2006) with occasional reservations (Schneider, 1984) found that most practitioners have positive attitudes towards risk-based auditing. The research literature has been more critical, identifying weaknesses in the structure and use of the model and anomalies between practice and theory (Zamzulaila, Zarina and Dalila, 2007).

A major issue of concern with the audit model is the treatment of inherent factors. Stringer's original model (as reported in Tucker, 1989, p. 32) ignored inherent risk and the initial AICPA approach (SAS 39) effectively did the same thing by setting inherent risk equal to one because of perceived quantification difficulties (AICPA, 1981).

From an agency perspective, the importance of strong governance stems from the need to align the interests of management with other stakeholders in the firm in order to reduce agency costs (IIA, 2004). Various corporate governance mechanisms can be used to monitor management's behaviour and these include independent directors on the board, an independent board chair, an

effective audit committee and both external and internal audit (Hung and Han, 1998) describe the complex interactions between these governance mechanisms as the “corporate governance mosaic”.

Lin, Pizzini, Vargus and Bardhan, (2007) argue that internal audit is a substitute mechanism for monitoring by directors. However, information asymmetry problems between executive and independent directors suggest that internal audit is more likely to be a complementary mechanism. This is supported by research evidence examining the relationship between internal audit and audit committees (Goodwin, 2003; Scarbrough et al., 1998) and is also consistent with the IIA view that internal auditing helps an organization to evaluate and improve other governance processes (IIA, 2004).

Hence, expect a positive association between the use of internal audit and both an independent board chair and the proportion of independent directors on the board. We also expect a positive association between the internal audit function and a strong audit committee because the goals of both are “closely intertwined” (Scarbrough et al., 1998, p. 53). While a strong internal audit function can enhance the effectiveness of the audit committee (Sterck and Bouckaert, 2006), an effective audit committee in turn strengthens the position of the internal audit function (Montondon and Fischer, 1999). Following prior research, an effective committee is assumed to be the one that meets frequently and is comprised of independent and appropriately experienced directors (Margheim, 1986).

2.2.2 Institutional Theory

According to institutional theory by Schneider, (1984), an organisation is designed and functions to meet social expectations in so far as its operations are visible to the public. Therefore organisational internal operations, which are often complex and difficult to identify, may take second place to the issue of external legitimacy (Goodwin, 2004). It is suggested that the external image of the organisation may be “loosely coupled” with its operating processes (Sterck, and Bouckaert, 2006). Institutional theory, initiated in one form by Meyer and Rowan (1977), suggests that organizational structures in such an environment become symbolic displays of conformity and social accountability. Simultaneously, the real work of the organization is

accomplished by internal operating processes loosely coupled from the observable structures. Organizations with the appropriate structures in place avoid in-depth investigations of their operating core by external parties (Orton and Weick, 1990). This theoretical perspective has been applied to a wide set of social phenomena, including choice of accounting methods (Mezias, 1990), the use of accounting by public sector organizations and the adoption of innovative technologies (King et al., 1994).

The external expectations that have crystallized about corporate governance indicate the existence of an institutionalized environment which serves as the threshold for the application of institutional theory (Zucker, 1988). The recent concern over corporate control has reached the highest levels of government in the U.S. Demands for greater accountability have lead to threats of more regulation and to a new wave of interest in oversight and self-regulation (Committee of Sponsoring Organizations of the Treadway Commission, 1992).

Fogarty *et al.* (1997) developed this, asserting that the contribution of institutional theory is in the insight that the actual accomplishments of an organisation and what its structure suggests it should accomplish are often different. The organisation operates with internal processes that are not normally visible to those external to it, while other structures maintained for outsiders do not significantly add to output. Zamzulaila, Zarina and Dalila, (2007) observes that scrutiny by outsiders can be avoided if the right structures are adopted by organizations. Loose coupling enables organizations to show success in external problems whilst allowing flexibility in operational processes.

Fundamentally, the internal audit function is now much more part of the organization and less introspective. It involves the organisation more in the audit process and produces recommendations which contribute to its objectives. At the same time it has to be careful not to lose its independence and objectivity, as a result of getting closer to the operations (Brown, 1983). The United Nations has identified the basic characteristics for good governance in the public sector as portrayed under. Among these core elements of good governance in the public sector, the Internal Auditing Forum can emphatically focuses on the functioning and performance of the public sector. The four related characteristics of good governance are

transparency, public accountability, effectiveness/efficiency and responsiveness. As a result, the IAF has always been viewed as an integral part of the government financial management and increasingly as an instrument for improving the performance of the government sector (Hung, and Han, 1998).

Government auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. The government auditor's role supports the governance responsibilities of oversight, insight, and foresight. Oversight addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption.

2.3 The Role of Internal Audit

Historically, internal audit has been viewed as a monitoring function, the 'organizational policeman and watchdog' (Morgan, 1979,), tolerated as a necessary component of organizational control but deemed subservient to the achievement of major corporate objectives. An examination of the pressures on internal audit in recent years reveals the struggle to demonstrate that the function can add value.

Keitany (2000) concluded that though the extent of reliance of internal controls is not sensitive to the strength of internal audit departments, companies should not do away with it. This is because as a management tool, it assists management in its day to day operations and not necessarily of relevance to the external auditor. According to Millichap (2002) the following are the roles of an internal auditor: as an appraisal function, that is, to appraise the activities of others and not to perform a specific part of data processing; as a service to an organization by ensuring policies are fulfilled, information required is reliable and complete, assets are safeguarded, internal control system is well designed and works in practice; as an eye of the board within the organization.

According to the Basel Committee's Internal Audit Paper (2002), the scope of internal audit, from a general point of view, includes the following: the examination and evaluation of the

adequacy and effectiveness of the internal control systems; the review of: the application and effectiveness of risk management procedures and risk assessment methodologies, the management and financial information systems, including the electronic information system, the accuracy and reliability of the accounting records and financial reports, the means of safeguarding assets, the public's system of assessing its capital in relation to its estimate of risk, and the systems established to ensure compliance with legal and regulatory requirements, codes of conduct and the implementation of policies and procedures, the appraisal of the economy and efficiency of the operations; the testing of both transactions and the functioning of specific internal control procedures; the testing of the reliability and timeliness of the regulatory reporting; and the carrying-out of special investigations.

Looking at corporate governance as a whole, that is, the demands, pressure and tasks of the audit committee, management and the board in general, the expectations of the different stakeholders, the position of the internal auditor within the organization, an impact on the workload and the responsibilities of internal audit appears unavoidable. Corporate governance developments both locally and around the world have reaffirmed the board's responsibility for ensuring the effectiveness of their organisation's internal control framework. These developments have highlighted the key role that internal audit can play in supporting the board in ensuring adequate oversight of internal controls and in doing so form an integral part of an organisation's corporate governance framework. The key role of internal audit is to assist the board and/or its audit committee in discharging its governance responsibilities by delivering: An objective evaluation of the existing risk and internal control framework, systematic analysis of business processes and associated controls, reviews of the existence and value of assets, a source of information on major frauds and irregularities, ad hoc reviews of other areas of concern, including unacceptable levels of risk, reviews of the compliance framework and specific compliance issues, reviews of operational and financial performance, recommendations for more effective and efficient use of resources, assessments of the accomplishment of corporate goals and objectives, feedback on adherence to the organisation's values and code of conduct/code of ethics (KPMG, 2003).

The mere definition of internal auditing and the standards drawn up and implemented by the IIA give the internal auditor not just the mandate but the obligation to contribute in any way possible

(consulting or assurance) to the evaluation of the corporate governance process (Cattrysse, 2005). The study argues that while traditionally the role of the internal auditor was to help the organization to maintain the system of internal control of its financial statements, a whole range of new opportunities, possibilities and responsibilities present themselves in the wake of corporate governance. He notes that the ultimate challenge for the internal auditor is to find the necessary ways to provide the degree of reasonable assurance expected by all the participants. On other words, the internal auditor needs to become the key 'enabler' in the corporate governance process. Audit committees try to improve their own effectiveness through better and more frequent contacts with the internal auditor who represents one of their most valuable sources of information.

The dual position in which the internal auditor finds himself enables him, as it were, to keep one eye on the direction the company is going in, and the other on every aspect of internal control including rules and regulations, laws and expectations, risk and opportunities. Corporate developments, along with more inquisitive stakeholders and assurance requirements, not only on financial but also on non-financial measurements and reporting, increase the audit workload. Thus the internal auditor becomes 'an integral part' of the corporate governance process. The conviction that the internal auditor plays a valuable role in the 'corporate governance' process is recognized by many organizations of different interest. 'The role of auditors is vital to the corporate governance process. The effectiveness of the board and senior management can be enhanced by recognizing the importance of the audit process and by taking measures that enhance the independence and stature of auditors (Cattryse, 2005).

The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relation to; effectiveness and efficiency of operations, reliability and integrity of financial and operational information, safeguarding of assets and compliance with laws, regulations, and contracts. Based on the results of the risk assessment, the internal auditors evaluate the adequacy and effectiveness of how risks are identified and managed in the above areas. They also assess other aspects such as ethics and values within the organization, performance management, communication of risk and control information within the organization in order to facilitate a good governance process (IIA Research Foundation,

2004). The ideal core roles of internal audit department in risk management process, giving assurance on risk management processes, giving assurances that risks are evaluated correctly, evaluating the risk management processes, evaluating the reporting of key risks and finally, reviewing the management of key risks (Kibara, 2007).

2.4 Empirical Review

Zhang, Zhou and Zhou (2006) in their paper “Audit committee, auditor independence and internal control weaknesses” investigated the relation between audit committee quality, auditor independence, and the disclosure of internal control weaknesses after the enactment of the SOX. The study sample comprised of firms with internal control weaknesses and, based on industry, size, and performance, matched these firms to a sample of control firms without internal control weaknesses. The results of the data analysis suggested that a relation exists between audit committee quality, auditor independence, and internal control weaknesses. The study concluded that Firms are more likely to be identified with an internal control weakness, if their audit committees have less financial expertise or, more specifically, have less accounting financial expertise and non-accounting financial expertise, as well. They are also more likely to be identified with an internal control weakness, if their auditors are more independent. In addition, firms with recent auditor changes are more likely to have internal control weaknesses.

Globally, Donaldson and Davis (1991) conducted a study contrasting stewardship theory and agency theory on governance, incentive of the CEO and shareholder return. It sought to examine the effect of CEO duality on shareholder returns. A comparison was done of corporations whose board structure had a dual CEO-chair and where the CEO was independent from the chair. The sample for the study was a convenience sample of 337 US corporations taken from a compensation survey however only 321 firms had complete data¹⁵ and those were included in the sample. The companies covered a wide range of industries such as consumer products, technology, financial services, transportation, services and utilities. The study used a cross-sectional design and examined changes in structure and their effects on changes in shareholder returns. Size data was taken from Standard and Poor’s industrial reports and the million dollar directory. The board structure was coded as presence of CEO duality if the top executive was also chair of the board in 1987. The board structure was coded as independent if the board chair was not the CEO. Thus the board

structure had a binary code. Shareholder returns were measured by ROE and gain in shareholder wealth.

The results of the research indicated that contrary to agency theory, CEO duality is associated with higher returns to shareholders than is an independent chair of the corporate board. The study also revealed that incentive schemes to CEOs do not secure higher returns to shareholders. In summary the superiority of independent chair board structures and CEO financial incentives on shareholder returns as posited by agency theory was not found on ROE.

A number of surveys and empirical tests were carried out on the functioning and role of ACs in various countries. For example, the KPMG (2001) survey of 400 companies of six European countries reveals some interesting practices about ACs. Overall, 67 percent of respondents had established ACs, and in the UK, all sample companies had ACs and 41 percent of German companies. ACs comprised between three and four members and on an average were approximately one-third of the size of the board. Except UK where ACs comprised of solely non-executive directors, in other countries, approximately one-third of the members of ACs were not independent. Across Europe only 39 percent of ACs meet twice a year and 29 percent meet four times a year.

In Canada, Maingat and Zeghal (2000) investigated the motives, composition, selection, and frequency of ACs' meetings, ACs' relationship with internal and external auditors and its broader role. The aggregate results of their survey are consistent with the recent empirical findings in the US and UK. In another study, Green (1994) found that more than 90 percent of sampled respondents stated that their ACs discuss the scope of external audit work, problems in completing the audit, potential emerging accounting issues, the internal audit program, the effectiveness of internal control, and review company's note disclosure and selection of the external auditing firm. Again in a Canadian context, Scarbrough *et al.* (1998) examined the association between AC composition and the committee's interaction with internal auditing. In the US, the study by Abbot *et al.* (2002) addressed the impact of certain AC characteristics identified by the BRC on improving the effectiveness of corporate AC on the likelihood of financial misstatement. They examined 83 firms which misstated financial reports during the

period 1991-1999. Their study found that independence of the committee was significantly negatively related to misstatement, but that the size of the committee and the financial expertise of the AC members were not significant.

Krishnan and Visvanathan (2005) in their study sought to address the role of audit committees and auditors in the reporting of internal control deficiencies after the passage of the SOE. The study sample comprised of firms selected from the Compliance week and covered a period from November 15, 2004 till March 1, 2005. Compliance Week reported that 164 firms mentioned internal control issues in their filings with SEC during the sample period. To represent auditor attributes the study examined size of the auditor, tenure, auditor changes, and audit fees. The study found that a higher number of meetings of the audit committee, lesser proportion of "financial experts" in the audit committee, and more auditor changes characterize firms that report weaknesses in their internal controls compared to firms with no weaknesses. Prior restatements of financial statements are also higher for firms not reporting such weaknesses. The results were robust to controlling for a variety of firm characteristics such as complexity of operations, profitability, and growth. It underscored the importance of governance characteristics beyond general firm characteristics in examining the reporting of internal control weaknesses.

In Malaysia, the requirement to adopt internal audit function in public sector has been documented in the Treasury Circular No. 9, 2004. Historically, the development of internal auditing in the Malaysian public sector started in 1970 when the Ministry of Defense set up its internal audit department. However, the scope is limited to financial audit (Lee, 2004). Progressively, the extension of the scope has been recognized in later years where the scope covered both, financial and management audits. The recommendation is documented in the Treasury Circular No. 2, 1979 which required all ministries and departments in the Federal Government to establish their internal audit unit or department. In the year 2004, however, the Government issued Treasury Circular No. 9 to replace the 1979 circular. This Treasury Circular documents that the establishment of internal audit function to be extended to agencies and departments in the State Governments. However, this requirement excludes the state agencies, local authorities and state economic development corporations. This alluded to the assumption that internal audit is not a necessity in these organizations. In Malaysia, there are only a few

studies examining internal audit function in the public sector (Ali, Gloeck, Ali, Ahmi, and Sahdan, 2007; NAD, 2007). Zamzulaila, et al. (2007) studied on the role of internal auditors in Malaysian local authorities. They noted that internal auditors have complied with the guidelines issued by the Treasury Circular. The results suggest that internal auditing in the local authorities has shown a good progress as a majority of the respondents claimed that they have started focusing on risk management although this area is not covered by the Treasury Circular. Even though positive perceptions were found, the sample of the study was limited to the head of internal auditors in local authorities of the states situated in the West Coast of Peninsular Malaysia. A study to examine the practices of internal audit in all State and Local Governments Bodies (SLOGBs) in Peninsular Malaysia was conducted by (Ali, et al., 2007). The results of the study were not encouraging as compared to the results of Zamzulaila, et al. (2007). Based on a series of semi-structured interviews, Ali, et al. (2007) found out that there were only 35 out of 202 SLOGBs have internal audit function. According to the researchers, there were various problems faced by the internal audit function in the SLOGBS. However, two greatest problems were inadequate audit personnel and the audit personnel's lack of proper skills and competency.

According to Schwartz and Sulitzeanu (2002), emerging request from boards is that internal auditors review and comment on the organization's governance policies, processes, and practices. The IIA recognizes this in its International Standards for the Professional Practice of Internal Auditing (Standards). Standard 2100 states (emphasis added): "The internal audit activity should evaluate and contribute to the improvement of risk management, control, and governance processes using a systematic and disciplined approach."

Hung and Han (1998) investigated the factors that influence the effectiveness of internal auditing for listed firms in Taiwan. The findings showed that on average, regular performance evaluation of internal auditors, positive attitude of controller to internal auditing job, and well-designed education and training of internal auditors are useful to enhance the management perceived performance. However, professionalism is useful to increase the audit department head's perception of performance. The results also implied that both inside and outside internal auditing department have some factors that influence the progress of annual audit plan. In identifying the factors that influence the effectiveness of internal auditing, different questionnaires were mailed

to the general manager, the head of audit department and the head of internal auditing department of each company. Contrast to the study by Hung and Han (1998), only solicited the opinion of the internal auditors to provide information on important factors that contribute towards the effectiveness of an internal audit function among Malaysian listed firms. Interpersonal skills, internal auditor's commitment and support from audit committee and BOD, audit performance and integrity, audit department efficiency, auditing competencies, internal auditor's knowledge on company's business operation and industry and auditor's independence are found to be important attributes contributing towards internal audit function effectiveness.

The publication "Integrated governance handbook 2006" and "Audit Committee Handbook 2005" "Department of Health-UK: 2006 have represented the foundation of our research. These publications are for NHS boards and for their continued development towards good governance principles. In the researches conducted lately, a growing attention was given to measuring the effectiveness of Audit Committees (ACs). For example, Lin, Pizzini, Vargus and Bardhan, (2007). Review 37 empirical studies published between 1987 and 2002. They provide a framework with four fundamental determinants of AC effectiveness (composition, authority, resources, and diligence) and discuss each study according to these dimensions. They conclude that while each of the four dimensions has been examined to some degree, significant opportunities exist in each area and provide specific research opportunities for each of them.

Instead of focusing on the determinants of AC effectiveness, Dittenhofer, (2001) analyze the effects of ACs using a framework composed of three dimensions (audit function, financial reporting quality, and corporate performance). Differing from previous reviews on AC effectiveness which focus on economics based empirical studies with US firms (Margheim, 1986) cover a broader spectrum of theoretical perspectives from various fields (law, economics, psychology, sociology), methods (archival, survey, laboratory case, and interviewbased), and countries. Their review differs from that of (Annuar and Zulkarnain, 2001). In its emphasis on international comparisons and a more systematic analysis of the association between AC characteristics and a broader range of indicators of effectiveness that they group into four categories (information quality; audit quality; internal control effectiveness)

Mihret and Yismaw, (2007) reported that 25 percent of the top 100 companies listed on the Italian Stock Exchange performed traditional compliance activities and generally followed an audit cycle approach in the annual audit planning process. In 67 percent of their responding companies, internal auditors adopted the model proposed by the Committee of Sponsoring Organizations of the Treadway Commission and mainly applied operational auditing at the macro level (annual audit planning). In a few large companies (8 percent), auditors applied risk-based approaches both at the macro level and the micro level (individual audit assignments).

In January 2005, a study of the development of internal auditing practices in Ireland by the IIA – (2005) and concluded that 89 percent of heads of internal audit use a risk-based method when preparing annual internal audit plans; 93 percent use a risk-based method in their internal audit assignments; 81 percent liaise with divisional or business heads when compiling their internal auditing plans; 72 percent perform their work in accordance with international standards; and 32 percent are responsible for compliance or risk management. The study concluded that while a large proportion of organisations adopt best practice approaches, there is scope for improvement.

Kibet (2008) in his study „a survey on the role of internal audit in promoting good corporate governance in SOEs“ aimed to explore the role and the use of internal audit function in promoting good corporate governance in public sector enterprises and the challenges faced by the internal auditors in SOEs. The study followed an exploratory research design and the population comprised of all SOEs with government equity of over 50% located in Nairobi. A sample of 43 state corporations was selected by way of geographical location and government shareholding. Data collection was by way of questionnaires and the respondents were the heads of internal audit departments. Data collected was analysed using the SPSS and the output presented in frequency distribution tables, pie and bar charts. The study concluded that internal audit function played a role in corporate governance. The limitations of the study were time constraints and restriction to state owned corporations. Recommendations of further study were effectiveness and contribution of internal audit in promoting corporate governance for companies listed in the NSE. Additionally, a study on the influence of internal audit and audit committee on financial reporting quality was recommended.

2.5 Factors Influencing Effectiveness of Public sector Audit Committee

The professional guidance of the Institute of Internal Auditors (IIA), states that an effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their government accountable. Auditors perform an especially important function in those aspects of governance that are crucial in the public sector for promoting credibility, equity, and appropriate behavior of government officials, while reducing the risk of public corruption. Therefore, it is crucial that government audit activities are configured appropriately and have a broad mandate to achieve these objectives. The audit activity must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. At a minimum, government audit activities need (IIA, 2006) organizational independence, audit charter, unrestricted access to any forms of audit evidences, sufficient funding, competent leadership and staff, existence of audit committee, stakeholders' support, audit standards and unlimited scope.

The perceived need for more audit committees (and for those audit committees to be more effective) has been galvanized through a combination of legislation and/or supported "best practice" guidelines. Evidence has shown a significant rise and harmonization in the use of audit committees internationally, including the European Commission's requirement that all public-interest entities in the European Union have an audit committee (Sterck and Bouckaert, 2006). Likewise, in the USA, the Sarbanes-Oxley Act (2002) was enacted, which requires, among other things, that companies use audit committees and disclose the composition of their audit committees in their annual reports. In discharging governance responsibilities, the key role of audit committee is to assist the board and/or its audit committee by delivering a review of organization's control culture, an objective evaluation of the existing risk and internal control framework, ensuring existence of appropriate internal management control system (monitoring compliance with laws, regulations, supervisory requirements and relevant internal policies), considering management's response to major internal audit recommendations and progress in their implementations.

2.5.1 Organizational Independence

Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct its work without interference and be seen to be able to do so. The historical reporting relationship between Internal Auditing and the finance unit began to change during the latter 20th century (Mihret and Yismaw, 2007). The CFO as well as other heads of business units continues to need to know what is right and wrong with their finances and operations within their scope of company responsibility.

The increasing frequency of financial reporting and external auditing failures, however, motivated the Internal Auditing profession to seek greater independence for its actions and judgments. As a result, in countries where the role of internal audit is highly valued functional reporting preference has shifted from current senior officers to the Board or Audit Committee and administrative reporting preference is extend to the Board or Audit Committee and retain the present report links with senior management (Messier and Schneider, 1988).

2.5.2 A Formal Mandate (Existence of Approved Audit Charter)

As per the IIA pronouncements, in every type of entity, the Audit Committee should develop appropriate Internal Audit Charter that specifies on how the Internal Audit function could be administered and approved by senior management. The government's constitution, charter, or other basic legal documents should establish the audit activity's powers and duties. The existence of proper audit charter helps the audit function to perform its role independently of management influence and objectively. Proclamation No. 17/1996, Part Two, Article 6, stipulates the responsibilities of internal audit function in public bodies, but it doesn't say anything about on how the function itself could be managed. It is not clear which Ethiopian law requires public bodies to define the administrative and functional reporting, the right that auditors have in executing their duty, their remuneration, performance appraisal, etc in the form of audit charter.

The principles of good governance transparency and accountability, fairness and equity, efficiency and effectiveness, respect for the rule of law and high standards of ethical behavior

represent the basis upon which to build open government (OECD, 2005). For RBA to provide good governance in public sector they must embrace the International Auditing standards that guide the internal audits ethics of work and maintain professional auditing standards. The internal audit should identify the elements of COSO controls such as factors of internal control environment, risk management, control activity, information and communication and finally monitoring. They should also identify the limitations of internal control and factors which override control activities

The importance of internal control and audit is aggravated even more after accounting firms are being sued by shareholders for their inability to detect fraud (Lerach, 2001) – since then the changes involved strengthening internal control in organisations (for instance . At the same time, several authors proposed that quality and corporate governance (CG) should be dealt as inseparable areas. For instance, the CSR/CG framework published by British Standards Institution (Castka 2004) makes a significant contribution to this trend. This work offers organizations a framework for establishing, maintaining, improving and documenting their CSR/CG management system. The authors assert that these concepts cannot be mutually exclusive but merge together, each offering a different yet complementary perspective on the activities of an organisation, to form a robust strategic business management tool.

Liebesman (2004) strongly advocates that ISO 9000 and ISO 14000 can be used to reduce risks with compliance with the Sarbanes-Oxley act (SOX, 2002): Because of SOX, the CEOs and CFOs of public companies must certify their financial statements, and each year they must certify the effectiveness of their systems of internal controls mandated by the law. Top management needs to obtain better information about the effectiveness of their organizations. Quality and environmental people should be at the table when the internal financial auditors develop their reports to top management and the board of directors.

However, internal auditing practices are often criticised – as mechanisms that lead to compliance mentality (Karapetrovic, 1999) or adding little value to the running of organisations (Seddon, 2000). Similar arguments can be drawn in relation to third-party certification. Third-party certification is under increased attack and looking at the findings from the discovery of frauds

(only 3 percent attributed to external auditors; Schnatterly, 2001), this should be of little surprise. Problems can be summarised in three areas. First, the critiques point at the commercial nature of the relationship between the certifier and the audited organization (Lal, 2004). This relationship can cause laxity and malpractice in ISO certification. Second, the competence of auditors is often questioned and they are seen as adding little value to organisations. Third, the accountability of the certification body to final customer and end user is marginal.

2.5.3 Unlimited Access

Audits should be conducted with complete and unrestricted access to all forms of audit evidences like employees, property and records sufficient funding .The audit activity must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization under audit because the budget impacts the audit activity's capacity to carry out its duties.

2.5.4 Competent Leadership

Corporate boards have prominent board characteristics as board independence, trustworthiness, leadership. Then, corporate boards must be careful and active for operation like the owner (OECD, 2004). In general concept, the corporate board is characteristics as leadership, vision, independent to decision making. Moreover, they have an experience and expertise to support the business operation including the effort that creates the strength of firms. The composition of board director is separated into three groups: executive director, independent director include the audit committee, and outside director. The government requires independent directors to have at least three of all, and at least three independent directors. Moreover, the chairman of board must be independent, that is, without related to management. Prior research found the board composition in governance associated with lower rates of gorverment failure (Black, Jang, and Kim, 2006). In addition, Fama and Jensen (1983) argue the outside directors will value their reputation. They will motivate paying time and effort to protect stockholders next to their own reputation. Then, the corporate board accountability enhances of corporate governance effectiveness. Currently, the board of director has a role of duty to be approved as vision, mission, strategies business, business risk, planning, and budget to controlling and monitoring

the top management to succeed in business goal through efficiency and effectiveness (SET, 2002). The corporate board helps listed firms to achieve corporate governance, and audit committee is a mechanism of governance. Hence, board corporate accountability has direct positive audit committee effectiveness, when the board corporate concentrates on business operation

The management of the internal audit function is critical to its effectiveness. In many countries, management of the internal audit function is often poor- poor work practice, lack of planning and weak personnel management system. Moreover, management is constrained by the institutional management for internal audit function, which often compromises the role of the internal audit as an aid to internal management. According to Mihret and Yismaw (2007), lack of attention from management may send a wrong signal about the importance of internal audit services to the auditor, which in turn adversely affects the auditor attributes. Besides lack of attention from top management, the respondents mentioned that lack of understanding on the role and responsibilities of the internal audit function is another factor that contributes to the lack of The effectiveness of internal audit in Malaysian public sector cooperation between internal audit function and the auditor.

2.5.5 Competent Staff

The audit committee competency is most important for governance mechanism. Audit committees are independent director of listed firms, who are selected to monitor or oversight business operation to assist the board. The Stock Exchange of Thailand (SET) issues the rules for audit committee that must be an independent, hold share of right not surplus one percentage, and not related party transaction pass two year ago (SET, 2008). Moreover, they require expertise and experience related to audit, accounting, and financial issues of business (SET, 2008). Hence, the audit committees have most qualifications. This study defines audit committee competency as the characteristics of audit committee to have unique ability to oversight duties. In prior research, the characteristics of AC create AC effectiveness, financial reporting quality and other factors. In previous studies, characteristics of AC members have an effect on AC effectiveness as independent (Abbot and Parker, 2000), expertise (DeZoort, 1997), active (Kalbers and Forgarty,

1993), knowledge, meeting, and communication. Certainly, the audit committee competency is the unique competency of audit committee as independence, experience, expertise, and diligence (DeZoort et al., 2002) that improve their oversight role. Then, the audit committee competency has a positively relationship the audit committee effectiveness. Based on the connection of AC competence would appear to enhance the audit committee's oversight function that relates directly to increasing the audit committee effectiveness.

Competency of auditors determines the quality of the audit work performed in an organization. Competency is measured in terms of academic level, experience, skill and the effort of staffs for continues professional development. Competency determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

In developing nations, Auditor General was responsible for maintaining the financial and operational activities of public enterprises. However, due to the low quality and inadequate number of staff that the Auditor General has, Audit Service Corporation was established by Proclamation No. 126/1977, so as to accommodate for professional auditing of public enterprises and to give guidance needed so badly in the country. However, it is noted that, the Audit Service Corporation had no staff to even perform the normal financial audit of enterprises leave alone to extend itself to more lofty ideas of development in the profession (Kariuki, 2002).

This consequently affects their competency and knowledge on auditing techniques. Practice Advisory of the IIA (2004) stated that internal auditors should possess knowledge, skills and other competencies to practice the profession. Lack of competency and knowledge on auditing techniques is another major problem encountered by internal audit function in the public sector organizations. The findings indicate that the problem encountered by the internal audit function is similar to local authorities where a study done by NAD (2007) revealed that many of the officers carrying out internal auditing in the local authorities lacked knowledge and exposure on the right techniques and methodology (“Audit standard not up to mark”, 2007).

The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. In order to ensure good governance, auditors must comply with minimum continuing education requirements established by their relevant professional organizations and standards. The head of the audit activity must be able to effectively recruit, retain, and manage highly skilled staff. Moreover, the chief audit executive should be an articulate public spokesperson for the audit activity (Kunkel, 2004).

Independency and objectivity of internal audit function depends on to whom it reports to. In an organization where there is audit committee, the internal audit function should report to the audit committee. The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed government officials, as well as the media and involved citizens. But from the perspective of Ethiopia, do concerned stakeholders value the various internal audit activities and give the required support (Mihret and Yismaw, 2007)

2.5.6 Professional Audit Standards

The IIA audit standards support the implementation of elements mentioned above in audit function of public bodies and provide a framework to promote quality audit work that is systematic, objective, and based on evidence. International Organization of Supreme Audit Institutions has also issued its own auditing standards to guide the auditing and accounting practices in the public sector (Schneider, 1984).

The IIA standard described the scope of the IAF as a tool of management where the internal audit function closes the loop in the public sector management cycle to ensuring the efficient and effective use of resources. For many parts of the world, the internal audit has often been, and continues to be defined rather narrowly-focusing on financial compliance and regularity, rather than broader management issues. Moreover, governance problems and lack of professional competence also constraints the internal audit function to this role and hinders its ability to generate timely and relevant reports (Omar and Sharofi, 2007).

The increased capability and scope of internal audit work has enabled external auditors to rely increasingly on internal audit's work in conducting the external audits. Furthermore, as a result of

increasing their investment in internal auditing, companies have sought ways to reduce external audit fees by substituting internal audit work. A 2005 survey of 117 chief internal audit executives found that in 88% of their companies external auditors relied to some extent on the work of the internal auditors (Lee, 2004).

The auditors' should be interested in attending courses for the purpose of gaining professional qualification, such as for certification as an internal auditors and the employer can provide financial support. Since, internal audit work requires knowledge and experience on a wide range of systems and operations, it is imperative to deploy auditors with extensive professional skills and to upgrade their skills through continuing professional training and development. Given the high level of staffing with temporary employees, the difficulty of recruitment and retention of auditors with the right technical proficiency is evident. Annuar and Zulkarnain, (2001) revealed that the auditors view the office as given insufficient attention in terms of staffing. Continuous skill upgrading is another dimension that deserves attention so as to achieve a high level of technical proficiency. Therefore, audit quality is arguably a function of extensive staff expertise; reasonableness of the scope of service; and effective planning, execution and communication of internal audits.

2.6 Conclusion of Literature Review

The aim of an audit committee is to improve organisational governance, regardless of whether the organisation is in the private or the public sector. As a subcommittee of the governing body, an audit committee aims to provide assurance on financial and compliance issues through increased scrutiny, accountability, and the efficient use of resources. An audit committee may also serve an advisory function aimed at performance improvement within the organisation. Information transfer in a non-hierarchical setting is problematic because of the agency problem of moral hazard. If the principal has imperfect information about the agent's ability to perform the task that is demanded of the agent, the principal will have difficulty ensuring that the agent has performed that task. This lack of measurement ability will provide the agent with an incentive to shirk on the proper performance of that task (Goodwin, 2004). Kibara (2007) in his study 'a survey of internal auditor's risk management practices in the banking industry in Kenya'

found out that, most banks in Kenya were in process of drafting the ERM process and strategies. Kibet (2008) concluded that internal audit function played a role in corporate governance. The limitations of the study were time constraints, restriction to state owned corporations and having to make prior arrangement in order to meet the heads of IADs. Recommendations of further study were effectiveness and contribution of internal audit in promoting corporate governance for companies listed in the NSE. Additionally, a study on the influence of internal audit and audit committee on financial reporting quality was recommended

Donaldson and Davis (1991) in his study contrasting stewardship theory and agency theory on governance, incentive of the CEO and shareholder return found out that CEO duality is associated with higher returns to shareholders than is an independent chair of the corporate board. The study suggested that a similar study could be conducted which utilizes a more sophisticated market based measure which adjusts for risk. Stewardship theory could also be investigated in strategic management whose premise should not be restricted to the narrow confines of agency and organizational economics.

The above studies have looked at the scope of independence of internal auditing, internal audit control functions and its implication for risk assessment by the external auditor, the role of internal audit in promoting good corporate governance and the agency theory. The timing of the research is also different. Therefore, the study aims to establish the challenges affecting effectiveness of audit committee in public sector focusing on selected government ministry in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter presented the research design and methodology that was used to carry out the research. The chapter also presented the research design, the population, sample size and sampling procedure, data collection and data analysis

3.2 Research Design

The research design according to Chandran, (2004) provides answers for questions such as; what techniques was used to gather data, what kind of sampling strategies and tools was used and how will time and cost constraints be dealt with. In other words, it is an arrangement of conditions for collection and analysis of data in a way that combines their relationship with the purpose of the research (Chandran, 2004). It is a means of achieving the research objectives through empirical evidence that is required economically.

For the purpose of this study, survey design was adopted. This was carried out using census which refers to the study of the total population where all the items under study are investigated and this applicable where the population is so small that selecting a sample would be meaningless (Mugenda and mugenda, 2003). The researcher included all the 42 ministries in the study. The collection of qualitative data enabled the study establish the effectiveness of audit committee in public sector focusing in the selected ministries in Kenya.

3.3 Study Population

Target population is that population to which a researcher wants to generalize the results of a study (Mugenda and Mugenda, 2003). The target population in a research study comprised all those potential participants that could make up a study group (Kothari, 2004). The study population was 42 staff working in the department of finance and accounting in all the 42 government ministries in Kenya (Republic of Kenya , 2011).

3.4 Data Collection Procedures and Instruments

The data was gathered through the use questionnaires to collect both quantitative and qualitative information. Primary data was collected using semi-structured questionnaires, which also contain A 5 point Likert scale questions. Close –ended or structured questions gave a respondent limited and pre determined response option to choose from. The advantage of structured questions was that they were easy to analyse but they leave no room for other possible responses. The questionnaires was administered using drop and pick method. The questionnaire was self-administered to some respondents while the researcher administered them.

3.5 Validity and Reliability

Piloting was carried out to test the validity and reliability of the instruments. Validity indicated that degree to which the instrument measures the constructs under investigation (Mugenda and Mugenda, (2003). There are three types of validity test which include content, criterion and related construct validity. This study used content validity because it would measure the degree to which the sample of the items represents the content that the test was designed to measure.

A pilot study was conducted by the researcher taking some questionnaires to the respondents which were filled by some respondents at random. From this pilot study the researcher was able to detect questions that need editing and those that are ambiguous. The final questionnaire was then printed and used to collect data to be used for analysis.

3.6 Data Analysis and Reporting

After receiving questions from the respondents, the responses were edited, classified, coded and tabulated to analyze quantitative data using Statistical Package for Social Science (SPSS version 17). Tables and charts were used for further representation for easy understanding and analyzes. Inferential statistic was used to establish the relationship between Audit Committee features and the effectiveness of the audit committee measured by quality of financial reporting. The inferential statistic sought to establish a causal effect relating independence variables to the dependent variable. While audit committee features, independence, competency, Audit standards, was quantified from Liekert questions. Correlation analysis was used to establish the

strength of the relationship between audit committee and effectiveness of Audit committee in public sectors

A linear regression model of effectiveness of Audit committee in public sectors versus Audit committee in public sectors was applied to examine the effectiveness of Audit committee in public sectors. The model treated effectiveness of Audit committee in public sectors as the dependent variable while the independent variables were the Audit committee features in public sectors which included Audit Independence, formal mandate, unlimited access, competent leadership and competent staff. The response on Audit committee practices in public sectors was measured by computing indices based on the responses derived from the Likert-Scaled questions. The relationship equation represented in the linear equation below.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$$

Where

Y= effectiveness of Audit committee

α = Constant Term

β = Beta coefficients

X_1 = Audit independence

X_2 = Formal mandate

X_3 = Unlimited access

X_4 = Competent leadership

e = Error Term

Source Author 2011

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

This chapter presented the findings of the study on the effectiveness of audit committee in public sector in Kenyan government ministries. The data collected through the questionnaire was analysed using descriptive statistics such as measures of variation and central tendency.

4.1.1 Response Rate

The respondents were staff from the Audit departments in the 42 government ministries in Kenya. Out of 42 questionnaires distributed, a total of 31 questionnaires were returned constituting to 73% response rate. Mugenda and Mugenda (2003) indicated a respondent rate of 50%, 60% or 70% is sufficient for a study and therefore a respondent rate of 73% for this study was very good.

4.1.2 Reliability Results

Table 4. 1 Reliability Results

Variable	Crobanch	No of Item
Organizational independence	0.7891	31
A formal mandate	0.6913	31
Unlimited Access	0.7527	31
Competent leadership	0.8892	31
Competent staff	0.8049	31
Professional audit standards	0.8250	31
Overall	0.8219	31

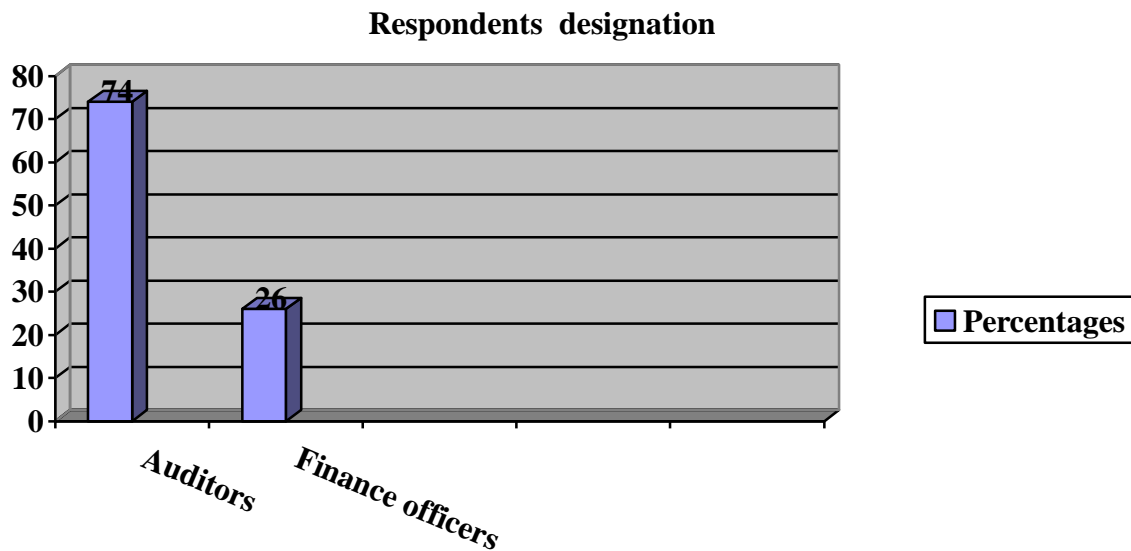
Source Author 2011

The table 4.1 illustrates the findings of the study concerning the reliability analysis. In this study, reliability was ensured by piloted questionnaire with a selected sample from government ministries staffs. The pre-test was conducted principal researcher (Neuman, 2000). From the

findings, the coefficient was 0.8219 approximately 0.82 which was closer to 1 making the instrument very reliable.

4.2 General Information

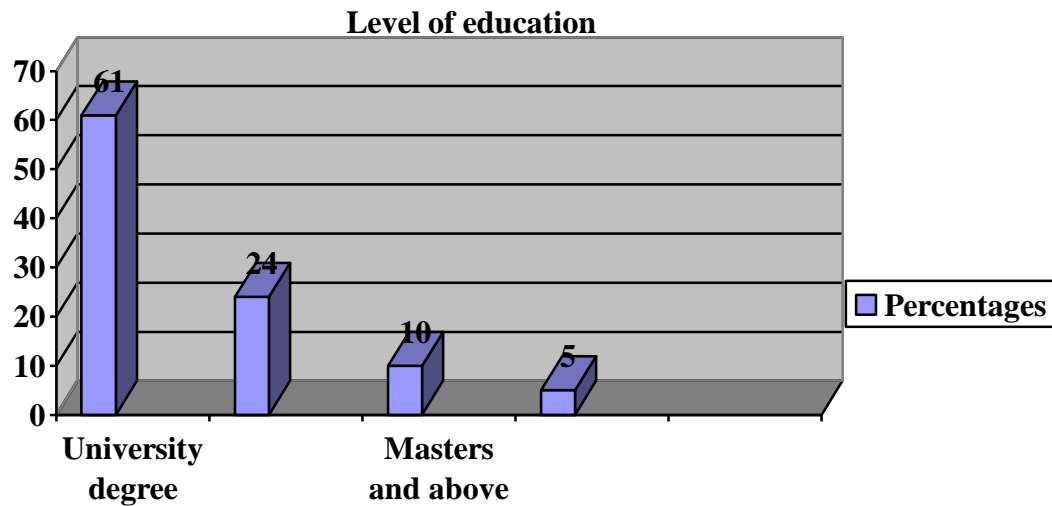
Figure 4. 1 Respondents designation



Source Author 2011

The study sought to investigate the respondent's designation. From the findings, most 74% of the respondents were auditors, 26% of the respondents were finance officers. This implied that the information on audit committee effectiveness was collected from the relevant personnel's in the government ministries.

Figure 4. 2 Respondent's Level of Education



Source Author 2011

The study sought to investigate the highest level of education attained by the respondents as indicated by the figure 4.2 above. From the findings, majority 61% of the respondents indicated that they had attained university highest level of education most 24% of the respondents had attained diploma level of education, 10% of the respondents had masters and above level of education while 5% of the respondents had certificate and below level of education. This implies the government ministries employed qualified personnel who could adopt effective auditing strategies and tools and were in a position of offering relevant information concerning effectiveness of audit committee in government ministries.

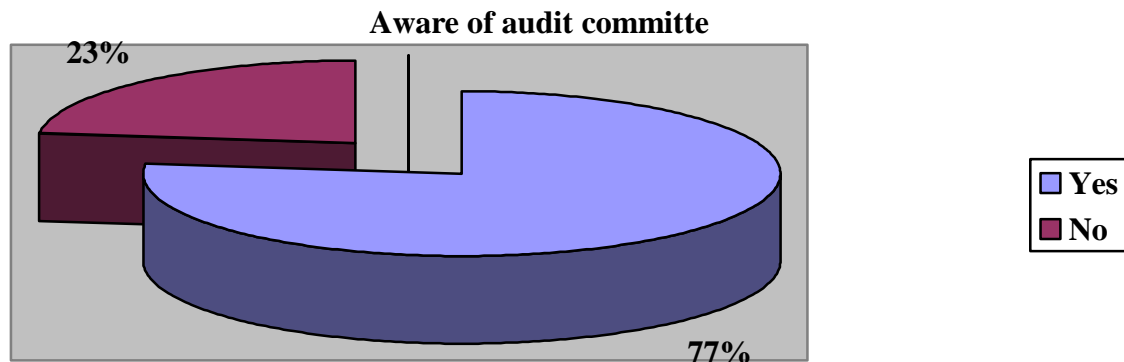
Table 4. 2 Respondent's Years of Service

	Frequency	Percentages
0-5 yrs	2	6
5-10 yrs	8	26
10-15 yrs	16	52
15 yrs and above	5	16
Total	31	100

The study requested the respondents to state the period that they had been working in the ministry. From the findings, 52% of the respondents had worked for 10 to 15 years, 26% had worked between 5-10 years, and 16% had worked for over 15 years while 6% of the respondents had worked for less than 5 years. This implied that majority of the respondents had worked in the government ministries for more than 5 years and therefore were experienced on whether audit committees were effective in performing their mandate and offered the relevant information to answer the study research questionnaires.

4.4 The Main Issues

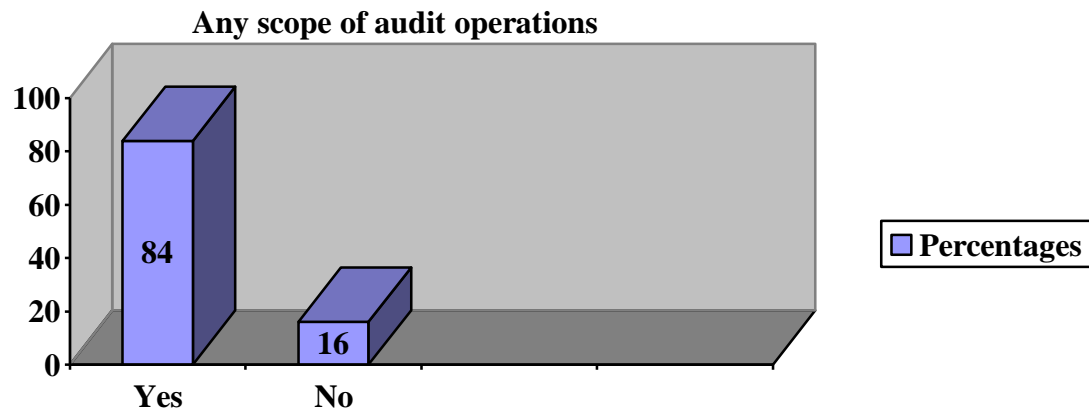
Figure 4. 3 Organizational Independence



Source Author 2011

From the findings in the Figure 4.3, majority 77% of the respondents were aware of audit committees in the ministry while 23% of the respondents were not aware of audit committees in the ministry. This implied that the government ministries had audit committees but their effectiveness in the ministries and therefore there was a need to enhance audit committees to improve financial reporting in the ministries.

Figure 4. 4 Any scope of audit operations defined



Source Author 2011

The study sought whether the scope of audit operations was defined in the ministry. From the findings, majority 84% of the respondents indicated that there was a scope of audit operations defined in the ministry while 16% of the respondents indicated that the scope of audit operations was not defined. This implied that the government ministries chief finance officer and audit were aware of their mandate in the Ministries.

Table 4. 3 Extent to which management valued role of audit committee and administrative reporting

	Frequency	Percentages
Very great extent	21	69
Great Extent	10	31
Total	31	100

Source Author 2011

The study sought the extent to which role of audit committee and administrative reporting preferences were valued by management in the ministry. From the findings, majority 69% of the respondents indicated that management in the Ministries valued role of audit committee and administrative reporting to a very great extent while 31% of the respondents indicated that management in the ministries valued role of audit committee and administrative reporting to a

great extent. This implied that the ministries valued the audit committee and administrative reporting as it promoted corporate governance through adopting skilled and qualified manpower, enabled properly delineated authority and responsibilities and effective financial reporting status that permits the maintenance of integrity, objectivity, and professional independence to enhance internal auditing and improve corporate governance. This concurred with Dittenhofer,(2001) who found that public and private owned institutions now employ financial reporting and management practices given to executives on the basis of performances.

Table 4. 4 Extent to which audit department is independent in carrying its mandate

	Frequency	Percentages
Strongly agreed	20	65
Disagreed	11	35
Total	31	100

Source Author 2011

The Table 4.4 indicated the respondent's responses on the extent to which they agreed that audit department was independent in carrying its mandate. From the findings, 65% of the respondents strongly agreed that audit department is independent in carrying its mandate while 35% of the respondents disagreed that audit department was independent in carrying its mandate. This implied that the audit committee in the government ministries was not independent in carrying out their mandate and there was interference and therefore could not perform its role independently and objectively.

Table 4. 5 Rating the effectiveness of the audit committee

	Frequency	Percentages
Effective	19	61
Moderately Effective	8	26
Inneffectibe	4	13
Total	31	100

Source Author 2011

The Table 4.5 indicates the respondent's responses on the rating of the effectiveness of the audit committee. From the findings, 61% of the respondents indicated that audit committee was effective, 26% of the respondents indicated that audit committee was moderately effective while 13% of the respondents indicated that audit committee was inneffectibe. This implied that goverment ministries had a weak internal audit function as audit committee was innefective which in turn strengthens the position of the audit function in the ministries .

Table 4. 6 Extent to which audit committee achieve the given role in ministry

	Moderate	Great extent	Very great extent	N	Mean	Std dvt
Strengthen the quality of financial information in the ministry	6	13	12	31	1.46	0.38
Assist the board and/or its audit committee by delivering a review of organization's control culture	5	15	16	31	1.90	0.36
Ensuring existence of appropriate internal management control system	7	7	17	31	3.86	0.31
Improve corporate governace in the ministry	5	9	17	31	4.48	0.46
Reduction in corruption and fraud cases	5	8	18	31	1.78	0.76
Ensure establishment and maintainance of effective internal accounting controls in the ministry to provide reasonable assurance for safeguarding of the ministry assets	4	7	20	31	4.90	0.89

Avoid unnecessarily duplicating audit procedures	3	9	19	31	4.34	0.41
Ensure ministries' procedures, policies, and business environment effective	10	5	16	31	3.89	0.34
Ensuring governance policies and practices operate effectively	7	8	16	31	4.27	0.68
Promoting compliance with applicable rules and regulations	4	13	14	31	4.13	0.43
Audit committee provide consulting services to assist management in implementing or improving existing governance processes	10	8	13	31	1.71	0.73
Reducing the risk of public corruption	9	9	13	31	1.65	0.55

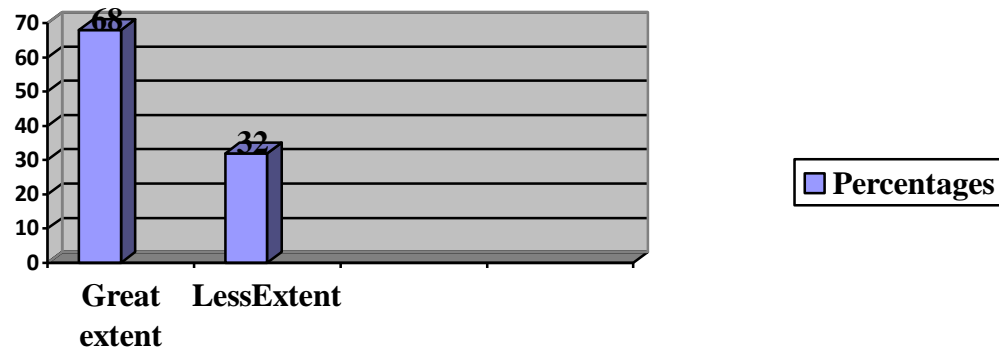
Source Author 2011

The table 4.6 indicated the respondent's responses on the extent to which audit committee achieve the given role in the ministry. From the finding, majority of the respondents disagreed that audit committee achieved the given role in the ministry as it ensured establishment and maintainance of effective internal accounting controls in the ministry to provide reasonable assurance for safeguarding of the ministry assets, reduce corruption and fraud cases, provide consulting services to assist management in implementing or improving existing governance processes and reducing the risk of public corruption to a very great extent as indicated by a mean of 1.90, 1.84, 1.71, 1.65 supported by standard deviation of 0.89, 0.86, 0.73 and 0.55. The study also found that most of the respondents moderately agreed that audit committee achieved the given role in the ministry as it improved corporate governace, strengthened the quality of financial information, avoid unnecessarily duplicating audit procedures, ensured governance policies and practices operate effectively and promoted compliance with applicable rules and regulations to a great extent as indicated by a mean of 3.48, 3.46, 3.34 supported by standard deviation of 0.46, 0.38, 0.41. The study further found that most of the respondents agreed that audit committee achieved the given role in the ministry as it assisted the its audit committee by delivering a review of organization's control culture, ensured company's procedures, policies, and business environment effective and ensured existence of appropriate internal management control system to a moderate extent as indicated by a mean of 3.90, 3.89 and 3.86 supported by standard deviation of 0.36, 0.34 and 0.31.

This implied that audit committee failed to ensured establishment and maintainance of effective internal accounting controls, provide reasonable assurance for safeguarding of the ministry assets, reduce corruption and fraud cases, provide consulting services to assist management in implementing of governance processes, reduce the risk of public corruption, improve corporate governace, strengthen the quality of financial information, avoid unnecessarily duplicating audit procedures and promote compliance with applicable rules and regulations thereby affecting effectiveness of the audit committee in the ministries. These findings concurred with concurred with Kariuki, (2002) who stated that the ineffective legislation fail to clearly set out the requirement for internal auditing and the appropriate governance arrangements, such as an audit committee and its role and operations, as well as specific sign-off requirements.

4.5 Unlimited Scope

Figure 4. 5 IIA standard described the scope of the IAF



Source Author 2011

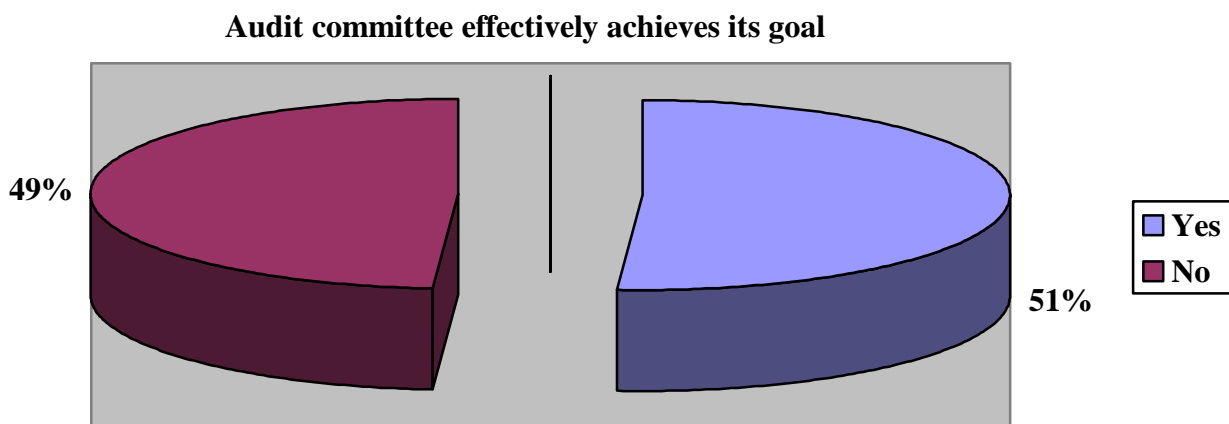
The study sought the extent to which the respondents agreed that IIA standard described the scope of the IAF as a tool of management in public sector management cycle to ensuring the efficient and effective use of resources. From the findings, majority 68% of the respondents indicated that IIA standard described the scope of the IAF as a tool of management in public sector management cycle to a very great extent while 32% of the respondents indicated that IIA standard described the scope of the IAF as a tool of management in public sector management cycle. This implied that that IIA standard described the scope of the IAF as a tool of management in public sector management cycle to a less extent. This implied that audit committee was not effective as its scope was to a certain extent limited.

Table 4. 7 Extent to which ineffective of governance constraints hinders audit committee ability

	Frequency	Percentages
Very effective	15	48
Effective	10	32
Moderately effective	6	20
Total	31	100

The study sought the extent to which respondents agreed that ineffective of governance constraints hinders audit committee ability to generate timely and relevant reports. From the findings, 48% of the respondents indicated that ineffective of governance constraints hindered audit committee ability to generate timely and relevant reports to a very great extent, 32% of the respondents indicated that ineffective of governance constraints hindered audit committee ability to generate timely and relevant reports to a great extent while 20% of the respondents indicated that ineffective of governance constraints hindering audit committee ability to generate timely and relevant reports was moderately effective. This clearly indicated that the audit committee in the ministries was not as effective as required governance practices adopted in the ministries constraints audit committee in the ministries from carrying its mandate effectively.

Figure 4. 6 Audit Committee Effectively achieves its goal

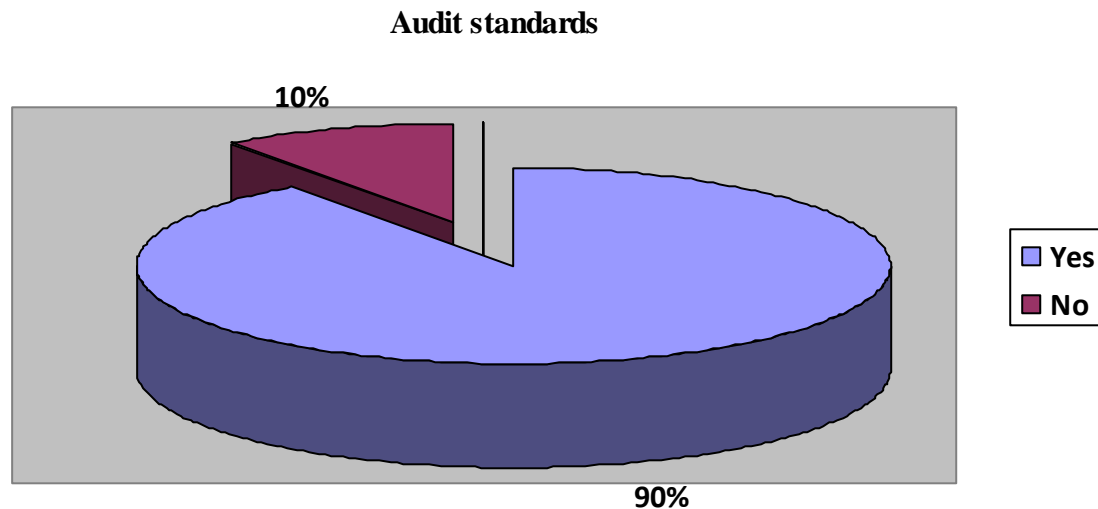


Source Author 2011

The study sought whether audit committee effectively achieved its goal in the ministry. From the findings, 51% of the respondents indicated that audit committee effectively achieves its goal while 49% of the respondents indicated that the audit committee did not effectively achieve its goal in the ministry. This implied that the government ministries need to adopt strategies that would enable the audit committee to be effectively achieving its goal in the ministry.

4.6 Professional Audit Standards

Figure 4. 7 Any audit standards ensure audit committee carry out its mandate effectively



Source Author 2011

The figure 4.6 indicated the respondent's responses on whether there has been audit standards adopted to ensure audit committee carry out its mandate effectively. From the findings, majority 90% of the respondents indicated that there has been audit standards adopted to ensure audit committee carry out its mandate effectively while 10% of the respondents indicated that there has been no audit standards adopted to ensure audit committee carry out its mandate effectively. This implied that audit committee in the ministry work under the set audit standards which provides a framework to promote quality audit work that is systematic, objective, and based on evidence. Schneider, (1984), also stated that International Organization of Supreme Audit Institutions has issued its own auditing standards to guide the auditing and accounting practices in the public sector

Table 4. 8 Increased capability and scope of internal audit work

	Frequency	Percentages
Very great extent	20	63
Great Extent	11	37
Total	31	100

Source Author 2011

The study sought whether the increased capability and scope of internal audit work has enabled external auditors in the ministry to rely increasingly on internal audit's work in conducting the external audits for the organization. From the findings, majority 63% of the respondents indicated that increased capability and scope of internal audit work has enabled external auditors in the ministry to rely increasingly on internal audit's work in conducting the external audits for the organization 37% of the respondents indicated that increased capability and scope of internal audit work has enabled external auditors in the ministry to rely increasingly on internal audit's work in conducting the external audits for the organization to a great extent . This impleid that the internal audit work had increased its capability and scope enabling the external auditors in the ministry to rely mostly on it in conducting the external audits for the organization this enables the company to sought ways to reduce external audit fees by substituting internal audit work. This concurred with Lee, (2004) who found that in 88% of their companies external auditors relied to some extent on the work of the internal auditors in a 2005 survey of 117 chief internal audit executives.

Table 4. 9 Extent to which the given factors affect the effectiveness of audit committee in the ministry

	Neutral	Agree	Strongly agree	N	Mean	Std dvt
Lack of Organizational independence	3	4	23	31	4.43	0.52
Non existence of proper audit charter	8	8	15	31	4.60	0.66
Improve corporate governace in the ministry	7	7	15	31	4.66	0.68
Incomplete and restricted access to all forms of audit evidences like employees, property and records sufficient funding	2	19	10	31	4.88	0.86
Lack of planning and weak personnel management system	1	11	19	31	4.81	0.87
lack of attention from top management	9	15	8	31	4.24	0.43
lack of understanding on the role and responsibilities of the internal audit function	9	10	12	31	4.71	0.75
Lack of cooperation between internal audit function and the external auditor.	3	10	18	31	4.48	0.69
Lack of competency and knowledge on auditing techniques	3	15	12	31	3.53	0.35
Decreased capability and scope of internal audit in the ministry	1	14	16	31	4.49	0.58
Insufficient staffing greatly affect effectiveness of the ministry	1	13	17	31	4.59	0.67

Source Author 2011

The Table 4.9 indicates the respondent's response on the extent to which the given factors affect the effectiveness of audit committee in the ministry. From the finding, majority of the respondents strongly agreed that incomplete and restricted access to all forms of audit evidences like employees, property and records sufficient funding, lack of planning and weak personnel management system, lack of understanding on the role and responsibilities of the internal audit function, improve corporate governace in the ministry and that non existence of proper audit charter, insufficient staffing greatly affect effectiveness of the audit committee in the ministry as indicated by a mean of 4.88, 4.81, 4.71, 4.66, 4.60 and 4.59 supported by standard deviation of

0.86, 0.87, 0.75, 0.68, 0.66 and 0.67. From the findings the respondents agreed that decreased capability and scope of internal audit in the ministry, lack of cooperation between internal audit function and the external auditor, lack of organizational independence and lack of attention from top management affect effectiveness of the audit committee in the ministry as indicated by a mean of 4.49, 4.48, 4.43 and 4.24 supported by standard deviation of 0.58, 0.69, 0.52 and 0.43. The study further found that most of the respondents were neutral on whether Lack of competency and knowledge on auditing techniques affected the effectiveness of the audit committee in the ministry as indicated by a mean of 3.53 supported by standard deviation of 0.35. This implied that incomplete and restricted access to all forms of audit evidences; lack of planning, personnel management system, understanding on the role and responsibilities of the internal audit function, proper audit charter, sufficient staffing greatly affected effectiveness of the audit committee in the ministry, decreased capability and scope of internal audit; lack of cooperation between internal audit function and the external auditor, lack of organizational independence and lack of attention from top management hindered achievinh of effectiveness of the audit committee in the ministry. This concurred with Zamzulaila, Zarina and Dalila, (2007) who viewed the internal audit quality to be determined by the internal audit department's capability to provide useful findings and recommendations being the central to audit effectiveness.

4.7 Competent Staff

Table 4. 10 Extent to which staff in audit committee is competent

	Frequency	Percentages
Great extent	17	55
Moderately Extent	10	32
Less Extent	4	13
Total	31	100

Source Author 2011

The Table 4.10 indicated the respondent's responses on the extent to which staff in audit committee is competent in carrying out their role. From the findings, 55% of the respondents indicated that staff in audit committee was competent in carrying out their role to a great extent, 32% of the respondents indicated that staff in audit committee was not competent in carrying out their role to a moderately extent while 13% of the respondents indicated that staff in audit committee was competent in carrying out their role to a less extent. This implied that there was less staff competency which hindered efficiency of the auditors in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. This concurred with Kariuki, (2002) who found that Audit Service Corporation was established by Proclamation No. 126/1977, so as to accommodate for professional auditing of public enterprises and to give guidance needed for audit staff committee competency.

Table 4. 11 Extent to which the given factors affect the effectiveness of audit committee

	Neutral	Agree	Strongly	N	Mean	Std dvt
Competency of auditors determines the quality of the audit work performed in your ministry	2	11	18	31	4.62	0.71
Competency determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes in your ministry	2	8	21	31	4.73	0.85
Low educated and less competent staff affects competency and knowledge on auditing techniques.	0	15	16	31	4.45	0.55
Lack of competency and knowledge on auditing techniques is another major problem encountered by internal audit function in the public sector organizations	8	12	11	31	4.21	0.75

Source Author 2011

The table 4.11 indicates the respondent's response on the extent to which the given factors affect the effectiveness of audit committee in the ministry. From the finding, majority of the respondents strongly agreed that competency determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, governance processes and competency of auditors determines the quality of the audit work performed in the ministry affecting the effectiveness of audit committee to a very great extent as indicated by a mean of 4.73 and 4.62 supported by standard deviation of 0.85 and 0.71. The study also found that most of the respondents agreed that low educated and less competent staff affects competency and knowledge on auditing techniques and lack of competency and knowledge on auditing techniques was another major problems hindering effectiveness of audit function in the public ministries to a great extent as indicated by a mean of 4.45 and 4.21 supported by standard deviation of 0.55 and 0.75. This implied that Competency and knowledge of auditors on auditing techniques, efficiency of the auditor, setting of a

systematic and disciplined approach in evaluating and improving the effectiveness of risk management factors affecting the effectiveness of audit committee in the ministry. This concurred with Practice Advisory of the IIA (2004) which states that internal auditors should possess knowledge, skills and other competencies to practice the profession. The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate.

Ways through which effectiveness of audit committee could be improved

The study sought suggestion on ways through which effectiveness of audit committee in the ministries could be improved. From the findings, respondents suggested that audit committee in the Ministry must comply with minimum continuing education requirements established by their relevant professional organizations and standards, the head of the audit activity must be able to effectively recruit, retain, and manage highly skilled staff in order to ensure audit staff performance.

4.8 Regression Analysis

A multivariate regression model was applied to determine the effectiveness of Audit committee in government ministries

The Linear regression used in this model was:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$$

Where

Y= effectiveness of Audit committee in public sectors

α = Constant

β = Beta coefficients

X_1 = Audit independence

X_2 = formal mandate

X_3 = Unlimited access

X_4 = Competent leadership

ϵ = Error Term

4.8.1 Model Summary of Regression analysis

Table 4. 12 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.087(a)	.728	.788	0.34	1.762	6	.214	8.101	.001(a)

Source Author 2011

Predictors: (Constant) audit independence, formal mandate, unlimited access and competent leadership

Dependent: Effectiveness of Audit committee

R-Squared is the proportion of the variance in the dependent variable effectiveness of Audit committee that was explained by variations in the independent variables audit independence, formal mandate, unlimited access and competent leadership. This implied that there was 72.8% of variance or correlation between variables in general.

Adjusted R^2 is called the coefficient of determination which indicates how effectiveness of Audit committee varies with variation in factors affecting effectiveness of Audit committee which includes audit independence, formal mandate, unlimited access and competent leadership. From table above, the value of adjusted R^2 is 0.788. This implies that, there was a variation of 78.8% of effectiveness of Audit committee varied with variation in factors affecting effectiveness of Audit committee which includes audit independence, formal mandate, unlimited access and competent leadership and was statistically significance with P-Value of 0.01 which was less than 0.05 at a confidence level of 95%.

4.8.2 ANOVA (b)

Table 4. 13 ANOVA (b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	4.104	9	.227	5.231	0.01(a)
	Residual	1.762	36	.021		
	Total	6.466	45			

Source Author 2011

Predictors: (Constant) audit independence, formal mandate, unlimited access and competent leadership

Dependent: Effectiveness of Audit committee

The total variance was the difference into the variance which can be explained by the independent variables (Model) and the variance which was not explained by the independent variables (Error). The strength of variation of the predictor values influence the effectiveness of Audit committee dependence variable at 0.01 significant levels.

4.8. 3 Regression Coefficients (a)

Table 4. 14 Coefficients (a)

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	7.000	.535		4.601	0.01
	Audit independence,	-0.732	.455	.787	3.191	0.02
	Formal mandate	-0.944	.626	-0.972	3.383	0.04
	Unlimited access	-0.678	.248	-.619	2.606	0.03
	Competent leadership	-0.771	.710	-.692	2.272	0.01

Source Author 2011

Predictors: (Constant) audit independence, formal mandate, unlimited access and competent leadership

Dependent: Effectiveness of Audit committee

$$Y = 7.000 - 0.732 X_1 - 0.944X_2 - 0.678X_3 - 0.771X_4$$

Where X_1 = Audit independence, X_2 = Formal mandate, X_3 = Unlimited access X_4 = Competent leadership

The values, 0.732, 0.944, 0.678, 0.771 are the unstandardized coefficients. These were the coefficients that the study would obtain when standardized of all of the variables in the regression, including the dependent and all of the independent variables, and running of the regression

The column of coefficient shows the predictor variables of constant, audit independence, formal mandate, unlimited access and competent leadership. The first variable constant of 7.000 represented the constant which predicted value of effectiveness of Audit committee when all other variables affecting effectiveness of Audit committee were constant at zero (0).

4.9 Discussion of the Findings

From the above regression model, it was found that effectiveness of Audit committee in government ministries would be at 7.000 holding, audit independence, formal mandate, unlimited access and competent leadership constant at Zero. Decreased in audit independence would lead to an decrease in effectiveness of Audit committee in government ministries by factor of 0.732 with P value of 0.002 while failing in adoption of formal mandate practices would lead to an decrease in effectiveness of Audit committee in government ministries by a factor of 0.944 with P value of 0.004. The study also found that ineffective unlimited access affected effectiveness of Audit committee in government ministries by a factor of 0.678 with P value of 0.003 while a unit increase in competent leadership would result to an increase in effectiveness of Audit committee in government ministries by factor of 0.771 with P value of 0.001. This clearly indicated that there existed a negasitive relationship between factors affecting effectiveness of Audit committee in government ministries clearly indicating that there was lack of well designed Audit committee practices of audit independence, formal mandate, limited access and competent leadership affecting effectiveness of Audit committee in government ministries as they were statistically significant with a P-Value of 0.02, 0.04, 0.03 and 0.01 at 95% confidence level. This implied clearly that audit committee in the ministries was not effective in undertaking it mandates.

CHAPTER FIVE:

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter provided the summary of the findings from chapter four, conclusions and recommendations of the study based on the objectives of the study. The main objective of the study is to find out the effectiveness of audit committee in public sector in Kenyan government ministries.

5.2 Summary

From the findings, the study established that audit committee in government ministries comprised of auditors, finance officers and accountants who were qualified personnel who could adopt effectiveness of audit committee as they had an experience of more than 5 years in the service.

The study established that the management of the government ministries valued the audit committee and administrative reporting through promoting corporate governance, adopting skilled and qualified manpower, enable properly delineated authority and responsibilities and a reporting status that permits the maintenance of integrity, objectivity, and professional independence to enhance internal auditing and improve corporate governance.

The study revealed that various mechanisms for the audit department to independent audit committee carrying its mandate in the ministry were adopted which included independent directors on the board, an independent board chair, an effective audit committee both external and internal audit. Hung and Han, (1998) indicated that the existence of proper audit charter helps the audit function to perform its role independently of management influence and objectively and that a strong internal audit function enhances the effectiveness of the audit committee which in turn strengthens the position of the internal audit function.

From the findings, the study established that audit committee in the government ministries ensured establishment and maintenance of effective internal accounting controls, provide

reasonable assurance for safeguarding of the ministry assets, reduce corruption and fraud cases, provide consulting services to assist management in implementing of governance processes, reduce the risk of public corruption, improve corporate governance, strengthen the quality of financial information, avoid unnecessarily duplicating audit procedures, promote compliance with applicable rules and regulations, assist the audit committee by delivering a review of organization's control culture, ensure company's procedures, policies, and business environment effective and ensure existence of appropriate internal management control system.

The study revealed that ineffective of governance constraints hindered audit committee ability to generate timely and relevant reports and audit committee fails to effectively achieve its goals.

From the findings, the study established that audit committee in the government ministries work under the set audit standards which provide a framework to promote quality audit work that was systematic, objective, and based on evidence. Schneider, (1984), also stated that International Organization of Supreme Audit Institutions has issued its own auditing standards to guide the auditing and accounting practices in the public sector. The internal audit work had increased its capability and scope enabling the external auditors in the ministry to rely mostly on it in conducting the external audits for the organization this enables the company to sought ways to reduce external audit fees by substituting internal audit work.

From the findings, the study established that incomplete and unrestricted access to all forms of audit evidences; lack of planning, personnel management system, lack of understanding on the role and responsibilities of the internal audit function, improper audit charter, insufficient staffing greatly affected effectiveness of the audit committee in the government ministries.

The study revealed that decreased capability and scope of internal audit; lack of cooperation between internal audit function and the external auditor, lack of organizational independence and lack of attention from top management hindered effectiveness of audit committee in the ministry.

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From the findings, the study established that lack of competency and knowledge of auditors and audit committee members on auditing techniques, inefficiency of the auditor, poor setting of a systematic and disciplined approach for evaluating and improving the effectiveness of risk management factors affected the effectiveness of audit committee in the ministry.

The study established that there existed a negative relationship between lack of audit independence, informal mandate, unlimited access and incompetent leadership and effectiveness of Audit committee in the government ministries clearly indicating that well designed Audit committee practices of in government ministries as needed to be adopted. This implied that audit lack of independence, informal mandate, unlimited access and incompetent leadership affected effectiveness of Audit committee in public sector affecting quality service perceptions, public satisfaction and optimization of the service delivery.

5.3 Conclusions

From the findings, the study concluded that government ministries needs to enhance the effectiveness of audit committee through creating awareness of audit committee to the concerned departments, defining scope of audit in ministries, management's valuing the audit committee, promoting corporate governance, adopting skilled and qualified manpower, enabling properly delineated authority, maintenance of integrity, objectivity, and professional independence enhance internal auditing as well of enabling the organization's chief finance officer and other heads of business units to understand the firm's finances and operations.

The study concluded that independent directors on the board, an independent board chair, an effective audit committee both external and internal audit mechanisms need to be adopted so as to independently carry audit mandate in the department and existence of proper audit charter helps the audit function to perform its role independently of management influence and objective strengthening the position of the internal audit function.

From the findings, the study concluded that government ministries need to ensure the effectiveness of audit committee as it would lead to establishment and maintenance of effective internal accounting controls, provide reasonable assurance for safeguarding of the ministry assets, reduce

corruption and fraud cases, provide consulting services to assist management in implementing of governance processes, reduce the risk of public corruption, improve corporate governance, strengthen the quality of financial information, avoid unnecessarily duplicating audit procedures, promote compliance with applicable rules and regulations, assist the audit committee by delivering a review of organization's control culture, ensure company's procedures, policies, and business environment effective and ensure existence of appropriate internal management control system.

From the findings, the study concluded that IIA standard describe the scope of the IAF as a tool of management in public sector management cycle to ensure the efficient and effective use of resources. Ineffective of governance constraints hinders audit committee ability to generate timely and relevant reports therefore organization need to adopt strategies that would enable the audit committee to effectively achieve its goal in the ministry.

From the findings, the study concluded that government ministries need to set audit standards which provides a framework so as to promote quality audit work that is systematic, objective, and based on evidence. Increased internal audit work capability and scope must be ensured so as to enable the external auditors in the ministry to rely mostly on it in conducting the external audits for the organization reducing external audit fees by substituting internal audit work.

From the findings, the study concluded that government ministries must avoid incomplete and restricted access to all forms of audit evidences; lack of planning, personnel management system, understanding on the role and responsibilities of the internal audit function, improper audit charter, insufficient staffing as this would hinder the effectiveness of the audit committee in the ministry greatly..

The study concluded that ministries need to ensure the competency of its auditing staff through setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes as this would lead to efficiency of the auditor. Management in the Ministries must ensure the professional auditing and guidance needed for audit staff committee competency.

5.4 Recommendations of the Study

From the conclusion the study recommended management in the government ministries and other public institutions should enhance the effectiveness of audit committee by ensuring defined scope of auditing, top management supports to the audit committee, promote corporate governance, adopt skilled and qualified manpower, enable properly delineated authority, maintain integrity, objectivity, and professional independence and understand the firm's finances and operations.

From the findings and conclusion, the study recommended that in government ministries adopt proper audit charter by having independent directors on the board, an independent board chair, an effective audit committee both external and internal audit mechanisms so as to independently carry audit mandate in the department.

From the findings and conclusion, the study recommended that government ministries must ensure the effectiveness of audit committee operations so as to establish and maintain effective internal accounting controls, provide reasonable assurance for safeguard ministry assets, reduce corruption and fraud cases, provide consulting services to assist management in implementing of governance processes, reduce the risk of public corruption, improve corporate governance, strengthen the quality of financial information, avoid unnecessarily duplicating audit procedures, promote compliance with applicable rules and regulations, deliver a review of ministry's control culture, ensure company's procedures and policies.

From the findings the study recommended government ministries should adopt strategies that would discourage incomplete and restricted access to all forms of audit evidences; lack of planning, personnel management system, understanding on the role and responsibilities of the internal audit function, proper audit charter, sufficient staffing so as to pave way for effective audit committee operations in the government Ministries .

From the findings the study recommended that government ministries should ensure the staff competency, professional auditing and offer guidance needed for audit staff committee competency, knowledge of auditors on auditing techniques, efficiency of the auditor, set a

5.4 Limitations of the Study

The main limitation of study was inability to include more government institutions. The study would have covered more institutions across all public sectors so as to provide a more broad based analysis. However, resource constraints placed this limitation.

The study also faces challenges of time resources limiting the study from collecting information for the study particularly where the respondent delay in filling the questionnaire and travelling for collection the filled questionnaire.

The respondents were found to be uncooperative because of the sensitivity of the information required for the study. The researcher explained to the respondents that the information they provided was to be held confidentially and was only for academic purpose only.

5.5 Recommendation for Further Study

The study investigated the effectiveness of audit committee in public sector focusing on a case study of government ministries. This study recommends that a further study should be carried out to investigate the factors that influence the effectiveness of audit committee in public institutions focusing on state owned enterprises.

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APPENDIX

Appendix I: QUESTIONNAIRE

This questionnaire is prepared for the purpose of collecting data for Research Proposal in partial fulfillment of the requirement for an award of master degree in business administration (MBA) and therefore all information will be handled confidentially.

SECTION A: BACKGROUND INFORMATION

1. Indicate your designation in the ministry? (Tick as applicable)

- i. Head of departments [☐]
- ii. Auditors [☐]
- iii. Finance Officers [☐]
- iv. Accountants [☐]

2. Please indicate the highest level of education attained? (Tick as applicable)

- a) Masters & Above [☐]
- b) University Degree [☐]
- c) Diploma [☐]
- d) Certificate and below [☐]

3. Years of service/working period in the Ministry (Tick as applicable)

- 1. 0-5 yrs [☐]
- 2. 5-10 yrs [☐]
- 3. 10-15 yrs [☐]

4. 15 yrs and above []

The Main Issues

Organizational Independence

4. Are you aware of audit committee in the ministry?

Yes []

No []

5. Is the scope of audit operations defined in your ministry?

Yes []

No []

6. To what extent is the role of audit committee and administrative reporting preferences valued by management in the ministry?

i. Very great extent []

ii. Great Extent []

iii. Moderately Extent []

iv. Less Extent []

v. No Extent []

7. To what extent do you agree with the following statement that your audit department is independent in carrying its mandate?

i. Strongly agreed []

ii. Agreed []

iii. Moderate agree []

iv. Disagree []

v. Strongly disagreed []

8. How do you rate the effectiveness of the audit committee in your ministry

i. Very effective []

ii. Effective []

iii. Moderately effective []

iv. Less effective []

v. Not effective []

9. To what extent does audit committee achieve the following role in your ministry? (Where 1- Not at all, 2-Less extent, 3-Moderate Extent, 4 –Great extent and 5 -Very Great extent)

Statement	1	2	3	4	5
Strengthen the quality of financial information in the ministry					
Assist the board and/or its audit committee by delivering a review of organization's control culture					
Ensuring existence of appropriate internal management control system					
Improve corporate governance in the ministry					
Reduction in corruption and fraud cases					
Ensure establishment and maintenance of effective internal accounting controls in the ministry to provide reasonable assurance for safeguarding of the ministry assets					
Avoid unnecessarily duplicating audit procedures					
Ensure company's procedures, policies, and business environment effective					
Ensuring governance policies and practices operate effectively					
Promoting compliance with applicable rules and regulations					
Audit committee provide consulting services to assist management in implementing or improving existing governance processes					
Reducing the risk of public corruption.					

Unlimited Scope

10. To what extent do you agree with the statement that The IIA standard described the scope of the IAF as a tool of management in public sector management cycle to ensuring the efficient and effective use of resources

- vi. Very great extent []
- vii. Great Extent []
- viii. Moderately Extent []
- ix. Less Extent []
- x. No Extent []

11. To what extent do you agree with the following that ineffective of governance constraints hinders audit committee ability to generate timely and relevant reports.

- i. Very great extent []
- ii. Great Extent []
- iii. Moderately Extent []
- iv. Less Extent []
- v. No Extent []

12. Does audit committee in your ministry effectively achieve its goal?

- i. Yes []
- ii. No []

Professional Audit Standards

13. Are there audit standards that have been adopted to ensure audit committee carry out its mandate effectively

- Yes []

No []

14 Do you think the increased capability and scope of internal audit work has enabled external auditors in your ministry to rely increasingly on internal audit's work in conducting the external audits for the organization

- i. Very great extent []
- ii. Great Extent []
- iii. Moderately Extent []
- iv. Less Extent []
- v. No Extent []

15. To what extent does the following factor s affect the effectiveness of audit committee in your ministry (Where 1-Not at all, 2-Less extent, 3-Moderate Extent, 4 –Great extent and 5 - Very Great extent)

Statement	1	2	3	4	5
Lack of Organizational independence					
Non existence of proper audit charter					
Improve corporate governace in the ministry					
Incomplete and restricted access to all forms of audit evidences like employees, property and records sufficient funding					
Lack of planning and weak personnel management system					
lack of attention from top management					
lack of understanding on the role and responsibilities of the internal audit function					
Lack of cooperation between internal audit function and the external auditor.					
Lack of competency and knowledge on auditing techniques					
Decreased capability and scope of internal audit in the ministry					
Insufficient staffing greatly affect effectiveness of the ministry					

Competent Staff

16. To what extent do you think staff in audit committee is competent in carrying out their role?

- i. Very great extent []
- ii. Great Extent []
- iii. Moderately Extent []
- iv. Less Extent []
- v. No Extent []

17. To what extent does the following factor s affect the effectiveness of audit committee in your ministry? (Where 1-Not at all, 2-Less extent, 3-Moderate Extent, 4 –Great extent and 5 - Very Great extent)

Statement	1	2	3	4	5
Competency of auditors determines the quality of the audit work performed in your ministry					
Competency determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes in your ministry					
Low educated and less competent staff affects competency and knowledge on auditing techniques.					
Lack of competency and knowledge on auditing techniques is another major problem encountered by internal audit function in the public sector organizations					

18. Suggest ways through which effectiveness of audit committee in you ministry could be improved.

- i.....
- ii.....
- iii.....
- iv.....