THE EFFECT OF INTERNAL CONTROLS ON REVENUE COLLECTION BY COUNTY GOVERNMENTS IN KENYA

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A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF A DEGREE IN MASTER OF BUSINESS ADMINISTRATION, UNIVERSITY OF NAIROBI

OCTOBER, 2014
DECLARATION

I declare that this research project is my original work and has never been submitted to any other University for assessment or award of a degree.

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This project has been submitted with my authority as the University supervisor.

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This research project is my original work and has not been submitted for any award in any other university. The success of this study is indebted to many people who either used their treasured time to give their ideas, support and suggestions or contributed to my whole well-being which was essential to the completion of this project.

I am very grateful to the Almighty God for giving me strength and the gift of life to go through this demanding but rewarding exercise. The completion of this study was realized through the will of God and the contribution and support of many people who whole heartedly supported me.

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May the Almighty God bless you all.
DEDICATION

I dedicate this research project to my dear parents Mr. and Mrs. Mati for their love, understanding, and encouragement and support while conducting this study and throughout the MBA course. I would also like to thank my children, Tanita and Bryden for their constant support and encouragement and for keeping it fun.
ABSTRACT

This study sought to examine the part played by internal control system in the collection of revenue by county governments in Kenya. The objective of this study therefore was to closely look at the internal controls in revenue collection by county governments Kenya with a view to establish whether such internal controls have produced any meaningful results in increased collected revenue. The research was conducted using both qualitative and quantitative approaches. Questionnaires were used on a population of 47 respondents in gathering primary data for the study. The data collected was then analyzed and findings have revealed that the five components of control environment, risk assessment, control activities, information and communication and monitoring must be available for internal controls to work. The study established that weak internal controls activities and lack of proper information and communication systems have encouraged collusion to fraud, loss of revenue and embezzlement of collected revenue. The study therefore concludes that internal controls do function although with hiccups and that there is a significant effect between internal controls and revenue collection in county governments in Kenya.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>DECLARATION</td>
<td>ii</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENT</td>
<td>iii</td>
</tr>
<tr>
<td>DEDICATION</td>
<td>iv</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>v</td>
</tr>
<tr>
<td>TABLE OF CONTENTS</td>
<td>vi</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>ix</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>x</td>
</tr>
<tr>
<td>CHAPTER ONE</td>
<td>1</td>
</tr>
<tr>
<td>1.0 INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>1.1 Background of the Study</td>
<td>1</td>
</tr>
<tr>
<td>1.1.1 Internal Control Systems</td>
<td>1</td>
</tr>
<tr>
<td>1.1.2 Revenue Collection</td>
<td>4</td>
</tr>
<tr>
<td>1.1.3 Internal Control Systems and Revenue Collection in County Governments</td>
<td>5</td>
</tr>
<tr>
<td>1.1.4 County Governments in Kenya</td>
<td>8</td>
</tr>
<tr>
<td>1.2 Research Problem</td>
<td>8</td>
</tr>
<tr>
<td>1.3 Objectives of Study</td>
<td>10</td>
</tr>
<tr>
<td>1.4 Value of the Study</td>
<td>10</td>
</tr>
<tr>
<td>CHAPTER TWO</td>
<td>11</td>
</tr>
<tr>
<td>2.0 LITERATURE REVIEW</td>
<td>11</td>
</tr>
<tr>
<td>2.1 Introduction</td>
<td>11</td>
</tr>
<tr>
<td>2.2 Theoretical Review</td>
<td>11</td>
</tr>
<tr>
<td>2.2.1 Agency Theory</td>
<td>11</td>
</tr>
<tr>
<td>2.2.2 Transaction Cost Economics Theory</td>
<td>12</td>
</tr>
</tbody>
</table>
4.4 Inferential Analysis.................................................................28
  4.4.1 Coefficient of Correlation..........................................................28
  4.4.2 Regression Analysis .................................................................28
4.5 Summary and Interpretation of Findings .............................................31
CHAPTER FIVE .............................................................................................33
SUMMARY, CONCLUSION AND RECOMMENDATIONS...............................34
  5.1 Summary .........................................................................................34
  5.2 Conclusion ......................................................................................34
  5.3 Limitation of the Study .....................................................................35
  5.4 Policy Recommendations ..................................................................36
  5.5 Suggestions for Further Study ............................................................37
REFERENCES ...............................................................................................38
APPENDICES ...............................................................................................44
Appendix 1: Letter of Introduction ............................................................44
Appendix II: Questionnaire..........................................................................45
Appendix III: List Of Counties In Kenya .....................................................47
LIST OF TABLES

Table 1 Response Rate............................................................................................................. 21
Table 2 Mean and Standard Deviation of Control Activities................................................... 21
Table 3 Mean and Standard Deviation of Control Environment........................................... 24
Table 4 Mean and Standard Deviation of Risk Assessment..................................................... 25
Table 5 Mean and Standard Deviation of Information and Communication........................... 26
Table 6 Mean and Standard Deviation of Monitoring.............................................................. 27
Table 7 Coefficients of Correlation....................................................................................... 28
Table 8 Model Summary........................................................................................................ 29
Table 9 ANOVA Analysis....................................................................................................... 29
Table 10 Coefficients of Multiple Regression Analysis......................................................... 30
LIST OF ABBREVIATIONS

COSO-Committee of Sponsoring Organizations

FASB-Financial Accounting Standards Board

IIA-Institute Of Internal Auditors

KRA-Kenya Revenue Authority

SOX-Sarbanes Oxley Act

SPSS-Statistical Package for Social Sciences

TCE-Transaction Cost Economics

TI -Transparency International

UNES-University of Nairobi Enterprise and Services Limited
CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

According to Fight (2002), cash is the most liquid of assets and is susceptible to loss if not properly controlled. Therefore, it is extremely important that, all departments handling cash implement and adhere to strong internal controls. The recent financial crisis has put cash collection and its management through effective internal control system back in the spotlight, forcing treasurers to focus their efforts on ways to improve their companies’ cash management.

The embezzlement of funds from public institutions or organizations, particularly in essential services or monopolistic public institutions, is becoming more common. Such scandals have raised concerns about their internal control systems. Recent reports on the mismanagement of funds by the media coupled with exposure of the complex web of rot and poor control system has raised curtains on internal control system. These developments have called into question the internal control system found in public utility provider organizations. According to Gibbs, (1997) most public institutions do not have efficient internal control system on cash collection which has often accounted for poor financial management. Accordingly, it is no surprise that, some public service providers more often than not, views internal controls as unnecessary and irrelevant.

Any entity of whichever form or size should put in place its own system of controls in order to achieve its objectives Mwindi (2008). A system of effective internal controls is a critical component of company management and a foundation for the safe and sound operation of organizations. However, ineffective internal controls result in ineffective programs and eventually leading to losses (Olumbe, 2012).

1.1.1 Internal Controls Systems

COSO (1992) defines internal control as a process, carried out at various organizational levels, aimed at providing reasonable certainty regarding the achievement of the objectives of efficiency and effectiveness of operating activities,
Internal control is a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in various categories. Internal control is a key element of the reliability of financial reporting, effective and efficient entity operations, and compliance with laws and regulations. Internal control increases the efficiency of operations by applying the standardized procedures; it adds value to control processes, standard definitions of processes, job definitions, and regulations therefore, contributes the promotion of management effectiveness and efficiency. Meanwhile, it helps to secure an entity's current assets through control mechanisms because it becomes a systematic approach to secure its assets as the entity grows.

Internal control provides the reliability of financial reporting; supports management in making right financial decisions and eliminates or identifies fraudulent acts within the entity. Internal control reinforces and ensures compliance with laws and regulations. In other words, it prevents the entity from any financial or property loss, inaccurate decision making, fraud, loss of income and assets. The role of internal controls, therefore, provides support for management in safeguarding company assets, elimination of any income and resource loss, making goal-oriented and accurate decisions, identifying and preventing fraud. To sum up, internal control is a process affected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. It provides reasonable assurance and is the responsibility of the entity management.

Failure in reaching organizational goals may be as a result of lack of internal controls. Internal control has been recognized in most organization as one of the most essential ingredients, necessary for the survival of the business enterprise and government agencies. Apart from the problem of scarce resources, organizations run a high risk of fraud, errors, miss-appropriation funds and inefficient and ineffective operations. Steps are required therefore to minimize, if not eliminate completely, these risks, by establishing internal control system. For every organization, there are
risks that the organizational goals and objectives are not achieved. All efforts aimed at identifying and correcting such risks are viewed as internal control. Anthony (1998) defined internal control as the process by which managers assure that resources are obtained and used effectively and efficiently in the accomplishment of the organization objectives.

Garrison and Noreen (2000) suggested a different definition for internal control as those steps taken by management that attempt to increase the likelihood that the objectives set down at the planning stage are attained and to ensure that all parts of the organization function in a manner consistent with organizational policies. He further defined internal control as those set of organizational activities which include: planning, co-ordination, communication, evaluation and decision making as well as informal processes aimed at enhancing the efficient and effective use of the organizational resources towards the achievement of the organizational objectives.

According to Hamed (2009), Internal Control System refers to an organized amalgamation of functions and procedures, within a complete system of controls established by the management and whose purpose is the successful function of the business. Internal Control System is all the methods and procedures followed by the management in order to ensure, to a great extent, as much successful cooperation as possible with the director of the company, the insurance of the capital, the prevention and the detection of fraud, as well as the early preparation of all the useful financial information. Hongming and Yanan (2012), adds that Internal Control System resembles the human nervous system which is spread throughout the business carrying orders and reactions to and from the management. It is directly linked to the organizational structure and the general rules of the business.

Internal Control provides reasonable assurance that the objectives of the organization are being achieved in the following categories: effectiveness and efficiency of operations including the use of the entity’s resources. Reliability of financial statement and other report for internal and external use, compliance with applicable laws and regulation. Internal control was designed to provide reasonable assurance regarding preventions of or prompt detection of unauthorized acquisition, use or disposition of organizations assets. Internal Control is not one event, but a series of
actions and activities that occur throughout an entity’s operations and on an ongoing basis. Internal control was recognized as integral parts of each system that management uses to regulate and guide its operations rather than as a separate system within an organization. Internal control is management tools that are built into the entity as a part of its infrastructure to help manager run the entity and achieve their aims on an ongoing basis.

Internal control is affected by people: people are what make internal control work. The responsibility for good internal control rests with all managers. Management sets the objectives, put the control mechanisms and activities in place, and monitor and evaluates the control. However, all personnel in the organization play important roles in making accountability happen. Internal control provides reasonable assurance, not absolute assurance; management design and implement internal control based on the related cost and benefits. No matter how well designed and operated, internal control cannot provide absolute assurance that all organization objectives will be met. Factors outside the control or influence of management can affect the entity’s ability to achieve all of its goals. For example, human mistakes, judgment errors, and acts of collusion to circumvent control can affect meeting organization’s objectives. Therefore, once in place, internal control should be reviewed periodically to ensure that loopholes are sealed immediately.

1.1.2 Revenue collection

The Financial Accounting Standards Board (FASB) (1985) defines revenue as inflows or other enhancements of assets of an entity or settlements of its liabilities (or combination of both) during a period from delivery or producing goods, rendering service or other activities that constitutes the entity’s ongoing major or central operations. In addition, Hongreen (2002) described revenue as inflows of asset (almost always cash or accounts receivables) received for products or services provided to customers.

Government revenue includes all amounts of money (i.e. taxes and/or fees) received from sources outside the government entity. Large governments usually have an agency or department responsible for collecting government revenue from companies.
revenue may also include reserve bank currency which as an advance to the retail bank together with a corresponding currency in circulation expense entry, that is, the income derived from the Official Cash rate payable by the retail banks for instruments such as 90 day bills. There is a question as to whether using generic business-based accounting standards can give a fair and accurate picture of government accounts, in that with a monetary policy statement to the reserve bank directing a positive inflation rate, the expense provision for the return of currency to the reserve bank is largely symbolic, such that to totally cancel the currency in circulation provision, all currency would have to be returned to the reserve bank and cancelled. (Bringham et al, 2008)

1.1.3 Internal Control Systems and Revenue Collection in County Governments in Kenya

In the financial year 2013/2014, the total revenue available to the Counties was Kshs. 40.4 billion which consisted of national shareable revenue of Kshs. 32.9 billion (81.4%), Kshs.4.3 billion(10.8%) as locally collected revenue and a balance brought forward of Kshs. 3.2 billion(7.8%) which had remained unspent in the previous financial year. however, most counties were not able to collect as they had budgeted and this was attributed to among other factors a weak internal control mechanism. This therefore calls for the County governments to ensure that internal controls are well enhanced in the counties so that proper revenue collection can be attained.

An internal control system enables management to deal with quickly changing economic and competitive environments, market changes such as shifting customer demands and priorities and restructuring. Similarly Willis (2000) reported that effective internal control helps an organization achieve its operations, financial reporting, and compliance objectives. Effective internal control is a built-in part of the management process (i.e., plan, organize, direct, and control). Internal control keeps an organization on course toward its objectives and the achievement of its mission, and minimizes surprises along the way. Internal control promotes effectiveness and efficiency of operations, reduces the risk of asset loss, and helps to ensure compliance with laws and regulations. Internal control also ensures the reliability of financial reporting (i.e., all transactions are recorded and that all recorded transactions are real,
Theoretically, effective internal control system increases efficiency in revenue collection since its built-in part of the management process (i.e., plan, organize, direct, and control). Internal control keeps an organization on course toward its objectives and the achievement of its mission, and minimizes surprises along the way. Internal control promotes effectiveness and efficiency of operations, reduces the risk of asset loss, and helps to ensure compliance with laws and regulations. Theoretically therefore, an Organization with effective system of internal control is expected to achieve its objective efficiently and effectively.

Internal controls provide an independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better revenue generation (Beeler et al., 1999). According to Fadzil et al. (2005), an effective internal control system unequivocally correlates with organizational success in meeting its revenue target level. Effective internal control for revenue generation involves; regular a review of the reliability and integrity of financial and operating information, a review of the controls employed to safeguard assets, an assessment of employees' compliance with management policies, procedures and applicable laws and regulations, an evaluation of the efficiency and effectiveness with which management achieves its organizational objectives Ittner et al., (2003). Most organizations no longer set up internal control system as a regulatory requirement but also because it helps in ensuring that all management activities are appropriately carried out Kenyon and Tilton, (2006). Further, organizations are making it a point of duty to train, educate, and sensitize their employees on how to use these internal control systems since its effectiveness depends on the competency and dependability of the people using it.

Good internal control systems lead to improved recognition, assumption and prevention of risks associated with revenue collection, which is of prime importance in a sector with the particularities of revenue collection. Also competitiveness will be fostered by appropriate controls not only in the short but also in the long term. It will also help reduce the impact of unexpected events, or even to avoid them altogether, for example by means of good early warnings or scenario testing. According Mautz
A control system guarantees some reasonable assurance: to the existence of a certain degree of uncertainty that cannot be completely controlled or absorbed by the undertaking. Accepting the idea that internal control systems have to be linked with the cost of carrying out control procedures, yet they have to guarantee a reasonable degree of confidence according to the nature and extent of risks taken (Van Der Nest, 2000; Mautz and Winjum, 1981; Angelovska, 2010).

From the foregoing analysis of importance of internal control, it could be concluded that, the overall purpose of the concept is to help an organization achieve its mission, internal control also helps an organization to: promote orderly, economical, efficient and effective operations, and produce quality products and services consistent with the organization's mission, safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud. Finally is to promote adherence to laws, regulations, contracts and management directives as well as develop and maintain reliable financial and management data, and accurately present that data in timely reports.

The broader nature of public sector governance necessitates an effective internal control system in order to meet the demanding responsibilities imposed by stakeholders. Internal controls can help to improve governance processes by focusing on how values are established to ensure effective and efficient control and management of public sector entities. Such a value system requires an open government that is transparent in its dealings with a high sense of ethical behavior and fairness. The complexity of the public sector operating environment requires that the internal controls to be properly designed, well approached, and their scope reformed to ensure open, accountable and prudent decision-making with all public sector organizations.
County Governments in Kenya

Established in 47 Counties (based on the 1992 Districts of Kenya), County Governments are geographical units envisioned by the 2010 constitution of Kenya as the units of devolved Government. Their powers are provided in Articles 191 and 192, and in the Fourth Schedule of the Constitution of Kenya and the County Governments Act of 2012. This governments are responsible for: county legislation, executive functions, functions transferred from the national government, functions agreed upon with other counties and establishment and staffing of a public service. Counties in Kenya were created as a result of devolution which is principally meant to take away and re-distribute/share out the power to plan, legislate, budget and make policies for governing from the highly centralized national executive and legislature to forty seven county executives and assemblies.

Devolution aims at serving county citizens better by delivering goods and services that may not be provided by the private sector, at a price that makes them accessible to all. This is essentially a ‘public good’ concept and therefore such goods are recognized as public goods and have the characteristics of non-excludability and non-rivalness. The prices of these public goods or social necessities, like health, education and mode of public transportation, are not necessarily determined by market forces.

In the financial year 2013/2014, counties cumulatively budgeted for Kshs. 277.4 billion to finance their expenditure. This comprised of Kshs. 210 billion grant from the National Government, and Kshs. 67.4 billion to be generated from local revenue sources. In the period under review, the total revenue available to the Counties was Kshs. 40.4 billion which consisted of national shareable revenue of Kshs. 32.9 billion (81.4%), Kshs. 4.3 billion (10.8%) as locally collected revenue and a balance brought forward of Kshs. 3.2 billion (7.8%) which had remained unspent in the previous financial year. However, most counties were not able to collect much revenue as they had budgeted and this was attributed to among other factors a weak internal control mechanism.
Research Problem

Organizations continue to experience low levels of revenue generation most of which are man-made and therefore avoidable. Despite the numerous rules and regulations, the varying levels in revenue generation occur across all entities in the government and private sectors. No matter how well it is designed and operated, internal audit can only provide a reasonable, not absolute assurance that the objectives of the company’s internal control system are met in terms of revenue generation.

Over the years the public sector has been experiencing massive corruption and fraud related cases where public funds end up in the hands of corrupt individuals Adari, (2007). And in most instances such lost funds are never recovered despite having litigations against the perpetrators. Public organizations in Kenya are faced with risks emanating from internal controls weaknesses which more often than not result to financial losses for the organizations Njoroge (2003). Weak internal controls also provide avenues for fraud in these organizations Wagacha, and Ngugi (2009). According to Wagacha, and Ngugi (2009) these risks need to be identified and mitigated to ensure that imminent threats are controlled.

Ndungu (2013) studied the effect of internal controls on revenue generation in University Of Nairobi Enterprises and Services limited (UNES) and concluded that systems of internal control should be functioning as per the intended plans to help in enhancing efficiency and accurate data capturing. This will go in a long way in ensuring that revenue collection targets are attained.

Muio (2012) studied the impact of internal control systems on the financial performance of private hospitals in Nairobi and established a significant relationship between internal control system and financial performance.

Njui (2012) investigated the effectiveness of internal control and audit in promoting good governance in the public sector in Kenya and found that internal control has the greatest effect on corporate governance within Kenya government ministries followed by risk management while compliance and consulting had the least
The above researcher concentrated on internal controls and revenue collection of Kenya Revenue Authority and University Of Nairobi Enterprise and Services limited.

This research will be different from all the above mentioned as it will specifically look at effect of internal controls on revenue collection in county governments in Kenya.

This study attempts to answer question: What is the relationship between internal control systems and revenue collection by County Governments in Kenya?

1.3 Objective of Study

The objective of this study will be to establish the effect of internal controls on revenue collection in county governments.

1.4 Value of the study

The results of the study will help identify gaps within the systems of internal control in County governments in Kenya. It is also the researcher's belief that this study will benefit:-

Management and those charged with revenue collection in County Governments since they will appreciate the internal controls and come up with ways on how to streamline the systems of internal controls thus ensuring improved revenue collection thus ensuring attainment of the county objectives.

Researchers and scholars - this study will also add to the existing body of knowledge regarding internal controls and the group of individuals will be also get to know whether internal controls add value to revenue collection in county governments and will also use the findings herein as reference to other studies and further research

General public and donors-This people will be able to understand the role of internal controls in ensuring that county Governments are able to account properly for the revenue collected by them.
CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction
The chapter explains the theoretical contributions from various authors on internal audit and revenue collection. It also gives contribution of various research studies as carried out by various authors and then concludes on the general view of the various authors.

2.2 Theoretical Review
The main theoretical perspectives that have affected internal audit and revenue collection in county governments are the agency theory, transaction cost economics, stakeholders theory and stewardship theory.

2.2.1 Agency Theory
A significant body of work has built up in this area within the context of the principal-agent framework. The work of Jensen and Mecklin (2000) in particular and of Fama (2001) is important.

Agency theory identifies the agency relationship where one party, the principal, delegates work to another party, the agent. The agency relationship can have a number of disadvantages relating to the opportunism or self-interest of the agent: For example, the agent may not act in the best interests of the principal, or the agent may act only partially in the best interests of the principal. There can be a number of dimensions to this including for example, the agency misusing his power for pecuniary or other advantage, and the agent not taking appropriate risks in pursuance of the principals interests because he (the agent) views those risks as not being appropriate and the principal may have different attitudes to risks. There is also the problem of information asymmetry whereby the principal and the agent have access to different levels of information; in practice this means that the principal is at a disadvantage because the agent has more information.
The extent to which principals don’t trust their Agents will tend to determine the level of the monitoring mechanism created for the overview of agents’ activities and the extent to which agents’ compensation levels are determined to be acceptable. Upon this principle rests the foundation of auditing profession Millichamp and Taylor (2008). As mentioned in the agency theory, the problem which has always existed when managers report to owners is ‘can the owners believe the report? The report may: - contain errors, not disclose fraud, be inadvertently misleading, be deliberately misleading, fail to disclose relevant information and fail to conform to regulations. The solution to this problem of credibility in reports and accounts lies in appointing independent professionals called auditors to investigate the report and report their findings (Millichamp and Taylor, 2008).

Agency theory provides a useful theoretical framework for the study of the internal auditing function. It has been proposed that agency theory not only helps to explain and predict the existence of internal audit but that it also helps to explain the role and responsibilities assigned to internal auditors by the organization, and that agency theory predicts how the internal audit function is likely to be affected by organizational change.

2.2.2 Transaction cost economics Theory

The most well-known translation of the Coasian theory of the firm is that by Olivier Williamson and his transaction cost economics (TCE). The objective of TCE is to explain different forms of organization based on the differences in transaction costs. Williamson describes the firm as a governance structure, rather than as a production function Williamson (1996). The theory is based two assumptions; the first assumption relates to bounded rationality Simon (1976), the notion that decision makers’ capabilities are bounded in terms of formulating and solving problems and processing all information during the decision-making process. The second assumption deals with opportunism, e.g. possible conflict because individuals are promoting their own self-interest.

Transaction cost economics provides a basis for describing a contractual or transactional relationship between parties, in which each party expects something from the other Speckle (2001). This can be a relationship within the organization, but
The choice of mechanism depends on a comparative analysis of the transaction costs characteristics (i.e. asset specificity, uncertainty and frequency) Williamson (1996). TCE analyses the most economic, value preserving governance structure to infuse order, thereby to mitigate conflict and realize mutual gain Williamson (2002). Williamson argues that an internal monitor (a manager, an internal auditor) has an advantage over external monitors, as he has greater freedom of action, a wider scope, understands the language of the firm and can rely on less formal evidence Williamson (1975). With that TCE seems to imply an advantage of the internal auditor over the external auditor.

2.2.3 Institutional Theory

According to this theory by Fogarty et al. (1997), an organization is designed and functions to meet social expectations in so far as its operations are visible to the public. Therefore organizational internal operations, which are often complex and difficult to identify, may take second place to the issue of external legitimacy. It is suggested that the external image of the organization may be loosely coupled with its operating processes and the kind of technology it adopts.

Fogarty et al. (1997) developed this, asserting that the contribution of institutional theory is in the insight that the actual accomplishments of an organization and what its structure suggests should accomplish are often different. The organization 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. Fogarty (1996) observes that scrutiny by outsiders can be avoided if the right structures are adopted by organizations. Loose technological coupling enables organizations to show success in external problems whilst allowing flexibility in operational processes. Thus the institutions should be ready to meet the high cost of adopting various technologies in the internal audit department and ensure that the staffs are trained in order for the department to operate efficiently.
In internal control, the control environment sets the tone of the organization by influencing the control consciousness of its people Whittington and Pany, (2001). Control environment is the foundation for all the other components of internal control. It comprises of factors like; integrity and ethical values of personnel tasked with creating, administering, and monitoring the controls, commitment and competence of persons performing assigned duties, board of directors or audit committees, management philosophy and operating style, and organizational structure.

Internal control systems not only contribute to managerial effectiveness but are also important duties of corporate boards of directors. Accounting literature likewise emphasizes the importance of an organization’s integrity and ethical values in maintaining an effective control system Verschoor (1999). A focus on integrity and ethical values was the principal contribution of Internal Control—Integrated Framework published by the Committee of Sponsoring Organizations of the Treadway Commission on fraudulent financial reporting.

2.3.2 Risk Assessment
Risk assessment refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved. It refers to the identification and analysis of relevant risks associated with achieving the objectives of the organization Karagiorgos et al., (2009). They add that risk assessment is the process of identifying and analyzing management relevant risks to the preparation of financial statements that would be presented fairly in conformity with general accepted accounting principle. In organizations, management must determine the level of risk carefully to be accepted, and try to maintain such risk within determined levels. It is therefore the management’s responsibility to design internal controls to ensure efficiency and effectiveness, reliability of financial reporting as well as compliance with laws and regulations. This is ensured by periodic performance review and evaluation of the adequacy and effectiveness of the controls designed by the internal audit department.

An organization’s system of internal control has a key role in the assessment of risks
that are significant to the fulfillment of its business objectives. A sound system of internal control contributes to safeguarding of organizations assets. Internal control facilitates the effectiveness and efficiency of operations, helps ensure the reliability of internal and external reporting and assists compliance with laws and regulations. Whittington and Pany, (2000). A company’s objectives, its internal organization and the environment in which it operates are continually evolving and, as a result, the risks it faces are continually changing. A sound system of internal control therefore depends on a thorough and regular evaluation of the nature and extent of the risks to which the organization is exposed.

2.3.3. Information and Communication

According to Aldridge and Colbert (1994), internal control requires that all pertinent information be identified, captured, and communicated in a form and time frame that enable people to carry out their financial reporting responsibilities. Firms should adopt internal control and information systems that produce operational, financial and compliance-related information reports to make it possible to run and controls the business. Effective communications should occur in a broad sense with information flowing down, across, and up within all the sections of the organization.

The information function is the basis of management activities and the level of information processing ability is one of the most important symbols of the level of management. And this information must be delivered timely to those who fulfill its responsibility and other responsible ones in some form. Completing the information transmission is communication and it can translate the abstract goal and plans into language that encourage employees.

2.3.4 Control Activities

Control activities refer to policies, procedures, and mechanisms put in place to ensure directives of the management are properly carried out Aikins(2011); Rezaee et al., (2001). Appropriate and accurate documentation of policies and procedural guidelines helps to determine how the control activities are to be executed. Is also provides adequate information for auditors’ examination of the overall adequacy of control
This control activities should be taken with the aim to address risks so that organizational objectives are achieved. According to Rezaee et al. (2001), internal control activities occur throughout the organization. They include a range of activities like; approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of asset and segregation of duties. Most of them are made possible through the help of the internal audit function.

2.3.5 Monitoring

Monitoring refers to the process of assessing the quality of the internal control structure over time. Since internal controls are processes, it is usually accepted that they need to be adequately monitored in order to assess the quality and the effectiveness of the system's performance over time. By monitoring, the organization gets provided with assurance that the findings of audits and other reviews are promptly determined. Theofanis et al. (2011); Rezaee et al., (2001). Amudo and Inanga (2009) are of the view that monitoring of operations ensures effective functioning of internal controls system. It through monitoring that an organization determines whether or not its policies and procedures designed and implemented by management are being carried out effectively by employees.

According to Bowrin (2004), monitoring can be achieved by regularly supervising and managing activities like monitoring of customer complaints and feedback and audits conducted periodically by internal auditors. Internal auditors can investigate and appraise internal control structure and the efficiency with which the various functions are performing their assigned duties. This way, they can bring a systematic and disciplined approach for the evaluation and improvement of risk management activities and good governance process by examining of the internal controls and evaluating how adequate and effective the controls are. Monitoring ensures that the findings of audits and other reviews are promptly resolved (Rezaee et al., 2001)

2.4 Empirical Studies

Case studies on internal controls in Belgium illustrate the importance of the control environment when studying internal auditing practices. Sarens and De Beelde (2006)
Environment characteristics like tone-at-the-top, level of risk and control awareness, extent to which responsibilities related to risk management and internal controls are clearly defined and communicated are significantly related to the role of the internal audit function and fraud detection within an organization.

Mwachiro (2013) established that internal controls played an important role in ensuring revenue collection was carried out effectively. The research was conducted using both qualitative and quantitative approaches. Questionnaires were used on a population of 38 respondents in gathering primary data for the study. The data collected was then analyzed and findings have revealed that the five components of control environment, risk assessment, control activities, information and communication and monitoring must be available for internal controls to work. The study established that weak internal controls have encouraged collusion to fraud, loss of revenue and embezzlement of collected revenue. The study therefore concludes that internal controls do function although with hiccups and that there is a significant effect between internal controls and revenue collection in KRA. The internal auditors are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified.

Ewa and Udoayang (2012) carried out a study to establish the impact of internal control design on banks’ ability to investigate staff fraud and staff life style and fraud detection in Nigeria. Data were collected from 13 Nigerian banks using a Four Point Likert Scale questionnaire and analyzed using percentages and ratios. The study found that Internal control design influences staff attitude towards fraud such that a strong internal control mechanism is deterrence to staff fraud while a weak one exposes the system to fraud and creates opportunity for staff to commit fraud. In addition, most Nigerian banks do not pay serious attention to the life style of their staff members and that most staff members are of the view that effective and efficient internal control design could detect employee fraud schemes in the banking sector. The study concluded that effective and efficient internal control system is necessary to stem the malaise in the banking sector. The study therefore recommended that banks in Nigeria should upgrade their internal control designs and pay serious attention to the life style of their staff members as this could be a red flag to identifying frauds.
Spira and Page (2003) explored the change in internal control using sociological perspectives on risk and its conceptualization to frame the debate about internal control and risk management within the UK corporate governance arena. By using this method, the paper had been able to show that progresses in corporate governance reporting requirements offer chances for the misappropriation of risk and its management by groups, at the same time, enables to evaluate the current changes in Internal audit.

Ndungu (2013) researched on effects of internal controls on revenue collection by Kenya Revenue Authority and concluded that internal controls played an important role in ensuring effective revenue collection.

2.5 Summary of Literature Review

Effective internal controls include; the maintenance of proper accounting records, employee accountability, timely reporting on financial matters, risk mitigation by internal employees, effective communication among employees, efficient and effective utilization of financial and non-financial resources and information and communication technology in service delivery Emasu (2007). They help to ensure that the organization is not unnecessarily exposed to avoidable financial risks and that financial information used within the business and for publication is reliable Simiyu (2011). They also contribute to the safeguarding of assets, including the prevention and detection of fraud and misuse of organizational resources (Musa, 2010).
CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction
This chapter presented the research design and methodology that was used to carry out the research. It presented the research design, the population, sampling, data collection and data analysis.

3.2 Research Design
Research design refers to the way the study is designed, that is the method used to carry out the research Mugenda and Mugenda (2003). The study adopted a descriptive cross-sectional research design, which according to Kothari (2004), is used when the problem has been defined specifically and where the researcher has certain issues to be described by the respondents about the problem.

3.3 Population
According to Ngechu (2004), a study population is a well-defined or specified set of people, group of things, households, firms, services, elements or events which are being investigated. The target population for this study was the internal auditors and accountants in the 47 counties in Kenya. This is because they are more conversant with the subject matter of study.

3.4 Data Collection
According to Ngechu (2004), there are many methods of data collection. The choice of a tool and instrument depends mainly on the attributes of the subjects, research topic, problem question, objectives, design, expected data and results. This is because each tool and instrument collects specific data. Donald (2006) notes that there are two major sources of data used by respondents; primary and secondary data.

Questionnaires were used to obtain important information about the population. According to Sproul (1998), a self-administered questionnaire is the only way to elicit self-report on people’s opinion, attitudes, beliefs and values. The study used primary data, Primary data was collected using semi-structured questionnaires. The
questionnaires will be used because they will allow the respondents who are auditors to give their responses in a free environment and help the researcher gather information that would not have been given out had interviews being used.

3.5 Data Analysis

Data was analyzed using Statistical Package for Social Sciences (SPSS Version 20.0) program. Both quantitative analysis and regression analysis were used as data analysis technique. The data collected was run through various models so as to clearly bring out the effect internal controls on revenue collection in county government in Kenya.

The researcher also used a multivariate regression analysis to determine the relationship between the independent variables and the dependent variable. The regression equation was:

\[ R = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5 + \epsilon \]

Where,

- \( \beta_0, \beta_1, \beta_2, \beta_3, \beta_4 \) and \( \beta_5 \) are the regression co-efficient
- \( R \) - Revenue collection by County Governments in Kenya (comparison between budgeted revenue and actual revenue collected)
- \( X_1 \) - Control Environment
- \( X_2 \) - Risk Assessment
- \( X_3 \) - Information and Communication
- \( X_4 \) - Control Activities
- \( X_5 \) - Monitoring
- \( \epsilon \) = Error term

3.6 Data Validity and Reliability

Piloting was carried out to test the validity and reliability of the instruments. Validity indicates that degree to which the instrument measures the constructs under investigation. Mugenda and Mugenda (2003). A pilot study was conducted by the researcher taking some questionnaires to the audit staff in county government which was filled by some respondents at random.
CHAPTER FOUR
FINDINGS AND INTERPRETATIONS

4.1 Introduction
This chapter discusses the interpretation and presentation of the findings. This chapter presents analysis of the data on the effects of internal controls on revenue collection of county governments in Kenya. This chapter also provides the major findings and results of the study.

4.2 Response Rate
The researcher targeted the heads of internal audit in all the 47 county governments in Kenya. This is because the people in management are the most conversant with the subject matter of the study. However, out of 47 questionnaires distributed 40 respondents completely filled in and returned the questionnaires, this represented 77% response rate. This is a reliable response rate for data analysis as Mugenda and Mugenda (2003) pointed that for generalization a response rate of 50% is adequate for analysis and reporting, 60% is good and a response rate of 70% and over is excellent.

Table 1: Response Rate

<table>
<thead>
<tr>
<th>Response Rate</th>
<th>Frequency</th>
<th>percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filled in questionnaires</td>
<td>36</td>
<td>77</td>
</tr>
<tr>
<td>Un returned questionnaires</td>
<td>11</td>
<td>23</td>
</tr>
<tr>
<td>Total</td>
<td>47</td>
<td>100</td>
</tr>
</tbody>
</table>

4.3 Descriptive Statistics on Internal Control systems.

4.3.1: Descriptive statistics on Control Activities.

Table 2: Mean and Standard deviation of Control Activities.

<table>
<thead>
<tr>
<th>CONTROL ACTIVITIES</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management is committed to the operation of the system</td>
<td>36</td>
<td>3</td>
<td>5</td>
<td>4.08</td>
<td>.439</td>
</tr>
<tr>
<td>Specific lines of authority and responsibility have been established to ensure compliance with policies and procedures</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.75</td>
<td>.967</td>
</tr>
</tbody>
</table>
Revenue collection departments have budget reviews where actual revenue is compared with budgeted revenue.

<table>
<thead>
<tr>
<th>Statement</th>
<th>N</th>
<th>Mean</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue collection departments have budget reviews where actual revenue is compared with budgeted revenue.</td>
<td>36</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>There is clear separation of roles in revenue collection department.</td>
<td>36</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Policies and procedures for authorization are established at an adequately high level.</td>
<td>36</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Variances between actual and budgeted revenue are explained by management on a timely basis.</td>
<td>36</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Valid N (list wise)</td>
<td>36</td>
<td>2</td>
<td>5</td>
</tr>
</tbody>
</table>

In table 2 are details of the measures of effectiveness of the control activities under different key statements obtained from the respondents. The statements have been ranked in terms of their means and standard deviations so as to deduce meaning out of the results. Therefore, the details of the table are discussed under subheadings of the corresponding statements tested.

The study as reflected in table 2 found that the respondents seem to agree that the management is committed to the operation of the system in place with a mean value of 4.08 which appears to be close to the maximum rank of 5. However, the corresponding standard deviation value of 0.439 shows that there is a clear variation in the responses provided by the respondents about management’s commitment. Management’s commitment to the operations of the internal control system is also supported by Verschoor, (1999) where he notes that internal control systems not only contribute to managerial effectiveness but are also important duties of the corporate boards of directors. Therefore management commitment to the operations of the system is a fulfillment of their obligation as highlighted by Verschoor.

From table 2 above, respondents seemed to agree that revenue collection departments have budget reviews where actual revenue is compared with budgeted revenue as reflected by the mean value of 4.03 which is tending towards the maximum point of 5.
A standard deviation of 0.736 suggests varied responses regarding budget reviews where actual revenue is compared with budgeted revenue.

In Table 2 above, respondents seemed to agree with the statement relating to timely explanations by management on variances between actual and budgeted revenue as reflected by a mean of 4.00 which is tending towards the maximum point of 5. However, a standard deviation of 0.828 suggests varied responses regarding timely explanations by management on variances between actual and budgeted revenue collected.

A greater standard deviation figure of 1.137 raises concerns regarding clear separation of roles in the revenue collection department, this figure of standard deviation further reveals that the respondents had varied opinion about role separation in revenue collection department.

The results of the survey in Table 2 suggest that respondents seem to agree that specific lines of authority and responsibility have been established to ensure compliance with policies and procedures. However, the standard deviation of 0.967 provided by the same respondents suggests that they possess varied understanding about the aspect of specific lines of authority and responsibility have been established to ensure compliance with policies and procedures.

The results of the survey as revealed by Table 2 suggest that policies and procedures for authorization are established at an adequately high level. This is evident when the mean of respondents as computed by the system is well above the average (i.e. 3.75). Nevertheless, the corresponding standard deviation of 0.874 suggests that respondents had variations in their responses on policies and procedures for authorization are established at an adequately high level.
4.3.2: Descriptive statistics on Control Environment.

Table 3: Mean and standard deviation of Control Environment.

<table>
<thead>
<tr>
<th>CONTROL ENVIROMENT</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management closely monitors implementation of internal control system</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.83</td>
<td>.609</td>
</tr>
<tr>
<td>Management acts with a great degree of integrity in execution of their roles</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.64</td>
<td>.833</td>
</tr>
<tr>
<td>Management provides feedback to the officers about the operation of the internal control system</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.69</td>
<td>.749</td>
</tr>
<tr>
<td>Responsibilities are delegated and follow up action is made to get feedback on results of performance of all tasks delegated</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.83</td>
<td>.609</td>
</tr>
<tr>
<td>Valid N (list wise)</td>
<td>36</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In table 3 are details of the measures of effectiveness of the control environment under different key statements obtained from the respondents. The statements have been ranked in terms of their means and standard deviations so as to deduce meaning out of the results. Therefore, the details of the table are discussed under sub headings of the corresponding statements tested.

The study as reflected in table 3 found that the respondents seem to agree on the statements that the management closely monitors implementation of internal control system and responsibilities are delegated with follow up action made to get feedback on results of performance of all tasks delegated both with a mean of 3.83. The corresponding standard deviation also revealed a significant value of 0.609, this also shows that there is a clear variation in the responses provided by the respondents about the two statements.
Descriptive statistics on Risk Assessment.

Table 4: Mean and standard deviation of Risk Assessment.

<table>
<thead>
<tr>
<th>RISK ASSESSMENT</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue loss and risks have been identified by management</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.92</td>
<td>.604</td>
</tr>
<tr>
<td>Management has put in place mechanisms for mitigation of critical risks that may result from fraud</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.83</td>
<td>.697</td>
</tr>
<tr>
<td>Management has defined appropriate objectives for the organization</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.83</td>
<td>.609</td>
</tr>
<tr>
<td>Revenue collection procedures are well documented</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.39</td>
<td>.964</td>
</tr>
<tr>
<td>Measures have been put in place for risk identification</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.72</td>
<td>.779</td>
</tr>
<tr>
<td>Staff are adequately involved in internal controls</td>
<td>36</td>
<td>2</td>
<td>4</td>
<td>3.50</td>
<td>.845</td>
</tr>
<tr>
<td>Valid N (list wise)</td>
<td>36</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 4 shows details of the measures of effectiveness of risk assessment under different key statements obtained from the respondents. The statements have been ranked in terms of their means and standard deviations so as to deduce meaning out of the results. Therefore, the details of the table are discussed under sub headings of the corresponding statements tested.

From the findings, most of the respondents indicated that revenue loss and risks have been identified by management as indicated by mean score of 3.92, through risk assessment, the management has put in place mechanisms for mitigation of critical risks that may result from fraud as depicted by mean score of 3.83. Further respondents indicated management has defined appropriate objectives for the organization, revenue collection procedures are well documented, measures have been put in place for risk identification including staff are adequately involved in internal controls were effective as depicted by mean score of 3.83, 3.39, 3.72 and 3.50 respectively.
The reporting on organizational structures spells out all the responsibilities of each section/unit in the organization as indicated by mean score of 3.97, communication helps to evaluate how well guidelines and policies of the organization are working and being implemented were effective as depicted by a mean score of 3.81 in each case, further, management receiving timely, relevant and reliable reports for decision making and an effective reporting of revenue targets to be achieved in a particular year were effective as depicted by a mean score of 3.75 and 3.69 respectively.

Further table 5 shows a mean of 3.00 which is slightly below the mean average, implying that respondents disagree with the statement that all employees understand the concept and importance of internal controls, including the division of responsibility, Consequently, a higher standard deviation figure of 0.986 raises...
employees understand the concept and importance of the division of responsibility, it further reveals that the respondents had varied opinion about this statement relating to information and communication.

4.3.5: Descriptive statistics on Monitoring.

Table 6: Mean and Standard deviation of Monitoring.

<table>
<thead>
<tr>
<th>MONITORING</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are regular and periodic reviews of collections before the end of financial year report</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.94</td>
<td>.532</td>
</tr>
<tr>
<td>Internal reviews of implementation of internal controls in revenue collection units are conducted continuously</td>
<td>36</td>
<td>3</td>
<td>5</td>
<td>3.94</td>
<td>.475</td>
</tr>
<tr>
<td>There are independent process checks and evaluations of control activities on an ongoing basis</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.81</td>
<td>.668</td>
</tr>
<tr>
<td>Management assesses the system of control from time to time</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.89</td>
<td>.523</td>
</tr>
<tr>
<td>Periodically management carries out internal reviews of internal control systems in place</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td>3.86</td>
<td>.593</td>
</tr>
<tr>
<td>Valid N (list wise)</td>
<td>36</td>
<td>2</td>
<td>5</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The study sought to establish the extent to which respondents agreed or disagreed with the above statements relating monitoring as part of internal control. From the study findings as shown in table 6, most of the respondents pointed out that there were regular and periodic reviews of collections before the end of financial year report which was depicted by a mean score of 3.94, internal reviews of implementation of internal controls in revenue collection units were conducted continuously as depicted by a mean score of 3.94. In addition, the respondents agreed that the management assesses the system of control from time to time, there are independent process checks and evaluations of control activities on an ongoing basis and periodically the management carries out internal reviews of internal control systems in place as indicated by a mean score of 3.89, 3.86 and 3.81 respectively.
To establish the relationship between the independent variables and the dependent variable the study conducted inferential analysis which involved coefficient of correlation, coefficient of determination and a multiple regression analysis.

### 4.4.1 Coefficient of Correlation

Table 7: Coefficient of Correlation

<table>
<thead>
<tr>
<th>Control Activities</th>
<th>Pearson Correlation</th>
<th>Control Environment</th>
<th>Risk Assessment</th>
<th>Information and Communication</th>
<th>Monitoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sig. (2-tailed)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control Environment</td>
<td>Sig. (2-tailed) .053</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Risk Assessment</td>
<td>Pearson Correlation .243</td>
<td>Sig. (2-tailed) .154</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.757</td>
<td>.822</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Information and Communication</td>
<td>Pearson Correlation -.264</td>
<td>Sig. (2-tailed) .120</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.238</td>
<td>.402</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monitoring</td>
<td>Pearson Correlation .291</td>
<td>Sig. (2-tailed) .086</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>.389*</td>
<td>.748</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Correlation is Significant at th0.05 level (2-tailed)

### 4.4.2 Regression analysis

The coefficient of determination was carried out to measure how well the statistical model was likely to predict future outcomes. The coefficient of determination, r2 is the square of the sample correlation coefficient between outcomes and predicted values. As such it explains the extent to which changes in the dependent variable can
the independent variables or the percentage of variation in actual revenue versus budgeted revenue) that is explained by all the three independent variables (control activities, control environment, risk assessment, information and communication and finally monitoring).

Table 8: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.190&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.036</td>
<td>.089</td>
<td>3.27318</td>
</tr>
</tbody>
</table>

From the findings in the above table the value of adjusted R squared (co-efficient of determination) was 0.089 an indication that there was variation of 89% on actual/budgeted revenue collected by county governments in Kenya due to changes in aspects of internal control systems that include: control activities, control environment, risk assessment, information and communication systems and monitoring at 95% confidence interval.

Table 9: ANOVA Analysis

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Regression</td>
<td>12.051</td>
<td>5</td>
<td>2.410</td>
<td>.225</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>321.412</td>
<td>30</td>
<td>10.714</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>333.463</td>
<td>35</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 9 shows a summary of the analysis of the model. The F critical at 5% level of significance was 333.463 since F calculated is greater than the F critical (value = .225), this shows that the overall model was significant.
Table 10: Multiple Regression Analysis

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>.421</td>
</tr>
<tr>
<td></td>
<td>Control Activities</td>
<td>-.050</td>
</tr>
<tr>
<td></td>
<td>Control Environment</td>
<td>.181</td>
</tr>
<tr>
<td></td>
<td>Risk Assessment</td>
<td>.153</td>
</tr>
<tr>
<td></td>
<td>Information and Communication</td>
<td>-0.671</td>
</tr>
<tr>
<td></td>
<td>Monitoring</td>
<td>.406</td>
</tr>
</tbody>
</table>

a. Dependent variable: actual/budgeted revenue

Table 10 illustrates results of a linear regression analysis determining the effect of the independent variables (control activities, control environment, risk assessment, information and communication systems, and monitoring) on the dependent variable (actual/budgeted revenue).

Using the results, we have the regression equation as:

\[ R = .421 - .050X_1 + .181X_2 + .153X_3 - .671X_4 + .406X_5 \],

where \( Y \) is the dependent variable (revenue generation), \( X_1 \) is control activities, \( X_2 \) is control environment, \( X_3 \) is risk assessment, \( X_4 \) is information and communication systems, and \( X_5 \) is monitoring. According to the regression equation established, taking all factors into account with constant at zero, actual/budgeted revenue will be 0.421. The data findings analyzed also show that revenue generation is greatly influenced by monitoring followed by control environment and risk assessment. Taking all other independent variables at zero, a unit increase in monitoring will lead to a 0.406 percentage increase in the ratio of actual/budgeted revenue collected while a unit increase in control environment will...
result in a 0.181 percentage increase in the ratio of actual/budgeted revenue collected by county governments in Kenya.

4.5 Summary and Interpretation of Findings

According to Hayes et al. (2005), the internal control system comprises five components which are: the control environment, risk assessment process, the information and communication systems, control activities and the monitoring of controls. Internal controls are essential to an organization's success and survival because they provide reasonable assurance on the achievement of objective in a number of categories including: effectiveness and efficiency of operations; reliability in financial reporting; and compliance with applicable laws and regulations (Chambers, 2009).

The study found that assessment of internal control framework from time to time, internal reviews of implementation of internal controls in revenue collection units, independent process checks, regular and periodic reviews of collections before the end of the financial year were an effective aspect in monitoring due to application of internal controls. Amudo and Inanga (2009) add that monitoring of operations ensures effective functioning of internal controls system. It is through monitoring that an organization determines whether or not its policies and procedures designed and implemented by management are being carried out effectively by employees. Doyle et al. (2007) and Millichamp (2002) add that internal control is a whole system of controls established by the management for the business entity to check the conduct of the business in terms of internal check, internal audit and other forms of control.

From the findings the study revealed that there was greater variation in revenue collected by county governments in Kenya due ineffectiveness in the information and communication systems. A greater variation in revenue collected could be accounted for by employees not understanding the concept and importance of internal control systems, including the division of responsibility, presence of an effective reporting of targets to be achieved in a particular financial year and management receiving timely, relevant and reliable reports for decision making. This is not in line with Aldridge and Colbert (1994), who state that internal controls require that all pertinent information be identified, captured and communicated in a form and time frame that enable people to carry out their financial reporting responsibilities. The management
From the study, it has also been revealed that management has identified individuals who are responsible for coordinating the various activities within the entity. The reporting system on the organizational structures spells out all the responsibilities of each section/unit in the organization. Information must be communicated throughout the entire organization in order to permit personnel to carry out their responsibilities with regard to objective achievement (Amudo and Inanga, 2009). All employees understand the concept and importance of internal controls, including the division of responsibility.

From the study, it was found that control activities as an aspect of internal control systems were also ineffective in revenue collection by since a decrease in control activities lead to a decrease in actual/budgeted revenue by county governments in Kenya by factor of 0.050. This clearly indicated that there existed a negative relationship between some factors affecting revenue collection by county governments clearly indicating that there was lack of well-designed system of control activities and information and communication systems. This implied clearly that the internal control systems in county governments need to be improved.

From the findings, the element of control environment in the internal control systems did also contribute effectively in the revenue collected by county governments. A unit increase in the control environment led to an increase of 0.081 in the ratio of actual/budgeted revenue by county governments in Kenya. This was facilitated by the fact that the management did closely monitor implementation of internal control systems, the management also did act with a greater degree of integrity in their role execution, there was feedback from the officers about operations of the internal control systems and finally there was delegation of responsibilities and follow up by management.
The study found that close monitoring implementation of internal control systems and delegation of responsibilities and follow up actions on feedback of results of performance of all tasks delegated were very significant in influencing the control environment as indicated both by a mean of 3.83.

From the findings, the study further revealed that revenue loss and risks had been identified by management as indicated by mean score of 3.92, through risk assessment, the management had also put in place mechanisms for mitigation of critical risks that may result from fraud as depicted by mean score of 3.83. This is consistent with Spira and Page (2003) who found that the internal control systems 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. Jackson (2000) also observed that the idea of risk had become essential to the idea of internal control systems.

The findings of this study are consistent with those of Ndungu, (2013) where internal control systems played a significant role in revenue generation in UNES. Mwachiro, (2013) also concluded that there was a positive relationship between internal control systems and amount of revenue collected by KRA.
CHAPTER FIVE
SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The study sought to evaluate the effect of internal controls on revenue collection in County governments in Kenya. The objective was to establish the effect of internal controls on revenue collection in county governments in Kenya.

A descriptive cross-sectional design method was preferred for this study. The target population of this study targeted the heads of internal audit all the 47 county governments. The research design that was employed in this study is descriptive design. The study population was the heads of internal audit in the 47 county governments in Kenya during the financial year 2013/2014.

The study collected both primary and secondary data on the current state of affairs. The research was both quantitative and qualitative in nature. This implies that both descriptive statistics and conceptual content analysis were employed. The researcher also used a linear regression analysis to determine the relationship between the independent variables and the dependent variable. Collected raw data was cleaned and edited for completeness and consistency. Statistical Package for Social Sciences (SPSS, v. 21) was used to aid in quantitative data analysis in this study. The results were presented in tables. Qualitative data from the open-ended questions was analyzed through content analysis. The output for this study was presented using descriptive statistics like the mean score and standard deviation.

The study concludes that monitoring had the greatest effect on revenue collection in county governments in Kenya government followed control environment while information and communication had the least effect. The study recommends that the county government should recognize contributions of internal control systems. Additionally, the study recommends that the county governments should apply internal control systems in their operation to effectively ensure that revenue collected meets the targets set. Likewise the study recommended that county government should put in place proper internal control systems as tool for effective revenue collection so as to realize their objectives set with ease.
The study revealed that monitoring of the internal control system was an important aspect in ensuring that there was not a big variance between actual and budgeted revenue by the county governments in Kenya. Monitoring plays a number of roles in supporting the internal control systems by ensuring that management assesses the systems from time to time, internal reviews of implementation of internal controls in revenue collection units are conducted continuously, there are independent process checks and evaluations of control activities on an ongoing basis, there are regular and periodic reviews of collections before the end of the financial year report and periodically, management carries out audit reviews of the internal control systems in place.

On information and communication as an element of internal control system, the study concluded that all employees understand the concept and importance of internal controls, including the division of responsibility, there is effective reporting of revenue targets to be achieved in a particular financial year, management receives timely, relevant and reliable reports for decision making, communication helps to evaluate how well guidelines and policies of the organization are working and being implemented and the reporting system on organizational structure spells out all the responsibilities of each unit/section in the organization making process were not effective.

The study concluded that revenue loss and risks had been identified by the management for the benefit of the County governments. Management has put in place mechanisms for mitigation of critical risks that may result from fraud. Management had also defined appropriate objectives for the entire organization, revenue collection procedures were well documented, measures were in place for risk identification and staff were adequately involved in internal controls.

### 5.3 Limitations of the Study

The researcher encountered various limitations that were likely to hinder access to information that the study was looking for. The main limitation of study was its inability to get information from all the county governments in Kenya. Lack of
Reluctance to respond to questionnaires was also a factor that led to failure of collecting all the required data for the study. This was due to some reservations held by the target population. This hence would have led to generalization during the analysis and presentation of the data made from those who responded to represent the views of the rest of the respondents. The researchers countered the limitation by making prior arrangements with the respondents as well as making personal calls and visits to remind the respondents to fill in the questionnaire.

The information given by respondents was uncontrollable and not sure if it was true or false. The respondents were explained to that the information would only be used for education purpose. This allowed them to be confident that they would not be persecuted of the information they gave.

### 5.4 Policy Recommendations

Since it was evident in the study, that the control activities were not effective, the management should ensure that aspects relating to control activities should be enhanced so as to ensure attainment of objectives. The management should be committed to operations of the system, establish policies and procedures for authorizations at an adequately high level, ensure specific lines of authority and responsibility have been established to ensure compliance with policies and procedures, ensure clear separation of roles in revenue collection department, train staff on implementation of the accounting and financial management system and finally ensure that variances between actual and budgeted revenue are explained by management on a timely basis.

Additionally, the study recommended that for the county governments to effectively attain their revenue collection target, they should ensure that information and communication system as an element of internal control system is well managed in the revenue collection departments so as to enable all parties within the department to freely access and utilize the official information.
5.5 Suggestions for Further study

The study suggests that further research to be done on the effect of internal controls on revenue collection public institutions such as parastatals and the National government agencies in order to give both negative and positive sides that can be reliable.

The study also suggested further research to be done on effectiveness of internal controls on revenue generation of the private organization in order to depict reliable information that illustrates real situation in both public and private sector organizations.

The study further recommends that research should be done on the challenges to effective performance of internal control systems in the Kenyan public sector since the departments are bogged with myriad challenges.

The study also suggests that research on impact of internal control on operational efficiency of county governments in Kenya should also be carried out since the county governments need to be operating efficiently for proper service delivery.
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APPENDICES

Appendix 1: Letter of Introduction

Musya Faith Mawia
School of Business,
University of Nairobi,
P.O. Box 30197 Nairobi

Dear Respondent,

RE: REQUEST FOR RESEARCH DATA.
I am a student pursuing a Master’s degree in Business Administration at the University of Nairobi. In partial fulfillment of the requirements to the award of the Master’s degree, I am required to carry out a study on “Effects of Internal Controls on Revenue Collection of County Governments in Kenya”.

You have been selected to form part of those to provide the necessary data needed for this study. You are therefore kindly requested to assist by granting an opportunity for the filling in of the attached questionnaire at your convenience when contacted for an appointment. The information you provide will be treated in strict confidence and is purely for academic purpose. Your assistance and cooperation will be highly appreciated.

I thank you in advance for your co-operation.

Yours faithfully,

MUSYA FAITH MAWIA
MBA Student – UoN
Appendix I

I: Questionnaire

To what extent do you agree with the following statements regarding Internal Control System? Use a scale of 1-5, Where, 1 = strongly disagree; 2 = disagree; 3 = not sure; 4= agree; and 5= strongly agree.

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<tr>
<th>CONTROL ACTIVITIES</th>
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<td>Management is committed to the operation of the system</td>
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<td>Policies and procedures for authorizations are established at an adequately high level</td>
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<td>Specific lines of authority and responsibility have been established to ensure compliance with the policies and procedures.</td>
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<td>There is clear separation of roles in revenue collection department</td>
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<td>Staff are trained to implement the accounting and financial management system</td>
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<td>Revenue collection departments have budget reviews where actual revenue is compared with budgeted revenue.</td>
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<td>Variances between actual and budgeted revenue are explained by management on a timely basis</td>
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<th>CONTROL ENVIRONMENT</th>
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<td>Management closely monitors implementation of Internal control systems.</td>
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<td>Management acts with a great degree of integrity in execution of their roles</td>
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<td>Management provides feedback to the officers about the operation of the internal control system</td>
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<td>Responsibilities are delegated and follow up action is made to get feedback on results of performance of all tasks delegated</td>
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<th>RISK ASSESSMENT</th>
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<tr>
<td>Revenue loss and risks have been identified by management.</td>
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<td>Management has put in place mechanisms for mitigation of critical risks that may result from fraud</td>
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<td>Management has defined appropriate objectives for the organization.</td>
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<td>Revenue collection procedures are well documented</td>
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Measures have been put in place for risk identification in internal controls

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<tr>
<th>INFORMATION AND COMMUNICATION SYSTEMS</th>
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<tr>
<td>All employees understand the concept and importance of internal control systems including the division of responsibility</td>
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<td>There is effective reporting of revenue targets to be achieved in a particular financial year</td>
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<td>Management receives timely, relevant, and reliable reports for decision-making</td>
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<td>Communication helps to evaluate how well guidelines and policies of the organization are working and being implemented</td>
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<td>The reporting system on organizational structures spells out all the responsibilities of each section/unit in the organization</td>
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<td>Management assess the system of control from time to time</td>
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<td>Internal reviews of implementation of internal controls in units are conducted continuously</td>
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<td>There are independent process checks and evaluations of control activities on an ongoing basis</td>
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<td>There are regular and periodic reviews of collections before the end of financial year report</td>
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<td>Periodically, management carries out reviews of internal control systems are in place</td>
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Thank you for your cooperation
Appendix III: List of Counties in Kenya

1) Baringo County
2) Bungoma County
3) Bomet County
4) Busia County
5) Elgeyo Marakwet County
6) Embu County
7) Garrisa County
8) Homa Bay County
9) Isiolo County
10) Kajaido County
11) Kakamega County
12) Kericho County
13) Mombasa County
14) Kirinyaga County
15) Kisumu County
16) Kitui County
17) Kilifi County
18) Kwale County
19) Laikipia County
20) Lamu County
21) Mandera County
22) Machakos County
23) Makueni County
26) Migori County
27) Kisii County
28) Muranga County
29) Nakuru County
30) Nairobi County
31) Kiambu County
32) Nandi County
33) West pokot county
34) Narok County
35) Nyamira County
36) Nyandarua County
37) Nyeri County
38) Samburu County
39) Siaya County
40) Taita Taveta County
41) Tana River County
42) Tharak Nithi County
43) Trans Nzoia County
44) Turkana County
45) Uasin Gishu County
46) Vihiga county
47) Wajir county