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Internal Audit Function And Financial Accountability Of Laikipia County Government, Kenya: Application Of Internal Audit Independence

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Abstract:
The public sector has experienced a growing demand for accountability and the need to optimize value within the constraints of limited resources. This research sought to assess the effect of internal audit function on financial accountability in the county government of Laikipia, Kenya. The specific objective of the study was to evaluate the effect of independence of the Internal Audit function on financial accountability of Laikipia County Government. The study targeted 105 employees working in the finance and economic planning department. Out of these, a sample of 51 employees were chosen and 48 questionnaires were duly filled and qualified for analysis. Data was gathered, sorted, coded, and entered on SPSS for analysis. Descriptive statistical analysis was applied to provide a summary of the data using mean as well as standard deviation metrics. Correlation and multiple regression analysis were employed to explore relationships and provide insights into the variables. The outcomes were presented using tables and charts. The questionnaire was found to be reliable, and the data was normally distributed and homogeneous, with no intercorrelation between the variables under study. The model adopted in the study was confirmed significant using ANOVA. Independence of the audit function was found to be a positive and significant predictor of financial accountability. The study recommended that policymakers should: enhance the independence of the audit function in Laikipia County Government by structurally separating the internal audit section from the Finance and Economic Planning department to strengthen its oversight capacity; implement measures to manage conflicts of interest, minimize management interference, and ensure adherence to auditing standards. To enhance effective financial accountability in the public sector, future research should examine factors influencing internal audit effectiveness.

Key Word: *Internal Audit Function, Internal Audit Independence, Financial Accountability, County Government*

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I. Introduction

Background of the study

The fundamental goal of public sector organizations is to enrich the well-being of society, spanning across key sectors including health, education, agriculture, security and various other domains. In recent times, the public sector has faced mounting pressure for accountability and a growing demand for enhanced value while optimizing resources. Accountability, an essential element in management, entails the responsibility to answer for the duties assigned to an individual, entity, or group (Postula, *et al.*,2020). Mohamed and Samson (2022) characterize it as a process wherein entities and individuals embrace responsibility and ownership for their decisions, actions, and performance outcomes, willingly subjecting themselves to both internal and external scrutiny. This accountability is often demonstrated through periodic financial reports, which serve as a means of transparency and accountability for the resources of an institution (Zeyn, 2018).

According to Nurdiono and Rindu (2018), achieving accountability requires a clear understanding of roles and obligations by all parties involved. In Kenya, the paramount duty of ensuring the integrity and effective management of public resources rests upon the accounting officers of ministries, departments, and agencies (MDAs), as well as upon members of parliament, county assembly representatives, and other public officials. Auditing is deemed as a crucial link in that chain of accountability as it enhances accountability both upward to the national government, which provides resources, and outward to the taxpayers and the larger community.

Internal Audit

The audit function has always been viewed as a monitoring unit, sometimes referred to as the "organizational watchdog or policeman" (Nkwasibwe,2022). The function was accepted as a crucial element of organizational oversight; however, it was perceived as being subordinate to the attainment of primary business goals. Quality internal audit, as supported by Gharbaoui and Chraibi (2021) and Çakali and Baloğlu (2022), goes beyond identifying misstatements; it involves the auditor's willingness to disclose any misstatements discovered during the audit. The ability to detect misstatements reflects the competency of an auditor, while the willingness to report them demonstrates ethics and auditor integrity, particularly in terms of independence. Combining auditor competence and ethical principles ensures that internal audits effectively contribute to enhancing organizational processes and ensuring reliable financial reporting

Financial Accountability

At its core, financial accountability encompasses the duty of an organization to use allocated funds efficiently and transparently, instilling confidence among stakeholders (Chanua & Kithinji, 2019, Adeyemi & Olarewaju, 2019). According to Gabriel and Aduda (2021), financial accountability can be described as the act of reporting operational performance to its stakeholders. In their study, they underscore the criticality of five essential actions that are indispensable for achieving successful financial accountability: the delineation of roles; clarification of responsibilities; the establishment of explicit performance targets; managing expectations; and maintaining balanced capacity. These measures ensure effective financial management and transparency, leading to better outcomes for the institution and all stakeholders involved. According to studies by Chanua and Kithinji (2019), Zeyn (2018), and Gabriel and Aduda (2021), internal audits are a crucial tool for enhancing financial responsibility in firms. Internal audits help organizations monitor and assess their financial practices, leading to enhanced transparency and responsible financial management.

Laikipia County Government

The county government of Laikipia is one of the forty-seven counties established in line with Kenya's 2010 constitution. Laikipia County is endowed with diverse natural resources, including fertile lands and abundant wildlife, which serve as foundational pillars for a range of economic activities. To catalyze economic growth, attract investments, and provide essential services, achieving and maintaining financial sustainability and accountability within the County Government is of paramount importance. However, a recurring concern emerges from the consistent issuance of qualified opinions on the financial reports of the Laikipia County Government as evidenced by Auditor General reports from 2016/2017, 2017/2018, 2018/2019, 2019/2020, and 2020/2021. According to Infotrak (2020), Laikipia County performance index declined from 52.8% in 2015 to 45.7% in 2020. This substantial decrease raises concerns about the county overall financial governance and accountability. The decision to center this study on the Laikipia County Government, rather than any other county in Kenya, is motivated by the imperative to address the unique decline in this region and provide targeted insights to resolve issues that are specific to this locality.

Statement of the problem

The Laikipia County Government, like many other public organizations, has encountered challenges in overseeing its financial affairs and ensuring transparent utilization of public funds. In the 2020-2021 financial year, the Auditor General report highlighted that the Laikipia county government had amassed unpaid bills totaling Kshs. 709,664,227. A review of the pending bills schedules and aging analysis disclosed that certain bills had remained unpaid for an extended period, with some originating from as far back as the 2016/2017 financial year. Further, the county government is reported to have rejected bills equivalent to one billion as the authenticity was questionable due to a lack of verifiable support documentation. As a result, suppliers and contractors who did business with the County Government as of the period are exposed to potential losses over county financial accountability hurdles. According to CoK, 2010, chronic financial difficulty in a County Government may result in a takeover by the National Government. Such a sweeping takeover could inadvertently undermine the strides made in devolution and self-governance, as highlighted by Bii and Langat (2022). While County Governments are mandated to establish internal audit functions, concerns have been raised about the efficacy of internal auditing in fulfilling its oversight obligations and fortifying financial accountability.

Studies have shown an increasing interest in financial accountability both internationally and locally (Zeyn, 2018; Nkwasibwe,2022; Ojili *et al*,2022). However, there is a noticeable oversight in emphasizing the crucial role of audit as a foundational element of corporate governance, especially in shaping accountability within Kenyan County Governments. The study therefore aims at deepening understanding of the link between internal audit function and financial accountability in Laikipia county government, Kenya, as well as offer insights that can support more effective governance and management of financial resources in public entities.

Objectives of the study

General Objective

The main objective of this study was to determine the effect of the Internal Audit function on the Financial Accountability of Laikipia County Government, Kenya.

Specific Objectives

The specific objective of the study was to evaluate the effect of independence of the Internal Audit function on the financial accountability of the Laikipia County Government, Kenya.

Conceptual Framework

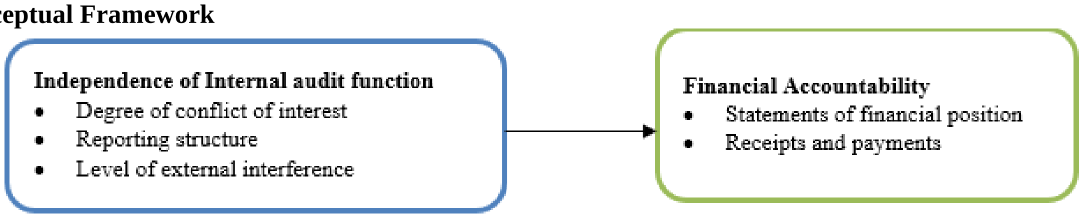

Figure 1: Conceptual Framework

II. Literature Review

Theoretical Review

Agency theory

An agency relationship emerges when one or more individuals (the principal) designate another individual to serve as their agent, responsible for performing a task on their behalf. In this arrangement, the principals (citizens) entrust specific decision-making authority to the agent (elected officials and/or management), authorizing them to act in the best interests and pursue the principals (citizens)'s goals. However, conflicts of interest between principals and agents are common due to differences in goals, interests, and information. Agency issues occur when managers fail to commit to carrying out the County Government's mandate and instead put their own interests first.

Due to the issues of moral hazard and information asymmetry in agency theory, Kibor and Kiprop (2019) contend that an agent may employ a range of techniques, such as the diversion of time, materials, and financial resources, to serve their own interests. Moral hazard issues deal with the agent's desire to cheat the principal, whereas information asymmetry, as described by Ahmed and Nganga (2019), pertains to the differences in information possessed by the principals as well as their agents. Because of information imbalances and conflicting motivations among agents, principals may lose trust in their representatives.

In this study, agency theory anchors the internal audit function as a governance framework. It helps principals align their interests and improves understanding of internal audit in supporting an entity's financial accountability. The agency theory serves as the foundational basis for instituting the internal audit function within the governance framework explored in this study. This not only results in the realignment of the principal's interests but also facilitates a comprehensive comprehension of the integral role that internal audit assumes in upholding an entity's financial accountability.

According to Agency Theory, an agency relationship emerges when one or more individuals (the principal) designate another individual to serve as their agent, responsible for performing a task on their behalf. In this arrangement, the principals (citizens) entrust specific decision-making authority to the agent (elected officials and/or management), authorizing them to act in the best interests and pursue the principals (citizens)'s goals. However, conflicts of interest between principals and agents are common due to differences in goals, interests, and information. In this study, agency theory anchors the internal audit function as a governance framework.

Empirical Review

Independence stands as the core of auditing. As defined by Ojili *et al.* (2022), audit independence is the capacity internal auditor to execute responsibilities without interference. Both in fact and in appearance an auditor must remain separate from personnel and operational functions of an organization (Angmor & Diaboh, 2022). This ensures the auditor's ability to operate autonomously and impartially within the scope of the task, safeguarding the credibility of their opinions, conclusions, and recommendations. In essence, independence is essential for successfully carrying out internal audit mandates. This autonomy stems primarily from two fundamental features: organizational status and objectivity Abdi (2022).

Independent internal audit departments are better equipped to identify and address financial risks. Kiplangat and Theuri (2021) research argued that organizations with independent internal auditors are more proactive in assessing and mitigating financial risks, leading to improved overall financial accountability. Kiplangat and Theuri (2021) explored the elements of audit committees, risk management, independence, and internal controls. The researchers acquired primary data from five SACCOS in Kericho County Kenya. Auditor independence was shown to have the poorest link with financial performance. While these findings are immensely significant for cooperative organizations, they may have limited direct relevance to county governments.

As per Boutena and Chraibi (2022), internal audit units not unduly swayed by financial interests or senior management are better positioned to deliver impartial assessments of financial practices. The researchers assert that independent auditors, unaffected by personal or organizational interests, can accurately identify potential risks and deficiencies. The findings of the study indicate that internal auditor independence plays a role in influencing the profitability, liquidity, and solvency of Moroccan listed banks. However, it was noted that the correlation between auditor independence and the profitability of these banks was weak. The study focused on commercial banks which operate with distinct goals and objectives compared to the public sector.

Organizations with independent internal audit functions tend to exhibit stronger compliance with regulations, codes of ethics, and best practices, enhancing stakeholder trust and financial accountability (Kiema *et al.*,2015). The researcher was investigating the effect of accessibility of records, reporting lines, and auditor qualifications. The study found that some internal auditors were not given the proper independence to provide insightful opinions on the financial statements, which explained the dismal performance of the surveyed enterprises. The study focused on commercial institutions which differ from the unique context of county governments.

III. Methodology

Research Design, Population and Sampling

This study used a descriptive research design. The study targeted 105 employees working in the finance, county planning, and development department in Laikipia County Government, Kenya. A sample of 51 respondents was selected using Yamane (1967) formula.

Table 1: Sample Size Distribution

Departments	Target Population	Sample Size	%
Accounting services and financial reporting	45	22	43%
Economic Planning, monitoring and evaluation	12	6	11%
Budgeting	7	3	7%
Internal Audit	7	3	7%
Supply chain management and asset management	34	17	32%
Total	**105**	**51**	**100%**

Data Collection and analysis

Primary data was gathered using a standardized questionnaire, sorted, coded, and entered on SPSS for analysis. Correlation and multiple regression analysis were employed to explore relationships and provide insights into the variable. The following regression model was adopted by the researcher.

$$Y= \beta_0+\beta_1 X+ \varepsilon$$

Whereby:
Y = Financial Accountability;
$\boldsymbol{\beta_0}$ **=** Constant ;
$\mathbf{X_1}$ =Independence of Internal Audit ;
E **=** Error term.

IV. Research Findings

Reliability Test Results

The study variable exceeded the predetermined Cronbach alpha cut-off point of 0.7 demonstrating existence of good internal consistency. Therefore, the questionnaire used in this study was deemed reliable for gathering data on the variable.

Table 2: Reliability Test Results

Variable	Cronbach's Alpha	No. of Items	Comment
Independence of Internal Audit Function	0.801	10	Reliable

Response Rate

Ojili *et al.* (2022) suggest that a 60% response rate is adequate for data analysis and inference about the phenomenon under study. Of the 51 distributed questionnaires, 48 were dully filled and deemed suitable for analysis, representing a response rate of 94.12%.

Descriptive Statistics
Independence of Internal Audit Function

To assess the effect of independence on financial accountability, the respondents were asked to rate their agreement with given statements.

Table 3: Descriptive Statistics on Independence of Internal Audit Function

Statement	N	Mean	Standard deviation
Internal auditors' independence enhances organizational financial accountability	48	4.16	0.241
The County Government administration does not interfere with the responsibilities of internal auditors.	48	2.99	0. 766
Conflicts of interest among internal auditors' impact financial accountability of an entity	48	3.81	0.605
Internal auditors at County Government ensures the absence of conflicts of interest in executing their mandates.	48	3.28	0.423
Interference by senior management in internal audit operations from external sources has an adverse effect financial accountability	48	3.98	0.652
Internal auditors maintain impartiality by having no family ties with top management.	48	2.99	0.305
Internal auditors possess the necessary integrity to fulfil their obligations effectively	48	3.12	0.805
The integrity of internal auditors positively impacts financial accountability.	48	3.65	0.783
Internal auditors perform their duties impartially and without being intimidated by management.	48	2.78	0.267
Financial accountability suffers when management intimidates internal audit staff	48	3.98	0.180
Composite Figure		**3.47**	**0.503**

The majority of respondents (M=4.16, SD=0.241) agreed that internal auditor independence improves financial accountability. However, respondents showed a neutral stance regarding the level of interference by county government management in internal auditors' responsibilities (M= 2.99, SD= 0. 766). This finding mirrors the results of studies conducted by Nankunda (2018), Mursida and Setiyono (2021), and Ojili *et al* (2022), all of which observed that management frequently limits the scope of internal audits in numerous county governments.

The respondents were asked whether conflicts of interest among internal auditors impact the financial accountability of an entity. The statement was widely agreed upon by the majority (3.81) of respondents, with a standard deviation of 0.605. When asked about whether auditors in their county ensure the absence of conflicts of interest, the majority of respondents (M = 3.28, SD = 0.423) expressed indifference.

Most respondents (M = 3.98, SD = 0.652) agreed that external interference in internal audit operations negatively affects financial accountability. When asked whether Internal auditors maintain impartiality by having no family ties with top management many were indifferent (M=2.99, SD=0.305).

Most of the respondents (M = 3.65, SD = 0.783) suggested that upholding the integrity of internal auditors positively influences financial accountability. However, when questioned about whether auditors in their county possess the required integrity to fulfill their obligations effectively, the majority of respondents exhibited indifference (M=3.12, SD=0.805). This suggests a potential disparity between the perceived importance of integrity in internal auditors and the confidence in the actual integrity of internal auditors within the county.

A significant majority of respondents (M=3.98, SD=0.180) agreed that management threats have a detrimental effect on financial accountability. Moreover, a considerable number of respondents (M=2.78, SD=0.267) disagreed with the notion that internal auditors perform their duties impartially and without intimidation from management. This finding aligns with previous studies conducted by Angmor and Diaboh (2022), Bilal *et al.* (2018), and Ojili *et al*. (2022). When internal audit staff face threats or intimidation from management, it can create conditions where they feel compelled to generate subjective or biased reports. This pressure may compromise the objectivity and integrity of the audit process, potentially resulting in fraudulent activities going undetected or inadequately addressed. As a consequence, county governments may suffer significant financial losses due to undetected fraud or mismanagement of resources.

Financial Accountability

The table below shows the average rating and standard deviation of financial accountability in the Laikipia county government as of the time of the study.

Table 4: Descriptive Statistics on Financial Accountability

Statement	N	Mean	Standard deviation
The financial statements accurately represent the true and fair position of the county government	48	3.14	1.077
All transactions are accompanied by relevant supporting documents.	48	3.09	0.963
Financial statements are presented fairly in accordance with statutory and legal obligations	48	3.91	0.071

Creating financial statements in line with statutory and legal prerequisites enhances financial accountability.	48	3.87	0.441
Financial statements provide stakeholders with transparent and verifiable information.	48	3.46	0.698
The county has implemented adequate safety measures to protect all its assets.	48	2.45	0.198
Implementation of safety measures to protect assets has a positive impact on financial accountability.	48	3.85	0.317
Asset losses are investigated and addressed.	48	3.09	0.412
Audits enhances the ability timely achievement of the goals and objectives of the county government	48	3.98	0.011
The county government's financial reports are prepared with great transparency.	48	3.46	0.698
Composite Figure		**3.43**	**0.489**

The study aimed to assess perceptions of the respondent on whether annual reports and financial statements accurately portrayed a true and fair view of the financial status of their county government. Majority of respondents (M=3.14, SD=1.077) expressed indifference on this matter. This finding was consistent with the results of the question on whether all transactions are accompanied by relevant supporting documents, where respondents also expressed indifference (M=3.09, SD=0.963). These findings collectively suggest concerns about the completeness and accuracy of financial reporting within the county governments. It indicates doubts regarding whether fraudulent activities are fully disclosed in the annual reports and financial statements.

All county governments in Kenya are provided with a standardized reporting template by the National Treasury through the Public Sector Accounting Standards Board (PSASB). The researcher aimed to understand the respondents' perception regarding whether creating financial statements in line with statutory and legal prerequisites enhances financial accountability. The majority of respondents agreed with this notion (M=3.87, SD=0.441). Similarly, when asked whether the financial statements are presented fairly in accordance with statutory and legal obligations, the majority of respondents also agreed (M=3.91, SD=0.071).

However, when queried about whether the financial statements provide verifiable and transparent information to stakeholders, the respondents were indifferent (M=3.46, SD=0.698). This suggests a lack of consensus among respondents regarding the clarity and reliability of the information presented in the financial statements. It underlines the importance of enhancing transparency and clarity in financial reporting to ensure that stakeholders have access to all necessary information in a manner that is easily understandable and verifiable.

According to the majority of respondents (M=3.85, SD=0.317), the asset protection measures deployed by entities including counties influences financial accountability positively. On the adequacy of safety measures implemented to safeguard county assets, respondents expressed indifference (M = 2.45, SD = 0.198). Similarly, when asked whether asset losses are investigated and addressed the respondents were indifferent (M=3.09, SD=0.412). This indicates there is a possibility for assets to be lost in the County Government without proper accountability. There is a need therefore for the county government to put in place better controls and continue monitoring its adequacy as per the Asset Management policy issued by the National Treasury.

Respondents were asked whether audits enhance the ability of county government to achieve their goals and objectives on time. According to the majority of respondents (M=3.98, SD=0.011), county governments need to support a suitable audit environment in order to guarantee the efficacy and sufficiency of the audit function. As noted by Zeyn (2018), the internal audit function can significantly contribute to proper governance and financial accountability when provided with a conducive environment. Creating such an environment, as suggested by Nkwasibwe (2022), involves providing sufficient resources, support, and autonomy to internal auditors, as well as fostering a culture that values and prioritizes internal audit activities in alignment with the goals and objectives of the county government.

Inferential Statistics

Inferential statistics employed in this study included correlation analysis, Analysis of Variance (ANOVA) together with regression analysis.

Correlation Analysis

To test for significant relationships between the variable, the researcher performed Spearman's rank-correlation coefficient test. Khanyile (2017) explains that Spearman's rank-correlation coefficient is employed to measure correlations in nominal and ordinal data. Positive coefficients indicate a direct relationship, while negative coefficients indicate an inverse relationship. The Spearman's rank correlation coefficients obtained are presented below.

Table 5: Spearman's rank-correlation coefficient results

Independence of Internal Audit function	Correlation Coefficient	.704**
	Sig.(2-tailed)	.000
	N	48

The findings indicates a significant positive relationship between the independence of the internal audit function and financial accountability (Correlation coefficient of $r = 0.704$, $p < 0.01$ level). This indicates that the independence of the internal audit function significantly determines the financial accountability of Laikipia County Government.

Regression Analysis

Regression analysis was conducted to explore the link between the internal audit function and financial accountability in Laikipia County Government, Kenya.

Table 6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.489[a]	.316	.302	.203
a. Predictors: (Constant), Independence of Internal Audit Function b. Dependent Variable: Financial Accountability				

The adjusted R squared was 0.302 which meant that about 30.2% of the change in Financial Accountability in Laikipia County could be explained by independence of the Internal Audit Function. The remaining 69.8% of the variation in financial accountability may be explained by other factors not included in the model.

Analysis of Variance (ANOVA)

To evaluate the statistical significance of the regression model, an ANOVA test was conducted. The ANOVA test was performed at a significance level of 5%, where the alpha value (α) was subsequently compared to the p-value to determine the significance of the model. The findings of this analysis are presented below.

Table 7: ANOVA Results

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.932	4	.373	9.056	.0000[b]
	Residual	13.062	44	.154		
	Total	14.994	48			
a. Dependent Variable: Financial Accountability						
b. Predictors: (Constant), Independence of Internal Audit Function						

As shown in Table 7 above, the F statistic is 9.056 with a p-value of 0.00 and a p-critical value of 0.05. The p-value is less than the p-critical($p=0.0001<0.05$), hence the model is confirmed significant at a 5 percent significance level. This implies that the independence of Internal Audit Function is therefore deemed suitable to predict the financial accountability of Laikipia County, Kenya.

Regression Coefficients

The results of the regression model are shown in the following table.

Table 8: Regression Model Results

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	2.179	.329		.500	.000
Independence of Internal Audit function	.421	.114	.427	3.705	.029

The regression coefficient of independence of the internal audit function had a positive and significant effect on the financial accountability of Laikipia County Government ($\beta = 0.421$, p-value = 0.029). This indicates that enhancing the independence of the audit function will strengthen the financial accountability of the County government. The regression equation can therefore be written as follows.

Financial Accountability (Y) = 2.179+0.421X

These results are in line with Ojili *et al.* (2022), who suggested that better financial accountability is linked to the internal audit function's effectiveness, which is supported by its independence, a clear reporting line, and sufficient budget allocation. Similar findings on accountability of public funds were reported Nankunda (2018) on local government in Uganda.

V. Conclusion

Summary

The effect of the independence of the audit function was assessed based on factors like conflict of interest, reporting structure, and external interference. The findings revealed that the management in the county government often interferes with the responsibilities of internal auditors. The internal auditors were also reported to lack impartiality due to familial ties with top management. They were reported to sometimes perform duties partially under management influence. The correlation analysis revealed a positive association between the independence of internal audit function and financial accountability. Regression analysis yielded a positive and significant coefficient suggesting that enhancing internal audit independence could improve financial accountability at Laikipia County Government.

Conclusion and Recommendation

The study concluded that financial accountability is significantly affected by the autonomy of the audit function. Maintaining independence enhances the credibility of auditors' opinions, conclusions, and recommendations, thereby strengthening financial accountability.

Based on the research findings and conclusions, this study recommends that policymakers should focus on enhancing the independence of the audit function within the County Government. This might involve structurally separating the internal audit section from the Finance and Economic Planning department to strengthen its oversight capacity. Secondly, there is a clear need to address the understaffing issue within the audit section by recruiting additional qualified personnel. This would not only improve audit coverage but also enhance the effectiveness of audit activities.

Measures should be implemented to address conflicts of interest among audit team members before undertaking audit assignments. Protocols for declaring and managing conflicts of interest should be introduced to ensure impartiality and integrity in audit processes. Auditors should be granted autonomy to carry out their duties independently and the management should refrain from interfering with the work of the auditors. This approach will uphold the integrity and credibility of audit processes and reports and thereby improving financial accountability.

Suggestion for Further Research

This study relied on survey data and perceptions to analyze the relationship between variables at a single point in time (cross-section). Consequently, any analysis conducted over different time periods may be significantly influenced by changes in conditions, auditor competencies, and auditor independence. These factors can affect the effectiveness of internal audits and, consequently, financial accountability. Therefore, further research is needed to identify changes and test the consistency of relationships between variables. To enhance effective financial accountability in the public sector, future studies should explore factors influencing internal audit effectiveness.

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