

**INFLUENCE OF INTERNAL CONTROL PRACTICES ON FINANCIAL
MANAGEMENT OF COUNTIES IN WESTERN KENYA REGION**

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DECLARATION

This proposal is my original work and has not been presented for the award to any university or institution of higher learning.

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ABSTRACT

Organizations face common risks in the form of failures in internal control mechanism, financial fiasco, catastrophe or environmental disasters, non-compliance, and regulatory violations. The public sector is undergoing transformation towards more efficient and effective delivery of services. To ensure sustainable, efficient and effective daily operations, management of any organization must come up with internal control procedures that guide in allocating, controlling and ensuring efficient utilization of resources so as to achieve the overall objectives of an organization. However, internal control is not a sole procedure or policy performed at a certain point but rather a continually operating, integrated system at all levels within an organization. Prior studies have not explored the influences of control activities on financial management. The purpose of this study is, therefore, to analyze how internal controls and in specific how the control activities impact on financial management of Counties in Western Kenya. The specific objectives will be to: determine the influence of Internal Audit function, effects of policy on authorization and approval for all transactions on financial management and the effects of segregation of duties on the financial management by the county governments of western Kenya region in financial management. The study will be anchored on agency, system and financial control theories. A survey research design will be employed. The study population shall be the 150 heads of department and senior managers in the financial and accounting departments in all the 10 counties. A purposive sampling technique will be used to arrive at a sample size of 109 chief officers, head of accounting services, directors of internal audit and budget, accountants in charge of payments, departmental accountants, examination officers and Authority to Incur Expenditure holders who shall constitute the respondents in the study. Structured self-administered questionnaires will be used to collect primary data. Secondary data will be collected through desk reviews. Reliability of questionnaire will be tested on pilot data from 10 respondents. Results from the pilot study shall be excluded from the main study. Cronbach reliability coefficient will be used for reliability test. Content validity will be done using expert reviewers. Data will be analyzed using descriptive statistics and inferential statistics done with multi regression analysis to show support for the proposition that internal control activities influence financial management in counties of Western Kenya. Statistical Package for Social Sciences (SPSS) V. 21.0 will be used. The study findings will be of significance to management of county governments in getting an in-depth knowledge of how the control activities they have put in place are working. In addition it will form a basis for future research on other areas internal control practices.

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LIST OF ACRONYMS & ABBREVIATIONS

A.I.E	-	Authority to Incur Expenditure
COSO	-	Committee of Sponsoring Organizations
EACC	-	Ethics and Anti-Corruption Commission
ERM	-	Enterprise Risk Management
GoK	-	Government of Kenya
ISO	-	International Standards Organization
PFMR	-	Public Finance Management Regulations
PPDA	-	Public Procurement & Disposal Act
KENAO	-	Kenya National Audit Office

OPERATIONAL DEFINITION OF TERMS

County Government	Unit of devolved Government in Kenya
Internal control	the statutory delegation of powers from the central government of a sovereign state to govern at a sub national level, such as regional or local level.
Performance	the measure of attainment achieved by an individual, team, organization or process against the set target or objectives.
Financial performance	measure of the company's policies and operations in form of monetary terms
Public Finance Management Regulation	Government regulations of 2015 issued to public officers in Kenya aimed at ensuring finances are managed at both national and county levels of government in accordance with the principles set out in the constitution and public officer who are given responsibility to manage on behalf of the public.
Segregation of duties	Is the concept of having more than one person required to complete a task. In business, the separation by sharing of more than one individual in one task is an internal control intended to prevent fraud and error.
Internal audit	is a unit set up in an organization with an aim of helping it accomplish its objectives by bringing a systematic , disciplines approach to evaluate and improve the effectiveness of risk management, control and governance processes.
Counties in western Kenya region	ten counties that were formed along the original administrative boundaries of western and Nyanza provinces of Kenya. They include Kakamega, Vihiga,,Bungoma and Busia counties in the former western Province as well as Kisumu, Siaya, Kisii,Homa Bay, Migori and Nyamira counties from the former Nyanza province.
Authority to Incur Expenditure holder	Accounting officers appointed in writing to be responsible for approving expenditures in their departments.

1.0 INTRODUCTION

1.1 Background of the Study

Organizations face common risks in the form of failures in internal control mechanism, financial fiasco, catastrophe or environmental disasters, non-compliance, and regulatory violations. The public sector is undergoing transformation towards more efficient and effective delivery of services (Aziz, Rahman, Alam, & Said, 2015). To ensure sustainable, efficient and effective daily operations, management of any organization must come up with internal control procedures that guide in allocating, controlling and ensuring efficient utilization of resources so as to achieve the overall objectives of an organization. However, internal control is not a sole procedure or policy performed at a certain point but rather a continually operating, integrated system at all levels within an organization (Aziz, Said, & Alam, 2015). Organizational risks become complex as technology advances, activities accelerate, multi-faceted financial sophistication sets in and globalization becomes a reality. Whereas organizational risks have been a historical concern since Sarbanes Oxley, financial impropriety is a continued concern in organizations. It is thought its implications are higher in the public sector where regulations may be weak due to bureaucracy.

Internal control is critical for an organization in order to meet the vision and mission for stakeholders in today's dynamic environment (Aziz N. A., 2013). First, it helps organizations to work effectively and in harmony by revealing errors and irregularities in operations (Wardiwiyono, 2012). Secondly, it helps organizations to recognize the importance of internal control system and risk management. Internal control system is viewed as an integral component of the overall governance structure intended to direct and control the activities of an organization (Bowrin, 2004). The structure achieves this through the promotion transparency, accountability, responsibility, and fairness to all stakeholders. Internal control in the public sector supports the system to establish and at the same time foster the accountability (Bianchi, 2010).

According to COSO (2004), the findings of the Treadway Commission Report of 1987 in the United States of America (USA) confirmed that absence of, or a weak, internal control was the primary cause of many cases of fraudulent company financial reporting. In response to several high-profile financial frauds, COSO issued a report providing a foundation for assessing internal control effectiveness. Ever since, several waves of accounting scandals have led to regulatory requirements for managers and auditors to report on internal control effectiveness (Tackett & Claypool, 2006). Most recently, the Sarbanes Oxley Act (SOX) internal control provisions have

fueled the ongoing debate among regulators and practitioners about the effectiveness of this type of regulation in improving financial reporting quality given the subsequent financial crisis (Aziz N. A., 2013).

Besides the increased interest in internal control practices, organization managers are equally finding it necessary to link these practices as part of a system with financial management. There have been reported cases of companies that have been closed down as a result of malpractices attributed to weaknesses in their internal controls. Notable cases include Enron, WorldCom, AIG among others in the international scenes (Sawyer , 2003). Studies have assessed the practices of internal control system in the public sectors of Malaysia (Aziz *et al*, 2015). Other concerns have spanned accountability of public sectors through integrity system, internal control system and leadership practices (Aziz, Rahman, Alam, & Said , 2015).

Weaknesses in internal control systems have been attributed to the downfall of giant institutions in Kenya. Companies like Kenya National Assurance Company, Kenya Planters Cooperative Union (KPCU), Pan African Paper Mills, Blue Shield Insurance Company among others (Njiru, 2016). The most recent is the sugar scandal that has thrown the sugar industry in the country on its deathbed as well as the maize scandal that are all attributed to weak internal controls. All these examples of corporate failures have one thing in common in the sense that they point to weaknesses in internal controls in their day to day operations. None of these cases, however, were specifically focused on each element of the wider financial management.

Whereas prior studies on internal controls have largely focused on its relationship with financial performance (Onyango , 2014) and (Munene, 2017), its relationship with financial management focused on elements such internal audit function and the financial management (Jepkemei , 2016) and the effects of control activity on financial management (Wakiriba, Ngahu, & Wagoki, 2014).

1.2 Research Problem

Strong and working Internal control system is an important pre-requisite for governance, risk and compliance issues in any organization. This is because it provides an assurance that measures and checks instituted by an organization works in an effective and efficient manner that enables them to achieve their objectives. A well established, an efficient internal controls not only prevents but also goes a long way in the detection of fraudulent activities in an organization. There have been reported cases of companies that have been closed down as a result of malpractices attributed to

weaknesses in their internal controls. . Notable cases include Enron, WorldCom, AIG among others in the international scenes. On the local scene, weaknesses in internal control systems have been attributed to the downfall of giant institutions in the country like the Kenya National Assurance Company, Kenya Planters Cooperative Union (KPCU), Pan African Paper Mills, Blue Shield Insurance Company among others.

Prior studies relating to internal control systems have focused on areas such as county performance, liquidity, accountability and reporting. Others have looked at internal controls and performance of county governments in Kenya; effectiveness of the Internal Audit function and the financial management in county governments in Kenya; internal controls on financial performance of Embu county and the effects of control activity on financial management. From the above studies it is evident that none of these researches have addressed the internal control system practices and financial management of expenditure. How internal control practices influence financial management is an imperative research question. It is on this basis that this study seeks to establish the influence of internal control practices on financial management on expenditure. This study on the influence of internal control practices on financial management of county governments in Western Kenya is an attempt at finding answers to this question.

1.3 Research Objectives

The general objective of this study shall be to establish the influence of internal controls on financial management of County Governments in Western Kenya region. The specific research objectives for the study shall be:

- i. To determine the influence of Internal Audit function on the financial management in the County Governments in western region
- ii. To establish the effects of segregation of duties on the financial management by the county governments of western region
- iii. To determine the effects of policy on authorization and approval for all transactions on financial management by the County Governments of Western region.

1.4 Research Hypotheses

The study shall seek to test the following null hypotheses:

- i. Internal audit functions of western counties in Kenya do not have significant influence on financial management of expenditure

- ii. Authorization processes of western counties in Kenya do not have significant influence on financial management of expenditure
- iii. Segregation of duties of western counties in Kenya do not have significant influence on financial management of expenditure

1.5 Scope of the study

This study seeks to analyse the relationship between internal control practices on financial performance of county governments in Western Kenya region.. The researcher shall use expenditure management as the dependent variable while internal audit function, authorization processes and segregation of duties as independent variables. The researcher shall use the services of research assistants to collect the needed information from all the ten counties in the region. The whole exercise is expected to take an average three months as per the attached project schedule.

1.6 Justification of the Study

This study was justified by the recent spark of corruption and misuse of public resources by the central and county governments in Kenya that has brought into question the kind of internal control practices put in place to manage the available resources. The annual reports by the Auditor General have consistently reported glaring discrepancies in the management resources by the county governments across the country. The findings have been alluding to weaknesses in the public sector accountability systems by highlighting weak internal control systems contrary to the requirements by the Public Finance Management Regulations (PFMR), flouting of procurement regulations, nepotism and other forms of social evils that have not only led to misuse of county resources but also deplorable service delivery by the county governments in Kenya. These ought to have been picked and well addressed only if effective internal control practices were implemented by the respective county governments

The submission of the findings from this study shall be of value to the management of the County Governments in the Western Kenya region as well as other Counties in the Country. The research findings will help them gain insight and adopt effective internal control practices that will lead to improved performance in the delivery of services to their stakeholders. They will use the information to formulate informed policies and procedures aimed at effective internal control practices.

The study shall also be of value to the government of Kenya through their agents Commission on Revenue Allocation, Treasury, Kenya National Audit Office among others that are charged with the responsibility of implementing and enforcing policies related to the internal controls in the County Governments in the country. Specifically, they shall get more information on the internal control practices needed to improve the operations and service delivery of devolved governments in the country.

The scholars and academicians will also benefit from this study by gaining knowledge on internal control practices and service delivery by County Governments in Kenya. These knowledge seekers may adopt the findings of the study as a basis to further their research in the area of internal control practices by the County Governments in Kenya. Additionally, consultants in the area of governance, risk and control shall also benefit from the findings of this study as they will get practical information needed to make informed opinions and therefore advice their clients accordingly.

1.7 The Conceptual Framework

Independent Variables

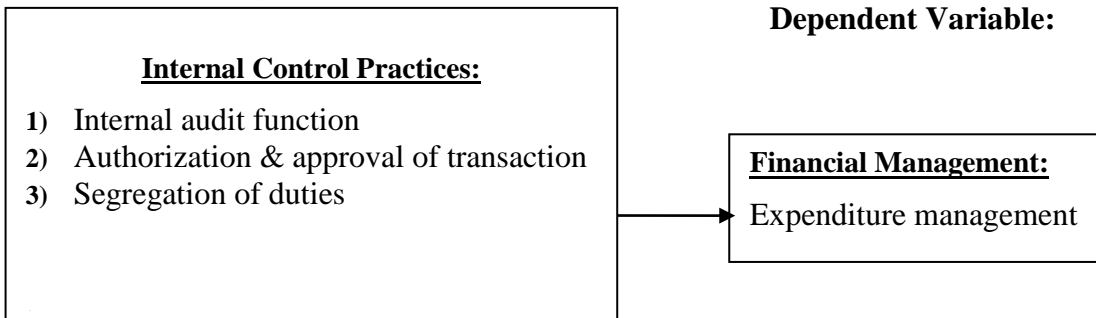


Figure 1.1: Conceptual Framework

Source: Adapted from Onyango (2014)

This study conceptualizes the definition of internal controls according to Tunji (2013) and Jajo (2005) and SAS (2002). Accordingly, the study views internal controls as rules, policies, and procedures the county government implements in order to ensure accountable and legal financial engagements on behalf of its people. A statement on auditing standards defined control activities as the policies and procedures that help ensure the implementation of directives from the management (SAS, 2002). Control activity categories include segregation of duties, record keeping safeguarding and reconciliations (Jajo, 2005).

A diagrammatic representation of the hypothesized relationships between the internal control practices and financial management is depicted above. The study shall seek to establish the kind of relationship, if any, that exists between the two variables as depicted in the diagram.

2.0 LITERATURE REVIEW

This section discusses the theoretical framework of the study, theories guiding the study, empiric studies done on internal control practices and financial management, and identifies gaps for hypothesized relationships in study variables.

2.1 Theoretical Review

The study shall be based on the agency theory that describes the relationship between the principal and the agent, the systems theory that provides that the purpose of an organization is to create as much value as possible to its stakeholders and the theory of financial control that highlights the need for prudent management of resources for sustainability of any organization.

2.1.1 The Agency Theory

A key assumption of the Agency Theory (AT) is in its management approach where an individual called the agent, and acting on behalf of another individual called the principal, is supposed to advance the principal's goals. Jean et al 2002. The theory describes firms as necessary structures for maintaining contracts and through which it is possible to limit opportunistic behavior of agents. The theory strives to resolve problems existing in agency relationships either because of variance in goals or different aversion levels to risk. The most common agency relationship in finance occurs between shareholders as principals and company executives as agents.

Accordingly, Meckling and Jensen (1976) posit that in order to harmonize the interests of the agent and the principal, a comprehensive contract is written to address the interest of both the agent and the principal. They further explain that the relationship is further strengthened by the principal employing an expert to monitor the agent. This position is also supported by Baiman and Mukherji (1990) who maintains that the contract provides for conflict resolution between the agent and principal, the principal determines the work and agent undertakes the work.

The agency theory recognizes the incomplete information about the relationship, interests or work performance of the agent described as adverse selection and moral hazard. Meckling and Jensen (1976) explains that moral hazard and adverse selection affects the output of the agent in two ways; not doing exactly what the agent is appointed to do, and not possessing the requisite knowledge about what should be done. This therefore, affects the overall performance of the relationship as well as the benefits of the principal in form of cash residual. Agency may be delegated or intrinsic making agency theory more closely related to stakeholders management and

therefore, complementing the systems theory. Intrinsic common agency occurs when an individual is naturally that is not voluntarily and not independently endowed with the right to make a particular decision affecting other parties who may in turn attempt to influence that decision. Communities do not choose to entrust decisions to agents but find themselves subject to these managers' decision-making activities.

A major limitation of the theory is the moral hazard problems where, in an agency relationship, agents are required to work toward meeting principals' goals, yet it is the agents' own goals that drive them to succeed on behalf of their principals. The agency theory has been criticized for only showing a relationship between owners and managers and it providing deception and misappropriation of funds by the agent. This constitutes a moral hazard problem endemic in principal-agent complexities (Laffont & David , 2002). Agents in the agency theory make decisions that best fit their interests which they champion and which may risk conflicts of interests (Buchanan, 1996) and lead to agency costs (Shankmann , 1999).

As adopted for this study, agents make decisions on behalf of the interests of shareholders. Therefore, leaders and actors in government may take financial decisions through planning and execution on behalf of the public. This may, however, serve the interest of the agents more than it serves the public as a consequence of project identifications and locations, service to unspecified interests, and or in order to achieve other gains in the nature of corrupt deals. Their remuneration packages are not in contests, however, as they are entrusted to offer services on behalf of the public. Overall, this study proposes to use the theory to test elements of moral hazard in the county as leaders serve the public as seen through the porous lens of weak financial and administrative internal controls.

2.1.2 System Theory

Biologist Ludwig von Bertalanffy developed the systems theory in the 1930s in order to simplify and clarify the complexity of the world in the human mind (Bertalanffy, 1968). Simply put, systems theory is used to understand how things around us work. The theory views the world as a major system made of smaller sub-systems. Systems represent life phenomena and are daily used by humanity to describe the functioning of these phenomena. For example, a county government is a system with inputs, processes and outputs. The county itself is a component of a larger system, a country. Systems comprise the socio-economic-political system within which we live. They are collections of independent but interrelated elements or components organized in a meaningful way to accomplish an overall goal. Systems function by converting or processing

materials, energy and or information, generally, regarded as inputs into a product that is used within and or outside the system.

Systems theory can be used to clearly and concisely understand county government structures, processes and outcomes processes and their interactions within a county government network. As a framework the theory can be used to describe the components of systems and the relationships between these components, the boundaries of the system, the goals of the system, and system's ability to change and adapt in response to internal and external forces. This correct and clear understanding of the organization as a system is a necessity to be able to manage organizations effectively and efficiently and to achieve organization's goals.

A key limitation of the systems theory is because of its complexity. All parts must be function to achieve equilibrium. In addition better outcomes are achieved when all parts work together as opposed to individual system component activities. There can be no one way of managing systems but their effectiveness is contingent upon the environments in which they operate. In this respect system theory complements the agency theory by accounting for the limitations of agents and principals.

County government systems consist of a pattern of organized relations where different components of the system are related to each other in a particular way. Organizational structures and charts constitute a graphical representation of these relationships. County government bylaws, rules, policies and procedures regulate these relationships. As adopted for this study the theory will help isolate, analyze and understand the implications of inputs such as money, human, information, material, time, equipment and tools as they are processed for better outputs like financial management for better service quality.

2.1.3 Financial Control Theory

Financial Control is a theory of accounting that offers a general approach to financial control for all types of organizations. Financial control theory supplements the systems theory in so far as it is an approach for a global value chain where resources are turned into outputs. Because chains, hierarchies, and personal functions change over time organizations are exposed to risk. As an approach Financial Control theory can provide insights into control problems for every organization and system by helping in understanding relationships between value chains globally and a hierarchy in or between organizations. But time is of essence.

The theory of financial controls for organizations views organizations from the perspective of activities and outputs, structure of the organization and activities, and of transactions that various parties have with each other, recurrent procedures, and the future and present implication of the relationship between internal and external resources and methods (Ostman, 2009).

County governments are organizations that are in continuous work even if they may not be eternal. As adopted for this study financial control theory will be used to illustrate specific processes of the county governments for certain issues and as they relate to their global environment.

2.1.4 The Concept of Internal Control Practices

Generally, authors agree on the definition of internal controls. Some have defined it as a system of a set of rules, policies, and procedures implemented by an organization for the purposes of an assurance that its financial reports are reliable, operations effective and efficient, and activities are within the laws and regulations (Tunji, 2013). Internal controls also refer to the measures instituted by an organization so as to ensure attainment of the entity's objectives, goals and missions (O'Leary, 2006). According to Zhang (2007), internal control refers to whole system of controls, financial and otherwise, established in order to provide reasonable assurance of effective and efficient operation, internal financial control and compliance with laws and regulation. If well implemented, a system of internal controls will greatly contribute to the success of an organization by eliminating the undesired outcomes. However, these definitions are general and may not aptly apply to the situation of government.

A generally applied definition of internal controls is from the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In an integrated framework internal control is defined as a process, effected by an entity's board of directors, management and other personnel in order to provide reasonable assurance about the achievement of the entity's objectives considering reliability of financial reporting, effectiveness and efficiency of operations; and compliance with applicable laws and regulations (COSO, 1992). Even though governments may not be strictly viewed as entities run by boards, they nonetheless pursue objective similar to the ones listed above.

In other views internal control system is defined as the policies and procedures put in place to ensure the protection of an organization's assets and the reliability of financial reporting (Sulaiman, Siraj, & Mohamed , 2008). In addition, other authors have viewed internal controls as divided into financial internal control and non-financial or administrative internal control (Reid &

Ashelby, 2002). Those activities that are financial in nature and exemplified by cash receipts constitute the financial internal controls. However, non-financial internal control activities that are those that are indirectly financial like controls over company's personnel section and its operations, fixed assets controls and even controls over laid down procedures.

The implementation of control is an agency of managers (Hopper & Macintosh, 1998). Managers, therefore, have a requisite to aggressively demand obedience to stop fraudulent or self-advantageous practices. Although accounting provides a structure of financial goals, budgets and performance measures, accounting within government cultures receives little attention as to how internal control practices may influence their financial management. According to Azimah (2015), any organization without an internal control system in place is generally exposed to several threats that are capable of crumbling the organization in no time. If well established, an efficient internal control in government not only prevents but also goes a long way in the detection of fraudulent activities.

This study conceptualizes the definition of internal controls according to Tunji (2013). Accordingly, the study views internal controls as rules, policies, and procedures the county government implements in order to ensure accountable and legal financial engagements on behalf of its people. A statement on auditing standards defined control activities as the policies and procedures that help ensure the implementation of directives from the management (SAS, 2002).

Control activities have been categorized as authorization, segregation of duties, record keeping safeguarding and reconciliations (Jajo, 2005). It is however, important that the activity under consideration shapes these controls and, therefore, specific knowledge is a necessity for each activity as a requisite for choosing controls (Hubbard, 2003). A typical framework for modeling control activities include control objectives for information technology, system's assurance and control, total quality management and system development life cycle (COSO, 1992) but this also depends on the activities involved. Control activities have also been viewed in terms of a policy establishing what should be done and procedures to effect the policy (Warren, 2003).

Past organizational losses and corporate failures resulting from internal control weakness in their day to day operations has led to development and adoption of various mechanisms aimed at protecting other organizations from walking the same path. The principles of internal controls and financial prudence in the public sector are enshrined under Chapter Twelve of the Constitution of Kenya, 2010 and the Public Finance Management Regulations for County Governments. They

advocate for the need to use public money in a prudent and responsible way (PFMR, 2015). Other than responsible financial management, they also require fiscal reporting to be clear and revenue collected to be shared equitably among national government and county governments. According to the Committee of Sponsoring Organizations (COSO, 2004) an efficient internal control system aims at achieving three objectives namely, effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

Sawyer (2003) defined internal control as the whole system of control, financial and otherwise established by management in order to carry on the business of the enterprise in an orderly and effective manner so as to ensure adherence to managerial policies and directives, safeguard the assets and ensure that as far as possible the completeness and accuracy of the records, prevention and detection of errors and fraud as well as timely preparation of financial information for an organization. According to Tackett and Claypool (2006) Internal Control refers to the means by which organization's resources both tangible and intangible are directed, monitored, and measured thereby leading to more predictable outcomes by reducing process variations. In view of this, an effective internal control is the one that is able to: prevent errors from occurring; detect errors if they occurred; and correct detected errors.

Chepkorir (2017) indicated that the effectiveness of an internal control in an organization to a large extent is determined by the diverse ways in which the whole system has been implemented, controlled and monitored by the organization. Primarily, it is the responsibility of the management to come up with an effective internal control system in an organization. At the same time, management is in a position to override the internal controls which it has established, for its own interest. According to Mugo (2013), management has the capacity to determine the effectiveness or ineffectiveness of any form of internal controls instituted by an organization depending on their character and the way in which they handle misbehaviors or misconducts among workers. If management deals with the misconduct with levity, there is an increased possibility that the whole organization will relax in the sense that employees will work at their own pace and desires an avenue that could increase fraud and other social evils in the organization. The reverse is true for an organization whose leadership is committed to frowning at any type of mal practice or misconduct as a way of ensuring effective internal control.

Depending on the nature of an organization, various internal control frameworks have developed to aid in the implementation of internal controls. The most popular and authoritative bodies on control framework and models that have been adopted world over includes the COSO framework

that was published by the Committee of Sponsoring Organizations of the Treadway Commission, Criteria of control (CoCo) framework that was published by the Canadian Institute of Chartered Accountants, COBIT (Control Objectives for Information and Related Technologies) framework developed by international professional association ISACA for information technology (IT) management and IT governance, Basel Accord Standard that provides a regulatory framework on bank capital adequacy, stress testing, and market liquidity risk as well as the UK Corporate Governance Code that was formerly referred to as the combined Code (Ironkwe & Promise , 2015). This study shall focus on the COSO framework to evaluate the internal control practices in county governments of western Kenya region.

According to the COSO framework, internal control is a process that is effected by the entity's board and senior management that is designed to provide reasonable assurance regarding effectiveness and efficiency of operations, reliability of financial reporting as well as compliance with the applicable laws and regulations (COSO, 2004). This framework comprises of five unified components that are derived from the way an organization is managed. The components are the control environment, risk assessment, control activities, information and communication as well as monitoring.

According to Chepkorir (2017), control environment forms the basis for all other components of internal control in an organization. The control environment consists of actions, policies and procedures that reflect management attitude about the control of the entity (Njiru , 2016). This touches on integrity and ethical values, commitment to competence, Board of Directors or audit committee participation, management's philosophy and operating style, organization structure, and assignment of authority and responsibility and Human Resource practices.

According to Chepkorir (2017), control activities are policies and procedures designed by an organization to help in ensuring that necessary actions are taken to address potential risks to an organization in its effort to achieve the set objectives. Control activities are placed all over the organization and includes a range of activities such as segregation of duties, proper authorization, proper documentation and records, physical controls over assets, independent performance reviews among others,

2.1.5 The concept of Financial Management

Performance refers to the measure of attainment achieved by an individual, team, organization or process against the set target or objectives (Pandey, 2015). Organizational performance comprises

of the actual output or results of an organization as measured against its intended outputs in terms of its goals and objectives. It involves the ability of an organization to fulfill its mission through sound management, strong governance and a persistent rededication to achieving results (Lerno , 2015). Financial performance refers to the extent to which the financial objectives of an organizations has been accomplished. According to Mugo (2013), financial performance is a measure of the company's policies and operations in the form of monetary terms. It is general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Pandey, 2015).

From the aforementioned, it can be established that an appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. According to Chepkorir (2017), a sound financial performance requires a careful tracking and prudent management of a company's financial resources and cash-flows. Pandey (2015) argues that a sound financial performance of an organization can be determined by adequate utilization of the entity's financial resources to achieve organizational objectives in terms of budget adherence and reduction or outright elimination of financial loss in the organization. He further states that in organizations where financial performance is deemed weak, there is a high probability that the information can be wrong or absent, decision-making is flawed, and minor issues can become serious problems that put the business itself at risk.

To achieve a sound financial management in an organizations, clear guidelines should be given on the roles and responsibilities of all the concerned stakeholders in the institution including procedures for corrective action to be taken if necessary in every situation. Among the other control measures put in place, the finance department should be actively involved in the planning, design and control of processes in the organization. According to Owizy (2008) a desire for improved performance in the Nigerian States led to the adoption of a common approach to evaluating financial performance that involved planning policy adherence, annual budgets, cash balances stability, debt ratios, cash management, internal controls, inventory management as well as creditors' management.

Pandey (2015) argues that for an organization to realize a sound financial performance, financial resources must be optimally planned and allocated between required outputs, optimal investment in total assets required to support specified departmental outputs must be quantified and economically funded, use of financial resources to achieve specified outputs must be monitored

and controlled against the strategic and operational plans of the department by means of quantitative and qualitative data. For the purpose of this study, the researcher shall use five parameters of financial performance evaluation by Fisher (1998) that includes planning and budgeting, revenue and cash management, expenditure and procurement, asset and liability management as well as accounting and reporting requirements.

Expenditure management relates to how the effective or the appropriateness of the expenses incurred by the county government and procurement processes adopted by the county government to purchase the necessary goods and services. The expenditure is guided by the budget and the provision of the Public Finance Management Regulations

In spite of the stringent laws in the country that advocates for efficiency and accountability in the management of public resources in Kenya, there is still potential that a great amount money and resources can be lost through fraudulent actions and or unintentional errors of commission or omission by employees. The recent spark of corruption and misuse of public resources by the central and county governments in Kenya is a good testament to this assertion. The continued misuse of public resources has brought into the fore the kind of internal controls that have been put in place to safeguard the public resources. The significance of establishing a robust internal control system in any organization cannot be ignored due to its positive effects on its long term sustainability in the market.

2.2 Empirical Studies

2.2.1 Internal audit function and financial management

Wangui and Jagongo (2017) carried out a study on internal auditing and financial performance of public institutions in Kenya using a case study of Kenya Meat Commission. The objective of the study was to determine the effectiveness of the internal audit function on the governance and controls in the public sector institutions in the country. A case study of the Kenya Meat Commission (KMC) was used with a sample size of all the fifty seven management staff at KMC by then. Primary data was collected from respondents using open and close ended questionnaires and descriptive statistics, time series and regression analysis were used to analyze the data. The findings indicated that the relationship between the internal audit function existence and financial performance at the KMC was insignificant. According to the results, existence of internal auditing does not influence the profitability and return on investment. The study recommended that in order

to add value to the public institutions, the internal audit function should be more independent and manned by qualified and professional staff.

Ondieki (2013) carried out a study on the effect of internal audit on financial performance of commercial banks in Kenya. The objective of the study was to determine the effect of internal audit on financial performance in commercial banks in the country. The study adopted a descriptive cross-sectional research design with the target population of all the forty three registered commercial banks in Kenya by then. A purposeful sample of twenty commercial banks were selected from the targeted population. Banks were selected in terms of their size as follows: 5 big banking institutions, 10 medium size banks and 5 small banks. The study purposively selected one senior manager in the finance department thus a sample population of 20 respondents. Questionnaires were administered to the selected respondents who provided the primary data was analyzed using Statistical Package for Social Sciences (SPSS). Internal audit was looked at from the perspective of internal audit standards, professional competency, internal controls and independence of internal audit function as independent variables that influenced financial performance as the dependent variable.

The study found that a unit increase in internal audit standards would lead to increase in financial performance of commercial banks, a unit increase in independence of internal audit would lead to increase in financial performance of commercial banks, a unit increase in professional competency would lead to increase in financial performance of commercial banks and further unit increase in internal control would lead to increase in financial performance of commercial banks. The study concludes that internal audit standards, independence of internal audit, professional competency and internal control had a positive relationship with financial performance of commercial banks in the country.

Jepkemei (2016) did a study on the effectiveness of the Internal Audit function and the financial management in county governments in Kenya. The objective of the study was to examine the relationship between audit committee effectiveness and financial management in county governments in Kenya. Specific objectives of the study were to establish the effect of independence of internal audit function on financial management in county government in Kenya, to determine how internal audit charter affects financial management in county government in Kenya, and to establish the relationship between internal audit staff members' technical skills and financial management in county government in Kenya. The study established that the structure of department as well as the competency of staff determines the efficiency of the auditor in setting a systematic and disciplined approach to evaluate and improve the effectiveness of risk management,

control, and governance processes in the county government. At 5% level of significance and 95% level of confidence, audit structure, independence, audit charter, and audit staff members' technical skills are significant in financial management. This study was limited to internal function only as a control process and did not test other aspects of internal controls like segregation of duties and completeness of documentation that greatly contributes to financial management

Munene (2017) did a study on the effects of internal controls on financial performance of Embu county government. The objective of the study was to establish the causes of persistent poor financial performance from the perspective of internal controls put in place by the county government. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting. The study took a survey approach and both quantitative and qualitative approach. Data was collected using Questionnaires as well as review of available documents and records and the target population of study were all chief officers and heads of departments in the county. The collected data was summarized and analyzed based on the content analysis and Statistical Package for Social Science was used to draw the relationship between the variables. The study established a significant relationship between internal control system and financial management at the county. From the findings, the county government was not committed to strengthen the internal controls in their operations for instance, the internal audit department did not have adequate resources since they were understaffed and their operations were largely manual. As a result, the following flaws in financial management was directly linked to the inefficiencies in the internal control processes at the county: There was limited sharing of information amongst the various departments including security measures to safeguard the assets of the county. Further, it was also established that there wasn't enough cash to pay for county obligations on timely basis, that the fees charged for services offered by the county were not appropriate to cover costs, that all taxes meant to be remitted to the county government were not collected. It was further revealed that all revenues and expenditures were not properly accounted for with noted cases of unsupported claims and expenditure by the county government. How internal controls practices influence financial performance of governments and public sector organizations is less understood.

Ndifon (2014) studied the effect of internal audit function on the financial performance of tertiary institutions in Nigeria. The objective of the study was to establish the relationship between internal audit function and financial performance in Tertiary Institutions in Nigeria using a case study of Cross River State College of Education, Akamkpa. The design of the study was a cross sectional

survey that targeted top management staff both in academic and nonacademic division in the college. Data was collected using questionnaires and interview guide as well as review of available documents and records. The collected data were analyzed using simple percentages, tables, correlation coefficient and z-scores. From the findings, the study revealed that all activities of the College were initiated by the top management. On the effectiveness of internal audit, the study found that the internal audit department at the College was not sufficiently staffed and did not perform their duties with greater degree of autonomy and independence from management. In addition, the study further revealed that internal audit function did not have a significant effect on the financial performance of Cross River State College of Education. The study recommended competence profiling in the internal audit unit of the Institution which should be based on what the College expects the internal audit to do and what appropriate number of staff would be required to do the job. It also recommended that members of the internal audit department should be professionals or members of any professional Accountancy body in Nigeria for ethical justification.

From the aforementioned literature , the studies focused on the existence of internal audit unit against financial performance. In another , the focus was on internal audit standards, professional competency and their independence from management against financial performance. Other areas focused was on the effectiveness of internal audit and governance processes. However ,this study will seek to approach the functionality of internal audit and how their role influence expenditure management in counties of western region.

2.2.2 Authorization and approval of transactions and financial management

Masinde (2014) studied the effects of Internal Control Systems on Financial Performance of Sugarcane out grower companies in Kenya. This study was designed to investigate the effect of internal control practices on the financial performance of sugarcane outgrower companies in Kenya. The specific internal control practices included the policies and procedures on approval and authorization of transactions, risk management, information system and control activities. The study adopted a descriptive correlational survey design where all the sugarcane out grower companies were studied. Primary data was collected from the key informants from all the nine outgrower companies in Kenya using questionnaires. Secondary data was extracted from annual reports, publications and document analysis. The key informant's method was used, hence, all the Finance Managers and heads of internal audit for every outgrower company were selected to take part in the study. The data collection instruments were administered to all the nine sugarcane

outgrower institutions. The data was analyzed using statistical package for social scientists (SPSS) computer software version 19.0 to generate cumulative frequencies and percentages.

The study found a positive significant effect of internal control system on the financial performance ($R = 0.682$), and R square 0.428 thus internal control components accounted for 42.8% variance in performance. On the extent to which the respondents agreed or disagreed on whether the policy on authorization and approval of transactions in their organization, the findings established that 27.8 percent of the respondents strongly disagreed, 11.1 percent disagreed, 38.9 percent agreed and 22.2 percent strongly agreed that indeed the policy on authorization and approval of transactions in their organization affected the financial management in their organizations. This study also was limited to the Sugarcane outgrower companies in Kenya and the findings could not be generalized to apply in other organizations especially in public and private sector hence the need to carry out the a similar study in county governments in order to come up with a conclusive evidence about the area of study.

Kang'aru (2016) carried out a study on the effect of internal control systems on financial performance of companies quoted in the Nairobi Securities Exchange. The main objective of the study was to determine the effect of internal control systems and financial performance of companies quoted in Nairobi Securities Exchange. The specific objective of the study was to investigate the relationship between Authorization and approval of transactions, internal audit function, risk management, internal control activities, and financial performance. The study adopted descriptive research design using both quantitative and qualitative approach. The target population was 372 senior managers in 62 companies quoted in Nairobi Securities exchange. Survey data was collected by use of a structured questionnaire. The data obtained was analyzed using both qualitative and quantitative analysis. Multiple regression models were used to test whether authorization and approval of transaction, internal audit function, risk management, internal control activity and corporate governance have any influence on financial performance.

It was found that internal control systems had a significant relationship with financial performance. Based on the research findings it can be concluded that internal control system is a positive significant predictor of financial performance. Specifically, the study established that a unit change in the approval and authorization function of internal control increased financial performance by the rate of 0.660. This implied that authorization and approval of transactions in the selected institutions as an internal control process should be enhanced due to its contribution to the financial management in the respective institutions. This study was restricted to companies listed

on the Nairobi Securities Exchange hence the findings cannot be generalized to apply in other industries or sectors in the country especially the county governments. There is need for further research on the area extended to the county governments in the country so as to come up with a conclusive evidence about the topic.

From the aforementioned literature, it emerges that timely authorizations had a significant relationship with financial performance in terms of liquidity and profitability. The studies do not indicate how internal controls influence expenditure in financial management, a gap that the current study will bridge.

2.2.3 Segregation of duties and financial management

Njiru (2016) studied the effects of internal controls on financial performance of public water companies in Kenya. The purpose of the study was to determine the contribution of specific internal control practices on financial performance of public water companies in Kenya. The specific control practices included segregation of duties and bank reconciliations. A purposive sample of thirty (30) chief internal auditors was selected from the population of sixty five (65) chief internal auditors in urban water supply companies in Kenya as at December 2014. Primary data for the study was collected using a structured questionnaire that was administered to the respondents. The data obtained was coded, categorized and keyed into statistical package for social sciences (SPSS) computer software for analysis. Correlation analysis was used to establish the association between the variables while a multiple linear regression model was used to test the significance of the influence of the independent variables on the dependent variable. The study findings established a strong relationship between the segregation of duties and financial performance of the public water companies in Kenya.

According to the study, effective segregation of duties positively contributed to financial management in the public water companies by reducing the risk of fraudulent loss resources internal manipulation of information. In addition, the independent review of transactions before approval eliminates unintentional errors that could prove costly to the organization. The study concludes that management of public water services in the country consider putting in place an effective system of segregation of duties in their day to day operations as part of their internal controls that will enhance effectiveness in their financial management.

Onyango (2014) studied the influence of internal controls on performance of County governments in Kenya, The drive behind the study was to establish internal control practices that help County Governments in Kenya to perform efficiently and effectively for the benefit of the general interest.

The specific objectives of the study were to establish the relationship between internal audit, reporting, control of activities, information communication and risk assessment and performance of County Governments in Kenya. The study established that internal controls influenced the performance of county governments in the sense that where internal controls were strong, the performance was improved and vice versa. The study also established that majority of counties were performing below the expectation because of lapses in the internal controls that included failure to implement internal audits recommended by the Auditor General as well as lack of clear separation of roles among employees that led to errors and or fraudulent manipulation of records. The study recommended that county governments should implement a robust system of internal controls that includes segregation of duties, regular internal audits as well as conclusive implementation of audit recommendations. The finding of this study was that generally the internal controls directly influenced financial performance without indicating which component of financial performance in the county.

From the aforesaid literature, the segregation of duties was from the view point of bank reconciliations where it was established that the processes reduced fraudulent activities through detection of errors and manipulations. The current study will address the gap in payment process that has not been previously conducted.

2.3 Summary of Literature Gaps

Although studies have looked into the relationship between internal controls no study looked into the influence of internal control practices on financial management from the perspective of expenditure. Studies have confirmed that internal controls influenced the performance of county governments in the sense that where internal controls were strong, the performance was improved and vice versa (Onyango , 2014). However, this looked at this relationship with financial performance in a general perspective. Further studies looked into the effectiveness of the Internal Audit function and the financial management in county governments in Kenya (Jepkemei , 2016).In this study, the focus was not on expenditure. Other studies looked at sugarcane out growers (Masinde , 2014), Nairobi Securities Exchange (Kang'aru , 2016) and public water companies (Njiru , 2016). Specific objectives of the study were to establish the effect of independence of internal audit function on financial management in county government in Kenya, to determine how internal audit charter affects financial management in county government in Kenya, and to establish the relationship between internal audit staff members' technical skills and financial management in county government in Kenya. A study on the effects of internal controls

on financial performance of Embu county government established the causes of persistent poor financial performance from the perspective of internal controls put in place by the county government (Munene, 2017).

From the above analysis, it has been established that there is no study that have focused on internal controls from the perspective of expenditure management which is a major sub-component in financial management as a whole.

3.0 RESEARCH METHODOLOGY

In this section, the researcher provides insight to how the study shall be carried out. The chapter covers the design of the study, the data collection methods as well as how the researcher shall analyze the collected data.

3.1 Research Design

This study will employ a survey research methodology, which research design, presents oriented methodology used to investigate population by selecting samples and analyzing them to discover occurrences (Oso & Onen, 2005). *Survey* refers to collection of data from a specific population, or a sample from that population; and typically using a questionnaire or an interview as the survey instrument (Robson, 1993). A survey is ideally suited as the researcher seeks to consider issues such as the economy of the design, rapid data collection and the ability to understand a population from a part of it. A key purpose of the design in this study will be to provide numeric descriptions of some part of the population and to describe and explain events as they are.

3.2 Study Area

This study will be conducted on counties of western Kenya region. Counties in Western Kenya region were formed along the original administrative boundaries of Western and Nyanza provinces of Kenya. They are ten in number and include Kakamega, Vihiga, Bungoma and Busia Counties in the former Western province as well as Siaya, Kisumu, Homa Bay, Migori, Kisii and Nyamira Counties from the former Nyanza Province.

3.3 Study population

The population for this study will constitute all the senior and some middle level managers involved in the day to day operations in the counties as they are responsible for the formulation and implementation of internal controls in their areas of operation. The study will use all the 10 counties of Kakamega, Vihiga, Bungoma and Busia Counties in the former Western province as well as Siaya, Kisumu, Homa Bay, Migori, Kisii and Nyamira Counties from the former Nyanza Province. The accessible population shall comprise of chief officers, heads of accounting services, directors of audit departments and personnel at supervisory levels in key department of operations, treasury and finance.

3.4 Sample and Sampling Technique

Owing to the differences in size of each county, a purposive sampling technique shall be used in selecting the respondents. Accordingly, the study shall work with 109 respondents selected from 15 people drawn from 10 departments of each of the 10 counties in the region.

The research will draw a respondents' from a sample assuming a 95% confidence level, and a margin of error of +/- 5%. Accordingly from a target population size of 150 (15x10), and using an online computer generated formula, a sample size of 109 will be used for the study.

3.5 Data Collection

To accomplish the research objectives, the researcher shall use both primary and secondary data. The secondary data shall be gathered from the internal and external audit reports on the ten county governments in the western Kenya region for the last five years. Primary data shall be obtained from the targeted respondents in the identified counties that are directly involved in the formulation and implementation of the County's internal control practices and are involved in the day to day operations in the county. The researcher shall use structured self-administered questionnaires to collect primary data. The questionnaire will be closed ended.

3.5.1 Reliability Test

According to Mugenda and Mugenda (2003), a research instrument is termed as reliable if it yields consistent results after repeated trials. Reliability of the interview guide shall be achieved by carrying out a pilot test to at least one member of staff in the target population across ten counties in the region. The rule of the thumb suggests that 5% to 10% of the target sample should constitute the pilot test (Kothari, 2004). Thus in the current study, 10% will be selected which represents 10 respondents. Results from the pilot study shall be excluded from the main study. Selection shall be carefully done not to include staffs who would participate in the actual study. The results from the questionnaire shall then be analyzed using Cronbach reliability coefficient in the Statistical Package for Social Sciences (SPSS, 21.0).

3.5.2 Validity Test

Validity is the accuracy and meaningfulness of inferences, which are based on the research results. Validity is therefore the degree to which results obtained from the analysis of the data actually represent the phenomenon under study Mugenda & Mugenda (2003) According to Kothari (2004), validity is the most important criterion and indicates the degree to which an instrument measures

the accuracy of the data. Content validity of the questionnaire will be ensured by giving it to research experts in the field of finance to review.

3.6 Data Analysis

Descriptive analysis will be used to analyze quantitative data obtained from the respondents. Multiple regression analyses will be used to determine the relationship between the independent variables and the dependent variable. The regression model to be used is as shown below:

$$Y_0 = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where;

Y_0 = Financial Management – Expenditure Management (Dependent variable)

$\beta_1, \beta_2, \beta_3$ = Coefficient of the Independent Variables

X_1 = Segregation of duties

X_2 = Internal audit function

X_3 = Authorization and approval of transactions

i = Number of respondents

β_0 = Constant representing the fixed items on the Y

ε = Error or stochastic term representing factors that affect Y not included in the study

3.7 Ethical Considerations

Confidential and anonymous information by respondents' is an important consideration in social research. Validity of responses is guaranteed if a researcher satisfies the respondents' confidentiality and anonymity. This study will seek the consent of respondents by providing information to them as to the nature and purpose of the study. A letter of introduction from Maseno University and from National Authority and Council of Science & Technology Institute (NACOSTI) will be used to increase confidence in the respondents regarding the purpose of the study.

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APPENDIX 1: QUESTIONNAIRE

This questionnaire seeks to collect information on internal control practices and financial management. You have been selected to participate in this survey. The data provided from this exercise shall be treated in strict confidence and will be used for academic research purposes only. Am kindly requesting your support in terms of time to respond to questions below.

Part I: Respondent’s Background Information.

- 1. Name: (optional)_____
- 2. What is your current Job Title in the County Government?_____
- 3. What is your Job description?_____
- 4. How many years have you worked with the County Government? _____
- 5. How do you rate the following processes in your county, using the keys, below?

Strongly disagree (1), Disagree (2), Not sure (3), agree (4), strongly agree (5)

Impacts of Internal Control Practices on the Financial Performance of the County.	Strongly disagree	Disagree	Not sure	Agree	Strongly agree
	1	2	3	4	5
a) Expenditure Management					
1) Payments are only initiated when funds are available					
2) All payments are in line with approved budget					
3) All payments are supported with relevant documents					
4) All payments are fully authorized					
5) All payments are committed in vote books					
6) All payments are recorded either electronically or manually					
7) Variations in planned and actual expenditures are regularly					

analyzed for root cause and corrective actions.					
8) The total expenditures on wages, recurrent and development at the end of each year corresponds with the limits of the budget					
b. internal audit functions					
9) There exists a functional internal audit office in the county which is independent from management influences					
10) The department carries out regular audits and issues reports promptly on quarterly basis					
11) The findings of audit are discussed with management					
12) The internal audit have unrestricted, direct and prompt access to all records and officials					
13) Recommendations of audit are implemented by management					
14) The internal audit make regular follow ups on both their reports and external audit reports					
c. Authorization					
15) There exists an approved budget					
16) Accounting officers are appointed in writing.					
17) Treasury regularly issues A.I.E s					
18) Accounting officers and all other persons involved in approval of payments do not delegate their responsibilities					
19) Accounting officers have an up-dated status of balances of their votes					
20) Approvers of payments and the recording of those payments are not performed by the same officer.					
21) (a)The persons performing different levels of payment functions have different access rights to the system					
(b) Access rights are not shared under any circumstances					
c) when persons are transferred from one unit to another, these rights are terminated					
22) County staff are rotated on a regular basis					

Thank you.

