GSJ: Volume 11, Issue 10, October 2023, Online: ISSN 2320-9186

www.globalscientificjournal.com

The Relationship Between Internal Audit and Management of Public Funds in Marsabit County, Kenya

Haro Ture St Paul's University
Dr. Stephen Ndungu St Paul's University
Dr. Daniel Kung'u St Paul's University

ABSTRACT

The prudent management of public funds is a critical pillar of effective governance and sustainable development. Marsabit County, grapples with unique challenges in managing its public funds. The Auditor General's report on operations of the Marsabit County Executive for the year 2021/2022 also revealed that projects worth Kshs 118 million were initiated but had stalled due to lack of feasibility study on their viability. This clearly indicates there are issues with public fund management therefore the study sought to assess the relationship between internal audit and management of public funds in Marsabit County. The study was informed on the concept of the agency theory and stewardship theory. The study employed an explanatory research design. The target population was 54 employees in the county government of Marsabit drawn from the department of accounts and finance. Since the study population was small census technique was conducted. Questionnaires were used to collect primary data desirable for the study. A pilot study was conducted in Baringo County where five questionnaires were distributed to the finance officers. Content validity was ensured with the help of the research supervisors. The reliability was determined using Cronbach's alpha test. Both descriptive and inferential statistics were used. After data analysis, results were presented in form of tables. From the findings the study concluded that there is positive and statistically significant relationship between internal audit and management of public funds in Marsabit County, Kenya. From the findings of the study recommended that the county governments should implement robust systems and processes that promote checks and balances in financial transactions.

I INTRODUCTION

Internal audit is a systematic and independent evaluation process conducted within an organization to assess and improve the effectiveness of its governance, risk management, and internal control processes (Sawyer, *etal*, 2021). It is an essential component of an organization's overall risk management framework and governance structure. Internal auditors, often referred to as internal audit professionals or internal audit teams, are responsible for performing these evaluations. Auditors develop audit plans based on identified risks and objectives, conduct fieldwork, gather evidence, and then provide findings and recommendations (Pickett et al., 2016). Auditors use a variety of techniques, including interviews, document reviews, data analysis, and testing of controls, to evaluate the effectiveness of internal controls and processes. After conducting their assessments, internal auditors produce audit reports that communicate their findings and recommendations to senior management and the board of directors (Ahmed & Nganga, 2019). These reports serve as a basis for improving internal controls and decision-making. Internal audit often includes a follow-up process to ensure that management has implemented the recommended improvements and to assess their effectiveness (Sawyer et al., 2021).

In the USA, the management of public funds involves various federal, state, and local government agencies, each with its own set of financial responsibilities and regulations. The U.S. Government Accountability Office (GAO) is the primary agency responsible for auditing federal government operations (Bessis & O'Kelly, 2019). GAO conducts financial and performance audits of federal agencies to ensure that public funds are used efficiently and effectively. Additionally, each federal agency has its internal audit function to monitor and improve financial controls and compliance. State governments and local municipalities also have their internal audit departments or rely on external audit firms to examine the use of public funds. These audits focus on budget compliance, financial management, and program performance. In the USA, public fund management is subject to various laws and regulations, such as the Federal Financial Management Improvement Act (FFMIA), the Chief Financial Officers (CFO) Act, and the Government Performance and Results Act (GPRA), all of which promote accountability, transparency, and effective financial management (Government Accountability Office (GAO), (2021).

China's public fund management system is characterized by a strong central government with a hierarchical administrative structure (Diba, 2021). The National Audit Office (CNAO) in China is responsible for auditing public funds at the central level. It conducts audits to assess the legality, efficiency, and effectiveness of government spending. Each province and major municipality have its own audit office responsible for internal audits. These offices ensure compliance with regulations and investigate corruption and mismanagement. China places significant emphasis on performance audits, evaluating the outcomes and effectiveness of public fund utilization in achieving economic and social development goals (National Audit Office of China, 2021).

In South Africa, the management of public funds is governed by the Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA) (Wabwire, & Bogonko, 2019). The Auditor-General of South Africa (AGSA) is responsible for auditing public funds at national, provincial, and local levels. It conducts financial audits, performance audits, and investigations to assess compliance and identify areas for improvement (Ondieki, 2019). Government departments and municipalities in South Africa are required to establish internal audit units. These units conduct regular internal audits to assess financial controls, compliance with laws and regulations, and the efficiency and effectiveness of public fund management. The PFMA emphasizes transparency and accountability, requiring government entities to prepare annual financial statements and ensuring that public funds are used for their intended purposes (Dorozik, 2020).

In Tanzania, the Controller and Auditor General (CAG) is the primary institution responsible for auditing government operations. The CAG conducts financial and performance audits to assess the legality, efficiency, and effectiveness of public fund utilization. Various government ministries and departments in Tanzania maintain their internal audit units. These units are responsible for conducting internal audits to evaluate financial controls, compliance with laws and regulations, and the efficiency of public fund management within their respective organizations. The Public Audit Act and the Public Finance Act govern public fund management and internal audit processes in Tanzania, emphasizing transparency and accountability in the use of public funds (Dunyoh, Ankamah & Kosipa, 2022).

The Office of the Auditor-General is responsible for auditing public funds at both the national and county levels in Kenya. The Auditor-General conducts financial audits, performance audits, and special audits to assess compliance with financial regulations and the effectiveness of public fund management (Florentin, 2019). Kenya's devolved system of governance has led to the establishment of internal audit units at the county level. These units are responsible for conducting internal audits of county government operations, including financial management. The Public Audit Act and the Public Finance Management Act govern public fund management and internal audit practices in Kenya, emphasizing transparency and accountability in the use of public funds. Marsabit County, like other counties in Kenya, has established internal audit units within various county government departments and entities. These units are tasked with conducting internal audits to evaluate financial controls, adherence to laws and regulations, and the efficiency of public fund management at the departmental level. The legal framework governing internal audit and the management of public funds in Marsabit County includes the Public Audit Act, the Public Finance Management Act, and other relevant regulations at the county level. These laws emphasize transparency, accountability, and responsible financial management. Internal audit in Marsabit County places a strong emphasis on transparency and accountability in public fund management. It involves the preparation of annual financial statements, adherence to procurement regulations, and the prevention of fraud and corruption. Therefore, the study sought to assess the relationship between internal audit and management of public funds in Marsabit County, Kenya (Khan, & Ahmed, 2021).

II LITERATURE REVIEW

The study was anchored on agency theory, stewardship theory, and risk management theory. The agency theory, developed by Jensen and Meckling (1976), explains the relationship between two parties: the principal party that assigns duties and responsibilities and the agent who executes those duties. The theory emphasizes the potential for conflicts of interest between the two parties, as the agent may act in their own self-interest rather than the principal's. The theory posits that a company consists mainly of a set of contracts between its economic resources (the owners, or principals) and its managers (the agents) who are responsible for managing the organization's assets. The theory recognizes that agents often possess more information than principals, which can create information asymmetry that makes it difficult for principals to determine whether their organization's interests are being served by their agents. Therefore, the theory views organizations as necessary structures for establishing contracts that can help control agents' behavior (Jussi & Petri, 2014). The agency theory was relevant to the study because internal controls are one-way organizations address agency issues and minimize the costs of agency that can impact profitability. The existence of internal audit, the nature of its job, and the specific approach internal auditors take can be explained using the agency theory. Therefore, the theory helps to explain the effect of internal audit on the management of public funds in Marsabit County, Kenya.

Stewardship theory was developed by Schoorman and Donaldson in 1997. The theory emphasizes employee empowerment and trust-based independence as essential for effective stewardship (Donaldson & Davis, 1997). According to the theory, staff and management should be as independent from investors as possible for optimal wealth development. As noted by Pirie and McCuddy (2007), stewardship theory promotes those good cultural practices in an organization, such as transparency, responsibility, accountability, and integrity. The theory encourages top management and the board of directors to work together to improve organizational performance in the foreseeable future by utilizing their capabilities (Schoorman, 2004). The theory is relevant to the current study in that risk management theory provides a comprehensive framework to understand how risk assessment influences the management of public funds (Ndifon, 2019). It highlights the importance of proactive risk identification, quantification, and mitigation in ensuring responsible governance, efficient resource allocation, and sustainable development. By integrating risk assessment into public fund management practices, governments can navigate uncertainties while safeguarding the interests of their constituents.

Internal audits assess the effectiveness of accounting processes. Marsabit County should conduct regular internal audits of its financial operations to ensure compliance with policies, accuracy of financial data, and the reliability of financial reporting. These audits provide insights into areas that need improvement. Audit reports provide valuable feedback to Marsabit County's management and stakeholders. Following an internal audit, the county should prepare detailed audit reports highlighting findings, recommendations, and suggested corrective actions (Mauli, & Rosmiati. 2020). These reports guide improvements and help ensure accountability. Internal audits involve reviewing financial transactions, controls, and processes. Marsabit County's internal audit team should conduct comprehensive evaluations of key financial activities, focusing on areas prone to risks or inefficiencies. Regular audit activities can uncover potential issues and contribute to continuous improvement (Mariwa & Ng’ang’a, 2021).

III METHODOLOGY

The study employed an explanatory research design. The target population was 54 employees in the county government of Marsabit drawn from the department of accounts and finance. Since the study population was less than 200 the study adopted census technique to include all the 54 respondents. Data was collected using a questionnaire as it provides more correct data that is obtained directly from the respondents. The questionnaire was structured in a Likert scale of 5 options. 5 respondents participate in the pilot study that was conducted in Baringo County. Further, these respondents were not part of the actual study. In this study, content validity, face and construct validity were used to measure the questionnaire contents and make sure that it is clear and it is of language that the respondents can understand without the help of a research assistant. The researcher involved the supervisor to evaluate the questionnaires items for validity. Face validity was assessed through subjective judgments by experts especially the research supervisor. Content validity is concerned with whether a measurement comprehensively covers the entire domain of the concept being measured. It involves evaluating the items or questions in a measurement instrument to ensure they adequately represent all aspects of the construct. Content validity was assessed through expert judgment, where subject matter experts review and rate the items for their relevance to the construct.

The reliability was determined using Cronbach's alpha test whereby an alpha value closer to 1 was sought. The researcher first sought permission from the St Pauls’ University to go out and collect data in form of introduction letter. After being granted the permission, the researcher then applied for authorization from National Commission for Science, Technology and Innovations (NACOSTI) to collect data from registered building contractors. With both the letter, the researcher proceeded to visit the administration of Marsabit County Government for introduction. The researcher then issued the questionnaires to the study respondent which was collected after two weeks. The time allocated for the respondents to fill in the questionnaires was meant to improve the response rate which is desired in this study since the sample size is small. This method of questionnaire distribution and collection is called Drop-Off and Pick-Up. The data that was gathered in this study was qualitative in nature. Quantitative data was analyzed by utilization of Statistical Package for Social Sciences (SPSS) version 24. Descriptive statistics was employed in the study. Descriptive statistics involved the use of percentages, frequencies, measures of central tendencies (mean) and measures of dispersion (standard deviation). Inferential statistics comprised correlation and regression analysis. The analyzed data was presented in form of tables. Pearson correlation was used to determine the relationship between various independent variables on the dependent variable while regression analysis was used to establish the effect of the independent variables on the dependent variable. Preliminary diagnostic tests were undertaken to ensure suitability of undertaking parametric statistics (correlation and multiple linear regression). The preliminary diagnostic tests included linearity test, normality tests and multicollinearity.

IV RESULTS

Response Rate

The study targeted a sample size of 54 respondents out of which 50 filled and returned the questionnaires giving a response rate of 96%. Four questionnaires were not obtained from the respondents. Therefore, with a 93% response rate, the study had a considerable sample size adequate for the research.

Internal Audit and Management of Public Funds

The study sought to establish the relationship between internal audit and management of public funds in Marsabit County, Kenya. The respondents were asked to indicate the aspect of internal audit. The results were as shown

Internal Audit and Management of Public Funds

Internal Audit Statement	SA	A	N	D	SD	N	Mean	Std
The County internal audit staff conduct regular audit activities which ensures effective management of funds	48%	28%	14%	10%	0%	50	4.140	1.010
Internal audit report addresses weaknesses in the County's internal control system	38%	36%	16%	10%	0%	50	4.020	.979
Internal auditor makes appropriate recommendations for management to improve	42%	36%	12%	10%	0%	50	4.100	.974
Internal auditor performs their duties with a greater degree of autonomy and independence from management	54%	24%	14%	6%	2%	50	4.220	1.036
Internal audit staff visits Sub County offices frequently	44%	34%	34%	12%	10%	50	4.120	.982

Budget reviews assist in enhancing financial accountability in county	46%	38%	8%	6%	2%	50	4.200	.969

From the findings 48% of the respondents strongly agreed that the county internal audit staff conduct regular audit activities which ensures effective management of funds, 28% agreed, 14% were neutral while 10% disagreed that the county internal audit staff conduct regular audit activities which ensures effective management of funds with a mean of 4.140 and a standard deviation of 1.010. In addition, 38% of the respondents strongly agreed that internal audit report address weaknesses in the county's internal control system 36% agreed, 16% were neutral, 10% disagreed that internal audit report address weaknesses in the County's internal control system with a mean of 4.020 and a standard deviation of 0.979

From the findings 42% of the respondents strongly agreed that internal auditor makes appropriate recommendations for management to improve, 36% agreed, 12% were neutral 10% disagreed while 4% strongly disagree that internal auditor makes appropriate recommendations for management to improve (mean of 4.100; a standard deviation of 0.974). Additionally, from the findings 54% of strongly agreed that internal auditor performs their duties with a greater degree of autonomy and independence from management, 22% agreed, 14% were neutral 6% disagree while 2% strongly disagree that internal auditor performs their duties with a greater degree of autonomy and independence from management (mean of 4.220; a standard deviation of 1.036). Further, 44% strongly agree that budget reviews assist in enhancing financial accountability in county, 34% agreed, 34% were neutral, 12% disagreed, while 10% strongly disagree that internal audit staff visits Sub County offices frequently (Mean of 4.120; a standard deviation of 0.982). Additionally, 46% of the respondents strongly agree that budget reviews assist in enhancing financial accountability in county, 38% agreed, 8% were neutral, 6% disagreed while 2% strongly disagree that budget reviews assist in enhancing financial accountability in county (mean of 4.200; a standard deviation of 0.969).

Inferential Statistics

The researchers undertook inferential statistics to make predictions of the relationship between variables and to test hypotheses.

Correlation Analysis

The researchers undertook correlation analysis to measure and assesses the strength and direction of the relationship between internal audit and management of public funds. The results are shown

Correlation Matrix

		Management of Public Funds	**Internal Audit**
Management of Public Funds	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	50	
	N	50	
Internal audit	Pearson Correlation	.828**	1
	Sig. (2-tailed)	.000	
	N	50	50

The study sought to establish the nature of the relationship between internal audit and management of public funds in Marsabit County, Kenya. The findings indicated that r=0.828 and p=0.000. The p value was less than the significant level of 0.00 meaning that there is positive statistically significant relationship between internal audit and management of public funds in Marsabit County, Kenya. This implies that internal audit has a significant statistical effect on management of public funds in Marsabit County, Kenya. The study findings concur with those of Endaya and Hanefah (2016) who argued that regular auditing provides a systematic and objective assessment of the financial management of public funds. The auditor examines the financial records, transactions, and other relevant documentation to verify their accuracy and ensure they follow relevant laws, regulations, and policies.

Regression Model Summary

The researchers used the value of adjusted R Squared to find out the strength of the relationship between internal audit and management of public funds in Marsabit County, Kenya. The findings are shown .

Regression Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.867[a]	.752	.730	.36261

a. Predictors: (Constant), Internal Audit

b. Dependent Variable: Management of Public Funds in Marsabit County, Kenya.

The obtained R-squared value implies that internal audit and the management of public funds in Marsabit County, Kenya have a positively, and linearly associated. In the case of the univariate analysis, adjusted R-Squared will be used as it provides a more precise view of the correlation by taking into consideration all the independent variables in the model. The value essentially represents the coefficient of multiple determinations. An adjusted R-squared score of 0.730 means that the estimated linear model with four aspects of internal audit accounts for 73.0% variation in management of public funds in Marsabit County, Kenya.

ANOVA of the Regression Model

ANOVA of the Regression Model

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	17.930	4	4.483	34.092	.000[b]
	Residual	5.917	45	.131		
	Total	23.847	49			

a. Predictors: (Constant) Internal Audit

b. Dependent Variable: Management of Public Funds in Marsabit County, Kenya.

The Analysis of Variance (ANOVA) output showed F value of 34.092 and the p-values of 0.000. The usual rule is to reject the null hypothesis when the computed F value is greater than the critical F statistic. In this case, the obtained p-value is less than the p-value of 0.05. The null hypothesis is thus rejected which led to a verdict that the model is statistically significant. It was further adjudicated that the output of multiple regressions could be used to infer the first three hypotheses of the study.

Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	**t**	**Sig.**
1(Constant)	.627	.490		1.280	.207
Internal Audit	.612	.207	.423	2.956	.005

Dependent Variable: Management of public funds in Marsabit County, Kenya.
The empirical model, internal audit was regressed on Management of public funds in Marsabit County, Kenya and the multiple regression model summarized as;
$Y = \beta 0 + \beta_1 X_1 + \varepsilon$………………………………
Where:
Y= is the Management of Public Funds
β0 = is the Constant Term
β1, is Beta coefficients
X_1 is the Internal Audit
ε = Error Term
The regression equation thus obtained from this output is:
$Y = 0.627 + 0.016X_1 + \varepsilon$
The multivariate regression model revealed the strength of the relationship between the study's independent and dependent variables. This implies that holding all factors constant, the management of public funds would stand at 0.627 or 62.7%.

Internal Audit and Management of Public Funds

The third objective sought to evaluate the relationship between internal audit and management of public funds in Marsabit County, Kenya. The third null hypothesis ($H0_3$) indicated that internal audit does not have a statistically significant relation with the management of public funds in Marsabit County, Kenya. Table 19 shows that the Beta value of internal audit was 0.612. Since the $P < 0.05$ level of significance, the null hypothesis was rejected and concludes that internal audit has a statistically significant relation with the management of public funds in Marsabit County, Kenya. The findings are in congruence with those of Babatunde and Olaniran (2017) which revealed that internal auditors contribute to the management of funds by conducting regular audits, assessing control effectiveness and recommending improvements to enhance financial accountability and transparency.

V DISCUSSION

The study revealed that there is a positive and a statistically significant relationship between internal audit and management of public funds in Marsabit County, Kenya. Moreover, the study revealed that internal audit report addresses weaknesses in the County's internal control system. The study further revealed that internal auditor makes appropriate recommendations for management to improve. Internal auditor performs their duties with a greater degree of autonomy and independence from management. The study also revealed that internal audit staff visits Sub County offices frequently. Further, the study revealed that budget reviews assist in enhancing financial accountability in county.

VI CONCLUSIONS AND RECOMMENDATIONS

From the hypotheses findings the study concluded internal audit has a statistically positive significant relation with the management of public funds in Marsabit County, Kenya. The study concluded that internal auditor makes appropriate recommendations for management to improve. Internal auditor performs their duties with a greater degree of autonomy and independence from management. The study further concluded that internal audit staff visits Sub County offices frequently. Further, the study concluded that budget reviews assist in enhancing financial accountability in county. The study further concluded that there is positive statistically significant relationship between internal audit and management of public funds in Marsabit County, Kenya. This implies that internal audit has a significant statistical effect on management of public funds in Marsabit County, Kenya. This includes reviewing financial statements, assessing the effectiveness of internal controls, and making recommendations for improvement. The internal audit function also helps to identify any potential weaknesses in the management of public funds, such as fraud or mismanagement, and makes recommendations for how to address these issues. Based on the study findings and conclusion, the study recommended that county governments should establish internal audit functions to conduct periodic assessments of their financial management practices. These internal audits should evaluate internal controls, identify potential risks, and provide recommendations for improvement. Since the study focused on the internal audit and the management of public finance, the researcher recommended that other studies should be conducted focusing on the segregation of duties on the management of public funds. Adoption of ICT on the management of public funds and monitoring and evaluation on the management of public funds. The researcher also suggested that since the study focused on Marsabit County alone, there is the need to conduct a similar study in other counties for comparison of the study findings.

VII REFERENCES

Government Accountability Office (GAO). (2021). *Standards for Internal Control in the Federal Government (Green Book).*

Controller and Auditor General (CAG) of Tanzania. (2021).

United Republic of Tanzania. (2016). "*Public Finance Management Act, 2016*." PDF

Pickett, K. H., & Graham, W. J. (2016). Internal audit in theory and practice: A comparison between public and private sector organizations. Managerial Auditing Journal, 21(6).

Sawyer, L. B., Matsumoto, K. J., & Wright, M. (2021). *The practice of modern internal auditing*. Wiley.

Government Accountability Office (GAO). (2021). Standards for Internal Control in the Federal Government (Green Book). https://www.gao.gov/greenbook/overview

Ahmed, A., & Nganga, S. (2019). Control environment and financial reporting quality: Evidence from the Nigerian banking industry. *Journal of Accounting and Financial Management*, *5*(2), 27-42.

Bessis, J., & O'Kelly, J. (2019). Effect of risk evaluation on performance of financial institutions. *Journal of Accounting*, 2(*1*), 54–68.

Diba, F. (2021). The impact of internal control on financial performance: Evidence from Iranian companies. *Journal of Finance and Accounting*, *9*(1), 1-13.

Dorozik, M. (2020). The impact of internal control on financial performance in the context of the digital economy. *Journal of Business, Management and Education*, *18*(1), 43-62.

Dunyoh, A., Ankamah, S., & Kosipa, L. (2022). Promoting stewardship behavior in organizations: A leadership model. *Journal of Business Ethics*, *80*(56), 121–128.

Florentin, M. (2019). The relationship between internal control systems and financial performance: Evidence from Romanian companies. *Journal of Economic Computation and Economic Cybernetics Studies and Research*, *53*(1), 197-214.

Khan, S. A., & Ahmed, K. (2021). An examination of government internal audits' role in improving financial performance. *Journal Public Finance and Management*, *11*(4), 306-337.

Mariwa, T., & Ng'ang'a, S. (2021). Control environment and financial performance of listed companies in Kenya. *International Journal of Economics, Commerce and Management, 9(*7), 108-124.

Mauli, S., & Rosmiati. (2020). Factors influencing internal control system effectiveness in public sector organizations. *Journal of Financial Crime*, *27*(1), 246-267.

Ndifon, R. A. (2019). Internal control and financial performance of selected listed deposit money banks in Nigeria. *Journal of Accounting, Finance and Auditing Studies*, *5*(2), 60-74.

Ondieki, K. M. (2019). Internal control systems and financial performance of microfinance institutions in Kenya. *Journal of Strategic Management*, *8*(4), 1-13.

Wabwire, S. M., & Bogonko, E. O. (2019). Effectiveness of internal control systems in managing risk in the banking sector in Kenya. *European Journal of Business and Management*, *11*(20), 140-155.