

**AN ASSESSMENT OF THE EFFECTIVENESS OF INTERNAL AUDIT SYSTEMS IN
THE MANAGEMENT OF DECENTRALISED FUNDS IN KENYA: A STUDY OF
LOCAL AUTHORITY TRANSFER FUND IN KISII MUNICIPAL COUNCIL**

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Requirements of the Award of Master of Business Administration Degree of Kisii
University College**

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DECLARATION AND RECOMMENDATION

This research project report is my original work and has not been presented for a degree or diploma in any other university

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DEDICATION

This research project report is dedicated to my husband Mr. Kennedy Machora and my children: Davis Achira, Mishael Atuti and Brian Nyangena.

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I would like to thank my supervisors: Dr. Charles Kombo Okioga and Mr. Patrick Ojera for their guidance in this study. I also sincerely thank my family members and my late mother, Pacifica Kerubo, who always encouraged me to work hard in school. She used to tell me that the sky should be the limit for my studies.

ABSTRACT

The purpose of this study was to assess the effectiveness of the internal audit systems in the management of LATF in Kisii Municipal Council. The study objectives were to determine whether the LATF disbursements were used in accordance with the objectives of LATF and to establish the effectiveness of internal audit systems in the disbursements and use of LATF. A descriptive study design (survey) was adopted in conducting this study. The researcher targeted the upper and middle cadre employees of the Kisii Municipal Council and the Councilors. The data were collected using structured questionnaires. The data analysis was undertaken using percentages and weighted averages. The study established that the internal audit systems were averagely effective in the management of LATF funds. This was a result of: the internal audit department not being fully independent; lack of enough trained personnel in the internal audit department; lack of division of duties in the department and lack of close supervision of projects. The study further established that there were delays in the release of LATF disbursements. The following recommendations were made. The Kisii Municipal Council should organize for the internal audit department to be fully independent. The department should not be a section of another department. This will enable the department to execute its duties well and with ease. The council should ensure that the department is well staffed with enough and trained personnel. This will enable division of duties and close supervision of projects. The managers of the council should organize for frequent meetings with the senior employees of internal audit department to formulate modalities of improving the effectiveness of the audit department. The Ministry of Local Government together with the Central Government should ensure that the LATF disbursements are released on time. The research offers the following suggestions for further study: a case study design should be applied so that we can find out whether it will give different results; further investigations can be done across industries to uncover the similarities and differences when using the internal audit systems in the management of finances; further research can be done by using other research instrument like the interview schedule or open ended questionnaire because this may give more information on this field of study; a further study should be carried out involving more than one LA because the present study focused on only one whose findings may not be generalized to all LAs and a replication of this study should be carried out in future to determine whether there are any notable changes.

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ACRONYMS / ABBREVIATIONS

LA	- Local Authority
LATF	- Local Authority Transfer Fund
KLGRP	- Kenya Local Government Reform Programme
KMC	- Kisii Municipal Council
LASDAP	- Local Authority Service Delivery Action Plan
KIPPRA	- Kenya Institute for Public Policy Research and Analysis
IIA	- Institute of Internal Auditors
CAE	-Chief Audit Executive
CCAB	-Consultative Committee of Accountancy Bodies
LG	-Local Government
DF	-Decentralized Fund
IT	- Information Technology

CHAPTER ONE

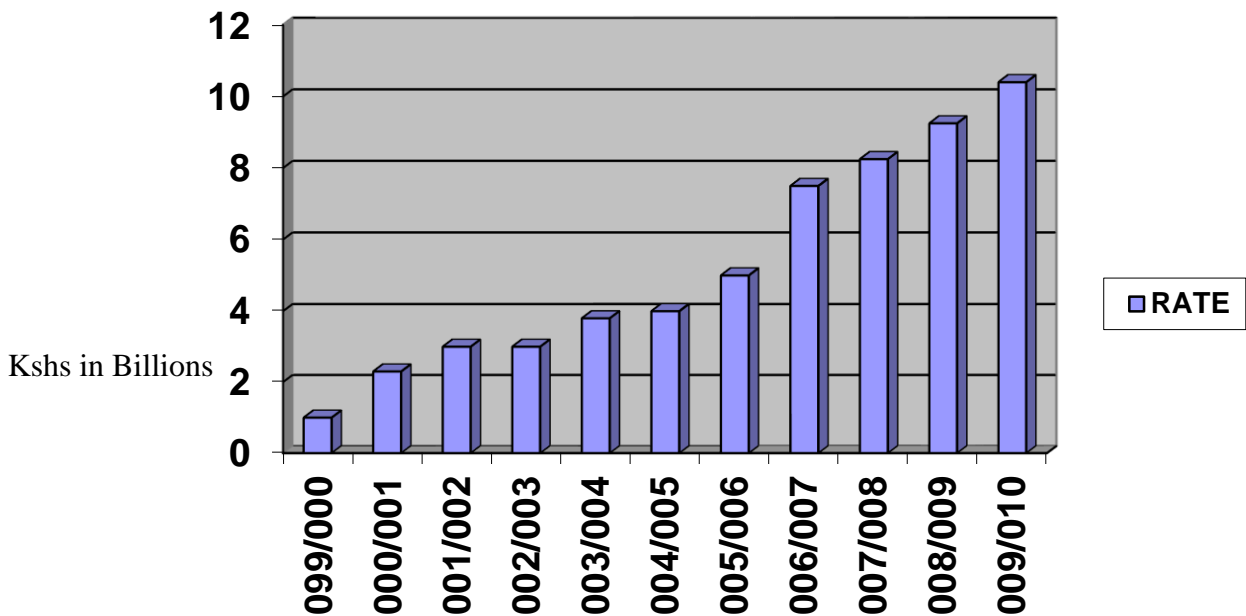
INTRODUCTION

1.1 Background to the study

The Ministry of Local Government through the Kenya Local Government Reform programme (KLGRP) has instituted a number of reforms aimed at strengthening the Local Government Institutional Capacity to effectively manage their revenues and expenditures, improve service delivery, enhance economic governance, promote citizen participation and alleviate poverty in their jurisdictions. One such reform is the establishment of the Local Authority Transfer Fund (LATF). LATF was established in 1999 through the LATF Act No. 8 of 1998, with the objective of improving service delivery, improving financial management and reducing the outstanding debts of Local Authorities (LAs). LATF, which comprises 5% of the national income tax collection in any year, currently makes up approximately 24% of local authority revenues (Oyugi, 2005). At least 7% of the total fund is shared equally among the country's 175 LAs, 60% of the fund is disbursed according to the relative population size of the LAs. The balance is shared out based on the relative urban population densities. LATF monies are combined with LAs revenues to implement local priorities. An advisory committee comprising the private sector, the ministry of finance, the permanent secretary ministry of local government and the KLGRP's secretariat, guides LATF operations. 60% of LATF allocations (the Service Delivery Account) are released based on LAs meeting set requirements like, upon LAs submission of the annual budget which must allocate a maximum of 50% of total expenditures for personal costs and a minimum amount that is equivalent to 65% of the Service Delivery Account for capital expenditures. In addition, LAs must provide certified confirmation that the amounts due to statutory creditors for the current year have been paid. The remaining 40% (the Performance Account) is released upon sub-mission of a statement of actual revenues and expenditures, debtors and creditors, abstracts of accounts, participatory service delivery plan-Local Authority Service Delivery Plan (LASDAP) and a revenue enhancement plan. Submissions must be timely, complete, include all required forms and be accompanied by full council minutes (Office of the Deputy Prime Minister and Ministry of Local Government, 2010).

LATF has risen from Kshs. 1 billion in 1999/2000 to Kshs. 10.4 billion in 2009/2010. The total LATF disbursement since inception amounts to 57.546 billion and the trend for all those years is shown in the figure below (KLGRP, 2010).

Figure 1. LATF allocations



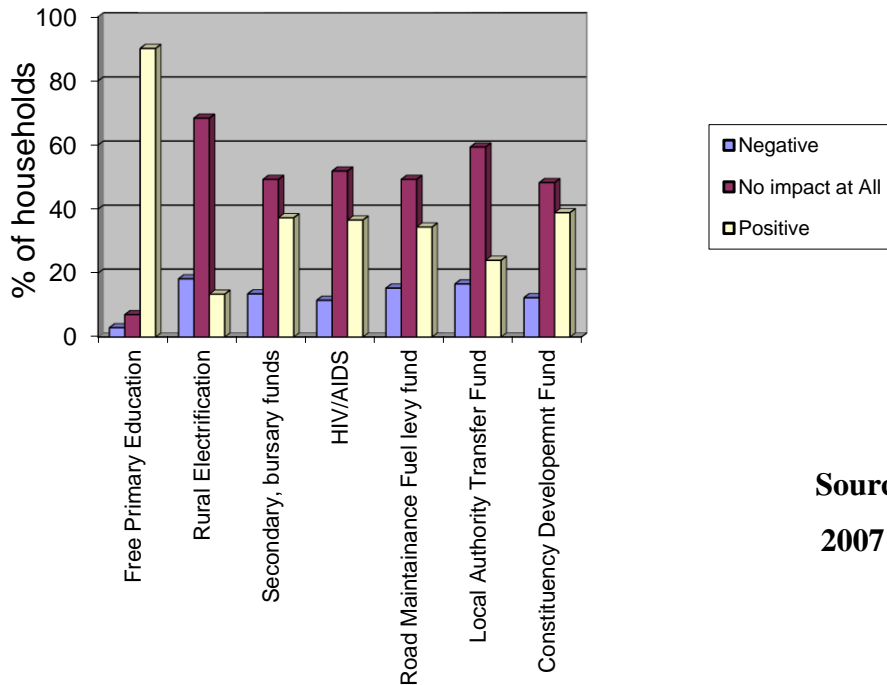
Source: KLGRP (APRIL 2010)

The above figure indicates an increase of LATF allocations every year except for 01/02- 02/03 where the amount remained constant. All LAs revenues and expenditures, including LATF monies, must be managed, executed and monitored in accordance with the Local Government Act, CAP 265. Elected councilors and local government officials as well as other local community and stakeholders groups are also responsible for monitoring proper budget execution and accountability. In addition, the Kenya national audit office is responsible for audit of LAs accounts. LATF monies are provided as budget support to LAs to be spent in accordance with local budget priorities, which are identified in consultation with the citizens and approved by full council and the deputy prime minister and minister for local government. Eligible local budget expenditures include those on personnel, operations, maintenance, debt resolution and capital projects. LATF policy is under the responsibility of the ministry of finance, while the administration is done by the permanent secretary, office of the deputy prime minister and

ministry of local government, who as the officer administering the fund, is responsible for ensuring that LATF monies are released and received in a timely and accountable manner by those LAs who comply with the LATF regulations(Office of the Deputy Prime Minister and Ministry of Local Government, 2010)

KIPPRA(2007), in their studies on the impact of decentralized funds indicated that the impact of LATF funds is rated among the worst when compared with other decentralized funds like Free Primary Education, Rural Electrification, Secondary Bursary Funds and Constituency Development Fund. Figure 2 below shows the impact of decentralized funds

Figure 2: Household rating of the impact of decentralized funds.



**Source: KIPPRA
2007**

KIPPRA(2007), in their study on accountability and performances indicated that in all other funds except Free Primary Education, a maximum of 15% of respondents rate accountability as good. More than double the number of respondents disagrees than agree that the various funds operate within their mandate, indicating the generally high levels of distrusts in fund managers with more than 30% of respondents indicating a lack of accountability within management.

Institute of Internal Auditors (IIA, 2004) defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objective by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The Treasury circular No. 16/2005 states in part that: "In order to enhance oversight, governance, accountability and transparency in the public service, the government has decided to enforce the establishment and strengthen audit committees in all ministries, departments, state corporations and local authorities. The audit committee will have the responsibility for independent in-depth review of the framework of internal control and of the internal audit process". The department of internal audit in the LAs has to employ qualified staff who meets the qualifications and requirement set out in the scheme of service applicable to local authority staff from time to time, and who will carry out internal audits evaluating the whole system of controls, financial and otherwise, established by the council in order to provide reasonable assurance of the local authority's operational effectiveness and efficiency, compliance with laws and regulations, the safeguarding of assets against unauthorized use or disposition and the maintenance of proper accounting records and reliability of financial information. The internal auditor conducts regular and continuous internal audits of the financial transactions of the local authority and reports any irregularities and /or inconsistencies to the audit committee, with copies to the clerk, the treasurer and the heads of departments. They also provide the necessary reports and support to Ministry of Local Government Inspectors, to the Controller and Auditor General and to any other outside auditors. They have unrestricted access to all establishments and financial records of the council and are entitled to require such explanations as he/she considers necessary to satisfy himself/herself of the correctness of any matter under examination. Effective internal auditing lead to better financial management (Office of the Deputy Prime Minister and Ministry of Local Government, 2008)

Rono (2006) in her study on the effectiveness of the Internal Control System in the management of finances in Public Universities in Kenya (a case of Egerton University) indicated that the Internal Control Systems in Egerton University were effective because the respondents indicated

an overall 70% effectiveness. This implied that the University had put in place Internal Controls and mechanisms to ensure adherence to the established controls set up by the university and the legislation by the government. The study indicated that the University had also set up monitoring units to ensure compliance to the laid down internal controls. Such monitoring units included Internal Audit Department, Audit and Governance Committee and Staff Development Committee. The setting up of strong monitoring units like the internal Audit Department can be borrowed by the LAs in their efforts in improving the management of LATF.

Oyugi (2005), in her study on Fiscal Decentralization in Kenya (The case of Local Authority Transfer Fund), concluded that LATF has not met its objectives of improving service delivery, financial management and debt reduction and that the performance of the programme has been constrained by a number of factors such as flawed regulations and lack of a coherent monitoring and evaluation framework. Her study recommended for the amendment of LATF regulations, provision of funds for capacity building in LAs and putting in place a coherent monitoring and evaluation framework. This study will therefore focus on the effectiveness of internal auditing, as one of the monitoring units, in the management of LATF.

1.2 Statement of the problem

LATF provides important resources and incentives to LAs to improve service delivery, improve financial management and help reduce debts. Through LATF, the government transfers 5% of the income tax revenues to 175 LAs annually (office of the Deputy Prime Minister and Ministry of Local Government, 2010). Despite the huge sums of money they receive, 77% of the LAs (135 councils out of 175) are not able to meet their recurrent expenditures among other obligations (Oyugi, 2005) for example, in the year 2007/2008, Mombasa council needed Ksh 50million to keep its books in order whereas Eldoret council required Ksh 29million to sort out its books of accounts(Gachiri, 2010). A recent study shows that over 30% of the LAs do not use the LATF funds for the intended purposes (KIPPRA, 2007). A recent report released by the minister of LG show that most councils' outstanding debts are on the increase every year for example the City Council of Nairobi has a debt of Kshs. 2.4 billion in 2009/2010 up from Kshs. 1.6 billion in 2008/2009 (Office of Deputy Prime Minister and Ministry for Local Government, 2010). This

brings into question the effectiveness of internal audit systems in the management of LATF. However, little research has been done to establish whether internal auditing assist in the management of LATF. This study, therefore sought to assess the effectiveness of internal auditsystems in the management of LATF in Kisii Municipal Council.

1.3 Research Objectives

1.3.1 General Objective

The overall objective of the study was to assess the effectiveness of internal audit systems in the management of LATF in Kisii Municipal Council.

1.3 Specific objectives

- i. To determinewhether the LATF disbursements were used in accordance with the objectives of LATF
- ii. To establish the effectiveness of internal audit systems in the disbursement and use of LATF
- iii. To come up with suggestions on how the internal audit department can improve the management of LATF

1.4 Research Questions

The study sought answers to the following questions:

- i. Are the LATF disbursements used in accordance with the objectives of LATF?
- ii. How effective is the internal audit systems in the disbursements and use of LATF?
- iii. What are the suggestions which can make the internal audit department improve the management of LATF?

1.5 Significance of the study

The study focused on the effectiveness of internal audit system in the management of LATF. The findings of the study were to assist the LAs to evaluate the effectiveness of internal audit in the management of LATF. It was also meant to assist the LAs to formulate strategies that will enable them to manage LATF better. The findings were to help the ministry of Local Government and the central government to know how well the LATF funds are managed. This will enable them to come up with better ways of managing and improving the kitty. The findings were also to be important to the public who will have an opportunity to know how well their money is used. The findings will also form a basis for further research. The findings will assist the LAs together with the Ministry of Local Government to point out areas that need capacity building programmes and fund them

1.6 Assumptions of the study

This study presumed important facts to be true or to exist but not actually verified. It was based on the following assumptions; First, the respondents of the sampled Local Authority were to respond more objectively and were to be truthful in revealing information regarding the effectiveness of internal audit systems in their departments. Second, the findings from the study will be of use to the management of the Local Authorities

1.7 The scope and justification of the study

The study concentrated on Local Authorities and their financial management. It sought to assess the effectiveness of internal audit systems in the management of LATF in Kisii municipal council of Kisii central district, Kenya.

Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. [IIA, 2004]. Generally, auditing is meant to detect error and frauds and prevent them from occurring [Millichamp and Taylor, 2008], hence leading into better management of finances in institutions and organizations. This is yet to be

quantified in the Kenyan LAs. Oyugi (2005), in her study on the Fiscal Decentralization in Kenya (a case of Local Authority Transfer Fund) concluded that LATF has not achieved its objectives because of many factors like politicization of the programme, and lack of a coherent monitoring and evaluation framework. One of her recommendations was that the LAs should put in place a coherent monitoring and evaluation framework. One of the monitoring units that are used to ensure compliance to the laid down internal controls is the internal audit department. Hence the needs to conduct a study on the effectiveness of internal audit systems in the management of LATF.

1.8 Limitations of the study

The scope of the study was narrowed to one unit of the LAs, Kisii municipal council in Nyanza because of time and financial constraints; hence generalization of the findings should be done with a lot of caution.

1.9 Definition of terms

Internal Auditing – It is an independent, objective assurance and consulting activity designed to add value and improve the local authority's operations. It helps LAs accomplish their objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Auditing – Is an independent examination of books of account and vouchers of LAs by a qualified auditor so as to ascertain whether the LAs have kept proper books of accounts as per the requirements and whether financial statements agree with the content of the books of account and whether such statements portray a true and fair view of the LAs state of affairs as at a given date.

Management Accounting – Is an integral part of management concerned with identifying, presenting and interpreting information used for formulating strategy, planning and controlling activities, decision taking, optimizing the use of resources, disclosure to shareholders and others external to the entity, disclosure to the employees and safeguarding assets (Lucey, 2008)

Accounting – is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part atleast, of a financial character and interpreting the results thereof (Alexander and Nobes, 1994).

Error – It is an unintentional mistake in financial information for example a clerical mistake in accounting data, posting figures wrongly which may include error of commission or omission in local authorities

Fraud - It is an intentional misrepresentation of financial information by one or more individuals among the management, employees or third parties and it may include manipulation, falsification and alteration of records and documents, misappropriation of assets usually for personal use for example cash in local authorities.

CHAPTER TWO: LITERATURE REVIEW

2.1 The concept of Internal Auditing.

There are several definitions of internal auditing some of which include: Internal auditing can be defined as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (IIA, 2004). The internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud (Millichamp and Taylor, 2008).

According to Manasseh (2007), Internal Auditing is a constant independent appraisal of the Company's/Organization's activities in a bid to ensure that the company runs in an orderly manner and is managed better so as to ensure strong controls in such organizations. According to Maheshwari (2004), internal auditing is a review of various operations of the company and of its records by the staff specially appointed for this purpose. The elements of effective Internal Audit Comprises; auditor independence good working relationship, proper staffing and training, exercising due care, evaluation of internal control systems, proper reporting and follow-ups, among others (IIA, 2004).

The main aim of internal audit is to provide independent and objective assurance to the Accounting Officer or equivalent officer, and the council, on the effectiveness of the risk management programs in the local authority. In respect of risk management, internal audit can either undertake assurance activities or consulting activities. An effective internal auditing activity should be able to provide independent and objective assurance on the effectiveness of risk management activities that help to ensure that key business risks are being managed appropriately. Internal Audit should: Give assurance that risks are correctly identified, analyzed and evaluated; and, give assurance that risks are being managed and maintained within the council's and government guidelines. Internal audit may provide the following consulting

services, provided that appropriate safeguards are in place: facilitating the identification and evaluation of risks by making available to the relevant officers the tools and techniques used by internal audit to analyze risks and controls, using internal audit's expertise in risk management and control, and overall knowledge of the local authority's operations and objectives to champion the established of a risk management framework, providing advice, facilitating workshops, and coaching accounting officers and other relevant officers on risk and control, and supporting the officers in identifying the best way to mitigate risk. The appropriate safeguards include: ensuring that it confirmed in writing that the accounting officers retain overall responsibility for risk management, ensuring that accounting officers decide the most appropriate responses to risk; internal audit should provide advice and offer critique without assuming responsibility and ensuring that internal audit does not perform any roles that constitute risk management. (KLGPR, 2008).

Independence is established by the organizational and reporting structure. Objectivity is achieved by an appropriate mind-set. The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relation to: Effectiveness and efficiency of operations, reliability and integrity of financial and operational information, safeguarding of assets and compliance with laws, regulations, and contracts. Based on the results of the risk assessment, the internal auditors evaluate the adequacy and effectiveness of how risks are identified and managed in the above areas. They also assess other aspects such as ethics and values within the organization, performance management, communication of risk and control information within the organization in order to facilitate a good governance process. The internal auditors are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified. While management is responsible for internal controls, the internal audit activity provides assurance to management and the audit committee that internal controls are effective and working as intended. The internal audit activity is led by the chief audit executive (CAE). The CAE delineates the scope of activities, authority, and independence for internal auditing in a written charter that is approved by the audit committee. An effective internal audit activity is a valuable resource for management and the board or its equivalent, and the audit committee due to its understanding of the organization and its culture, operations, and risk profile. The objectivity, skills, and knowledge of competent

internal auditors can significantly add value to an organization's internal control, risk management, and governance processes. Similarly an effective internal audit activity can provide assurance to other stakeholders such as regulators, employees, providers of finance, and shareholders. As the primary body for the internal audit profession, the IIA maintains the International Standards for the Professional Practice of Internal Auditing and the profession's Code of Ethics. IIA members are required to adhere to the Standards and Code of Ethics (The IIA Research Foundation, 2004). Internal audit is an independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic and effective use of resources (CCBA, 1990).

The key objectives of internal audit are stated as being: Assisting accounting officers in ensuring prudent financial management, risk management, control and governance processes, providing an independent objective assurance and consulting services designed to add value and improve government operations by assisting accounting officers and audit committee in the effective discharge of their duties and responsibilities. (IIA, 2004).

2.1.1: The role of Internal Auditor

The duties and responsibilities of internal auditors are to: Conduct systems audits to provide reasonable assurance that key local authority operating systems such as cash management, procurement, transport, revenue and asset management are functioning effectively and that the government's strategic and operational objectives are being met consistently, efficiently and in a cost effective manner, conduct Risk Based Audits to provide reasonable assurance that risk management processes and structures put in place by management are functioning effectively and recommending appropriate risks mitigation measure where necessary; provide consulting services to Local Authorities in developing appropriate risk management, control and governance frameworks and enhance the level of assurance provided to management; conduct value for money performance audits geared towards economic, effective and efficient use of public resources and sound management of public expenditure with the view to enhancing value for tax payer's money; conduct Information Technology (IT) supported audits, including payroll audits, with the view to enhancing internal controls in computerised environments; review,

analyse, and evaluate budgetary allocation and periodical budgetary performance reports submitted to treasury by line ministries to ensure that the allocation and expenditure patterns are in line with ministry's strategic objectives and that there is evidence of prudent and effective utilization of budgetary resources; review and evaluate Annual Appropriation Accounts, fund accounts and statements of asset & liabilities before they are submitted to controller and auditor general by accounting officers; verify and analyse periodical financial returns that are required to be submitted to the ministry of local government and/or treasury by local authorities from time to time (such as pending bills returns, expenditure returns, imprest returns, revenue, staff returns and vehicle returns); review and evaluate documents used in initiating commitments such as contract agreements, provide secretarial support to the local authority audit committee (Kenya Local Government Reform Programme,2008).

2.1.2 Internal Auditing Theories

Internal auditing theories can be borrowed from the theories for auditing. One of these theories is the agency theory. Agency is the name given to the practice by which productive resources owned by one person or group are managed by another person or group of persons. At its simplest agency theory is the recognition that the inclination of agents, in this case the directors or managers of the business, is to act rather more in their own interest than those of their employers and shareholders. The Institute of Chartered Accountants in England and Wales, in November 2006, put it this way: - In principle, the agency model assumes that no agents are trustworthy and if they can make themselves richer at the expense of their principals they will. The poor principal, so the argument goes, has no alternative but to compensate the agent well for their endeavors so that they will not be tempted to go into business for them using the principal's assets to do so. The origin of auditing goes back to times scarcely less remote than that of accounting. Whenever the advance of civilization brought about the necessity of one man being entrusted to some extent with the property of another the advisability of some kind of check upon the fidelity of the former would become apparent. The extent to which principals don't trust their agents will tend to determine the level of the monitoring mechanism created for the overview of agents' activities and the extent to which agents' compensation levels are determined to be acceptable. Upon this principle rests the foundation of auditing profession. (Millichamp

and Taylor, 2008). As mentioned in the agency theory, the problem which has always existed when managers report to owners is – can the owners believe the report?

The report may;- contain errors, not disclose fraud, be inadvertently misleading, be deliberately misleading, fail to disclose relevant information and fail to conform to regulations. The solution to this problem of credibility in reports and accounts lies in appointing independent professionals called auditors to investigate the report and report their findings (Millichamp and Taylor, 2008).

Internal Auditing is a branch of auditing where by, auditing is an independent examination of books of account and vouchers of an enterprise by a qualified auditor so as to ascertain whether the enterprise has kept proper books of accounts as per the requirements of the company's act and whether the financial statements agree with the content of the books of account and whether such statements portray a true and fair view of the company's state of affairs as at a given date (Manasseh, 2007).

Auditing is a branch of management accounting whereby management accounting is an integral part of management concerned with identifying, presenting and interpreting information used for formulating strategy, planning and controlling activities, decision taking, optimizing the use of resources, disclosure to shareholders and others external to the entity, disclosure to the employees and safeguarding assets (Lucey, 2008). The above involves participation in management to ensure that there is effective:- Formulation of plans to meet objectives, formulation of short term operation plans, acquisition and use of finances and recording of transactions, communication of financial and operating information, corrective action to bring plans and results into line, and reviewing and reporting of systems and operations. Management accounting, therefore, is primarily concerned with data gathering (from internal and external sources), analyzing, processing, interpreting and communicating the resulting information for use within the organization so that management can more effectively plan, make decisions and control operations. Management accounting is a branch of accounting whereby accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information. (Lewis & Pendrill, 2004). There are some factors that can hinder the results on the management of funds despite effective internal auditing.

Some of these include:- Governance – a governance framework comprises a mission to be accomplished with clear rules and recognized conventions to guide its accomplishments. In the context of local authorities (LAs), governance could be said to be concerned with the manner in which power is exercised in the management of LA's economic, social and human resources for sustainable development. Good governance is an aid to effectiveness; monitoring and evaluation. All local authority revenue and expenditures including LATF monies must be managed, executed and monitored in accordance with the Local Government Act, Cap 265. Elected councilors and local government officials, as well as other local community and shareholder groups are also responsible for monitoring proper budget execution and accountability. In addition, the Kenya national audit office is responsible for the audit of LA accounts. Proper monitoring and evaluation leads to effectiveness; release of the LATF fund – LATF is disbursed to the LAs in three tranches: 30th September – 45% of the total LATF allocations, 31st January – 39% of the total LATF allocations and 30th April – 16% of the total LATF allocation. Disbursement of these funds without delays leads to effectiveness (Office of the Deputy Prime Minister and Ministry of Local Government, 2010).

2.1.3: Emergency of the auditor

A series of company Acts, commencing in 1844, gradually developed to meet the need for stewards to account for their transactions and in time incorporated requirements that the stewardship accounts should be subjected to examination by independent experts – the auditor – who would then report (normally annually) the results of their findings to the shareholders who had appointed them. It is a relatively recent requirement that auditors should have a recognized qualification as a mark of their competence: before 1948, auditors required no external professional qualification. Subsequent companies Acts have, however, moved steadily towards such a stipulation, so that, in effect, all auditors must now be professionally qualified. Progress in auditing has been measured during the post-war decades in terms of the development of new and advanced audit methods and techniques. When company and case law first gave prominence to the audit function, there was no defined limitation to audit responsibility all investors, whether shareholders or creditors, were entitled to look upon the auditor as the guardian of their various interests. As time went on, case law gave more precise definition to this growth in accountability,

but throughout the nineteenth century there was little to suggest that audit responsibility should be confined to shareholders (Millichamp and Taylor, 2008).

Case judgments ranged wide and free over such matters as investment losses, recklessly optimistic prospectuses, determination of distributable profits, non-detection of cash and stock thefts, unjustifiable reliance on third party certificates, management frauds and window-dressed financial statements to select but a few. (Emile, 1997)

2.1.4 The essentials for effective internal auditing

There are several essentials for effective internal Auditing. They include the following:

2.1.4.1: Auditor Independence

The internal auditor should have the independence in terms of organisational status and personal objectivity which permits the proper performance of his duties. Internal auditors should be sufficiently independent of the activities that they audit to enable them to perform their duties in an impartial manner, and offer unbiased judgements and recommendations. Internal auditors should have an impartial, unbiased attitude characterized by integrity and objective approach to work. They should also avoid conflicts of interest and not allow any external factors to compromise their professional judgment. A key indicator of professional independence is that internal auditors should not have any executive (management) or other functional responsibilities at the units they audit. Consequently, Internal Auditors should maintain an independent attitude and appearance, and an objective and impartial mental attitude during audit assignments. Relationship between the internal auditors and the auditor must be seen to be independent by the authorities that need to rely on the work of internal auditors. Audit opinions and reports should only be based on the evidence obtained during the review; internal auditors should not misrepresent facts, or subordinate their judgement to others. They should offer constructive, value-adding advice (IIA, 2004). Independence may be impaired in fact, or appearance, by a number of factors including: Restriction of access to sources of information, actions or persuasion designed to influence the conduct, scope of an audit, or the content of an audit report and previous deployment by the local authority being audited, or association with its executive decision-making mechanisms, unless a suitable period (at least two years) has elapsed since the

auditor's involvement with the activity being audited. Attributes that will demonstrate that the internal auditor is conducting his/her duties independently include: Being fair and not allowing personal prejudices to override objectivity, declaring any conflicts of interest and not accepting any gifts, inducements, or other benefits from employees of the Local Authority or activity being audited, or its suppliers and other third parties (KLGRP, 2008).

2.1.4.2: Staffing and training of auditors

The internal audit unit should be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives. The internal auditor should be properly trained to fulfil all his responsibilities (IIA, 2004). The Head of Internal Audit, through the Clerk, should ensure that the department has access to the full range of knowledge, skills, qualifications and experience to meet the department's operating objectives. In addition to internal auditing skills, internal auditors may need to gain other skills that could be needed by the department, including IT skills, investigative skills. Internal auditors are responsible for continuing their education in order to maintain their proficiency. They should keep themselves informed about current developments in internal auditing (KLGRP, 2008).

2.1.4.3 Auditors' Relationships with others

The internal auditor should seek to foster constructive working relationship and mutual understanding with management, with external auditors, with any other review agencies and, where one exist, the audit committee (IIA, 2004). Internal Audit provides a support service to the Local Authority audits senior officers. Co-operative relationships with such officers enhance internal audit's ability to achieve its objectives effectively. Audit work should be planned in conjunction with such officers as far as possible, particularly in respect of the timing of audit work. Consequently, internal auditors should discuss internal audit plans and activities with the Clerk, Treasurer and other Heads of Departments and plan to cover any priority /high risk issues highlighted by the officers. However, internal audit retains the right to plan its work including deciding the nature of reviews to be done. Internal audit can also undertake spot check visits

without reference to the Local Authority's senior officers or line managers. Management and staff of the Local Authority should have complete confidence in the integrity, independence and capability of internal audit. The relationship between internal auditors and the staff and officers of the local authority is a privileged one hence any information gained in the course of audit work should remain confidential to those with legitimate interest. Officers and staff of the Local Authority should not delegate or assign any management roles or responsibilities to internal auditors ((KLGRP, 2008).

2.1.4.4: Professionalism in Auditing

The internal auditor should exercise due care in fulfilling his responsibilities. Exercising due professional care means working with the competence and diligence expected of a reasonably prudent person. It also means the use of audit skills and judgement based on appropriate experience, training (including continuing professional development), ability, integrity and objectivity. Due professional care means evaluating the nature and risks involved in the audit and taking appropriate steps to obtain and evaluate necessary evidence and to prepare audit reports. The internal auditor should exercise due professional care in planning and carrying out their audit work, in gathering and evaluating evidence, and in reporting findings. Due professional care should be appropriate to the objectives, complexity, nature and materiality of the audit being performed. The internal auditor needs to be alert for situations, control weakness, inadequacies in record keeping, errors and unusual transactions or results which could be indicative of fraud, improper or unlawful expenditures, unauthorized operations, waste, inefficiency or lack probity(honesty). Attributes that will demonstrate that the internal auditor is conducting his/her work with due professional care include:- Considering and documenting the work needed to achieve audit objectives, and all the work performed during the audit, considering and documenting the criteria used in evaluating audit findings and using all reasonable care and attention to obtain sufficient, relevant and reliable evidence on which to base audit conclusions (IIA, 2004).

2.1.4.5: Planning, Controlling and Recording

The internal auditor should adequately plan, control and record his work (IIA, 2004). Management of the internal audit activity comprises the following activities: Planning for the Internal Audit work - establishing risk-based plans to determine the priorities of the internal audit activity, which should be consistent with the Local Authority's goals, communication and approval - communicating the internal audit activity's plans and resource requirements, to senior management, and to the Audit Committee for review and approval. The internal auditor should also communicate the impact of any resource limitations, for instance, where personnel constraints mean that the annual plan of work cannot be achieved and managing internal audit resources Ensuring that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved strategic, annual and engagement plans (KLGPR, 2008).

2.1.4.6: Evaluation of the internal control system

The internal auditor should identify and evaluate the organisation's internal control system as a basis for reporting upon its adequacy and effectiveness. The Committee of Sponsoring Organizations framework defines internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:- Effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations. Effectiveness and efficiency of operations includes the safeguarding of assets, that is, the prevention or timely detection of unauthorized acquisition, use or disposition of the entity's assets. It also includes responding appropriately to the business risks that face the organization (IIA, 2004). An effective internal control system will assist the LA meet the following objectives pertaining to its operations:- ensure the efficiency, effectiveness and economy of operations, processes and procedures, safeguard the LA's assets by preventing policies, procedures and instructions, and the relevant external laws and regulations, ensure compliance with internal policies, procedures and instructions, and the relevant external laws and regulations and ensure the integrity and reliability of financial and other management information by ensuring that such information is timely, accurate, and relevant for effective decision-making. Whatever their nature or composition, controls should achieve the objective of controlling the processes to which they

relate and together provide an adequate internal control system over all the operations of a department.

Components of an effective system of internal control include:- the control environment – shared ethical values, including integrity, should be established, communicated and practiced throughout the organization; identification and evaluation of risk and control objectives – objectives should be established and communicated; information and communication – communication process should support the organization’s values and the achievement of its objectives; control procedures – policies designed to support the achievement of an organization’s objectives and the management of its risk should be established, communicated and practised so that staff understand what is expected of them and monitoring and corrective action – performance should be monitored against the targets and indications identified in the organization’s objectives and plans(KLGRP, 2008).

2.1.4.7: Audit Evidence

The internal auditor should obtain sufficient, relevant and reliable evidence on which to base reasonable conclusions and recommendations. Work papers are record of information developed by the internal auditor performing an audit engagement to support the findings, observations, recommendations and conclusions contained in an audit report. Audit evidence should be contained in the working papers, which should record all audit evidence collected during the audit review. The working papers should represent a clear record of the entire audit process, procedures, findings, conclusions and reports. Working papers should be capable of standing on their own without requiring any supplemental oral explanation from the auditor(s) who did work. Consequently, an independent reviewer should be able to understand all of the audit work performed, the findings and how exceptions and other issues were resolved, and the conclusions drawn from the work (IIA, 2004).

2.1.4.8: Reporting and follow-up

The internal auditor should ensure that findings, conclusions and recommendations arising from each internal audit assignment are communicated promptly to the appropriate level of management and he should actively seek a response. He should ensure that arrangements are

made to follow up audit recommendations to monitor what action has been taken on them. (CCAB, 1990). In addition to the follow-up procedures by internal audit, accounting officers should be required to prepare a quarterly report on the status of implementation of audit recommendations. Such reports should indicate in respect of all current reports whether action has been taken in accordance with report recommendations and if not, why and proposed time scale for implementation (KLGRP, 2008).

2.2 Empirical Literature

Haylas and Ashton (1982) in their efforts to provide evidence on the effectiveness of the particular audit techniques in detecting errors that affect the financial statements and on the causes of such errors conducted a study of 281 errors requiring financial statements adjustments. The results of the study suggested that all of the intentional errors are concentrated in relatively few audit areas majority of such errors affect income but the direction of the effect may either be an understatement or overstatement. Regarding signaling off an error, they found that a large portion of financial statement errors are initially signaled by less vigorous audit procedures such as analytical review and discussion with clients. Client personal problems such as inexperience, incompetence and insufficient knowledge and inadequate control, follow up or review were found instrumental in causing more errors.

Salih (1983) evaluated the internal controls of Ethiopian Airlines, Nairobi branch office and concluded that lack of segregation of accounting and custodian functions was the greatest weakness of the Branch office. He argued that there is need to centralize cash receipts, establish an internal audit, separate duties of purchase activities, establish perpetually inventory system for tickets.

In an attempt to define a client's control environment from the auditor's perception, Haskins (1987) identified 48 client control attributes and their perceived levels of importance in adequately describing a client's control environment thus serving to define more clearly audit planning concepts. Audit firms, firms' specialization and audit rank were found to be significant

mediating contextual variables and that seniors had the largest share of the evaluation of internal control attributes responsibility.

Schneider and Wilners (1990), in their study examined the effectiveness of internal audit and external audit in determining financial reporting irregularities. They conducted an experimental study that examined the effects of manager's perception of internal and external auditing on the potential of financial irregularities. A total of 264 subjects, the majority of whom were experienced managers were required to make decisions on three cases involving materiality type of irregularity, perceived extent of Generally Accepted Accounting Standards (GAAP) violation and incentives for misstating income. The decisions were made in a situation where there was no auditing at all, only internal auditing or external auditing. The results clearly supported internal and external auditing as deterrents to financial reporting irregularities when all of the four factors were present. It was also found that internal auditing effects were similar to those of external auditing. The study, however, suffered from the inability to explain why the existence of audits was perceived as having deterrent effects (Schneider and Wilners, 1990).

Ismailjee (1993) evaluated the internal controls of the Nyayo Bus Service Corporation, Nairobi and concluded that the analysis conducted on the cash receipts as well as the cash disbursements and the purchase cycle areas bore fairly strong controls. He attributed this largely to the fact that the government accounting system was still in operation in those areas. He however found weakness in the organization chart, payroll and the stores accounting system.

Oyugi (2005), in her study on fiscal decentralization in Kenya (a case of Local Authority Transfer Fund) analyzed the administration of LATF and its performance. She identified various challenges constraining the implementation of the programme. The findings of the study revealed that: LATF has not met its objectives of improving service delivery, financial management and debt reduction; and that the performance of the programme has been constrained by a number of factors such as flawed regulations, politicizing of the programme, and lack of coherent monitoring and evaluation framework. The study recommended for the amendment of LATF regulations, and putting in place a coherent monitoring and evaluation framework among others.

One of the monitoring units organizations have is the Internal Audit Department. This study therefore focused on the effectiveness role of Internal Audit as one of the monitoring units, in the management of LATF.

Rono (2006) studied on the effectiveness of the internal control system in the management of finances in public universities in Kenya. The study sought to determine whether there was a significant difference in the evaluation of the effectiveness of the internal control system in the financial management between the academic and non-academic departments in Egerton University. It concluded that the evaluation of the effectiveness of the internal control systems in the university depended on the category of the departments. The research revealed that the internal control systems in Egerton university were effective due to the well established departments charged with the responsibility of implementing the internal controls as they carry out the financial processes for example, finance, supplies and personnel departments with their various sections like cash office, salaries, computer, debtors and creditors.

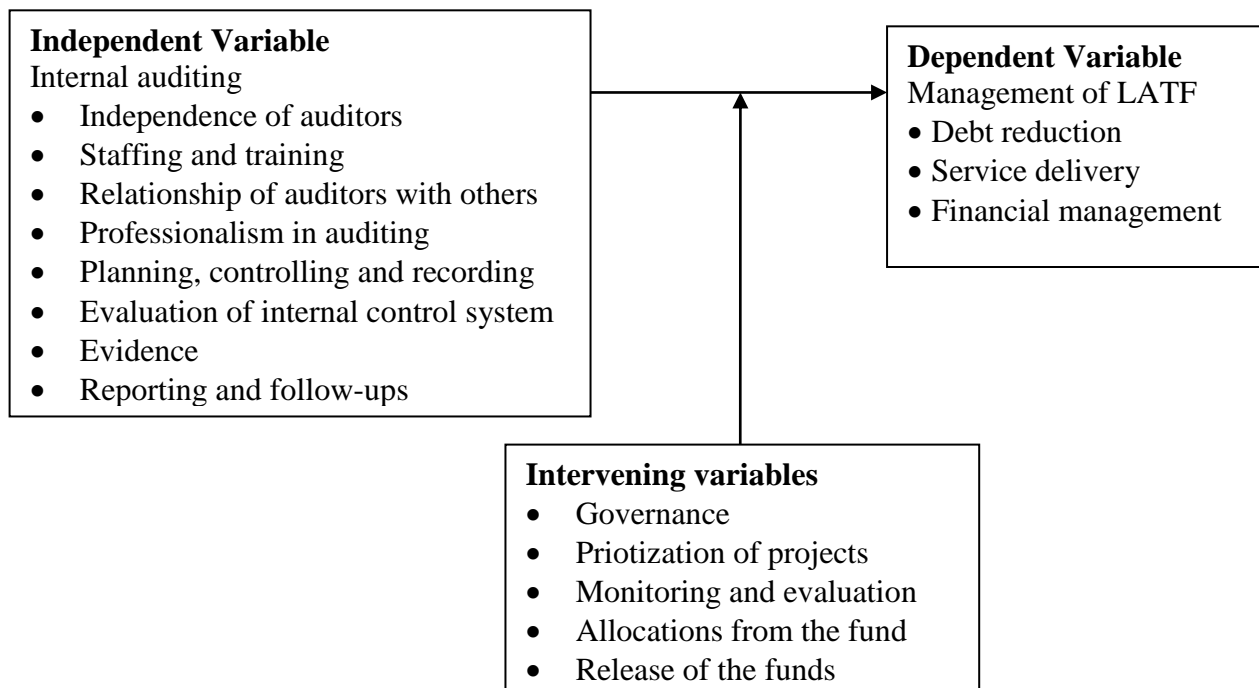
From the above, it is evident that a lot of research has been done on the evaluation and effectiveness of internal control systems in various organizations like Ethiopian Airlines and Nyayo Bus services; and institutions like public universities (a case of Egerton University). However, little research has been done on the effectiveness of internal audit systems in the management of finances in institutions and organizations. This study therefore focused on the effectiveness of internal audit systems in the management of LATF funds in Kisii Municipal Council.

2.3 Conceptual Framework

With internal auditing, auditors are able to detect and/or prevent errors and fraud (Millchamp and Taylor, 2008). The internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud (IIA attribute standard 1210). Detection of errors and fraud and their prevention translates to reduced errors and fraud and hence better management of funds in any organization. LATF can also be managed well with effective internal auditing. Effective internal auditing requires internal auditors be independent in their work, be well staffed and

trained, exercise due care, have a good relationship with others in management and outside the management, do proper planning, controlling and recording in their work, do proper evaluation of the internal control system, and make proper reporting and follow-up. Failure to do the above, then, internal auditing will not serve its purpose. Effective management of LATF will lead to improved service delivery, reduction of debts and improved financial management. However, there can be intervening factors which will affect results. Some of these intervening factors include: governance (for example poor governance - corruption); prioritization of projects; Monitoring and Evaluation- there can be lack of professional and technical supervision which can lead to poor project quality; and at the same time there can be low community participation in monitoring and evaluation due to the inadequacy of data and general information about the funds; Allocations from the fund and the release of the funds are other intervening factors which can affect the management of LATF even with proper and effective internal auditing. The interrelationships described above are summarized in figure 3 below.

Figure 3: Conceptual Framework



Source: The Author

CHAPTER THREE: METHODOLOGY

3.1 Design of the Study

A descriptive study (survey) design was adopted in conducting this study. Descriptive research is a process of collecting data in order to test hypotheses or to answer questions concerning the current status of the subjects in the study. Descriptive research determines and reports the way things are. Mugenda and Mugenda, (2003) also supports this. This design proved useful as respondents were given time to respond without any interference and manipulation hence information was generally obtained much faster.

3.2 Area of Study

The study was carried out in Kisii Central District within the Jurisdiction of Kisii Municipal Council. This municipality covers 29 square kilometers and it serves such markets as Bobaracho, Mwembe, Menyinkwa, Daraja Mbili, Getare and Kisii Municipal Market

3.3 Target Population

The researcher targeted a total population of 124 upper and middle cadre employees and councilors consisting of 3 top managers of the council, 100 departmental employees, 5 heads of departments and 16 councilors of the Kisii Municipal Council. A staff establishment list of the council was used as the sampling frame from which the required sample will be drawn.

3.4 Sampling and Sampling Techniques

The sample size of the study was 62 respondents consisting of 2 top managers, 5 heads of department, 5 councilors and 50 departmental employees. This was 50% of the target population which was appropriate because according to Nwadiuto Nkpa (1997), where a target population runs into hundreds, a sample population of 50% is recommended or adequate and where the

target population runs into thousands the sample population should be 15% - 20 %. The target population for this study was 124. The researcher will use stratified, random and purposive sampling techniques because the target population was classified into three subgroups namely; Top managers, councilors and departmental employees. Stratified, random and purposive sampling enabled the researcher to achieve desired representation from the various sub-groups in the population. Purposively, the researcher selected 2 in the top management, 5 councilors who are chairmen of the various departments in the council and all the 5 heads of departments into the sample.

3.5. Procedure of Data Collection and Data Collection Instruments

An introductory letter was obtained from the department of business and administration, Kisii University College which proved to the management of the sampled unit of study, Kisii Municipal Council (KMC) that the researcher was officially authorized to undertake the study. The researcher sought permission from the management of KMC and then administered the questionnaires to the top managers, departmental employees and councilors. The researcher collected completed questionnaires at the end of each day.

Structured questionnaires were administered by the researcher to collect quantitative data. To ascertain the effectiveness of the questionnaire, a validation process was carried out. The supervisors examined the contents of the questionnaires and gave recommendations. Necessary adjustments were made to accommodate the recommendations of the supervisors hence improving the validity of the instrument. A pilot study was used to test for the validity of the questionnaire before it was administered.

3.6 Data Analysis and Presentation

Quantitative data were analyzed using descriptive statistics that is frequency, distributions, percentages and weighted averages, and the results were presented using tables.

**CHAPTER FOUR:
DATA ANALYSIS, RESULTS AND DISCUSSION**

4.1 Questionnaire Response rate

Questionnaires were issued to 62 Councilors and Council workers out of which 56 were successfully filled and returned giving a response rate of 90.3%. This is illustrated in the table below.

Table 4.1: Response rate.

Particular	Sample	Percentage
Those who responded	56	90.3
Those who did not respond	6	9.7
Total	62	100

Source: Field data (2010)

4.2 Characteristic of respondents

Respondents were grouped into four categories that is top managers, heads of departments, other departmental employees and councilors. Respondents were asked to identify themselves with the group they belong. Those who responded as per the above groupings are shown in the table 4.2 below:-

Table 4.2 Characteristic of respondents

Respondent group	sample	Target sample	Percentage (%)
Top managers	2	2	100
Heads of department	5	5	100
Other departmental employees	45	50	90
Councilors	4	5	80
Total	56	62	

Concerning the characteristic of respondents, 100% of the targeted top managers responded to the questionnaires successfully; 100 percent of the heads of department successfully completed their questionnaires; 90% of other departmental employees successfully completed their questionnaires too and 80% of the targeted councilors successfully completed their questionnaires.

4.3 Use of the LATF disbursements to achieve the objectives of LATF

The first objective of the study was to determine whether LATF disbursements were used in accordance with the objectives of LATF: to improve service delivery, to improve financial management and reduce council debts. Below are descriptive findings on this objective.

Table 4.3: Use of LATF disbursements to achieve LATF objectives: to improve service delivery, to improve financial management and to reduce debts.

	Most dissatisfied 1	Dissatisfied 2	Moderately satisfied 3	Satisfied 4	Most satisfied 5	$\sum f$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Improve service delivery	0	0	0	30	26	56	250	4.464
Improve financial management	0	2	0	46	8	56	228	4.071
Reduce debts	0	0	0	30	26	56	250	4.464

Source: Field data (2010)

On whether LATF was being used to improve service delivery, responses as indicated by the huge weighted average of 4.464 show that it does. This implies that LATF disbursements are used

by Kisii Municipal Council in improving its service delivery. This finding is in contradiction with Oyugi (2005) finding that LATF funds have not met the objective of improving service delivery and the establishment by KIPPRA (2007) that LATF is not used for the intended purposes by LAs.

On whether LATF disbursements were being used to improve financial management, responses as indicated by the huge weighted average of 4.071 show that it does. The results show that LATF disbursements are used in improving the financial management. However the finding is at variance with the finding by Oyugi (2005) which indicated that LATF disbursement has not met the objective of financial management and the establishment by KIPPRA (2007) that LATF is not used for the intended purposes by LAs. The variance could have been as a result of Oyugi and KIPPRA covering a wider region as compared to this research.

On whether LATF disbursements were being used to reduce debts, responses as indicated by the weighted average of 4.464 shows that LATF funds have achieved this objective. This finding contradicts a finding by Oyugi (2005) which indicated that LATF has not met the objective of reducing debts and the establishment by KIPPRA (2007) that LATF is not used for the intended purposes by LAs.

4.4 Release of LATF funds

Respondents were asked to indicate whether LATF funds were released on time. Their responses were as indicated in the table 4.6 below.

Table 4.4: Release of LATF (whether always delayed or not)

Response	Sample	Percentage
Strongly Agree	10	17.9
Agree	22	39.3
Neutral (undecided)	6	10.7
Disagree	18	32.1
Strongly disagree	0	0
Total	56	100

Source: Field data (2010)

On the release of LATF funds, responses as illustrated above indicates that 57.2% agree that the disbursement were always delayed whereas 32.1% disagreed. The Researcher finds that this will have a negative effect on the achievement of the objectives of LATF because these funds can not be used within the targeted time.

4.5 Internal auditing of LATF

The second objective of the study was to determine the effectiveness of internal auditing systems in the disbursements and use of LATF. Respondents were asked questions relating to whether LATF funds are audited, involvement of employees in the discussion of audit reports, whether audit reports reflect the true picture of the Council, adherence to audit reports' recommendations and effectiveness of audit systems, frequency of auditing, release of audit reports, discussion of audit report, follow-ups on recommendations and adherence on recommendations by departmentsto asses internal audit in the disbursements and use of LATF. Below are descriptive findings on this objective.

4.5.1 Internal Audit of LATF funds

Respondents were asked to indicate whether LATF funds were audited internally. Responses were as shown in table 4.5 below.

Table 4.5: Internal audit of LATF funds.

Response	Sample	Percentage
Strongly Agree	14	25
Agree	42	75
Neutral (undecided)	0	0
Disagree	0	0
Strongly disagree	0	0
Total	56	100

Source: Field data (2010)

On whether LATF funds are audited internally, responses as illustrated above, indicate that all the respondents (100%) agree that the funds are audited internally. This implies that KMC has an operational internal audit system. This helps to ensure that the laid down controls are followed. This is inline with RONO (2006) who founded that there was an operational internal audit system in the management of finances in public institutions.

4.5.2 Involvement of departmental employees in the discussion of the recommendations in the internal audit reports.

Respondents were asked to indicate whether they are involved in the discussion of the recommendations in the internal audit report. Their responses were as shown in table 4.6 below.

Table 4.6: Involvement in the discussion of the recommendations in the internal audit reports.

Response	Sample	Percentage
Strongly Agree	10	17.9
Agree	36	64.3
Neutral (undecided)	2	3.6
Disagree	4	7.1
Strongly disagree	4	7.1
Total	56	100

Source: Field data (2010)

Responses as shown above indicate that 82.2% of the respondents agree that the employees in KMC are involved in the discussion of internal audit reports, 14.2% disagree whereas 3.6% neither agree nor disagree. This implies that officers in each department in KMC participate in the discussion of internal audit reports.

4.5.3 Reflection of the recommendations in the internal audit reports.

The study sought to find out whether the recommendations in the internal audit reports reflect the true picture in the council. The responses were as shown in table 4.7 below.

Table 4.7: Reflection of the recommendations in the internal audit reports.

Response	Sample	Percentage
Strongly Agree	16	28.6
Agree	30	53.6
Neutral (undecided)	10	17.8
Disagree	0	0
Strongly disagree	0	0
Total	56	100

Source: Field data (2010)

Responses as shown in above indicate that,82.2% of the respondents agree that they do, whereas 17.8% neither agree nor disagree.

4.5.4 Adherence of the recommendations in the internal audit reports by departments

The study sought to find out whether the departments adhere to the recommendations in the internal audit reports. The responses were as shown in table 4.8 below.

Table 4.8: Adherence of the recommendations in the internal audit reports by departments

Response	Sample	Percentage
Strongly Agree	16	28.5
Agree	38	67.9
Neutral (undecided)	2	3.6
Disagree	0	0
Strongly disagree	0	0
Total	56	100

Source: Field data (2010)

Responses as shown in table 4.8 above indicate that,96.4% agree that the recommendations of the internal audit reports are adhered to, whereas 3.6% neither agree nor disagree. This implies that departments at KMC adhere to the recommendations of the internal audit reports. However, as established by Oyugi (2005), putting up a coherent evaluation and monitoring units will enhance follow-up activities hence further promote adherence to audit recommendations.

4.5.5 Assessment of the effectiveness of internal audit systems in the management of LATF

The study sought to establish the effectiveness of internal audit systems in the disbursements and uses of LATF. The responses were as shown in table 4.9 below.

Table 4.9: Effectiveness of internal audit systems in the management of LATF.

Response	Sample	Percentage
Very good	2	3.6
Good	20	35.7
Average	34	60.7
Poor	0	0
Very poor	0	0
Total	56	100

Source: Field data (2010)

Responses as shown above indicate that 39.3% of the respondents assessed the effectiveness of the internal audit system to be either good or very good, whereas 60.7% assess the effectiveness to be average. This implies that the internal audit systems of KMC are averagely effective. This, as established by Rono (2006), may be due to lack of well established departments charged with the responsibility of implementing internal controls. Also as established by Schneider and Wilners (1990), ineffective internal audit may result to financial reporting irregularities.

4.5.6 Frequency of internal Auditing of department

The study sought to find out how often the internal audit department carries out audit of other departments. The respondents were the employees of the internal audit department only.

The respondents were asked how often they audit the disbursement and use of LATF in the various departments of the council. The responses were as shown in the table 4.10 below:

Table 4.10: How often internal Audit of departments is carried out

Response	sample	percentage
Every one month	3	100%
Every three months	0	0
Every six months	0	0
Every twelve months	0	0
Total	3	100

Source: field data (2010)

The table above show that 100% of the respondent indicated that they audit other departments every month. This implies that the internal audit system of KMC is in operation.

4.5.7 Time taken to release Audit reports

The respondents of this question were the employees of the internal audit department only. Respondents were asked to indicate how long it takes to release the Audit Reports. Results are indicated in the table 4.11 below.

Table 4.11 Time taken to release Audit report

Responses	Sample	Percentage
One week	0	0
One month	0	0
Three months	3	100%
Six months	0	0
Others	0	0
Total	3	100

The above table show that 100% of the respondents indicated that the Audit Reports are released every 3 months after various departments have been audited. This implies that the internal audit system of KMC is in operation.

4.5.8 Involvement of the Discussion of Audit Reports’ recommendations, Adherence and follow-ups by the internal Audit Departments.

The respondents of this question were the employees of the internal audit department only.

The study sought to find out whether employees of internal audit department are involved in the discussions of their recommendations in the audit reports, whether their recommendations are adhered to and if follow-ups are made by the internal audit department. The results were as shown in the table below:

Table 4.12: Audit report recommendations, Adherence and follow-ups by internal Audit Department.

Responses	Strongly disagree	Disagree	Neutral	Agree	Strongly agree	$\sum f_i$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
Involvement in discussing audit report recommendations	0	0	0	1	1	2	9	4.500
Discussion of audit report recommendations	0	0	0	1	1	2	9	4.500
follow-up to ensure adherence to internal audit reports recommendations	0	0	0	1	1	2	9	4.500

Source: field data (2010)

The study indicated that the respondents agreed that they are always involved in the discussions of their recommendations, the departments adhere to the recommendations and that the follow-ups are always made. This is shown by the high weighted average of 4.500 in each case. This implies that the internal audit system of KMC is in operation.

4.5.9 Level of satisfaction with the adherence of the recommendation on the audit reports by departments in the council.

The respondents of this question were the employees of the internal audit department only. The study sought to find out the level at which the various departments adhere to the recommendations on the audit reports. The results were as shown in the table below:

Table 4.13 Level of Adherence to audit Department Recommendations.

Response	Sample	Percentage
Very dissatisfied	0	0
Dissatisfied	0	0
Undecided	0	0
Satisfied	3	100
Very satisfied	0	0
Total	3	100

Source: field data (2010)

It was established that the internal audit department is satisfied by the way other departments adhere to their recommendations as shown above. This implies that the internal audit system of KMC is in operation.

4.5.10: Evaluation on the effectiveness of the internal audit systems by the internal audit department.

The respondents of this question were the employees of the internal audit department only. The study sought to find out how effective the internal audit systems were in the department. The results were as shown in the table below:

Table 4.14: Evaluation on the effectiveness of the internal audit systems by the internal audit department.

Response	Sample	Percentage
Very poor	0	0
Poor	0	0
Average	3	100
Good	0	0
Very good	0	0
Total	3	100

Source: field data (2010)

The results in the above table indicated that 100% of the respondents agreed that the internal auditing systems were averagely effective. This could be as a result of lack of segregation of duty and lack of enough trained personnel in the department as indicated in the findings in 4.5below.

4.6 Suggestions of what can assist the internal audit department to improve the management of LATF funds.

The third objective of this study was to come up with suggestions on how the internal audit department can improve the management of LATF.

The study sought the respondents' level of satisfaction with the use of the following suggestions in improving the management of LATF at KMC. A 5 point weighted average scale was used whereby 1= most dissatisfied, 2= dissatisfied, 3= moderately satisfied, 4= Satisfied and 5= most satisfied. The responses were as shown in table 4.15 below

Table 4.15: Suggestions on how the internal audit department can improve the management of LATF

	Most dissatisfied	Dissatisfied	Moderately satisfied	Satisfied	Most satisfied	$\sum f$	$\sum f_i w_i$	$\frac{\sum f_i w_i}{\sum f_i}$
	1	2	3	4	5			
The department should be fully independent	2	5	8	36	5	56	205	3.661
Posting more trained personnel	3	11	16	18	8	56	185	3.304
Segregation of duties	6	15	17	16	2	56	161	2.875
Close supervision of projects	0	1	1	19	35	56	256	4.571

Source: Field data (2010)

Responses as shown above indicate that the respondents were most satisfied with the use of close supervision of project by the audit department as a way of improving the management of LATF as indicated by its large weighted average of 4.571.

They were satisfied with the suggestion that the audit department be made fully independent (3.661), they were moderately satisfied with the posting of more trained personnel and segregation of duties as ways of assisting the audit department improve the management of LATF. This is in agreement with Salih (1983) who found that lack of segregation of accounting and custodian functions was the greatest weakness with the internal controls.

CHAPTER FIVE: SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary of findings

The first objective of the study was to determine whether LATF disbursements were used in accordance with the objectives of LATF. The objectives of LATF include: to improve service delivery, to improve financial management and to help reduce debts of LAs. The study established that disbursements of LATF were being used according to the objectives of LATF that is, they are used to improve service delivery, financial management and help reduce debts. However, it was established that the release of the LATF funds were always delayed and this contributed towards the slow achievement of the objectives of LATF.

The second objective of the study was to establish the effectiveness of internal audit system in the disbursement and use of LATF. The study found out that the internal audit systems were averagely effective. The third objective of the study was to come up with suggestions that would improve the management of LATF. The study came up with some of the following suggestions that could be used to improve the management of LATF. They included: the internal audit department should be fully independent, posting more trained personnel to the department, segregation of duties in the department and there should be close supervision of projects.

5.2 Conclusion

The purpose of the study was to assess the effectiveness of internal audit system in the management of LATF in KMC. Based on the study findings, it can be concluded that disbursements are used according to the objectives of LATF except that their release is always delayed. The delay in the release of LATF disbursement may negatively affect the achievement of the objectives of LATF. It was noted that the internal audit systems were averagely effective. This was said to be so due to lack of enough trained personnel in the department, the department not being fully independent, lack of division of duties and lack of

close supervision of projects. This implies that the effectiveness and efficiency of internal audit systems of KMC need to be improved.

5.3 Recommendations

The following recommendations important for policy and practice are made. Since the study established that the internal audit systems are averagely effective, the Kisii Municipal Council should organize for the internal audit department to be fully independent that is, it should not be a section of another department. This will enable the department to execute its duties well and with ease.

The council should also ensure that the department is well staffed with enough and trained personnel. This will enable division of duties and proper and close supervision of projects which will eventually lead into improved efficiency and hence making the department more effective. The managers of the council should organize for frequent meetings with the internal audit department senior employees to formulate modalities of improving the effectiveness of the audit department.

Since the study established that LATF disbursements are always delayed, the Ministry of Local Government together with the central government should ensure that the LATF disbursements are released in time as stipulated. This will positively contribute towards the achievements of the objectives of LATF.

Following the establishment that LATF disbursement are used as per to the objectives, the Ministry of Local Government should increase LATF allocations to LAs to enable them better their performance.

5.4 Suggestions for further study

This study was a survey. If a case study design is applied, probably, the result may be different. Further investigations can be done across industries to uncover the similarities and differences

when using the internal audit systems in the management of finances. Further research can be done using other research instrument like the interview schedule or open ended questionnaire as this may give more information on this field of study.

The present study focused on only one unit of the LAs which was Kisii Municipal Council. It was selected to represent the rest of the LAs in the Local Government. The results obtained from the LA may not be applicable to all LAs in the Ministry of Local Government. This is because different LAs are located in different geographical areas and are under different management. Further research incorporating more than one LA should be conducted so as to establish comparative findings on the effectiveness of internal audit systems in the management of LATE. A replication of this study should be made after some time to determine whether there is any notable change.

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APPENDIX I: QUESTIONNAIRE

Local authorities are important because they support the central government. The Kisii Municipal Council is one of the councils in Kenya. This study is meant to assess the effectiveness of internal audit systems in the management of Local Authority Transfer Fund (LATF) in Kenya. You have been selected as a respondent in this research and the information you give will assist the Local Authority Management and other managers to come up with ways of improving the management of LATF. Please tick where applicable on the rating spaces.

SECTION A: FOR ALL RESPONDENTS IN THE COUNCIL

1. By the use of a tick indicate where you belong in the following categories. Indicate the category where you belong.

Category	Response
Top managers	
Heads of department	
Other departmental employees	
Councilors	
Total	

2. Please rate the level of satisfaction with the use of LATF according to its objectives.

	Most dissatisfied 1	Dissatisfied 2	Moderately satisfied 3	Satisfied 4	Most satisfied 5
To improve service delivery					
To improve financial management					
To reduce debts					

3. Indicate by the use of a [√] the most appropriate response you would give to the following?

Dimension		Rating				
		Strongly disagree	Disagree	Neutral Undecided	Agree	Strongly agree
A	Disbursement of LATF funds are always delayed					
B	LATF funds are always audited internally					
C	You are always involved in the discussion of the recommendations in the internal audit reports					
D	The recommendations in the internal audit reports reflect the true picture in the council					
E	Your department adheres to the recommendations in the internal audit reports					

4. How would you assess the effectiveness of internal audit systems in the management of LATF for the last five years?

- (a) Very poor
- (b) Poor
- (c) Average
- (d) Good
- (e) Very good

Please rate your level of satisfaction with the use of the following suggestion in assisting the internal audit department improve in management of LATF.

	Most dissatisfied	Dissatisfied	Moderately satisfied	Satisfied	Most satisfied
	1	2	3	4	5
The department should be fully independent					
Posting more trained personnel					
Segregation of duties					
Close supervision of projects					

SECTION B: FOR INTERNAL AUDIT DEPARTMENT ONLY

5. As an Internal audit department, how often do you audit the disbursement and uses of LATF in the various departments of the Council?

- i) Every one month
- ii) Every Three months
- iii) Every six months
- iv) Every twelve months
- v) Other (specify)

6. How long do you take to release the audit reports?

- i) One week
- ii) One month
- iii) Three months
- iv) Six months
- v) Other (specify)

7. Please rate the following whether you are in agreement with your involvements in the discussion of audit reports, discussion of recommendations and followups.

Dimension		Rating				
		Strongly disagree 1	Disagree 2	Neutral Undecided 3	Agree 4	Strongly agree 5
A	You are always involved in the discussion of your recommendations in the audit reports					
B	Your recommendations in the audit reports are always discussed					
C	The Internal Audit department always makes follow-ups to ensure that the recommendations in the audit reports are adhered to.					

8. To what extent are you satisfied with the adherence of the recommendations on the audit reports by the departments in the council?

- i) Very Dissatisfied
- ii) Dissatisfied
- iii) Neutral(undecided)
- iv) Satisfied
- v) Very satisfied

9. How would you evaluate the effectiveness of the internal audit systems in the management of LATF for the last five years?

- i) Very poor
- ii) Poor
- iii) Average
- iv) Good
- v) Very good