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Influence of internal and external audit reforms on the performance of Non-Commercial StateCorporations in Kenya

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Abstract: *State owned corporations are very important in providing financial solutions in order to foster public service delivery and economic development. However, irrespective of this crucial role, these enterprises face numerous challenges, and they have over years recorded dismal performance as a result of poor financial management, different financial reporting formats, increased corruption, poor governance, political interference and others. In the past, a number of initiatives were undertaken to enhance the financial management among state corporations. These were initially necessitated by the fact that the roles of the Parliament and Auditor General had been previously ignored. As such, the purpose of the current study was to examine influence of internal and external audit reforms on the performance of Non-Commercial state corporations in Kenya. Descriptive design was employed by the study to gather descriptive information about the state of affairs as they exist. The study targeted state owned enterprises in the State executive agencies category in Kenya. There are 62 state- owned enterprises in this category in Kenya. The target respondents comprised of the finance managers. Purposive sampling method was used to select the sample. Questionnaire was the major data collection instrument employed by the study. Both descriptive and inferential analysis methods were used. The descriptive analysis was used to give an overview of the respondents and state-owned non-commercial enterprises. The inferential analysis involved the use of regression analysis. The study concluded that proper implementation of control reforms contributes to performance of noncommercial state corporations. Effective internal audit, proper control environment, and effective risk management contributes to increased accountability and transparency in public funds management.*

Key Words: *External audit reforms, internal audit reforms, Non-Commercial State Corporations performance, company performance, State Corporations reforms.*

INTRODUCTION

Internal control systems are measures devised and implemented by an Organization to foster the attainment of the organization's aims and goals (Kewo, 2017). They include procedures and policies that are used to safeguard the organisation's assets and devise a reliable and effective financial reporting system that promote compliance with the set regulations and rules. The control practices, in addition to being linked to the accounting and reporting, they are also related to the communication process of the organization internally and externally, and comprises of all the procedures involved in funds handling, preparation of appropriate and up to date financial reporting to the board members and other key stakeholders. Internal control comprises of the following aspects. One of the components is the control environment which stipulates the tone of the organization, shapes employees' conscience, and it offers a basis for all the other internal control components. It also offers structure and discipline (Phan, Lai, Le& Tran, 2020). Control systems also comprise of policies and procedures that an organization adopts and implements to steer the organisation to the right way. These are categorized as either operational, financial or compliance. Control activities comprises of various activities such as requests, verifications, approvals, reconciliations, authorizations, the security of assets, reviews of operating performance, and separation of duties and authority (Onyango, 2014). Another key component of internal control system is internal auditing. Through the internal auditing, the organization is able to monitor the prevailing risks and to determine the areas that require risk management (Hanim et al, 2005).

Auditing is done to ensure that public funds are safeguarded from waste and misappropriation. The internal audit is basically used to improve organisational efficiency and effectiveness via constructive criticism (Pretorius et al., 2008). Despite the internal audit reforms and controls, most corporations have had their audited accounts certified either with qualified, adverse or disclaimer of opinions. According to the report of the Auditor general for the national government for 2017/2018 Financial year, an analysis of the state Corporations that got unqualified opinion as a percentage of the total audited were: 2013/2014 at 26%, 2014/2015 at 25%, 2015/2016 at 27%, 2016/2017 at 36% and 2017/2018 at 34%. Though the number of entities with unqualified opinions has been increasing over the years, this is a concern as to whether the opinions are a measure of performance and whether the basis of the opinions is in relation to internal controls or other parameters as this study aimed to establish.

Internal and external audit reforms can also have a significant influence on the performance of non-commercial state corporations. The main objective of audit reforms is to enhance the transparency, accountability, and efficiency of the audit process. This can be achieved through a range of measures, including improving the independence of auditors, strengthening audit standards, and enhancing the effectiveness of audit oversight (Cao, Zhang, Qi, Yang& Li, 2022).One of the key benefits of audit reforms is that they can help to improve the quality of financial reporting by non-commercial state corporations. By ensuring that financial statements are accurate and reliable, audit reforms can enhance the credibility of these corporations with investors, lenders, and other stakeholders. This can, in turn, lead to increased access to capital, improved credit ratings, and reduced borrowing costs (Nerantzidis, Pazarskis, Drogalas&Galanis, 2022). However, some potential challenges associated with audit reforms. For example, some non-commercial state corporations may resist the implementation of new audit standards or procedures due to concerns about increased costs or the potential for reduced autonomy. Additionally, it can be difficult to strike the right balance between the need for effective oversight and the need to avoid excessive regulatory burden.

Internal audit reforms typically focus on improving the effectiveness of the internal audit function within an organization. This may involve enhancing the skills and training of internal auditors, establishing better internal controls and risk management processes, and ensuring that internal audit findings are acted upon promptly. Improved internal auditing can lead to better financial management practices and increased accountability within the organization (Keerasuntonpong, Manowan&Shutibhinyo, 2019).External audit reforms, on the other hand, are intended to improve the effectiveness of the external audit function, which is typically conducted by independent audit firms. These reforms may include strengthening the independence of external auditors, improving the quality of audits, and enhancing the transparency of audit findings. Better external auditing can lead to more accurate financial reporting, improved transparency, and increased accountability to stakeholders (Cao, Zhang, Qi, Yang& Li, 2022).
Control systems such as internal and external auditing are measures devised and implemented in order to promote the attainment of the pursued organizational goals (Kewo, 2017). The available research indicates that effective internal control practices contributes to effectiveness of financial management. In one study, Cheruiyot (2018) anlysed the Public Financial Practices and the application among county governmnets. Data was gathered from officials spanning the duration 2016/2017 financial year. The study concluded that the public financial reforms adopted by the county governments helped to improve the management of the public funds. With regard to control practices, the study established that the control environment and the internal auditing have helped to curb fraudulence at the county governments and increased accountability and transparency in the manner in which public funds are spent. The study was very informative and contributed significantly to the discussion on public funds management. However, the findings are only limited to the 10 county governments covered and cannot be generalized in Kenya. In addition, the findings are not applicable to State Corporation in the in Kenya and hence the need for a study covering the state owned enterprises in the State executive agencies category in Kenya. Empirical gaps also existed on the need to focus on more financial reforms.

The impact of internal and external audit reforms on the performance of NCSCs will depend on a variety of factors, including the specific reforms implemented, the level of compliance with those reforms, and the broader institutional and regulatory environment in which the NCSCs operate. However, in general, it is likely that improved audit practices will lead to improved financial management, increased accountability, and better overall performance of NCSCs.The influence of internal and external audit reforms on the performance of Non-Commercial State Corporations (NCSCs) can be significant. Internal and external audit reforms aim to improve the effectiveness, efficiency, and accountability of NCSCs by ensuring that their financial and operational practices are transparent, reliable, and compliant with regulatory standards (Demeke, &Kansal, 2019).In another study, Enofe et al. (2013) analyzed the influence of public financial reforms in the public sectors in Edo state, Nigeria. The study gathered data from directors, accountants, auditors and other public servants in various capacities and analyzed using Z-test statistical tool. From the analysis, there was internal audit and financial improvement. While this study was very informative, the findings were limited to Nigeria and the findings are not generalizable to another country. Also, the focus was solely on the public servants in the Edo state. As such, the current study intended to examine the influence of internal and external audit reforms on the performance of Non-Commercial State Corporations in Kenya.

METHODOLOGY

Research Design

A research design is a plan that offers insights on the manner to undertake research using a given methodology. It is a master plan that gives an outline of the research methods and procedures that a researcher uses to gather and analyze data (Kothari 2004). A descriptive design was used. It was used to gather descriptive information about the state of affairs as they exist (Zikmund et al., 2013). The design gave a description of PFMR on the one hand and the performance of the state owned enterprises on the other hand. The correlation design analyzed the relationship association between variables (Teddlie&Tashakkori, 2009).

Target Population

The target population included state owned enterprises in the State executive agencies category in Kenya. There are 62 state- owned enterprises in this category in Kenya. The target respondents comprised of the finance managers.

Sampling design

Probabilistic sampling methods were used in this study. Probabilistic methods gives every unit in the population equal chances of selection and participation; in non-probabilistic method, each unit in the population has unknown chances of selection and inclusion in the study (Kothari, 2004). Purposive sampling method was used to select the sample. Purposive sampling involves the use of prior judgement to determine the respondents. Using this method, all the finance managers of the 62 State executive agencies category in Kenya will be selected to participate in the study. The rationale for choosing the finance managers is that they are well acquainted with information about public financial management reforms.

Data Collection Methods

Data collection was done using a questionnaire. This tool was considered suitable for the collection of a wide array of data and it is also economical. Validity and reliability tests were done to determine whether the questionnaire would yield valid and reliable findings. Validity analysis done through consultations with research experts and supervisors in the research department in the university. This analysis helped the researcher to develop a questionnaire that yielded valid findings. Reliability analysis, on the other hand, was done to ensure the findings obtained are reliable and authentic. A pilot study was done in order to determine the reliability of the research questionnaire. Cronbach’s Alpha measure for all the questionnaire items was obtained. The value obtained was 0.72 which was greater than 0.6. The questionnaire was therefore considered reliable. Secondary data, on the other hand was collected from various relevant journal articles from research institutions and other academicians’ research works, library books, periodicals and annual reports.

Data collection was done by the researcher assisted by one assistant. The questionnaires were administered and collected after 3-4 days in order to allow the respondents fill them at their convenience and to ensure the exercise did not interfere with their job routines. To increase the response rate, follow up was made at regular intervals through phone calls or texts, emails and personal visits. Secondary data collection on the other hand, involved critical analysis of the secondary sources and gathering of relevant data.

Data analysis

Both descriptive and inferential analysis methods were used. The descriptive analysis was used to give an overview of the respondents and state-owned non-commercial enterprises. The inferential analysis involved the use of regression analysis.

Research Model

The research model that was used is shown below;

$$Y= \beta o + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \varepsilon$$

Where: Y = Organizational performance

β0=intercept

β1, β2, β3, β4 = model coefficients

X_1 = IFMIS re-engineering

X_2 = Budgeting process

X_3 = Accounting and reporting

X_4 = Internal and external audit reforms

ε -standard Error term

RESULTS

The study sought to examine demographic characteristics of the respondents. The demographics investigated included gender, age, education level, duration worked in the current organisation, and the working experience.

Regarding the gender distribution of the respondents, slightly more than two thirds (67.9%) of the respondents were males. Only 32.1% of them were females.

With reference to the age brackets of the respondents, less than a half (42%) of the respondents were between 36-45 years. Only a small proportion (4%) were below 25 years. The findings indicate that cumulatively, the majority were aged between 36-55 years. The distribution was normal as the percentage of the respondents increased with age and started declining at the age of 55 years.

With regards to education level, the nearly a half (45.1%)of the managers have attained post graduate education. Only 7.84% reported that they have attained professional training. The findings indicate that generally, the respondents have attained considerable education.

Regarding the working experience of the respondents, nearly a half (47%) of the respondents had worked for 5-10 years. Only a small proportion (11.76%) had worked for less than 5 years.

Internal and External Audit Reforms

The study sought to find out how internal and external control systems contribute to organizational performance. To begin, the study sought to determine how the respondents perceived internal and external control systems.

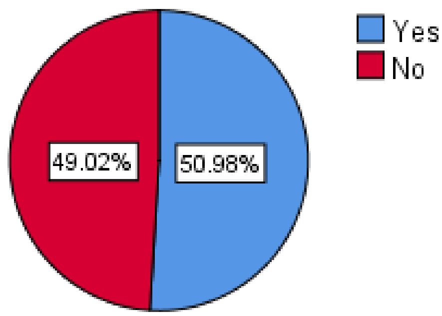

Figure 1: Internal and external control systems effectiveness

On the effectiveness of the internal and external control systems at the respective corporations, 50.98% reported that internal and external control systems have been effective while 49.02% reported that the internal and external control systems have not been effective at their organizations.

Based on the analysis, 96.08% of the respondents perceived internal and external control systems as vital to the performance of noncommercial state owned corporations. Only 3.92% reported that internal and external control systems are not vital to the performance of the organizations.

The respondents were further asked to give their views on internal and external control systems at their organisations.

Table 1

Internal control system and organizational performance

Statement	**N**	**Mean**	**Std**
There is sufficient staff in the internal audit department	51	4.1373	.34754
The weaknesses in the internal control systems are addressed by the internal audit reports	51	4.0588	.50643
There is an internal audit department in our organization	51	4.0588	.23764
Internal auditor recommends various areas for improvement	51	4.0392	.28006
There are regular audit reports produced by the organization.	51	4.0392	.28006
Regular audits are conducted by our internal audit staff	51	4.0392	.19604
The internal audit reports are regularly discussed by the management.	51	3.2941	.57599

The respondents agreed that there is sufficient staff in the internal audit department (Mean=4.1373, Std=.34754), that the weaknesses in the internal control systems are addressed by the internal audit reports (Mean=4.0588, Std=.50643), that there is an internal audit department in their organization (Mean=4.0392, Std=.28006), that there are regular audit reports produced by the organization (Mean=4.0392, Std=.28006) and that regular audits are conducted by their internal audit staff (Mean=4.0392, Std=.19604).

Regarding discussion of the audit reports by the management, the respondents were of neutral opinion that the internal audit reports are regularly discussed by the management (Mean=3.2941, Std=.57599)

Table 2

Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.023	.077		.300	.011
IFMIS re-engineering	.269	.089	.264	3.023	.002
Budget formulation and execution reforms	.165	.135	.168	1.226	.026
Accounting and reporting reforms	.238	.156	.037	1.526	.007
Internal and external audit reforms	.641	.113	.620	5.682	.001

Regarding internal and external audit reforms, the p value obtained (0.001) implies that proper implementation of internal and external audit reforms would lead to good performance of the noncommercial state corporations.

DISCUSSION

The study identified that respondents acknowledged the significance of IFMIS re-engineering reforms and believed that such reforms have the ability to ensure the organization manages its funds effectively, to increase transparency in the management of funds, to increase accountability, to reduce corruption and fraudulence and to foster service delivery. The findings agree to Njeru (2016) who identified that the IFMIS re-engineering helps to enhance and strengthen financial controls and to increase transparency and accountability. Similarly, the findings are in tandem with Magani (2018) who identified that IFMIS re-engineering helped to foster transparency, curb corruption, foster accurate recording of information and information processing among other benefits.

The other public finance reform analyzed was budget formulation and execution reforms. The respondents recognized that the resources available at the organization are utilized effectively, that the good financial decisions are made guided by the budgets, and it offers the organizations a suitable benchmark. The budget formulation and execution reforms would help to ensure there is proper budget absorption rate, that projects are completed as per the budget and that the ongoing projects are executed as per the budget formulated. The results agrees to Kuria (2011) who analysed the public fianncial managemnet reforms and the fianncial operations of the Minisy of Finance and concluded that effective budget planning, formulation, and execution ensures that budgets are released on a timely basis, fosters improved commitment control, and increases efficiency in public funds management. Similarly, the findings are in tandem with Gamaliel and Ali (2019) who analyzed the contribution of the public financial management at the Ministry of Devolution and Asal and concluded that effective budget implementation greatly improves the effectiveness in the financial decisions made as well as effective management of public funds. It helped to ensure that the public funds are put to the right use for the benefit of the people.

Accounting and reporting reforms were the other public financial reform that was examined. Based on the results, the respondents concurred that accounting and reporting reforms improve the efficiency of state enterprises that are not for profit. The administration of public funds is said to benefit from timely and accurate accounting since it encourages accountability and transparency. The study also discovered that digitizing paper documents encourages accounting and reporting, which in turn improves the administration of public finances and the effectiveness of the organization as a whole. The results aligns with Nyamita, Dorasamy and Garbharran (2019) who identified that the managemnet of public funds have been improved through proper implemnetation of accounting and reporting practices. Proper and effective accounting and reporting practices helped to streamline the internal controls of the governmental units and helped to increase accountability and transparency. Similarly, the current findings agree to Cheruiyot (2018) who analysed the role of public fiancial manamgemnet practices in the County governments of Kenya and concluded that effective accounting and reporting practices promote public financial management. The study identified that the county governments that invested in effective accounting and reporting practices, observed integrity and ethical values, conduct risk assessments and monitoring procedures had relatively better performance.

The other public financial reform analyzed was the internal and external control reforms. The study identified that proper implementation of internal and external control reforms contributes to organizational performance. This is achieved through effective internal audit, effective control environment and activities and proper risk management. Such practices increase transparency and accountability which in turn contributes to organization performance. The findings are in line with the results of Cheruiyot (2018) who did a study among the county governments in Kenya and concluded that the public financial reforms and specifically effective control environment helped to boost the performance of the county governments. Proper control environment and internal auditing helped to curb fraudulent activities, increase transparency and accountability in the manner in which the public funds were used. Similar to this, Enofe et al. (2013) conducted research to determine the impact of public financial reforms on resource management and service delivery in the public sectors in Edo state, Nigeria, and came to the conclusion that there was a statistically significant relationship between internal and external control practices and financial improvement. Their findings are consistent with the current study.

CONCLUSION

Both internal and external audit reforms can have a positive impact on the performance of NCSCs. By identifying areas for improvement and ensuring compliance with regulatory standards, these reforms can help to improve the financial and operational performance of NCSCs. They can also enhance the credibility of NCSCs with stakeholders such as investors, regulators, and customers, which can lead to increased funding, improved customer satisfaction, and enhanced reputation. However, the impact of internal and external audit reforms on NCSCs' performance will depend on a range of factors, including the scope and quality of the reforms, the level of NCSCs' commitment to implementing the reforms, and the broader economic and regulatory context in which the NCSCs operate. Therefore, it is important for NCSCs to carefully plan and execute internal and external audit reforms to maximize their potential benefits.

The influence of internal and external audit reforms on the performance of non-commercial state corporations can be significant. By improving the quality of financial reporting, strengthening internal controls and risk management systems, and enhancing transparency and accountability, audit reforms can help to promote better governance, improved operational efficiency, and greater access to capital. However, careful consideration should be given to the potential challenges associated with these reforms, in order to ensure that they are implemented in a way that maximizes their benefits while minimizing their costs. Internal and external audit reforms can have a significant impact on the performance of Non-Commercial State Corporations (NCSCs). These reforms are intended to improve the efficiency and effectiveness of the audit function, which can lead to better financial management, increased accountability, and improved overall performance of NCSCs. The study recommends the need for non-commercial state corporations to ensure the internal auditors are accorded requisite support in order to make risk assessments and prepare comprehensive risk matrices for action by other stakeholders in the state corporations. Also, the corporations are recommended to enhance the control environment and activities as well as risk assessment.

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