

INFLUENCE OF INDEPENDENCE OF INTERNAL AUDIT ON ORGANIZATIONAL PERFORMANCE OF SEMI-AUTONOMOUS AGENCIES IN THE STATE DEPARTMENT OF ENERGY IN NAKURU COUNTY, KENYA

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Abstract

Semi-autonomous government agencies within the state department of energy are critical to the taxpayer and the government for efficiency in public service delivery. Diverse studies have examined the role of internal audit on the organizational performance but do not link internal audit to organizational performance within semi-autonomous state agencies in Energy department. This study thus sought to establish the influence of independence of internal audit on organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya. The study used correlational research design with the target population comprising 72 internal auditors and senior management of the five semi-autonomous agencies in the state department of energy in Nakuru County. It employed census method to study all the population of the study, implying that the sample for the study was 72 respondents. A Questionnaire was used to collect data. To ensure content validity, the researcher constructed the instrument in line with the research objective. A Cronbach alpha coefficient of 0.7 was computed implying that the instruments were reliable. Descriptive statistics including frequencies, mean and standard deviation were used in data analysis. Also, inferential statistics; Pearson correlation and linear regression were used. The study established that there is a statistically significant influence of internal controls on organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya. The study thus recommended that in order to improve on the organizational performance of these semi-autonomous agencies in the state department of energy in Nakuru County, the management should enhance their focus on the independence of the internal audits.

Keywords: *Internal Audit, Internal Controls, Management Support, Professional Competencies, Semi-Autonomous Agencies*

I.INTRODUCTION

The primary function of the government is service delivery to its citizens in diverse public utility goods such as education, security, and infrastructure amongst other services. In the government public service delivery, there might be need to form semi-autonomous agencies to perform specific functions with a view of improving efficiency. According to Abang'a, (2017) semi-autonomous government agency refers to public entities delivering public utility goods or services but operate independently from the government with a capacity to generate their own resources (Mugo, 2016). According to Thiel (2009) government form semi-autonomous agencies due to diverse efficiencies that can be achieved in the public goods and services that they provide. In this context, some of the ways in which efficiencies are created include reduction of bureaucracy and political interference associated with government operations, decision flexibility in operational aspects, and operation in more business-like behaviour (Monakedi, 2012). Other ways in which efficiencies is achieved include creation of customer centric environments and flexibility in resources usage. Amongst the tasks undertaken by the semi-autonomous organizations include regulatory aspects of specific industries, policy implementation aspects, and diverse service delivery components (Kibisu, Muturi, & Elijah, 2014).The degree of being autonomous would vary from one organization to another.

Given their importance in public service delivery, the organizational performance of semi-autonomous government agencies is critical to the taxpayer and the government. The organizational performance relates to the ability of an organization to meet its stated objectives over a period of time. These objectives could relate to diverse aspects such as efficiency, effectiveness, and relevancy of the organization in its stated operations. Effectiveness relates to the organizational services ability to meet client's demands while efficiency relates to value for money, time and effort in relation to meeting organizational objectives. On the other hand, organizational relevancy relates to the ability of the firm to respond to changes in its operational environment. Diverse indicators have been used to measure organizational performance including service quality, customer service, product and services innovation, and customer satisfaction. Other aspects financial management, procurement performance, employee productivity, technology uptake levels, compliance to regulatory requirements, employee turnover, market share, product relevancy, management turnover, and corporate governance practices.

Challenges in organizational performance have necessitated measures to detect them and to address them as well. Amongst the aspects that are used in this effort include internal audit practices. Unegbu and Kida (2011) indicate that internal audits relates to the measures undertaken by organizational authorities to evaluate the efficiency and effectiveness of controls established by management for smooth running of the organization. On the other hand, Nwannebuike and Nwadiolor (2016) indicates that the internal audit are a set of measures undertaken by organization in order to evaluate effectiveness of financial and operations controls, confirm adherence to organizational policies, and verify accuracy of organizational reports. Internal audit has also been noted as an independent and objective assurance designed to add value to the organizational operational activities.

Scholars around the world have examined the influence of internal audit and organizational performance of government entities. In Nigeria, Unegbu and Kida (2011) noted that internal audit functions face diverse challenges compromising their efficiency levels in addressing organizational performance inadequacies in public sector. These challenges include lack of audit manual in public sectors, use of non-career auditors in auditing purposes, stagnation of career growths for internal auditors, lack of professional independence and increase in scope of work for auditors. These aspects have been found to have an influence on the efficiency levels of internal auditors.

In Kenya, organizational performance of semi-autonomous agencies is critical to the government public service delivery and to the Kenyan tax payer and citizens. The organizational performance of these semi-autonomous agencies in Kenya are often wanting. Kitolo (2016) noted that semi-autonomous agencies in Kenya are faced by diverse organizational performance challenges including inefficiencies, and ineffectiveness in service delivery and other operational aspects. Financial irregularities have been noted as a major organizational performance challenge for semi-autonomous government agencies. The importance of the organizational performance in diverse government institutions including the semi-autonomous government agencies is spelt in diverse legal provisions. The constitution of Kenya under article 232 (1) (b) notes that public service must be undertaken in efficient, effective, and economic use of resources (Government of Kenya, 2013). On the other hand article 232 (1) (c) states that public service delivery must be undertaken in a responsive, prompt, effective, impartial, and equitably (Government of Kenya, 2013).

The government of Kenya recognizes the importance of internal audit on the government organizations' performance. The Government of Kenya as stated by the Public Finance Act of 2012 views internal audit as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations, which 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 (Government of Kenya, 2012). Amongst the notable development in internal audits for the government bodies included the treasury circular No. AG3/086/6/ (61) of 8th August 2000 indicated that all government departments and organizations must establish audit committees (Obonyo, 2017). Circular No 15/2005 operationalized the audit committees in government organizations through provision of guidance of the internal auditors role in enhancing oversight, governance, transparency and accountability. Circular No 18/2005 detailed the action management must undertake in response to audit reports (Obonyo, 2017). The Mwongozo code of governance for state corporations indicates that the state corporations should be subjected to an annual governance audit on diverse issues including financial management, and effectiveness of internal control aspects.

In Kenya, the Public Finance Management Act of 2012 sections 73 (3) details the items that should be audited in all public bodies under national government inclusive of semi-autonomous government bodies (Government of Kenya, 2012). These aspects include governance mechanisms to ensure transparency and accountability; risk based, value-for-money and systems' audits to strengthen internal control systems; assets verification aspects; adherence to institutional policies, procedures and good business practices and robustness of decision making in the organizations (Government of Kenya, 2012).

The ministry of energy is composed of two state departments, that is, state department of energy and petroleum. Within the state department of energy, there are nine semi-autonomous agencies that is Energy Regulatory Commission (ERC), Energy Tribunal, Kenya Power and Lighting Company (KPLC), Kenya Electricity Generating Company (KenGen), and Rural Electrification Authority (REA). Others are Geothermal Development Company (GDC), Kenya Electricity Transmission Company (KETRACO), Kenya Nuclear Electricity Board (KNEB), and Independent Power Producers (IPPs). These semi-autonomous agencies undertake diverse functions. The ERC is a regulatory body charged with formulation, and oversight activities related to energy sector. The energy tribunal arbitrates disputes within parties in the sector. KPLC is charged with the transmission, distribution and supply of electricity to the consumers while KenGen generates the electricity power for usage. REA is mandated to facilitate electricity transmission within the rural regions while GDC undertakes geothermal energy exploration. The KETRACO undertakes the design, construct, own, operate and maintain new high voltage (132kV and above) electricity transmission grid and regional inter-connectors. On its part, the KNEB is mandated to develop nuclear electricity in the country while IPPs supplement the activities of GDC and KenGen from a private sector perspective.

II. RESEARCH OBJECTIVE

To examine the influence of independence of internal audit on organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya.

III. RESEARCH HYPOTHESIS

H₀₁: There is no statistically significant influence of independence of internal audit on organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya.

IV. LITERATURE REVIEW

Independence of Internal Audit and Organizational Performance

The ability of the internal auditors to work independently has been studied by a number of scholars in diverse contexts with its relation to the performance of organizations. Shamsuddin, Manijegar, Kirupanangtan, Rahman, and Selvanathan (2014) carried out a study to examine the factors affecting internal audit in Malaysian public sector. One of the study objectives that the study sought to achieve was to examine the influence of independence of internal auditors on the organizational performance of public sector in Malaysia. In doing so, the study used exploratory research design. The study conducted face to face interviews with eight internal auditors and one external auditor. The study established that it was difficult for internal auditors to attain full independence since they were auditing their colleagues in the same organization. In respect to this, the auditors interviewed cited that they always favour their bosses in their internal audit in order to secure their jobs. Mostly internal auditors performed their work in respect to the directions of their bosses whom they audit. All the auditors interviewed cited that internal audit in public sector was not independent and objective due to interference of the top management of the public sector organizations.

A study carried out by Kitojo (2014) in a local authority in Shinyanga region of Tanzania, sought to examine the effectiveness of internal audit in addressing financial challenges in public sector organizations. One of the study objectives was to identify factors hindering the efficiency in financial management of the public sector organizations. The study used a case study research design with a population of 165 employees from Shinyanga Local government Authority. The target population comprised of internal auditors, finance committee, audit committee, accountants and head of departments. A sample of 62 respondents was determined using a probabilistic sampling formula. Questionnaires were the main data collection tools for the study. The study established that out of the six councils in Shinyanga Local government Authority, four of them had a mean score of less than 2.5 in rating the independence of their internal auditors in a scale of 1=Strongly Disagree and 5=Strongly Agree. It was therefore found out that on average there was no independence internal unit functions in Shinyanga Local government Authority in Tanzania. Using regression analysis, it was found out that auditor's independence was correlated to efficiency of internal audit (correlation coefficient of 0.028) and workplace relationships at a correlation coefficient of 0.366, at 0.05 level of significance.

Ongeri (2011) carried out a study to examine the effect of internal audit on the management of Local Authority Transfer Fund. The study was done in Kisii Municipal Council. The study specifically focused on effectiveness of internal audit in disbursement of Local Authority Transfer Fund of the municipal council of Kisii. Using a descriptive research design, the study targeted 124 employees of the municipal council of Kisii and through sampling 62 employees were picked. To obtain its data, the study used questionnaires. Using a five point Likert scale, the study established that on average, the independence of internal auditing improved the level of service delivery (mean=4.464), financial management (mean= 4.071) and reduced the level of debts (mean=4.464) of the municipal council of Kisii. The study

recommended the municipal council of Kisii to make the internal audit unit independent and not to interfere with its operations.

Focusing on Ethiopian public sector offices, a study by Hailemariam (2014) sought to establish the determinates for effective internal audit practices. The study sought to establish whether the independence of internal auditors determines the performance of public sector offices in Ethiopia. The study targeted 72 public sector offices in Ethiopia and from which 15 public sector offices were selected through purposive sampling. Questionnaires were used to collect data for the study. The study established that organizational independency was correlated with the efficiency of audit functions in public sector offices at a correlation coefficient of 0.179. The study further established that a unit increase in the level of auditor's independence, the level of audit efficiency increases by 0.135 provided that other factors were held constant due to a beta coefficient of 0.135. This influence was found to be statistically significant at 5% significance level.

Knowledge Gap

The study has reviewed literature in respect to internal audit and organization performance. In reviewing the literature from past studies, research gaps have been identified and to which the current study seeks to fill. Shamsuddin et al. (2014) carried out a study to examine the factors affecting internal audit in Malaysian public sector. However, this study was done outside Kenya and therefore a contextual research gap that the current study seeks to fill. The study was qualitative in nature and therefore could not quantify the effect of internal audit on organizational performance, an aspect that was established by the current study.

Similarly, a study carried out by Kitojo (2014) in a local authority in Shinyanga region of Tanzania, to examine the effectiveness of internal audit in dressing financial challenges in public sector organizations and study by Hailemariam (2014) focusing on Ethiopian public sector offices that sought to establish the determinates for effective internal audit practices were also done outside Kenya. There is therefore a contextual research gap to be filled by the current study. A study by Ongeru (2011) to examine the effect of internal audit on the management of Local Authority Transfer Fund presents a methodological research gap in that it only used descriptive statistics and therefore failed to establish the link between the variables under investigation. The current study used regression analysis to establish the influence of independence of internal audit on organizational performance.

V. RESEARCH METHODOLOGY

The study used correlational research design with the target population comprising 72 internal auditors and senior management of the five semi-autonomous agencies in the state department of energy in Nakuru County. This study used census method to study all the population of the study, implying that the sample for the study was 72 respondents. This study used closed ended questionnaires to collect data from the study respondents. To ensure content validity of the research instruments, the researcher constructed the instruments in line with the research objectives of this study. A Cronbach alpha coefficient of a threshold of 0.7 and above was used to imply reliability. The pilot study was carried out in Kenya Power and Lightning Company in Kericho County. Descriptive statistics including frequencies mean and standard deviation were done on the data. For inferential statistics, Pearson correlation and multiple linear regression were used.

VI. RESEARCH FINDINGS AND DISCUSSIONS

Independence of Internal Audit and Organizational Performance

The study examined the influence of independence of internal audit on organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya using three metrics. These were interference from management, conflict of interest with the management, and favourism towards bosses. Respondents were asked to rate statements based on these metrics on a five-point Likert scale where items were scored as follows; strongly Disagree=1, Disagree=2, Undecided=3, Agree=4 and Strongly Agree=5, and results presented in Table 1.

Table 1: Independence of Internal Audit

	SD	D	U	A	SA	χ^2	P Value
	%	%	%	%	%		
Internal auditors do not seek to favour their bosses in their internal audit report.	1.7	5.0	6.7	75.0	11.7	19.563	0.000
The internal audit decisions are based on the expectations of the personnel being audited	3.3	11.7	10.0	60.0	15.0	13.398	0.021
There is separation of audit roles in the state corporation from the other duties of the state corporation.	8.3	10.0	3.3	65.0	13.3	16.991	0.000
Job security of internal auditors is not based on how their internal audit report favour their bosses	6.7	13.3	1.7	68.3	10.0	18.947	0.000
Internal audit unit does not have conflict of interest with the management of the state corporation.	5.0	8.3	11.7	58.3	16.7	15.895	0.001

In the context of favourism toward bosses, three quarters of the respondents tended to agree (75.0%) that internal auditors do not seek to favour their bosses in their internal audit report. In addition, 11.7% of the respondents tended to strongly agree with the statement. On the other hand, 5.0% of respondents tended to disagree and 1.7% of respondents tended to strongly disagree with the statement. This indicated that cumulatively, 6.7% of the respondents felt that internal auditors seek to favour their bosses in their internal audit report. There were 6.7% of respondents who were not sure whether internal auditors seek to favour their bosses in their internal audit report or not. A Fisher's exact value of 19.563 which was greater than the critical value (5.9915) and a p-value (0.000) less than the significant value implied that internal auditor favourism towards bosses in internal audit report and organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya are significantly related. The ability of the internal auditors to work independently has been studied by a number of scholars in diverse contexts with its relation to the performance of organizations.

A majority of respondents tended to agree (60.0%) that the internal audit decisions are based on the expectations of the personnel being audited. Further, 15.0% of the respondents tended to strongly agree with the statement. Some respondents were undecided (10.0%) on whether the internal audit decisions in their agency are based on the expectations of the personnel being audited. On the other hand, 11.7% of the respondents tended to disagree indicating that the internal audit decisions are not based on the expectations of the personnel being audited.

Further, 3.3% strongly felt that the internal audit decisions in their agency are not based on the expectations of the personnel being audited. The study found a Fisher's exact value of 13.398 which was greater than the critical value and a p-value of 0.021 which was less than the significant value (0.05). This implied that organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya is significantly related to the expectations of the personnel being audited.

The study established that 65.0% of the respondents agreed that there is separation of audit roles from the other duties of the state corporation, supported by 13.3% who strongly agreed with the statement. On the other hand, 10.0% of the respondents perceived that audit roles and other duties of the state corporation are not separated (Disagree), a perception that was strongly held by 8.3% of the respondents (Strongly disagree). The respondents who neither agreed nor disagreed (undecided) with either statement were 3.3%. The study established that organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya is significantly related to separation of audit roles from the other roles of the state corporation. This was because the Fisher's exact value was 16.991 which was greater than the critical value and a p-value of 0.000 which was less than the significant value.

A majority of respondents tended to agree (68.3%) that job security of internal auditors is not based on how their internal audit report favours their bosses. Ten percent of the respondents strongly felt that this was the case in their agency (Strongly Agree=10.0%). However, 13.3% of the respondents tended to disagree with the statement and indicated that job security of internal auditors is based on how their internal audit report favors their bosses, a sentiment that was strongly supported by 6.7% of the respondents who chose "Strongly Disagree". A negligible number of respondents were undecided (1.7%) on whether job security of internal auditors is based on how their internal audit report favour their bosses or not. A Fisher's exact value of 18.947 and a p-value of 0.000 implied that job security of internal auditors and organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya are related.

The study found that internal audit unit does not have conflict of interest with management of the state corporation according to a three quarters of the respondents (Agree=58.3%; Strongly Agree=16.7%) of the respondents who tended to agree with the statement. Some respondents tended to be undecided on the issue (11.7%). On the other hand, there were respondents who perceived that there is conflict of interest between internal audit unit and management of the state corporation. Finally, A Fisher's exact value of 15.895 which was greater than the critical value and a p-value of 0.001 implied that organizational performance of semi-autonomous agencies in the state department of energy in Nakuru County, Kenya and conflict of interest between internal audit unit and management are related. Similar findings were made by Shamsuddin, et al.(2014) in a study in Malaysia where interviewees cited that internal audit in public sector was not independent and objective due to interference of the top management of the public sector organizations. These findings support those of Shamsuddin, et al.(2014) in a study to examine the factors affecting internal audit in Malaysian public sector. The study established that it was difficult for internal auditors to attain full independence since they were auditing their colleagues in the same organization. In respect to this, the auditors interviewed cited that they always favour their bosses in their internal audit in order to secure their jobs. Mostly internal auditors performed their work in respect to the directions of their bosses whom they audit.

Correlation Analysis

The study sought to establish whether or not the study variables were related. This was done by use of Pearson Correlation. Pearson Correction is used to indicate the nature and strength of relationship between two study variables.

Table 2: Correlations

		Independence
Organizational Performance	Pearson Correlation	0.827**
	Sig. (2-tailed)	0.000
	N	60

This study establish that independence of the internal audit was positively and moderately related to professional competencies ($r=0.447$), internal controls ($r=0.591$) and management support ($r=0.449$). The study found that the independence of the internal audit was strongly and positively related to organizational performance due to a correlation coefficient of 0.827. The relationship was found to be significant at 5% significance level. This implies than an increase independence of the internal audit would result into an increase in professional competencies of internal auditors, internal controls, management Support and performance of semi-autonomous agencies in the state department of energy in Nakuru County and vice versa.

Using Beta Coefficients, the study sought to establish the level of contribution of each of the predictor variable to the variation of the predicted variable as shown in Table 3.

Table 3: Coefficients^a

Model	Unstandardized		Standardized	t	Sig.	Collinearity	
	Coefficients	Std. Error				Coefficients	Beta
(Constant)	0.218	0.341		0.639	0.526		
Independence	0.258	0.038	0.514	6.721	0.000	0.989	1.011

a. Dependent Variable: Organizational Performance

Beta coefficients shows the extent of influence of each of then predictor variables on the predicted variable when the rest of factors are held constant. The following beta coefficients were obtained; beta coefficient of 0.258 for independence of internal audit. This implies that one unit increase in independence of internal audit would lead an increase of 0.258 units in performance of semi-autonomous agencies in the state department of energy when other factors are held constant. These findings collaborate those made by Hailemariam (2014) that established that a unit increase in the level of auditor’s independence, the level of audit efficiency increases by 0. 135 provided that other factors were held constant due to a beta coefficient of 0.135. This influence was found to be statistically significant at 5% significance level. The independence of internal auditing improves level of service delivery, financial management, and reduces the level of debts of organisations (Ongeri, 2011).

VII. CONCLUSION

The study concluded that the independence of the internal audits had a significant influence on the organization performance. This relationship was statistically significant implying that

they would still hold in the population. This conclusion is based on the relative strengths of the beta coefficients of the study variable.

VIII.RECOMMENDATIONS

The study recommended that in order to improve on the organizational performance of the semi-autonomous agencies in the state department of energy in Nakuru County, Kenya, the management should enhance their focus on the independence of the internal audits.

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How to Cite This Paper:

Chepkonga, F. J., Nzioki, P. M., & Kiprop, S. (2018). Influence Of Independence Of Internal Audit On Organizational Performance Of Semi-Autonomous Agencies In The State Department Of Energy In Nakuru County, Kenya. *International Journal of Business Management and Processes (IJBMP)*, 4(2), 209-217.