

Internal Audit: A ‘watchdog’ for Financial Management in Kenya’s Technical and Vocational Education and Training (TVET) Institutions

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Abstract

In Kenya, Technical and Vocational Education and Training (TVET) consists of technical training institutions, Micro and Small Enterprises (MSE) centers, youth polytechnics and National Youth Service (NYS) skill development center. In Kenya, TVET is a very expensive project in terms of physical facilities, equipment, training materials and trainers’ salaries. According to TVET Authority Act for 2013, the sources of funds to facilitate the TVET programs consist of money provided by Parliament and from any other source provided for, donated or lent. In this regard, there is need for sound financial management plans for TVET institutions. This paper sought to answer the research question, what is the role of internal audit that can be used by Kenya’s TVET institutions in effective management of their finances? The study was guided by Porter’s competitive advantage theory which states that organization should perform at higher levels than its contemporaries. In this regard, the study intended to find roles played by internal audit to help in managing finances of Kenya’s TVET institutions well so as to enhance their operations beyond local or national markets. Using library research design and purposive sampling strategy to select three libraries in the month of March and April 2014, secondary data was obtained and analyzed using qualitative techniques. The findings from the study identified three roles of internal audit namely; evaluation of financial internal control system, financial risk management and business process improvement. The study concluded Kenya’s TVET institutions should be able to improve their technical understanding through adopting the internal audit as a vital tool for effective financial management. Furthermore, there is need for improved skills in internal control system implementation, use of computerized internal audit and appointment of internal audit committee to enhance the roles of internal audit.

Keywords: *Internal audit, financial management and Internal Control System (ICS).*

Introduction

TVET main aim is to give the skills which help in reducing poverty, economic recovery and sustainable development. Poverities Org in January 2011 states that there is a direct link between levels of education and poverty in Africa. In Kenya, the same link exists and the challenges facing development according to World Bank are youth unemployment, poverty and vulnerability to climate change. In the third international congress on transforming TVET organized by United Nations Educational, Scientific and Cultural Organization (UNESCO) in Shanghai, there was need to develop it to be the top priority in each country. By doing so, it will help in building greener societies, tackle global unemployment and make it more responsive to needs of 21st Century Societies. The participants in the congress called for deeper transformative and expansion of TVET by enhancing the stakeholders to participate in governance, improving its reliance.

Education in Kenya is a key to transforming and empowering community. Although it is expensive to provide the equipment, training materials, pay salaries for the trainers, the Kenyan government should put measures in place so as to improve the TVET institutions. One of the best ways is to ensure that finances are well managed for resources to be planned, directed, monitored and controlled to achieve the institutions' goals. According to the agency theory, the society is the principal who have delegated work the government (agent) of managing the TVET. In this regard, the government should be transparent and accountable to them to avoid agency problems that might arise.

Institute of Internal Auditors (IIA) state that internal auditing that is performed by internal auditors is designed to add value and improve an organization's operations. The scope of internal auditing within an organization is broad involving organization's governance, risk management and management controls over efficiency or effectiveness of operations (including safeguarding of assets), the reliability of financial and management reporting, and compliance with laws and regulations. In order to carryout out its work successfully, TVET institutions should ensure that the is an independent body of internal auditors and existence of an effective Internal Control System (ICS). Through this, there will be a thorough management of finances that reduces financial risks such as fraud, embezzlement or misappropriation.

UNESCO-UNEVOC (1996) states that some of main financing mechanisms of TVET are public financing through revenue, enterprise financing for training its own labour force, private and public sponsoring and international donor assistance. The mandate for value for money (VFM) audits Public Audit Act

2003 in part V section 29-33 provides for carrying out VFM examination. In August 2005, VFM auditing division, an independent audit for non-profit organization to assess the effectiveness and efficiency of its utilization of funds was established in Kenya national audit office. This aimed at examining whether public organization or programs have attained economy (acquire resources at low costs), efficiency (attain highest possible quantity of goods and services of acceptable quality from given inputs) and efficiency (achieving stipulated aims and objectives). In Kenya, despite TVET Institutions being faced with the challenge of lack of funds due to limited budgetary allocations, these institutions have managed to survive over years. This paper aims at analysing role of internal audit with the aim of suggesting to Kenya's TVET institutions ways to alleviate their financial management handicaps for better and competitive institutions internationally. The research question we endeavoured to answer was **what is the role of internal audit that can be used by Kenya's TVET institutions in effective management of their finances?**

Theoretical Framework

Porter's theory (1985), Competitive Advantage (CA) was singled out to buttress this study. This theory states that, an organization can achieve only relative to its rivals through, for instance, low costs and differentiations. According to this theory, competitive advantage is derived from organizational attributes such as: superior skills exercised by the management; relevant resource availability and use; as well as, the market position status. Accordingly, a business establishment would thus, be expected to perform at higher levels than its contemporaries. Most importantly, competitive advantage is normally attained through extensive and intensive coordination by the management among other business managerial functions.

The CA theory is therefore relevant in this study which intends to find relevant roles of internal audit which can help Kenya's TVET institutions for effective financial management so as to improve their services or operations beyond local/national level.

Literature Review

This review gives internal audit as the pillar in effective financial management in Kenya's TVET Institutions. To begin with, the review examines how internal audit is termed as the 'watchdog', just like a dog or watchful guardian who is kept or employed to guard property. The paper will then give the roles of internal auditors in managing TVET's finances. The review will also show how internal control system enhances the roles of internal audit.

Role of internal audit in financial management

Internal audit is an independent appraisal function set up within the organization for the view of systems of controls and quality performance (Arens and Loebbecke, 1994). The new definition of internal audit defines the function as consulting activity designed to add value and approve an organization's operations (Albert et. al 2000). 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 (Institute of Internal Auditors, IIA). Established in 1941, the IIA is a global international standard setting body serving 180,000 members in nearly 190 countries. IIA Kenya was registered locally in December 2002 under the Registrar of Societies Act but was officially launched in April 2003. Fabozzi and Peterson (2003) define financial management as often referred also as corporate finance or business finance. It is an area of finance that is concerned primarily with financial decision-making within a business entity. The decisions involved in financial management are financing (concerned with the acquisition of funds to be used for investing and financing day-to-day operations), investment (concerned with the use of funds) or decisions that involve both investment and financing decisions.

The main challenge being faced by TVET institutions in Kenya is poor financial management due to lack of independent internal audit. A study in Kenya's TVET institution which is a public sector was done to determine the effective role played by internal audit in financial management. Woolf (1994) emphasized the need for the internal audit to be independent. In the case study of Ethiopian public sector by Dessalegn and Aderajew (1986), they state that internal audit effectiveness is strongly influenced by internal audit quality and management support while organizational setting and auditee attributes don't have a strong impact on audit effectiveness. Alinaitwe (2011) did a study in Nakaseke district local government in Uganda and found out that internal audit was fairly performing due to lack of complete independence of internal auditors. As opposed to Dessalegn and Aderajew (1986), the institutions need to have a well-defined organizational structure or setting which is fully supported by the management. Lack of internal audit independence in study by Alinaitwe (2011) is also common in Kenya's TVET institutions. For internal audit to play its role effectively in Kenya's TVET institutions, internal auditors should have a strong attribute of being independent.

Internal audit has received an increased attention as an important component of financial management and as a tool for improving performance of the government sector. Unegbu and Kida (2011) in the study of effectiveness of

internal audit as an instrument of improving public sector management found out that ineffective internal audit in a public sector management can lead to ineffective financial decisions, emergence of fraud, low or noncompliance with internal policies and procedures. In the study by Diamond (2002), he defines the role of internal audit as an objective assurance and consulting activity managed within an organization to add value and improve organization operations. Furthermore, he states that internal audit gives a systematic and disciplined approach to evaluate and improve effectiveness of organization risk management, control and governance process. Internal audit cannot exist without having organizational operations in place which exist due to capital invested. Kenya's TVET institutions are government projects whose finances, a scarce resource, must be well managed through establishment of internal audit. By doing so, the operations of the institution will run smoothly due to effective risk management, control and governance processes.

Page and Spira (2004) in Turnbull study found out that the role of internal audit is to discover and evaluate the systems used in different parts of organization and recommend adoption of the best of them. In addition, internal audit play a role to identify risks that are not necessarily caught through formal processes or top-down reviews. For effective financial management, the findings of the Turnbull are very useful and applicable to TVET institutions in Kenya. The internal audit role should be to research on the financial management systems used by TVET institutions in other countries and thus apply them. Furthermore, the internal audit has a vital role in managing financial risks that might arise such as fraud and misappropriation of funds in TVET institutions in Kenya. Modena and Fish (2012) and Omboi (2011) states that a well-established internal audit can evaluate the firm's risk and control framework.

Their primary role as internal audit in Kenya's TVET institution should therefore be like those for a dog or watchful guardian. They should be qualified, independent and committed 'watchdogs' to give an assurance if internal controls exist and are effective in managing the finances of the institutions. Shim and Siegel (1998) states that modern managerial finance theory operates on the assumption that the primary goal of the firm is to maximize the wealth of its stockholders. In times when internal audit perceive to be dragged around of influenced by management or the government, they should stand tall in defending the interests of the Institutions so as to maximise the wealth of the stakeholders (Society benefiting from the education from TVET institutions). The agency problems as suggested by agency theory will not arise if TVET (agents) and Kenyan citizens (principals) will work tirelessly towards achieving the mission of building skills for work and life.

How internal control system (ICS) enhances role of internal audit

Internal controls have existed from ancient times such that in Hellenistic Egypt. Committee of sponsoring organizations of the Treadway commission, COSO, (1992) defined 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 relating to operations, reporting, and compliance. The key elements of that contribute to an effective ICS include environmental control (management's and employees' attitude and behavior), risk assessment, control procedures, monitoring and information and communication. According to Oshisami (1993), ICS is a managerial function of defining and allocating responsibilities for attainment of corporate objectives of an organization. Okwoli (2004) identifies the ICS objectives as to safeguard the organisation's asset against obsolescence and deterioration, to improve the organisation's efficiency in line with stated objectives, to ensure that everybody in the organisation follows stated directives. In this regard, ICS entails all systems of controls in the organization to ensure that operations run smoothly.

Sagwa (2013) states that organisations need to remain competitive by creating an ICS which leads to improved financial performance. Chebungwen and Kwasira (2014) did a study to test the effectiveness of ICS on financial performance in tertiary institutions. The study was carried out in African Institute of Research and Development (AIRADS) in Kenya whereby 75% of the respondents stated that there exist relationship between ICS and financial management. The study found out that institutions that had entrenched prudent ICS strategies were most likely to manage their finances better hence meeting their financial and other obligations. The study in TVET institutions in Kenya will help in emphasising the implementation of an effective ICS which leads to better financial management.

COSO's internal control-integrated framework is widely used around the world. In their 1992 report, COSO defines internal control system of an organization as having five vital components:

Control Environment - Sets the tone for the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control. It consists management philosophy and style, organization structure and management control system (internal audit function).

Risk Assessment - The identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed.

Information and Communication - Systems or processes that support the identification, capture, and exchange of information in a form and time frame that enables people to carry out their responsibilities.

Control Activities - The policies and procedures that help ensure management directives are carried out. These include reconciliation of book accounts, approval and control of balances, limit direct physical access to assets and records, compare budgetary estimates and actual estimates and physical verification of assets.

Monitoring - Processes used to assess the quality of internal control performance over time.

Moorthy (1999) in study to evaluate internal control of public sector enterprises in India states that internal controls can be either administrative or accounting controls. In relation to Kenya's TVET institutions, effective accounting internal controls are necessary to assist in ensuring that the work of internal audit is successful because they help safeguard assets and ensure reliability of financial records. In ensuring that finances of these institutions are well managed, ICS will give a strong baseline which consists of all the five components suggested by COSO internal-control integrated framework report. The internal audit in TVET institutions in Kenya will therefore use the framework which has served as a road map for effective internal control ever since.

Simmons (1997) states that internal auditors are concerned with entire range of an organization ICS which includes financial and compliance controls. In this regard, well-functioning internal audit and ICS help in protecting the organization against corruption, fraud or any form of funds misappropriation. In a study by Momoh (2005) to establish the role of internal auditors in Nigeria's Gwagwalada specialist hospital, there exists relationship between ICS and Internal audit. Internal audit aims at providing assurance to the management that the ICS in the organisation is sound in design and effective in operation. ICS enhances the role of internal audit in Kenya's TVET institutions. Having the components required by COSO, ICS will be effective such that the work of internal audit will be simplified. In this regard, TVET institutions in Kenya should have ICS in place which will help the internal audit in playing their role in ensuring that finances are well managed.

Research Methodology

Design, Study Area and Sampling

In order to search for answers to our research question, a library research design was instituted. The research area was in Nairobi city, Eldoret city and Kakamega town. Purposive sampling strategy was employed in this study. Accordingly, three university libraries of: The Catholic University of Eastern Africa, at Langata main campus, Nairobi and at Gaba campus, Eldoret libraries were selected and used. As well, the university library of Masinde Muliro University of Science and Technology in Kakamega was used during the search.

Data Collection and Analysis

The method used for data collection was document analyses (Saunders et al., 2007; Gall et al., 1996). A total of three weeks were spent in Langata, Gaba and Masinde Muliro libraries in the months of March and April, 2014. Only secondary data were utilized. The data were obtained from books, government documents, publications from private and public institutions in addition to relevant journal articles. The data were analyzed using qualitative techniques (Saunders et al., 2007).

Findings and Discussions

This study addressed only one research question, **“what is the role of internal audit that can be used by Kenya’s TVET institutions in effective management of their finances”**? The internal audit plays a big role in financial management. In Kenya, TVET institutions face the challenge of inadequate financing and thus there is need to establish the independent internal audit to ensure that the scarce financial resource is well managed (according to Alinaitwe, 2011; Dessalegn and Aderajew, 1986). Effective ICS will enhance the role of internal audit. ICS being a whole system of controls in the institution will help in improving financial performance and management (Sagwa, 2013). There exist a positive relationship between ICS and internal audit according to the study by Momoh (2005). Kenya’s TVET institutions should therefore have an effective ICS which consist the five components suggested by COSO report (control environment, risk assessment, information and communication, control activities and monitoring). As a result, the internal audit work will be simplified since the system to be evaluated will already be existing. Following below are the answers to the research question.

Evaluation of financial ICS - ICS aims at safeguarding the assets of the organisation, verify the accuracy and reliability of its accounting data, improve operational efficiency and encourage adherence to the prescribed managerial policies. The role of internal audit is to ensure that the ICS is effective for sound financial management to exist (Unegbu and Kida, 2011). The internal audit role is to highlight the areas of weakness in the operating system. During the audit of finances of the Kenya's TVET institutions, internal auditors should ensure that these transactions are complete and that the activity exists or have occurred. Furthermore, internal audit determines the rights and obligations of using the financial assets, valuation and that financial report have been prepared disclosing all the transactions.

Financial risk management - Internal auditors play the role of evaluating and controlling risks (Modena and Fish, 2012; Omboi, 2011). The internal audit's mandate is to assist the institutions to identify potential financial risks (fraud, embezzlement or misappropriation of funds) that might occur and come up with contingency plans. In order to successfully evaluate financial risk management, the internal audit should be able to assess financial risk exposure, development risk management process, analyse financial histories and establish process to minimize these risks. In Kenya's TVET institutions, internal audit redefine their role by focusing more evaluating and improving the effectiveness of institution's financial risk management.

Business process improvement - Page and Spira (2004) states that internal audit plays a role in giving an objective assurance to improve organizational operations. Through the report prepared after evaluating the financial operations, the organization's going concern can be determined. The role of internal audit as 'watchdogs' in ensuring that finances in Kenya's TVET institutions are well managed will automatically make these institutions going concerns (operate without closure due liquidation).

Table 1 displays the role of internal audit as 'watchdog' for effective financial management of Kenya's TVET institutions.

Table 1: Sampled roles and benefits of internal audit in effective financial management of TVET institutions in Kenya.

IAR	BENEFITS
Evaluation of financial Internal control system (ICS)	Highlights areas of weakness in the operating system
Business process improvement	Give assurance in the audit report that the organization is a going concern.
Financial risk management	Eliminates expected costs of financial risks; Maximizes profits

Source: *Integrated by Authors from Literature, 2014*

Key: IAR= Internal Audit role

Conclusions

TVET institutions in Kenya are key in providing formal and informal skills to the citizens. As a pillar for economic development towards providing education so as to attain the Vision 2030, the government of Kenya should ensure that the funds of TVET Institutions are well managed. Internal audit are referred to as ‘watchdogs’ because the roles they play are related to those of a dog or watchful guardian who is kept or employed to guard property. The paper concludes that the primary mandate of internal audit should be upheld by ensuring that they play their roles independently. An effective ICS should be in place which will enhance the role of internal audit. For Kenya’s TVET institutions to rise above local or national operations, they ought to improve their skills in ensuring that finances are well managed. TVET institutions in Kenya need to aggressively use internal audit as an effective tool for financial management so as to be compliant with our current information age operations.

Recommendations

Internal audit of Kenya's TVET institutions is crucial in ensuring that sound financial management is attained. In order to ensure that internal audit carryout their role of ensuring that finance are well managed, our paper strongly recommends the following to be done in Kenya's TVET institutions:

Skills to implement ICS - The internal audit of Kenya's TVET institutions should be able to acquire the skills on how to assist the institutions in implementing and effective ICS. The vital skills include assessing the institution's risk to know the areas which controls are essential. The internal audit should then be able to develop controls which include security of assets, segregation of duties, detective (help detect errors), preventive (keep errors from happening in the first place). The internal audit should be able to create effective communication lines to ensure that everyone in the institution is aware of the ICS and monitor the system using employee assessment, internal and external audit.

Computerized internal audit - The internal audit should adopt the new technology through the adaptation of Information Communication Technology (ICT). The internal audit team should be able to understand how auditing is done in Computer Information System Environment (CIS) or where Electronic Data Processing (EDP) exists (Institution uses computers to prepare financial statements). They should be involved in system and programs development to ensure that adequate internal controls and risks management are built into the system.

Existence of effective audit committee - The role of internal audit should be assessed by an audit committee to ensure that their work is independent and geared towards the main goal of managing well finances of the Kenya's TVET institutions.

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