

INFLUENCE OF INTERNAL AUDITORS' COMPETENCY ON FINANCIAL SUSTAINABILITY OF NON GOVERNMENTAL ORGANIZATION IN NAKURU COUNTY KENYA.

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ABSTRACT

Financial sustainability of an organization is a measure of an organization's ability to meet its financial obligations. The study is specifically examining the influence of, Internal Auditors Competency on financial sustainability of NGOs in Nakuru, County Kenya. Theory underpinning this study is Auditing Theory. From each NGO the researcher targeted three officials namely program managers, grants managers and accountants. 237 officials were the targeted population. Data collection was done through use of questionnaires constructed on a likert scale. IBM software was used for analyzing the collected data. The study established, auditor competency, with financial sustainability of non-governmental organization in Nakuru County. Correlation analysis showed that auditors' competence had a significant influence on financial sustainability of NGOs in Nakuru County. The study is of significance to Government as it would assist in formulating effective policies on issues appertaining to the NGOs finances. The study recommended that the organizations should ensure that internal auditors department operates independently without undue influence. Also the researcher recommended that the internal auditors department should ensure they recruit competent auditors in the organizations with sufficient knowledge and skills to ensure that the audit process is accurate and giving an accurate position of the financial standing of the organization

Keyword: Internal audit, financial sustainability, funds, competency, auditor

INTRODUCTION

Financial sustainability is an important factor in the long-term survival and effectiveness of NGOs. According to Lynn (2013) the more there are different sources of funds available the more financially sustainable an NGO is. In other words, financial sustainability of an NGO depends on its ability to diversify its sources of funds. In practice NGOs that are not dependent on a particular funding stream is likely to remain sustainable. A sustainable NGO is one that can continue to fulfil its mission over time and meet the needs of its key stakeholders, particularly its beneficiaries and supporters (Malvern, 2002). Sustainable NGOs are those that are able to respond strategically and effectively to such external changes, revise their mission and objectives accordingly, access new sources of income, and adapt their systems and processes to meet the new challenges.

The aims of this risk-based approach are to assess and identify the high-risk areas, while at the same time; the auditor is minimizing the risk of negligence (Griffiths, 2006). This can therefore speed the audit work and help to allocate specialists to specific areas of the audit. However, this process can cause more time to be spent on the audit and raise costs, thus not making economic

sense. Unfortunately, another problem faced by auditors when adopting the risk-based approach is when identifying high-risk areas. Auditors must decide what evidence is required and in how much detail (Commonwealth of Australia, 2004). Risk based audit can be an effective external mechanism because it signals to potential investors and donors whether the manager complied with the accounting practices and did not misrepresent financial information.

Quality of risk audit also matters as evidence suggests that it is usually driven by active stakeholders (Ashbaugh& Warfield, 2003). In addition, there is evidence that firms who voluntarily adopt the International Accounting Standards or US Generally Accepted Accounting Practices (GAAP) have lower cost of debt (Leutz&Verrecchia, 2000). Goodwin-Stewart and Kent (2006) assert that internal auditing plays a crucial role in monitoring a firm's risk profile and identifying areas to improve risk management.

The object of internal auditing is to improve organizational efficiency and effectiveness through constructive criticism. Generally, internal audit has become an indispensable management tool for achieving effective control in both public and private organizations. In a study on a sample of Australian and New Zealand firms, Coram et al. (2008) established that organizations with an internal audit function are more likely to detect and self report fraud through misappropriation of assets than those that do not. According to Serageldin (2006) sustainability is determined by several financial and human capital related factors. An NGO is considered sustainable if it has diverse funding sources, so that if one or two left the scene, no great harm would be done to the organization's capacity to continue its work (Pratt & Hailey, 2012). Risk Based Auditing could improve the precision of financial statement information by issuing qualified opinions to firms with unreliable financial statements. Auditors enable investors to screen out such firms (Gibson, 2003). The aims of this risk-based approach are to assess and identify the high-risk areas, while at the same time, the auditor is minimising the risk of negligence (Griffiths, 2006). This can therefore speed the audit work and help to allocate specialists to specific areas of the audit.

Chen (2003) investigated the relationship between Risk Based Internal Audit and corporate governance structures. It was found that there existed a significant positive relationship between the level of risk based internal audit (RBIA) used and corporate governance board size. The findings of this study indicated a significant negative correlation existed, suggesting that a small board size seems to be more effective, and is more likely to use RBIA, as a complementary mechanism.

STATEMENT OF THE PROBLEM

In Nakuru County, there has been a massive expansion of NGOs and a substantial infusion of money combined with the desire for change which has led to the financing of NGOs. Although donors are the major sources of funding of NGOs, the level of donor contributions has steadily declined. This has affected the operations of NGOs' in Nakuru County. As a result, the NGOs have been unable to achieve their objectives. Also complaints concerning sustainability of NGOs have been raised by the government, the community and the donors. Financial sustainability is critical to NGOs for stability and enhancement of growth. However, NGOs usually end their operations when funding stops. The emergence of new business risks has compelled many organizations to formulate strategies and to elevate the status of internal auditing (Szipirglas, 2006). This has been so through creation of independent internal auditing departments. Through

this, the internal auditors add value to the organizations through greater accountability, independence and objectivity (Mutchler, Chang & Prawitt, 2001). The success of internal audit is pegged in a strong, active management support and improved governance structures. The management have to allocate sufficient resources to the internal audit department to enable them hire competent staff to do their job efficiently. Effectiveness and transparency in the auditing process in the organizations is a sure way of enhancing performance resulting to sustainability of the organization. The trend in the running of NGOs raises doubt on the extent of their adoption of Risk based internal audit and the influence on their financial sustainability. NGOs tend to be dissolved once the donor funding stops trickling in rising doubt unto the sustainability of NGO projects. The foregoing prompts the undertaking of this study to examine the influence of risk based internal auditing on financial sustainability of NGOs in Nakuru County Kenya.

OBJECTIVE OF THE STUDY

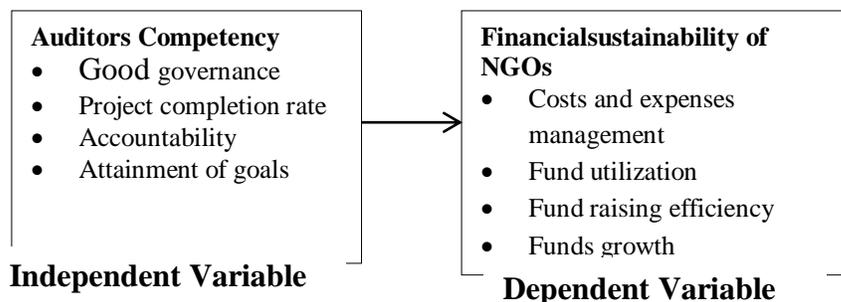
The study sought to establish the influence internal auditors' competency on financial sustainability of Non-governmental Organizations in Nakuru County Kenya.

Hypothesis of the study

H₀₁: There is no statistically significant influence of internal auditors' competence on financial sustainability of Non-governmental organizations in Nakuru County Kenya.

FRAMEWORK CONCEPTUALIZATION

Kombo & Tromp (2006), define a conceptual framework as a research tool intended to assist the researcher develop awareness and understanding of the situation under scrutiny and to communicate it. The dependent variable in this study was financial suitability of NGOs while the independent variable was auditors' competency.



Theoretical Review

The study was founded on theory of auditing.

Theory of Auditing

Auditing theory helps to explain why auditing is needed in organizations. It also reveals certain laws that govern the audit process and its activities. Auditing theory enhances the understanding of the relationships and interrelationships between different parties of an organization. A sub-

theory of auditing theory is the policeman theory. According to this theory, the auditor is responsible for searching, discovering and preventing fraud. Recently, the main focus of the auditors has been to provide reasonable assurance and verify the truth and fairness of the financial statements. The detection of fraud is, nevertheless, still a crucial topic in the debate on the auditor's responsibility, and typically after events where financial statement frauds have been revealed, the pressure increases the responsibilities of auditors in detecting fraud (Hayes, Pisano, Upton & Wheelwright 2005).

The lending credibility theory is another sub-theory of auditing theory which postulates that the primary function of the audit is to add credibility to the financial statements. In light of the foregoing, the auditors are perceived to sell "credibility" to the clients. Audited financial statements are viewed as having elements that enhance the confidence of the financial users in the results presented by the management in the financial statements. On the other hand, the users are perceived to gain benefits from the increased credibility; these benefits are ideally considered to be that the quality of investment decisions improve when they are based on reliable information (Ittonen, 2010).

Also another part of the audit theory is the "theory of inspired confidence" which Hayes et al. (2005) also regard as the "theory of rational expectations". The theory addresses both the demand and the supply for audit services. It is argued that the demand for audit services is a direct consequence of the participation of third parties in the organization. These parties demand for accountability from the management in return for their investments in the firm. In this light, accountability is realized through the issuance of periodic financial reports. It is, however, argued that the information provided by the management is probably biased, and as such outside parties have no direct means of monitoring. Auditing according to this theory risk based auditing is required to validate this information. It is emphasized that the auditor should always strive to meet the public expectations.

Internal Auditors' Competency on Financial Sustainability of Non-Governmental Organizations

The competency of internal auditors is important in promoting good governance and ensuring effective utilization of public resources. The internal audit function personnel both at the audit committee level and at actual internal auditors should be qualified, competent and knowledgeable to enable them perform their duties effectively. Morgan (2009) posited that internal auditors needed to be experienced and have the expertise. The uniqueness of internal auditor's competency is fostered by ensuring internal auditor's independence, expertise, integrity and diligence to perform their role effectively (DeZoort, Hermanson, Archambeault & Reed 2002). In organizations with internal auditors with high competency levels, there is a positive correlation with performance which results in overall more effective corporate governance.

Lack of experience, expertise, knowledge and qualification on auditing practices hinders performance of internal auditors. Kariuki, (2010) posited that internal auditors in a firm should be competent professionals. Lack of adequate understanding when coupled with low level of knowledge on auditing operations poses a major threat to the achievement of high performance. The audit function requires internal auditors to be competent with high professional qualification with required experience to effectively execute their mandate. To achieve good governance,

internal auditors must have attained minimum education level and have good professional standing in auditing. The chief auditor is required to effectively select and recruit highly trained and skilled internal auditors (Kunkel, 2014). Knowledge, competency and qualification of the internal auditors role depends on the level of staff competency attained and this impacts on the audit quality (Mihret&Yismaw, 2013).

Detecting fraud is a challenging task. Perpetrators actively engage in deception in an attempt to conceal their behaviour, auditors may have limited experience in fraud detection, and fraudulent activities are inherently unpredictable and difficult to detect (Nieschwietz et al., 2000). Hence, the organization would be optimally served by identifying and utilizing those individuals who, because they appear to share certain unique personality traits or characteristics, may be best suited to the fraud detection task. Uecker et al. (2011) used perceptions of relative aggressiveness between internal and external auditors to investigate the detection of corporate irregularities. Internal auditors play an important role in fraud detection with most frauds identified by the internal audit function (KPMG, 2013).

Due to the importance of effective fraud detection, any measures that can enhance the efficacy of auditors should be of value. While experience and ability are undeniably important in the detection process, certain individual characteristics may be predictive of the capacity to detect fraud (Ashton, 2013). Understanding how auditors are perceived, and how these perceptions lead to beliefs regarding their detection abilities, is an important first step in relating personality traits to the efficacy of auditors. Effective internal audit system helps in achieving performance, resource optimization and prevents loss of revenues. The public expenditure management systems of the government are greatly enhanced by effective internal systems in which the internal audit has an important role in raising the reliability of the internal control system, improving the process of risk management and above all, satisfying the needs of internal users.

Tan and Kao (2010) pointed out that it is important to focus on individual's competence in performing assigned responsibilities as people having relevant experience and knowledge normally demonstrate better performance as they tend to prove their competence. The internal audit support enhances the system of responsibility that the executive directors and employees have towards the owners and other stakeholders (Eighme&Cashell, 2010). Taken together, the internal audit department provides a reliable, objective, and neutral service to the management, board of directors, and audit committee, while stakeholders are interested in return on investments, sustainable growth, strong leadership, and reliable reporting on the financial performance and business practices of a company (Ljubisavljević&Jovanovi, 2011).

RESEARCH METHODOLOGY

The target population of this study included the management team of NGO's based in Nakuru County registered with the NGO council of Kenya. There are 79-registered NGO's in Nakuru County Kenya. 115 respondents were selected as the target population of the study. The study used structured questionnaire that was distributed to the managers in the real estate companies and agencies. According to Kothari(2006)a questionnaire is the best tool for the researcher who wishes to acquire the original data for describing a population. The questionnaire was composed of short structured closed ended statements constructed on 5 point Likert scale. Data collected was processed and analyzed based on the objectives and research hypotheses using Statistical

Package for Social Sciences (SPSS). This was done using both descriptive and inferential statistics. Descriptive statistics (percentages, frequencies, and means) presented in tables was used to organize and summarize data and to describe the characteristics of the sample while Pearson correlation coefficient was used to check the relationship between variables. ANOVA was used to test the influence of the independent variables on the dependent variable and the study hypothesis at $p < .05$ level of significance.

FINDINGS AND ANALYSIS

A total of 115 questionnaires were distributed for the staff in NGOs. 84 questionnaires were returned by the respondents. Six of the returned questionnaires were incompletely filled and were deemed inappropriate for data analysis thus were discarded. Thus 78 questionnaires were completely filled and returned indicating a response rate of 68%.

Auditors Competence

Respondents’ views were sought in regard to auditors’ competence in the NGOs in Nakuru. The analysis findings were as presented in table 4.11.

Table 1: Descriptive Statistics on Auditors Competence

	SA (%)	A (%)	U (%)	D (%)	SD (%)	χ^2	P-Value
The organization hires qualified auditors to perform its functions	44.2 (34)	37.7 (29)	9.1 (7)	2.6 (2)	6.5 (5)	57.740	.000
The hiring of competent auditors has enhanced good governance in the NGO	45.5 (35)	45.5 (35)	1.3 (1)	3.9 (3)	3.9 (3)	83.325	.000
Good management of financial resources enables the completion of NGO projects	51.9 (40)	37.7 (29)	3.9 (3)	2.6 (2)	3.9 (3)	82.935	.000
The audit department accounts for all the NGOs project expenditures	28.6 (22)	22.1 (17)	11.7 (9)	26.0 (20)	11.7 (9)	9.688	.047
The high understanding of audit operations by the auditors enables the achievement of high performance in the NGO	27.3 (21)	35.1 (27)	29.9 (23)	2.6 (2)	5.2 (4)	34.623	.000
The chief auditor in the NGO selects and recruits and recruits highly skilled auditors	24.7 (19)	23.4 (18)	13 (10)	10.4 (8)	28.6 (22)	9.558	.049
The internal control systems in the NGO is highly reliable in enhancing transparency	42.9 (33)	26.0 (20)	15.6 (12)	6.5 (5)	9.1 (7)	33.844	.000
Valid N (listwise)	77						

It was observed that 81.9% of the respondents strongly and/or agreed that the organization hires qualified auditors to perform its functions. 91% of them observed that the hiring of competent auditors enhances good governance in the NGOs. Further 89.6% of the respondents also strongly and/or agreed that good management of financial resources enables the completion of NGOs projects. 62.4% of the respondents strongly and/or agreed that the high understanding of audit operations by the auditors enabled the achievement of high performance in the NGOs. In addition 68.9% of the respondents noted that the internal control systems in the NGOs are highly reliable in enhancing transparency. Respondents were however undecided on whether the audit

department accounts for all the NGOs project expenditures with their responses appearing to balance across all response categories. In addition they were undecided on whether the chief auditors in the NGOs select and recruits highly skilled auditors. The chi-square (χ^2) statistic for the two aspects were found to be insignificant at $p < .05$ indicating that the responses did not indicate any significant differences. However all the other aspects had chi-square (χ^2) statistics significant indicating that the respondents demonstrated significant differences in their responses. Further, the study was in agreement with other researcher like Morgan (2009) who found out that competency of internal auditors is important in promoting good governance and ensuring effective utilization of public resources. The internal audit

function personnel both at the audit committee level and at actual internal auditors should be qualified, competent and knowledgeable to enable them perform their duties effectively

Financial Sustainability of NGOs

The study sought respondents’ views on the financial sustainability of the NGOs. The findings were as presented in table2 below

Table 2: Descriptive Statistics on NGOs Financial Sustainability

	SA %	A %	U %	D %	SD %	χ^2	P- Value
Auditors competence enhances timely completion of NGOs projects	28.6 (22)	31.2 (24)	32.5 (25)	1.3 (1)	6.5 (5)	34.104	.000
Audit transparency in the NGOs has resulted to increased donor funding	33.8 (26)	49.4 (38)	6.5 (5)	7.8 (6)	2.6 (2)	64.883	.000
Improved management support enables the NGO to operate efficiently and proactively to environmental threats	31.2 (24)	53.2 (41)	7.8 (6)	5.2 (4)	2.6 (2)	73.195	.000
There is accountability in financial management my NGO	32.5 (25)	44.2 (34)	18.2 (14)	2.6 (2)	2.6 (2)	51.896	.000
Auditors independence enhances the timely attainment of goals and objectives of the NGO	20.8 (16)	22.1 (17)	41.6 (32)	7.8 (6)	7.8 (6)	29.558	.000
Due to increased management support has led to increased capitalization of the NGO through good will donations and fundraising	28.6 (22)	32.5 (25)	31.2 (24)	2.6 (2)	5.2 (4)	33.714	.000
Increased management support has led to increased capitalization of the NGO through good will donations and fundraising	41.6 (32)	33.8 (26)	19.5 (15)	1.3 (1)	3.9 (3)	47.158	.000
Valid N (listwise)	76						

The findings indicated that 59.8% of the respondents strongly and/or agreed that the auditors competence enhances timely completion of NGO projects. Further 83.2% of them strongly and/or agreed that audit transparency in the NGOs has resulted to increased donor funding. They observed that improved management support enables the NGO to operate efficiently and proactively to environmental threats. On the other hand, 76.7% of the respondents strongly and/or agreed that there is accountability in financial management in their NGOs. Further, 61.1%

of the respondents strongly and/or agreed that increased management support has led to increased capitalization of the NGO through good will donations and fundraising. They were however inconclusive on whether auditors independence enhances the timely attainment of goals and objectives of the NGO with a majority of the respondents choosing to be undecided on this aspects. The respondents' views were however very diverse with all the responses having chi-square (χ^2) statistic significant at $p < .05$.

7.3 Auditor Competence and Financial Sustainability

The study sought to examine the relationship between auditor competence and financial sustainability of NGOs. The findings were presented as shown in table 2 below

Table3: Correlations between Auditor Competence and Financial Sustainability

		Auditors competence	Financial sustainability
Auditors competence	Pearson Correlation	1	.419**
	Sig. (2-tailed)		.000
	N	77	77
Financial sustainability	Pearson Correlation	.419**	1
	Sig. (2-tailed)	.000	
	N	77	77

** . Correlation is significant at the 0.01 level (2-tailed).

The findings indicated a relatively weak positive significant ($r=.419$, $p=.000$) relationship between auditor competence and financial sustainability of NGOs in Nakuru county. Thus auditor competence has a vital role in determining the financial sustainability of NGOs. The study findings were in agreement with findings of other authors like Morgan (2009) and DeZoort, Hermanson, Archambeault and Reed (2002) who posited that competency of internal auditors is important in promoting good governance and ensuring effective utilization of public resources. The internal audit function personnel both at the audit committee level and at actual internal auditors should be qualified, competent and knowledgeable to enable them perform their duties effectively. Internal auditors needed to be experienced and have the expertise. The uniqueness of internal auditor's competency is fostered by ensuring interna auditor's independence, expertise, integrity and diligence to perform their role effectively.

CONCLUSIONS OF THE STUDY

Descriptive statistics indicated that respondents agreed that the organization hires qualified auditors to perform its functions. They observed that the hiring of competent auditors enhances good governance in the NGOs.. Respondents further agreed that the high understanding of audit operations by the auditors enabled the achievement of high performance in the NGO. In addition they were undecided on whether the chief auditors in the NGOs select and recruit highly skilled auditors. Descriptive analysis demonstrated that internal auditors had a significant relationship with financial sustainability of NGOs in the county of Nakuru.

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