

# **THE IMPACT OF INTERNAL AUDIT PRACTICES ON FINANCIAL MANAGEMENT OF LOCAL GOVERNMENT AUTHORITIES: THE CASE OF MOROGORO MUNICIPALITY**

## **Abstract**

The importance of internal audit services in promoting good financial management in the public sector has received great attention in recent times. The purpose of this study was to examine the impact of internal audit practices on financial management of Morogoro municipality. Using a case study design, data was collected by means of questionnaires and interviews from 60 respondents. This was, then, descriptively analysed. The findings revealed that internal audit personnel in Morogoro municipality were found to have relevant audit experience something that enabled them to carry out their activities with confidence. Moreover, the internal audit department in Morogoro municipality was organisationally independent as it involved internal auditors who have full and unfettered access to all organisational records implying that the internal auditors were autonomous. Finally, there is no high level of corruption in Morogoro municipality as the municipality maintained transparency in its dealings to the extent of minimizing corrupt practices. Morogoro municipality should make sure that it retains its experienced internal auditors to enable it enjoy the benefit of good financial management of resources provided to it.

*Key Words: Internal Audit Practices, Financial Management, Local Government Authorities*

## **1.0 Introduction**

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations (Dogani, 2020). 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, 2018). Auditing practice is categorized into either internal or external auditing based on circumstances into which it is undertaken (Dogani, 2020). In terms of government institutions, internal audit practices helps government organizations to ensure accountability and integrity, improves the execution of government programs and develops a sense of trust and confidence among citizens and various stakeholders in the public interest (Dozie et al., 2019). The core purpose of internal auditing practices is to monitor government revenue collection and expenditure as appropriated by the parliament in order to bring about greater transparency and accountability in the management of public finances (Bilal et al., 2018). Internal audit

practice is, therefore, the use and application of knowledge, skills, tools, and mathematic techniques to audit activities to meet audit requirements (Wood, 2012).

A survey conducted in Malaysia by Fausto (2010) reported that auditors are best placed to understand and appreciate the business processes of any organisation and they act as financial performance consultants to reduce risks. Fausto (2010) indicated that auditors also help run an organization more efficiently and effectively to increase shareholders' value. The current auditing practice started developing from the 19<sup>th</sup> century when auditing came into existence as a separate legal entity (Wood, 2012). The demand of internal audit unit in most African countries increased since its early inception 1930 (Mohamed, 2013). Recently, in Tanzania the importance of internal audit has seen a rapid growth in public sectors to promote good governance by providing objective assessment of whether the public resources are adequately utilized in order to achieve favorable results (Cohen and Sayag, 2010). With a commitment to integrity and accountability, internal auditing practice provides value to governing bodies and senior management as an objective source of independent advice (Wood, 2012). In keeping with these assertions, to accomplish this, internal auditing practices in most local government authorities (LGAs) must function in a manner that is in accordance with applicable professional auditing standards (Dogani, 2020). That is, internal auditing practices enhance prudent use of resources, accountability and improve institutional efficiency. Besides, internal audit practice has been recognized as a tool for ensuring effective working of the internal control system (Mohamed, 2013).

Studies have been undertaken on how internal audit practices affect financial management and performance in various organisations. Ondieki (2013) in his study focusing on the effect of internal audit on financial performance of commercial banks in Kenya found out that internal audit standards, independence of internal audit, professional competency and internal control had a positive relationship with financial performance and management of commercial banks. According to Dogani (2020) the inability to complete the established internal audit effectively is an area of overwhelming concern audit management. From the above studies undertaken no studies have been done on the assessment of internal audit practice in improving financial management in local government authorities (LGAs). The above studies have majorly focused on control environment, internal audit standards etc. This was the gap to be filled.

The performance of an internal audit practices must function in a manner that is in accordance with applicable professional standards and the quality of the internal control systems (Ejoh, 2014). Internal audit practice is an essential part of the control of public organizations (LGAs being among them) as the main complaint in the sector is that internal audit departments are too understaffed and under resourced to be fully managing and effectively improving finance (Dozie et al., 2018). Yet, the importance of internal audit practice and internal controls are only recognised and emphasized after irregularities are discovered (Dozie et al., 2019). As the local government authority

implements an accrual accounting system and has a good quality financial report, it will have an impact on the quality of public services (Mohamed, 2013). Ejoh (2014) did a study on the effect of internal audit practices on financial performance in colleges in Nigeria and the findings of the study revealed that there was no significant effect of these practices on financial performance. Bett (2014) also did a study on the effectiveness of internal audit practices on operations of commercial banks in Kenya and the study findings showed that there was a relationship between embracing audit practices and the financial performance and management although the study did not empirically show to what extent does the internal audit practice affect financial performance and recommended further research to be done to ascertain the degree of effectiveness.

Moreover, the concept of internal audit practice in Morogoro municipality has not been fully tapped with regard to human resources, budgetary control, financial accountability and risk management. This could be seen in the numerous cases of misuses of public fund, frauds, errors, loses and poor handling of public funds and poor governance (CAG, 2021). Despite these observations, little research has been done to assess the internal auditing practices in improving financial management with reference to Morogoro municipality into perspective and how they contribute towards prudent financial management of the municipality. The purpose of this mixed methods study was to utilize the resource-based theory in order to test if internal auditors in the study area are able to practice their professional competence towards improving the financial management of Morogoro municipality.

## **2.0 Materials and Methods**

### **2.1 Description of the Study Area**

The study was carried out in Morogoro municipality in Morogoro region that has over 531 square kilometres and it is divided into 29 wards. The municipality is located on the eastern side of Tanzania mainland. The municipality lies between latitudes  $5^{\circ} 38^{\circ}$  and  $10^{\circ} 00^{\circ}$  south of Equator and between longitudes  $35^{\circ} 25^{\circ}$  and  $38^{\circ} 30^{\circ}$  east of Greenwich. It is bordered by seven regions. In the north are Tanga and Manyara while in the eastern side are the Coast and Lindi regions. On the western there are Dodoma and Iringa regions while Ruvuma is located in the southern side of the region. The district occupies an area of 260 square kilometers and population of 227,921 (URT, 2012 Census). The reason for conducting the study in this area is that internal audit practice in Morogoro municipality has not been fully tapped with regard to human resources, budgetary control, financial accountability and risk management. This follows numerous cases of misuses of public fund, frauds, errors, loses and poor handling of public funds and poor governance reported in the CAG reports of 2018/2019 & 2019/2010. Thus, despite these observations, little research has been done to assess the internal auditing practices on the financial management with reference to Morogoro municipality.

### **2.2 Research Approach and Design**

The study used a mixed approach that utilizes both qualitative and quantitative approaches. Qualitative approach aims to explore and discover issues about the problem on hand, because very little is known about the problem. There is usually uncertainty about dimensions and characteristics of the problem. It uses soft data and gets rich data (Cresswell, 2009). According to Yin (2003) qualitative approach is designed to help researchers understand people, the social and cultural contexts within which they live and work. Further, quantitative approach makes use of questionnaires, surveys and experiments to gather data that is revised and tabulated in numbers, which allows the data to be characterised by the use of statistical analysis (Yin, 2003). Quantitative researchers measure variables on a sample of subjects and express the relationship between variables using effective statistics such as correlations, relative frequencies or differences between means; their focus is to a large extent on the testing of theory (Kothari, 2004).

Moreover, the study utilized a case study design as it examines the data and it is conducted within the context of its use, that is, within the situation in which the activity takes place. Also, the variations in terms of intrinsic, instrumental and collective approaches to case studies allow for both quantitative and qualitative analyses of the data (Yin, 2003).

### **2.3 Study Population**

A target population is generally a large collection of individuals or objects that is the main focus of a scientific inquiry and it is for the benefit of the population that researches are done (Sekaran, 2003). Moreover, the target population refers to the total number of items about which the information is desired (Kothari, 2004). In this study the target population included staff working in finance and trade department, audit department, representative from audit committee and heads of departments in Morogoro Municipality.

### **2.4 Sampling Techniques and Sample Size**

Sample technique is the procedure used to select people, places or things to study in the target area (Yin, 2003). It is a plan for obtaining a suitable sample from a given population. Purposive sampling was used and it is a non-probability sampling, which refers to sampling procedures where the sample for the study is deliberately selected by the researcher (Kothari, 2004). In this respect, elements of the population have no equal and known chance of being selected into the sample (Saunders et al., 2007).

A sample is a part of the population from which it was drawn. Sekaran (2003) advises that too large a sample size could become a problem and recommended sample sizes between 30 and 500. Similarly, he recommended that a minimum number of samples for survey and case study research should be 30. The sample included 60 respondents from finance and trade department, audit department, representative from audit committee and heads of departments in Morogoro Municipality as the table hereunder shows.

**Table 1: Sample Size**

<b>No</b>	<b>Category</b>	<b>Sample Size</b>
1	Finance and trade department staff	34
2	Internal audit department staff	09
3	Audit committee members	07
4	Heads of other department	10
	<b>TOTAL</b>	<b>60</b>

### **2.5 Data Collection Tools**

In this study, primary data were collected through questionnaires and interview guide. Creswell (2009) and Kothari (2005) define a questionnaire is a data collection instrument consisting of a series of questions and other prompts for the purpose of gathering information from respondents and is often designed for statistical analysis of the response. In this study, the researcher applied a questionnaire to collect data from finance and trade department, audit department and heads of departments in Morogoro Municipality. These questionnaires were self-administered. Both open and close ended questions were designed for the respondents.

Interview guide was administered to the representative from audit committee. This is considered appropriate for this study as it enables one to obtain and elaborate answers to open ended questions from the respondents. Interviews are methods of gathering information through oral quiz using a set of preplanned core questions. Yin (2003) states that the interview tool is very important source of getting information and it is supportive in administering case study related matters as the study design indicates.

### **2.6 Data Analysis**

Both quantitative and qualitative data were collected. Quantitative data were analyzed descriptively using frequencies and percentages through Statistical Packages for Social Science (SPSS Version 20) to assess the internal audit practices on the financial management in Morogoro municipality.

Qualitative data from interviews were coded and analysed through content analysis where themes and emerging patterns were coded from the interview transcripts. Also, qualitative data from interviews were analysed using content analysis focusing on the observer's impression. Content analysis involved transcribing all information from verbal discussions with informants followed by breaking the recorded information into meaningful smallest units of thematic information, subjects and tendencies and presented as a text.

## **3.0 Results and Discussion**

### **3.1 Extent of Professional Proficient**

The first objective of the study aimed at determining the extent to which the internal audit personnel in Morogoro municipality are professionally proficient. Thus, respondents were asked to provide their opinions in terms of Likert type scale accordingly as provided in Table 2 below as follows;

**Table 2: Extent on Professional Proficient**

Statements	% Strongly agree	% Agree	% Uncertain	% Disagree	% Strongly disagree
The internal audit staff have relevant audit experience	0	80	0	20	0
Internal audit staff qualification is recognized by the professional accountancy body	0	90	0	10	0
Staff have up to date knowledge and abilities related to financial management	80	20	0	0	0
Staff have up to date knowledge and abilities related to government accounting and auditing policies	90	0	0	10	0

**Source: Research data, 2022**

The results in Table 2 indicate that 80% of respondents agreed that internal audit staff have relevant audit experience. This implies that Morogoro municipality has staff with experience on auditing something that enables it to carry out its activities with confidence. This confidence has enabled staff adhere to standards and practice well their professions. The statement above is in agreement with Gaballa & Ning, (2011) who found that when auditors gain experience, they know more about likely errors and how to deal with them. Moreover, when auditors work with a range of clients to review financial documents for accuracy and compliance with laws and regulations, to review documented organisational policies and procedures, they enhance their own knowledge and become well equipped to provide useful service to their clients. Therefore, auditing of such nature becomes important as it provides credibility to a set of financial statements and gives the shareholders confidence that the accounts are true and fair. Yet, 20% of respondents disagreed that some internal audit staff have no relevant audit experience. It is argued that this could be because they have not yet gained enough experience that could not enable them exhibit high levels of performance.

One of the key informants was of the following view:

*Internal audit staff at Morogoro municipality are proficient from the fact that, their experience in day to day practices proves that.*

On the other hand, the results in Table 2 indicate that 90% of respondents agreed that internal audit staff qualification is recognised by the professional accountancy body. In order to be recognized, one has to do and pass the professional body's exams in order to be registered as a member and have one's qualification to practice approved. It was found that 3 out of 5 staff had bachelor degrees with additional national board of accountancy and auditors' certificates of recognition. This level of expertise enabled those staff to carry out their activities professionally and with confidence. The statement above concurs with Samagwa (2015) who reported that upon recognition by the National Board of Accountants and Auditors, the staff are required to prove their expertise in their day to day activities. Yet, the results show that 10% of respondents disagreed that some of the internal audit staff qualification is not recognised by the professional accountancy body. This was proved from the fact that 2 out of 5 staff had such deficiency.

One of the interviewees was of the following view.

*It is as per ethics code that ensures that all practicing members demonstrate integrity and honesty in their work with clients and engage on other professional relationships to avoid any information that could be misleading or damaging the client or organisation. This is could only happen when staff are professionally fit to undertake the audit practice thoroughly.*

The other interviewee was of the following view;

*It has been stated that where staff are not as proficient as desired, they would not provide the best service expected of them. However, plans to redress the situation are provided such as providing in-service training for the purpose of eliminating errors that come by.*

On the other hand, the results in Table 2 indicate that 80% of respondents strongly agreed while 20% agreed that staff have up to date knowledge and abilities related to financial management. This implies that up to date knowledge enriches staff to practice their profession more usefully. The statement above concurs with Dogani (2020) who asserted that up dated knowledge maintains and expands the financial health of a staff and business as accounting plays an important role in running a business and helps staff track financial income and expenditures, management controls and statutory compliance in undertaking the business operations and decisions.

One of the interviewees was of the following view.

*Staff who possess a deep knowledge of accounting and auditing are in a better position to act as strategic advisors to organisational owners and leaders. This has been practiced in Morogoro municipality for its proper service provision.*

Furthermore, the results in Table 2 indicate that 90% of respondents strongly agreed that staff have up to date knowledge and abilities on government accounting and auditing policies. Up to date knowledge ensures better service to the organization and its functional managers. It is argued that the more staff are knowledgeable in accounting and the more they adhere to auditing policies, the more errors are eliminated. This is in line with Fjeldstad *et al.* (2010) who asserted that confident workers may manage financial documents, oversee budgets, and review accounting records for accuracy and compliance when they possess relevant knowledge on the matter. Yet, 10% of respondents disagreed that not all staff have up to date knowledge and abilities related to government accounting and auditing policies from the fact that some possess business knowledge that does not align to accounting. These could aid in other matters rather than accounting.

One of the interviewees was of the following view;

*When competence is lacking, members would not be in position to advise on issues that pertain to work. This has to some extent been found in Morogoro municipality.*

The other interviewee was of the following view;

*Professional proficiency goes hand in hand with training and development of staff that leads to improved profitability and/or more positive attitudes toward profit orientation, improves the job knowledge and skills at all levels of the organization, improves the morale of the workforce and helps the employees identify with organizational goals.*

The statements above concur with Ejoh (2014) who reported that with staff proficiency, the organisation attains value for money in its dealings. Similarly, staff proficiency results from training that addresses gaps or discrepancies between the ideal and an optimal stage of development. Here training helps eliminate the gap between the present performance and the standard desired performance.

Generally, the results show that internal audit staff in Morogoro municipality were found to have relevant audit experience something that enables it to carry out its activities with confidence. This confidence has enabled staff adhere and practice well their professions.

### **3.2 Effectiveness of Financial Performance**

The second objective of the study aimed at determining the effectiveness of financial performance at Morogoro municipality. Thus, respondents were asked to provide their

opinions in terms of Likert type scale accordingly as provided in Table 3 below as follows;

**Table 3: Effectiveness of Financial Performance**

Statements	% Strongly agree	% Agree	% Uncertain	% Disagree	% Strongly disagree
The organisation presents with clarity its financial statements	0	90	0	10	0
The organisation discloses its financial statements	90	10	0	0	0
The organisation attains profitability openly	0	80	0	20	0
The organisation has attained liquidity from its own operations	70	30	0	0	0

**Source: Research data, 2022**

The results in Table 3 indicate that 90% of respondents agreed that the organisation presents with clarity its financial statements. This implies that Morogoro municipality provides an overview of how well it manages its assets and liabilities.

One of the interviewees was of the following view;

*Clarity of financial statements presents information about what kind of assets the organisation owns and what percentage of assets are financed with liabilities in a clear manner that stakeholders may judge on its dealings. This has enabled it to earn reputation among the local government authorities.*

The statement above concurs with Dozie et al., (2019) who affirmed that clarity of financial statements provide a snapshot of an organisation's financial health, giving insight into its effectiveness, performance, operations, and cash flow. Therefore, clarity of financial statements is essential since they provide information about organisation's revenue, expenses, profitability and debt. Moreover, 10% of respondents were in disagreement that the organisation does not always present with clarity its financial statements something that causes queries among stakeholders.

The other interviewee was of the following view;

*Stakeholders of the organisation require clarity of financial information in order to know how well the organisation is doing, find out how the organisation has*

*earned and spent the resources provided to it and get an idea regarding strategic and tactical plans for the management appraisal.*

The statement above is in agreement with Fausto (2010) who reported that any responsible management team would disclose information beyond that which is technically required if it gives greater clarity to a matter of interest or concern to stakeholders, because greater clarity brings confidence and confidence brings a higher market rating.

Furthermore, the results in Table 3 indicate that 90% of respondents strongly agreed while 10% of respondents agreed that the organisation discloses enhanced the understanding of financial information. However, disclosure prevents the chance of window dressing and manipulation of accounts, thereby further increasing transparency in the market. The statement above is in agreement with Mohamed (2013) who stated that, disclosure of internal auditing practices enhance prudent use of resources, accountability and improve institutional efficiency. Besides, disclosure of internal audit practice has been recognized as a tool for ensuring effective working of the internal control system.

One of the interviewees was of the following view;

*In the financial world, disclosure refers to the timely release of all information about an organisation that may influence an investor's decision. It reveals both positive and negative news, data and operational details that impact its business undertakings towards financial performance.*

Similarly, the results in Table 3 indicate that 80% of respondents agreed that the organisation attainment is made faithfully transparent. Faithful representation enables users and decision makers to make better plans on how to reduce costs, increase in turnover and productivity towards change, growth and profitability. The success of any organisation depends on its ability to continually earn profits and enhance services to its customers. This statement concurs with Hayes et al (2015) who report that the advantage of earning profit is that you have a chance to retain earnings and increase your equity position. Likewise, 20% of respondents disagreed that the organisation in some instances does not attain profitability from various setbacks that it faces. Yet, Fausto et al (2015) suggests that the primary function of the audit is to add credibility to the financial statements. In this view the service that the auditors are selling to the clients is credibility that ends into financial performance.

Nonetheless, the results in Table 3 indicate that 70% of respondents strongly agreed while 30% of respondents agreed that the organisation has attained liquidity from its own operations. This implies that the organisation has been able to pay its debt obligations or current liabilities, without having to raise external capital or take out loans. Thus, high liquidity to the organisation means that it can easily meet its short-term

debts while low liquidity implies the opposite and that an organisation could imminently face bankruptcy. The statement above concurs with Fjeldstad et al., (2017) who reported that to achieve financial performance; liquidity is a measure of the organisation's ability to convert assets into cash. Appropriate level of liquidity helps organisations to overcome financial challenges, secure loans and plan for future financing.

Generally, the results show that various means aided the municipality attain effective financial performance such as presenting with clarity its financial statements, disclosing its financial statements as a matter of rules as disclosure prevents the chance of window dressing and manipulation of accounts, thereby further increasing transparency. Additionally, effective financial performance was obtained through continuous improvement enabled by better plans that led to reduction of costs, increased turnover and productivity. It is through liquidity that the organisation has been able to pay its debt obligations or current liabilities, without raising external capital or take out loans.

#### **4.0 Conclusion**

In Tanzania the importance of internal audit has seen a rapid growth in public sectors to promote good governance by providing objective assessment of whether the public resources are adequately utilized in order to achieve favorable results. The impact of internal audit practices on financial management of LGAs with reference to Morogoro municipality showed that internal audit personnel in Morogoro municipality are found to have relevant audit experience something that enables it carry out its activities with confidence. This confidence has enabled staff adhere to professional standards and practice well their professions while when staff are not as proficient as desired, plans to redress the situation are provided such as providing in-service training for the purpose of eliminating errors that come by.

On the other hand, it was shown that the internal audit department in Morogoro municipality was organisationally independent as it had internal auditors who have full and unfettered access to all organisational records implying that the internal auditors were autonomous in dealing with auditing matters and the independency of internal auditors' department was ensured. The Municipality was found to have auditors with the ability and skills to carry out audit work without external assistance. Most internal auditors in the Municipality have the requisite capacity to perform their jobs effectively and efficiently. This ability emanated from the commitment and accountability of internal auditors that led to successful implementation of their work.

Similarly, the results show that various means aided the municipality attain effective financial performance such as presenting with clarity its financial statements, disclosing its financial statements as a matter of rules as disclosure prevents the chance of window dressing and manipulation of accounts, thereby increasing transparency. It is through liquidity that the organisation has been able to pay its debt obligations or current liabilities, without raising external capital or take out loans.

## 5.0 Recommendations

Based on the findings and ensuing discussions, it is therefore recommended as follows:

- i) Morogoro municipality should make sure that internal auditors are always equipped with relevant audit experience to enable them carry out their activities with confidence.
- ii) Maintaining effective review financial performance by internal audit staff prevented the chance of window dressing and manipulation of accounts; this needs to be enhanced thereby increasing transparency.

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