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EFFECT OF INTERNAL AUDIT ON ENHANCING CORPORATE GOVERNANCE IN DEPOSIT TAKING MICROFINANCE INSTITUTIONS IN KERICHO COUNTY

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ABSTRACT

The need to focus on corporate governance has increased particularly in the wake of economic collapse and financial crises The Microfinance Act of 2006 that was enacted on 2nd May 2008 paved way for the transformation of Microfinance Institutions (MFIs) to deposit taking Microfinance Institutions (DTMs) in Kenya. The recommendations were consistent with the literature review. The study recommended that the institutional infrastructure that supports internal audit on enhancing corporate governance in deposit taking microfinance institutions should be improved. This was involved restructuring the laws, offering advanced training to the respondents' who handle internal audit directly. In addition, the public institutions charged with dealing with internal audit should be reformed to enable them carry out their duties effectively. To further the study the study did not consider the factors that affect the adoption of internal audit in the Kenyan microfinance sector. Therefore, another study should focus on the factors influencing the adoption of internal audit in Kenyan microfinance sector. The study has considered organizations in the microfinance sector. Another study should focus on another sector such as banking sector or the entire financial sector value chain.

Key Words: *Internal Audit, Microfinance Institutions,*

INTRODUCTION

Corporate governance is described as the framework of rules, relationships, system and processes within and by which authority is exercised and controlled within organisations. It encompasses mechanisms by which companies are held accountable (AUX, 2003).Corporate governance is a relationships between a company's board of directors, its shareholders, management and other stakeholders (Cadbury, 1992).According to the Organization for Economic Co-operation and Development (OECD, 1999), corporate governance stipulates the distribution of rights and responsibilities amongst different participants and spells out the rules and procedures for making decisions on corporate affairs.

The Kenya Microfinance sector consists of a large number of competing institutions which vary in formality, commercial orientation, professionalism, visibility, size and geographical coverage. These institutions range from informal organizations; rotating savings and credit associations (ROSCAs), financial services associations (FSAs), Savings and credit co-operative societies (SACCOs), NGOs, to commercial banks that are down scaling (Dondo, 2003). The goal of MFI organizations in Kenya is to raise the levels of income and welfare of people. They support the poor and unemployed by giving them loans often without collateral to establish small businesses.

The number of corporate bodies collapsing or being placed under statutory management has been on the increase not only in Kenya but all over the world (Manduku, 2008). This has forced researchers to look into the details of these corporate failures and in so doing, internal audit function has come out as one factor that need to be addressed by corporate entities to guarantee their good corporate management. Therefore, a microfinance institution must determine the extent to which the investor is cushioned from losses associated with poor corporate management by investing in strong internal audit departments.

Now legal established deposit taking microfinance institutions are infusing institution values into the day to day operations. Most empirical studies done in Kenya have focused on internal audit elements and corporate governance practices in other sectors other than deposit taking MFIs and among them are a survey on the role of internal audit in promoting good corporate governance in SOEs (Kibet, 2008);Corporate governance practices in microfinance institutions in Nairobi Kenya (Mwasi,2011);The relationship between internal controls and corporate governance in commercial banks in Kenya (Olumbe,2012) and the effectiveness of internal audit in promoting good corporate governance in the public sector in Kenya (Njui,2012).

To the best of the researcher's knowledge, there is limited research done on role of internal audit in enhancing corporate governance in deposit taking microfinance institutions. This study therefore sought to establish the effect of internal audit on enhancing corporate Governance in deposit taking microfinance institutions in Kericho County?

LITERATURE REVIEW

The Agency Theory

Meckling and Jensen (1976) in their paper on the theory of the firm defined the agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. Thus, for the internal audit to be effective there is need for not only their independence but also the top management support.

Risk Theory

The theory of Risk endeavors to explain the choices individuals tend to make when the future is uncertain. Ideally, a state where risk theory may be appropriate includes numerous factors in the domain, probable choices and appropriate result for every blend of state and conclusion. Risk theory tries to forecast a decision in relation to the spreading of probable outcomes it will yield. The risk theory is believed to be vital for individuals who make choices whose achievement stems on the way the risks in the universe turn out to be. Just to mention some few cases, individuals partnering with insurance companies, where their achievement majorly depends on predicting the frequency and degree of claims, use risk theory to help determine their optimal exposure to risks. Generally, at any point of time any choice an individual make about the future must have element of future uncertainty. Cases where an individual would like to make investment choices about companies that may default the price the investor will be ready to pay will be affected with ambiguity. Some individual believe uncertainty can make the variation on whether or not an individual should take an action at all.

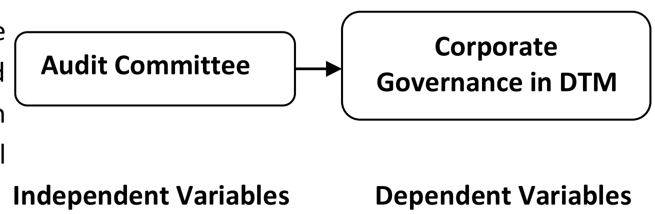
Stakeholders Theory

Habbash (2010) asserts that stakeholder refers to any one (external or internal) whose objectives have direct or indirect connections with the firm and influenced by a firm or who exert influence on the firms goal achievement. These include local community, employees, clients, suppliers, government, political parties and management. The stakeholders in corporate governance can create a favorable external environment which is conducive to the realization of corporate social responsibility.

The Chicago Theory of Regulation

In 1971 a start was made on the development of a theory of regulation called by some the economic theory of regulation (Posner, 1974) and by others as the Chicago theory of government (Noll, 1989a). 'The theory of economic Regulation' by Stigler (1971) appeared in that year. His central proposition was that 'as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit'. The benefit of regulation is that the government can grant subsidies or ban the entry of competitors to the branch directly so that the level of prices rises. The government can as well maintain the prices more easily than a cartel besides the government suppressing the use of substitutes in support of complements.

Conceptual Framework



RESULTS

Audit Committee

The regression of the Audit Committee on dependent variable, the effect of internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County was performed. The results showed that timeliness, frequency visit and reliability had a significant direct effect on internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County. In the table below the linear relationship between the variables is shown. The equation for this model is: internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County=2.438 +0.273*timeliness- 0.112*frequency visit+0.285*reliability.

Table 1: Audit Committee

	Unstandardized Coefficients		Standardized Coefficients		
Model	Beta	Std. Error	Beta	T	Sig.
(Constant)	2.438	0.28	------	8.703	0

Timeliness	0.273	0.056	0.339	4.886	0
Frequency visit	0.285	0.058	0.591	4.887	0
Reliability .	-0.112	0.047	-0.236	-2.389	0.018

In the model summary we found that 32.6% of internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County could be accounted for by timeliness, frequency visit and reliability the adjusted R square was 0.294.

Table 2: Model SummaryAudit Committeeand internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County

ModelSummary				
Model	**R**	**R Square**	**AdjustedR Square**	**Std.Errorof the Estimate**
1	0.571	0.326	0.294	0.45298

SUMMARY

Maintenance of sound Audit Committee for public organization is a fundamental aspect towards attainment of internal financial sustainability of the available funds. Failure to follow internal control procedures can have negative impact on any organization's strategic financial management. Financial management is one of the most important practices that an organization can be skilled in. With the challenges of financial sustainability facing today's public organizations, an understanding of the best financial management practices can help to ensure that these organizations are financially stable.

CONCLUSION

Audit Committee should be strengthen to encompass more areas, more involvement on internal audit on enhancing corporate governance in deposit taking microfinance institutions. Further, the study Risk Management, Audit Committee, Internal Control Systems and Government Regulations have significant effect on internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County.

Recommendations of the Study

The study makes the following recommendations about effects of internal audit on enhancing corporate governance in deposit taking microfinance institutions in Kericho County. The recommendations were consistent with the literature review. The study recommends that the institutional infrastructure that supports internal audit on enhancing corporate governance in deposit taking microfinance institutions should be improved. This was involved restructuring the laws, offering advanced training to the respondents' who handle internal audit directly. In addition, the public institutions charged with dealing with internal audit should be reformed to enable them carry out their duties effectively.

Area for Further Research

The study did not consider the factors that affect the adoption of Internal audit in the Kenyan microfinance sector. Therefore, another study should focus on the factors influencing the adoption of internal audit in Kenyan microfinance sector. The study has considered organizations in the microfinance sector. Another study should focus on another sector such as banking sector or the entire financial sector value chain.

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