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INFLUENCE OF INTERNAL CONTROL PRACTICES ON PERFORMANCE OF COUNTY GOVERNMENTS IN KENYA

[1*] **Mutai Patrick Cheruiyot**
patmutai@gmail.com

[2**] **Gregory Simiyu Namusonge**
gnamusonge@jkuat.ac.ke

[3***] **Maurice Sakwa**
msakwa@jkuat.ac.ke

[1] *Scholar, Jomo Kenyatta University Of Agriculture And Technology, Kenya*

[2, 3] *Professor, Jomo Kenyatta University Of Agriculture And Technology, Kenya*

Abstract

The general objective of this study was to examine the effect of public financial management practices on performance of county governments in Kenya with a specific aim of examining how the internal control practices influence the performance of county governments in Kenya. The study was carried out in March 2018 in ten counties; Nairobi, Mombasa, Kiambu, Nakuru, Narok, Machakos, Kisumu, Uasin Gishu, Nyeri and Kilifi. These were the top ten counties in local revenue collection during 2016/2017 financial year as per the Office of Controller of Budget report. The study used a descriptive research design and a purposive sampling technique. The study population consisted of 47 counties in Kenya as enlisted in Constitution of Kenya, 2010. The major finding was that internal control practices that include control activities, control environment and internal audits have a high significance on performance of county governments. Therefore, for any county government, an effective internal control unequivocally correlates with county success in meeting its revenue target level and eventually guaranteeing optimal service delivery. These will include; regular review of the reliability and integrity of financial and operating information, a review of the controls employed to safeguard assets, an assessment of employees' compliance with government policies, procedures and applicable laws and regulations, an evaluation of the efficiency and effectiveness with which a county government achieves its objectives. From the findings of the study, it was concluded that those county governments that had invested in effective internal control systems had more improved performance as compared to those county governments that had a weak internal control system.

Keywords: *internal control practices, county governments, financial management practices*

INTRODUCTION

1. Internal Controls Practices

Internal controls refer to the measures instituted by an organization so as to ensure attainment of the entity's objectives, goals and missions (Brennan & Solomon, 2008). They are systems of policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations and achieve effective and efficient operations. These systems are not only related to accounting and reporting but also relate to the organization's communication processes, internally and externally, and include procedures for: handling funds received and expended by the organization, preparing appropriate and timely financial reporting to board members and officers, conducting the annual audit of the organization's financial statements, maintaining inventory records of real and other properties and their whereabouts (Onyango, 2014). International Accounting Standards (IAS) categorizes internal control types as a plan of organization, segregation of duties, control of documents, safeguarding of assets, competence of staff, arithmetic and accounting controls, recording and record keeping, supervision, authorization and approvals and vocation. The Internal control includes the following: firstly, the control environment; it sets out the tone of an organization, influencing the conscience of its employees. It is the base for all other components of internal control, providing discipline and structure. Control environment factors include the following: Commitment to competence, human resource policies and practices, organizational structure, philosophy of management, responsible assignment. Secondly, control activities are the policies and procedures implemented by an organization to ensure that management's directives are carried out. These activities are often grouped into the three categories of objectives to which they relate, namely, operations, financial reporting, and compliance. Control activities include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties and authority (Onyango, 2014).

2. Kenya's Public Financial Management Reforms

Presently, Kenya is five years into implementing the devolved system of governance as espoused in the Constitution of Kenya (CoK) 2010. In addition to introducing 47 County governments with fiscal responsibility, the CoK 2010 also established new PFM institutions such as the Commission on Revenue Allocation (CRA), Salaries and Remuneration Commission (CRC) and Office of the Controller of Budget (COB) and expanded the mandate of the Auditor General. Additionally, the PFM Act 2012 has specified roles for the National Treasury and Parliament on public financial management. Furthermore, so as to meet the enlarged financing demands of both the national and 47 county governments there was a need for increased efficiency and effectiveness in utilisation of scarce public resources (ROK, 2016).

Since 2006, the government has undertaken PFM reforms which have contributed to the realisation of increased tax revenues, enactment of the first ever overarching PFM law and improved management of public funds through the re-engineered IFMIS and strengthening of control, audit and oversight institutions. To take forward the reform agenda, the government in early 2013 approved the successor public financial management reforms (PFMR) strategy (2013-2018), which aims to strengthen PFM systems in line with the COK 2010 requirements (ROK, 2016).

Public Finance Management Reforms (PFMR) for the Government of Kenya for the period 2013-2018 is still anchored on Vision 2030, Constitution of Kenya 2010 and PFM Act 2012 with the following as the key themes : Macro-economic management and resource mobilisation, strategic planning and resource allocation, budget execution, accounting and reporting and review, independent audit and oversight, fiscal decentralization and intergovernmental fiscal relations, legal and institutional framework, and IFMIS and other PFM systems. ROK (2016) notes that by June 2015, the PFMR Strategy 2013-2018 had been under implementation for about two and a half years. A midterm review of the strategy was carried out to assess progress in its implementation, identify emerging gaps and challenges in the reforms and to enlist measures to improve the implementation of the strategy in its final phase. The review established that significant progress had been registered in implementing the PFMR strategy with some of the reform interventions completed (13 out of 69) and many more (29) well on target and likely to be completed by the end of the Strategy. However, there were many areas (about 27) where implementation of reforms had been slow and likely to affect the achievement of the Strategy objectives by the end of its implementation (ROK, 2016).

3. County performance and its measurements

The genesis of performance management in the public service in Kenya is traceable to the Economic Recovery Strategy (ERS) and Wealth and Employment Creation of 2003-2007 inaugurated by the Coalition Government of NARC. Upon assuming power in December 2002, the NARC Government developed the ERS as a way of reversing the negative economic growth trajectory that had caused poverty and joblessness. The ERS was anchored in good governance under a democratic republic and the rule of law as the foundations of economic growth (CoG, 2017) . In operationalizing the expected outcomes of the public sector reforms, the Results-Based Management (RBM) system was introduced in September 2004 as a means of delivering the ERS. Subsequently, through a circular the government institutionalized RBM in the Public Service in April 2005 to deliver effective, efficient, ethical and targeted results for Kenyans.

RBM is a management strategy that seeks to achieve important changes in the way government agencies work with improving performance (achieving better results) as the overarching goal. RBM and performance management are synonymous and often used interchangeably in the Kenyan context. A key feature of RBM on performance management is the emphasis on improving performance and ensuring that government activities achieve the desired results.

The institutionalization of RBM in the Kenyan Public Service marked the beginning of the implementation of a performance management system. Performance management in the public service is anchored in the National Economic Development Blue Print which is Vision 2030 and the preceding ERS of 2003-2007. Key principles of Kenya's RBM include: Citizen-centered service delivery, results-oriented, accountability and transparency, horizontal integration, performance measurement, stakeholder participation, performance monitoring and reporting.

At the county government level, performance management is legally prescribed through various sections of the County Government Act, 2012 (CGA) and the Public Finance Management Act, 2012 (PFM). The PFM Act, 2012, Section 126 (1) requires every county to prepare a development plan which identifies: 1. Strategic priorities for the medium term that reflect the county government's priorities and plans; 2. Programs to be delivered with details for each program of; (a) The strategic priorities to which the program will contribute (b) The service or goods to be provided (c) Measurable indicators of performance where feasible, and (d) The budget allocated to the program.

4. Statement of the problem

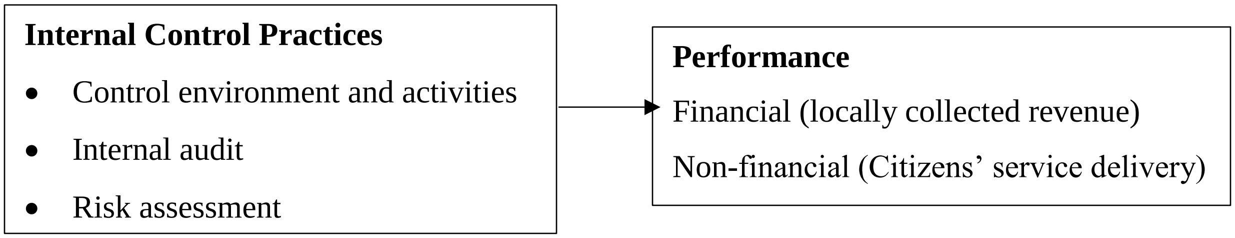
Despite the strong legislative and institutional frameworks for PFM in the last six years, Kenyan public finance management arena continues to experience myriad challenges that are not in tandem with the principles of public finance. For instance, since the beginning of devolved systems of government in 2013, every annual Auditor General's and Controller of Budget's Report has been indicating that some devolved units spend in total disregard to the PFM Act of 2012, the PPAD Act of 2015 and other fiscal responsibility principles (CoB, 2017). In particular, the reports clearly note that every year the county governments are allocated more than the stipulated 15 per cent of the national revenue with regular annual increments with Kshs 368 billion given in FY 2018/2019 compared to Kshs 341 billion in FY 2017/2018. However, lack of proper accounting systems and weak controls at the county level have continuously facilitated misuse of the allocated public funds, slowing down service delivery and overall performance of the county governments (CoB, 2017). Hence the need to for this study to investigate the nature and effect of public financial management practices on the performance of county governments in Kenya.

5. Research hypotheses

The study was guided by the following null hypothesis;

H_{01}: Internal control practices have no significant influence performance of county governments in Kenya.

6. Conceptual Framework



7. Research Methodology

The study used a descriptive research design and a purposive sampling technique. The study population consisted of 47 counties in Kenya as enlisted in Constitution of Kenya, 2010. The respondents included all accounting officers and directors from county treasuries in the top ten counties selected on the locally collected revenue list as shown in the Office of the Controller of Budget's Annual Budget Implementation Report for financial year 2016/2017. Primary data was collected using a questionnaire whereas secondary data was obtained from Office of Controller of Budget, Office of the Auditor General and County Treasury Offices. The study used both qualitative and quantitative data. Data was presented using tables, graphs and charts with corresponding explanations. Content analysis was used to analyse the qualitative data where the texts were used to categorize them into themes that corresponded to the study's objectives and interpreted accordingly. The quantitative data was analysed using Statistical Package for Social Science Version 21 that generated descriptive statistics and inferential statistics. Multiple linear regression analysis was used to establish the effect of public financial management practices on performance of county governments in Kenya.

RESEARCH FINDINGS AND DISCUSSION

8. Reliability

Zikmund et al., (2013) point out that reliability is the ability of the questionnaire to deliver consistent scores. Scale reliability coefficient was measured using Cronbach's Alpha rating which classified scores into excellent, good, acceptable and un-acceptable. The Cronbach's Alpha ratings shown below are congruent with Corbin, Strauss and Strauss (2014).

Table 1: Pilot testing and rating of Cronbach's Alpha scores

Variable Questions	Respondents	Cronbach's Alpha Values	Interpretation
Internal control practices	21	0.909	Excellent

Corbin et al., (2014) indicate that Cronbach's value of 0.7 and above and which include excellent, good and acceptable scores are indicators of good data collection instrument. The instrument was therefore confirmed to be reliable enough to collect the desired data. The instrument was however shortened to reduce the chance of fatigue by the respondents, without losing on key data collected per variable.

9. Descriptive analysis of internal control practices (ICP) on performance on county governments in Kenya

In the study, 70.4% (M=3.96, SD=1.048) of the respondents observed that they were aware of the existence of the audit committee. Seventy-one point five percent (71.5%) (M=3.90, SD=0.801) of respondents agreed that activities are carried out as planned. 75.8% (M=4.07, SD=0.786) indicated that they are confidence in the internal audit team. In the research findings, 51.5% (M=3.38, SD=1.064) of the respondents noted that internal accounting system is manual. However, 58.2% (M=3.34, SD=0.863) of the respondents opined that there are no incentives to discover and report control deficiencies.

Furthermore, 75.0% (M=3.93, SD=0.816) of the respondents showed that there is separation of duties and responsibilities in the audit team (for bookkeeping, deposits, reporting and auditing) 75.0% (M=3.93, SD=0.816). 85.5% (M=4.28, SD=0.784) of respondents revealed that access to different parts of an accounting system is controlled via passwords, lockouts and electronic access. While 69.6% (M=3.87, SD=0.839) argued that there are robust access tracking mechanisms that serve to deter attempts at fraudulent access, 61.9% (M=3.70, SD=0.962) observed that physical audits are frequently conducted on any physical assets tracked in the accounting system, such as inventory, materials and tools.

In addition, 91.6% (M=4.34, SD=0.675) of respondents pointed out that the county has standardised documents that are used for financial transactions, such as invoices, internal materials requests, inventory receipts and travel expense reports, to maintain consistency in record keeping over time. Ninety percent (90%) (M=4.13, SD=0.721) of the respondents indicated that occasional accounting reconciliations is done.

However, 78.2% (M=4.06, SD=0.784) of the respondents revealed that audit personnel have high integrity and ethical values with 95.8% (M=4.41, SD=0.623) of respondents stating that there are specific managers/officers required to authorize certain types of transactions. Besides, 57.5% (M=3.74, SD=0.882) of the respondents pointed out that the Governor has a “hands-on” oversight involvement in the audit activities. Seventy point four percent (70.4%) (M=3.96, SD=0.853) of the respondents noted that management personnel communicated the internal controls through frequent contact with accounting personnel.

Table 2: Response frequencies for Internal Control Practices

Statement	SD %	D %	N %	A %	SA %	Mean	Std. Deviation
a) I am aware of the existence of the Audit Committee	1.4	9.9	18.3	32.4	38.0	3.96	1.048
b) Activities are carried out as planned		4.3	24.3	48.6	22.9	3.90	.801
c) I am confidence in the internal audit team		1.4	22.9	42.9	32.9	4.07	.786
d) The internal accounting system is manual	3.0	21.2	24.2	37.9	13.6	3.38	1.064
e) There are incentives to discover and report control deficiencies		16.4	41.8	32.8	9.0	3.34	.863
f) There is separation of duties and responsibilities in the audit team (for bookkeeping, deposits, reporting and auditing)		5.9	19.1	51.5	23.5	3.93	.816

g) Access is controlled to different parts of an accounting system via passwords, lockouts and electronic access		2.9	11.6	40.6	44.9	4.28	.784
h) There are robust access tracking mechanisms that serve to deter attempts at fraudulent access.		5.8	24.6	46.4	23.2	3.87	.839
i) Physical Audits are frequently conducted on any physical assets tracked in the accounting system, such as inventory, materials and tools.	1.4	9.9	26.8	40.8	21.1	3.70	.962
j) The county has Standardised documents used for financial transactions, such as invoices, internal materials requests, inventory receipts and travel expense reports, to maintain consistency in record keeping over time.		1.4	7.0	47.9	43.7	4.34	.675
k) Occasional accounting reconciliations is done	1.4	1.4	7.1	62.9	27.1	4.13	.721
l) There are specific managers/officers required to authorize certain types of transactions		1.4	2.8	49.3	46.5	4.41	.623
m) Audit personnel have high integrity and ethical values.		2.9	18.8	47.8	30.4	4.06	.784
n) The Governor has “hands-on” oversight involvement in the audit activities.		6.1	36.4	34.8	22.7	3.74	.882
o) Management personnel communicate internal controls through frequent contact with accounting personnel.		4.2	25.4	40.8	29.6	3.96	.853

10. Forms of Internal Control Practices that can be implemented in order to increase the performance of county government in Kenya

The study sought to find the other forms of internal control practices that can be implemented in order to increase the performance of county government. In their responses, 19.7% of the respondents indicated that county monitoring and evaluation systems should be fully operationalized. This will verify whether the activities of each county’s priority project or programme are happening according to planning timelines and targets presented in the County Integrated Development Plan (CIDP); and whether resources are being used in a correct and efficient manner. Similarly, 19.7% of the respondents opined that we should have frequent rotational audit across all departments to enhance independence, objectivity, and professionalism.

In addition, 13.8% of respondents indicated that the county government should create opportunities for staff training and capacity building on internal control measures while at the same time 13.8% of respondents the human resource function should carry out an effective recruitment, selection and employ qualified staffs in all the departments. This will ensure that they carry out the county governments objectives and provide quality services to the general public. Furthermore, 11% of the respondents pointed that the county government should have regular update of policies to ensure that they are congruent to the socio-economic needs of their respective devolved units. Eleven percent (11%) of the respondents observed that all sectors of the county governments should put in place an effective and efficient revenue collection system in monitoring framework that ensures adequate supervision of the budgeted programs and project activities to enhance accountability and absorption of resources. Furthermore, 11% of respondents recommended that credible audit committees should be formed be responsible for providing oversight over the county governments' audit and other areas involving public financial management. The audit committee plays a critical role in creating the right environment for quality auditing and hence strong internal control systems.

Table 3: Forms of Internal Control Practices that can be implemented in order to increase the performance of county government in Kenya

Item	Frequency	Percent
a) Implement monitoring and evaluation systems	41	19.7
b) Conduct frequent rotational audit across all departments	41	19.7
c) Offer staff training opportunities and capacity building on internal control measures	29	13.8
d) Recruit, select and employ of qualified staffs	29	13.8
e) Institute regular update of policies	23	11.0
f) Automate revenue process	23	11.0
g) Form audit committees	23	11.0
TOTAL	**209**	**100.0**

11. Correlation results of Internal Control Practices (ICP) on performance of county governments in Kenya

The findings from the study established that there is linear relationship between Internal Control Practices (ICP) on performance of county governments in Kenya. Table 4 shows that there is positive correlation between ICP and the performance of county governments in Kenya, r (210) =0.573, p-value <0.05. Therefore, an increase in use of ICP led to an increase in performance of county governments in Kenya.

Table 4: Correlation results of Internal control practices on performance of county governments in Kenya

Variable		Internal Control practices	Performance
Internal Control practices	Pearson Correlation	1	.573**
	Sig. (2-tailed)		.000
	N	210	210

**. Correlation is significant at the 0.05 level (2-tailed).

12. Regression results of Internal Control Practices (ICP) on performance of county governments in Kenya

From the correlation analysis shown above, it is clear that there is a positive relationship between ICP and performance of county governments in Kenya. A regression analysis was conducted to establish the extent to which ICP influence performance of county governments in Kenya. A hypothesis to guide the research was as follows:

Hypothesis H_{01}: Internal Control Practices have no significant influence on performance of county governments in Kenya. To test this hypothesis, the model $Y = \beta_0 + \beta_2 X_2 + \varepsilon$ was fitted with ICP as an independent variable. Table 5 shows that the co-efficient of determination, R^2 was 0.328 meaning that 32.8 % of performance of county governments in Kenya can be explained by ICP with the difference of 67.2% being described by other factors outside the model.

Table 5: Internal Control Practices on performance of county governments in Kenya Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
M_2	.573[a]	.328	.327	.40026
a. Predictors: (Constant), Internal control practices				

Results in Table 6 show that the relationship between ICP and performance of county governments in Kenya in the model was significant ($F(1, 210) = 186.715$, $p<0.05$).

Table 6: Internal Control Practices on performance of county governments in Kenya ANOVA

ANOVA[b]						
Model		Sum of Squares	df	Mean Square	F	Sig.
M_2	Regression	29.914	1	29.914	186.715	.000[a]
	Residual	61.200	206	.160		
	Total	91.114	207			
a. Predictors: (Constant), Internal control practices						
b. Dependent Variable: Performance						

Moreover, β co-efficient for ICP was significant (β =0.573, t=13.664 p<0.05) meaning that for every 1unit increase in ICP there was an equivalent increase by 0.573 in performance of county governments in Kenya.

Hence, the model equation for ICP was;

Model m_2 $Y = \beta_0 + \beta_2 X_2 + \varepsilon$

$\mathbf{Y} = 1.784 + 0.474\mathbf{X_2}$

In conclusion, the results confirm that ICP has significant influence on the performance of county governments in Kenya and hence null hypothesis, $H0_1$ is rejected.

Table 7: Internal Control Practices on performance of county governments in Kenya, Regression Weights

Coefficients[a]						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
M_2	(Constant)	1.784	.124		14.429	.000
	Internal control practices	.474	.035	.573	13.664	.000
a. Dependent Variable: Performance						

13. Discussion of research findings on the relationship between Internal Control Practices (ICP) on performance of county governments in Kenya

Internal Control Practices (ICP) was measured using 5-point likert scale with 1= 'Strongly Disagree' and 5= 'Strongly Agree' statements. The research findings found that there was a positive correlation between ICP and the performance of county governments in Kenya (r (210) =0.573, p-value <0.05). An increase in use of ICP led to an increase in performance of county governments in Kenya. The model shows that the relationship between ICP and performance of county governments in Kenya was significant (F (1, 210) =186.715, $p<0.05$) and R^2=0.328 meaning that 32.8 % of performance of county governments in Kenya can be explained by ICP with the difference that is 67.2% being described by other factors outside the model. Furthermore, β co-efficient for ICP was significant (β =0.573, t=13.664 $p<0.05$) meaning that that for every 1 unit increase in ICP there was an equivalent increase by 0.573 in performance of county governments in Kenya. The finding were congruent to Nwaobia, Ogundajo and Theogene (2016) who examined the position of internal audit practices towards enhancing transparency in public financial management and reporting in Rwanda and Nigeria, as key components to agency and stewardship relationships between government and stakeholders. The findings indicated that internal audit function would enhance transparency in public financial management and reporting if the unit is given full autonomy in terms of independence and well equipped with both human capital and relevant infrastructural facilities. Nwaobia et al., (2016) further noted that in order to attain transparent financial management and reporting in public offices, there should be strict adherence to the nations' constitutional framework in terms of preparation and presentation of financial statements, submission and review as well as timely report of the Auditor-General to the National Assembly Public account committee. Also, the financial statements should be timely published for easy accessibility by the citizens.

However, on the other hand, the results were inconsistent with previous studies investigating the influence of internal control practices and performance. Onyango (2010) observed that county governments did not implement internal audits recommended by the Auditor General to improve management of financial resources. In addition, the study established that majority of employees neither submitted weekly reports nor held meetings to discuss the progress of activities. The issue that was of much concern was that the study revealed that there was no clear separation of roles among workers and employee work was not checked by others (Onyango, 2010). On the other hand Origa (2015) concluded that manufacturing firms which invested in effective internal control systems had more improved financial performance as compared to those manufacturing firms that had a weak internal control system. Hence, it was recommended that the Kenya Association of Manufacturers should monitor and supervise manufacturing firms to ensure that the accountants comply with accounting regulations and requirement as provided by the Institute of Certified Public Accountants. To ensure proper implementation and compliance with accounting standards and principles, organizations should develop a mechanism to incorporate relevant feedback from the various stakeholders into their internal control system; and also that the governing body ensure that the internal control system is periodically monitored and evaluated (Origa, 2015).

14. Summary of findings

Despite the fact that the study hypothesized that ICP has no significant influence on performance of county governments in Kenya the findings showed that a positive statistically significant relationship existed between the two variables with ICP explaining 32.8 % of performance of county governments in Kenya leaving the difference of 67.2% described by other factors outside the model. Internal controls practices that include control activities, control environment, internal audits are intended primarily to enhance the reliability of performance, either directly or indirectly by increasing accountability among information providers in an organization. Therefore, for any county governments, an effective internal control unequivocally correlates with county governments' success in meeting its revenue target level. These will include; a regular review of the reliability and integrity of financial and operating information, a review of the controls employed to safeguard assets, an assessment of employees' compliance with government policies, procedures and applicable laws and regulations, an evaluation of the efficiency and effectiveness with which county governments achieve their objectives.

15. Conclusions

The study concludes that there is positive statistically significant relationship between internal control practices and performance. From the findings of the study, it was concluded that those county governments that had invested in effective internal control systems had more improved performance as compared to those county governments that had a weak internal control system. From the findings, it was revealed that those county governments that observed integrity, ethical values, risk assessment, control activities, and monitoring procedures recorded high performance. Although internal audit is one area with the expertise to assess efficient utilization of public financial resources and help improve oversight and performance, public administration has paid little attention to the role of internal audit in the improving public financial management process. Therefore, there was need for county governments to fully invest in strong internal control systems that will help to mitigate fraud.

16. Recommendations

The study found out that county governments in Kenya did not fully implement internal audits recommended by the Auditor General to improve management of financial resources. In order to attain transparent financial management and reporting in public offices, there should be strict adherence to the nations' constitutional framework in terms of preparation and presentation of financial statements, submission and review as well as timely report of the Auditor General to the National Assembly Public account committee. Also, the financial statements should be timely published for easy accessibility by the citizens. In addition, an external body should be established by the national government to audit county governments regularly for accountability. The study recommends that the relevant county government officials should be constantly updated and well-grounded on international financial reporting standards (IFRS) and principles in order to enhance their knowledge and skills in application of accounting practices and to keep them updated on the contemporary issues.

17. Areas for further research

Although the measure of performance of county governments in Kenya incorporated financial and non-financial performance dimensions, there may be other financial and non-financial dimensions that measure the performance, but are not addressed in this study. Therefore, further study is needed to incorporate other financial and non-financial dimensions of county governments' performance. Moreover, there may be some practices that influence the performance of county governments that are not included in this study. Therefore, further study is needed to investigate other practices affecting the performance of county governments in Kenya.

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