

**INFLUENCE OF INTERNAL AUDIT INDEPENDENCE ON THE  
FINANCIAL PERFORMANCE OF SMALL AND MEDIUM  
ENTERPRISES: A CASE OF THE CONSTRUCTION INDUSTRY IN  
MOMBASA COUNTY, KENYA.**

**HARRISON MWINZI KIEMA**

**A Research Project Submitted in Partial Fulfillment for the Degree of Master  
of Business Administration of the Technical University of Mombasa.**

**2015**

## DECLARATION

I declare that this research project is my original work and has not been presented for a degree award in any other University.

Signature: \_\_\_\_\_

Date \_\_\_\_\_

Harrison Mwinzi Kiema

MBA/0006/2012

This Project has been submitted for examination with our approval as University Supervisors.

1. Signature: \_\_\_\_\_ Date: \_\_\_\_\_

Dr Anwar Ahmed PhD

Technical University of Mombasa

2. Signature: \_\_\_\_\_ Date: \_\_\_\_\_

\_\_\_\_\_

Dr Jane Ndirangu PhD

Technical University of Mombasa

## **DEDICATION**

This project is dedicated to my wife, children, brothers, sisters and parents.

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#### **LIST OF ACRONYMS**

AAA	American Accounting Association
ACCA	Association of Chartered Certified Accountants
CAE	Chief Audit Professionals
CCP	Chartered Credit Professionals

CIMA	Chartered Institute of Management Accountant
CPA	Certified Public Accounts
CI	Construction Industry
GAAP	Generally Accepted Accounting Principles
IAD	Internal Audit Department
IAF	Internal Audit Function
IIARF	Institute of Internal Auditors Research Foundation
IIA	Institute of Internal Auditors
IASC	International Accounting Standards Committee
IAS	International Accounting Standards
ISA	International Standards on Auditing
ASE	Australian Stock Exchange
IFAC	International Federation of Accountants
I T	Information Technology
NSE	Nairobi Stock Exchange
SBA	Small Business Administration
SEC	Securities and Exchange Commission
SMEs	Small and Medium Enterprise
SOE	Stated Owned Enterprises
SPSS	Statistical Package for Social Sciences

U.K	United Kingdom
U.S	United States
NCA	National Construction Authority
ACPAK	Association of Certified Public Accountants Kenya
IASC	International Accounting Standards Committee.

### **DEFINITION OF TERMS**

**Small and Medium Enterprises.** These are companies whose personnel numbers fall below certain limits. Small enterprises outnumber large companies by a wide margin and employ many more people.

SMEs are said to be responsible for driving innovation and competition in many economic sectors globally (Institute of internal auditors research foundation, 2004).

### **Auditing**

This is a systematic and independent examination of data, statements, records, operations and performances financial or otherwise of an enterprise for a stated purpose (American Accounting Association, 1973).

### **Internal Audit**

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations (Anita, 1998)

### **Auditor Independence**

This refers to the independence of the auditor in executing his duties. It is characterized by integrity and an objective approach to the audit process. The concept requires the auditor to carry out his or her work

freely and in an objective manner  
(Wines, 1994).

### **Financial Performance**

Financial performance is defined as the act of measuring the results of a firm's policies and operations in monetary terms (Yan , 1997).

### **Construction Industry**

This is a type of Industry which is involved in the art and science to form material objects such as buildings, roads, bridges, railway lines and so forth using human labour, machinery and materials (Bon, 1992).

## **ABSTRACT**

The focus of this study was to examine the influence of internal audit independence on the financial performance of Small and Medium Enterprises in the construction industry in Mombasa County. The study was specifically concerned with determining the effect of four components of internal audit independence, namely: records accessibility, reporting structure, internal auditors 'qualifications and internal audit roles on the financial performance of Small and

Medium Enterprises in the construction industry in Mombasa County. The study focused on the construction companies in Mombasa County. The study was carried out in 65 Class National Construction Authority (NCA 8) Construction Companies that represented the units of analysis for the study. Systematic sampling was used to obtaining the sample size of the respondents in the construction companies. Purposive sampling technique was used to get respondents from different construction companies and expected sample derived from internal auditors, audit committee members and audit assistants of the sample population. The survey involved collecting information by administering questionnaires. Data collected was descriptively analyzed using microsoft excel. Results were summarized using tables and presented in form of pie charts, graphs, and bar charts. The summarized responses were used for further analysis and facilitated comparison to ascertain if the objectives would be achieved from conducting the study. From the study, it was evident that some construction companies (59%) within Mombasa County did not accord the internal auditors the independence they deserved to effectively give their opinion on the financial statements of the organizations. It is recommended that SMEs should be given Public education by the Minister for commerce and industry on the importance of internal audit independence. The government should establish an internal audit unit, which should be independent to ensure that all SMEs in Kenya comply with the laid down audit procedures and rules.



## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background of the Study**

Meckling (2000) identified auditing as one of the methods for monitoring and controlling the activities in the agency theory, where both the parties try to maximize their utilities. Credit and loan officers, as users of audit reports, portray better comprehension of implications of audited financial statements based on their routine exposure to the audit reports and financial statements (Lin, Tang & Xiao, 2003). Auditor's independence in an organization has been termed as the cornerstone of the auditing profession since their opinion shades light to the management whether the financial statements for a given period depicts a fair and true position of the financial status of the organization (Craswell & Allen, 2001).

Raja (2002) argued that the increase of internal audit normally adds value and improves on an organizations operations because of its objectivity and the consultative forums with other departments in the same Organization. An organization could either employ full time internal auditors or contract them to tackle the same internal audit tasks as the need may arise. Internal audit greatly assists organizations to achieve their expected goals through use of strategic approaches for measuring and improving the effectiveness and efficiency of the governance processes of risk management and control (IIA, 1992). The quality of

internal audit is subject to the capability of the Department of Internal audit in the periodical report findings and recommendations produced. Depending on its performance, internal audit could either earn a good or bad reputation in the firm (Sarens G., 2006). For Internal audit to remain reputable, it has to keep on evaluating its performance and continually improving its services (Craswell, A. 1995). Previously, internal auditors were not recognized as in organizations and were treated as mere accountants but that scenario has changed in that their services are currently treated as management oriented services. The international accounting standards committee has worked for over twenty years to harmonize international accounting standards in different continents .

The auditor is expected to guide the management on the best accounting practices and at the same time assist in the formulation and updating of policies (Anderson, V., 2003). The internal auditor could be engaged either as a full time employee or on contract basis by the management of the company. The report of the auditor depicts the true and fair view of the company's financial statements in a given financial year. Auditing standards were required by multinational corporations which wanted a world wide, consistent, high quality audit. International auditing standards have existed since the international federation of accountants came into being as a result of initiatives put forward in 1973 and approved in 1977. Although international standards of audits are not required by all countries, the researcher will use them as the basic standards throughout his work because they represent

the highest and best international representation of generally accepted auditing standards. For long; auditing has been discussed in different studies and research areas but mostly in association with publicly listed companies. According to the Australian Stock Exchange Corporate Governance Council (2003), all organizations should have an internal audit function whether fully employed or externally hired for the internal audit function.

### **1.1.1 Internal Audit Independence**

Internal audit services are deemed as a monitoring mechanism because of the potential conflicts of interest between employees as well as owners and managers and other different categories of stakeholders in an organization (De Angelo, 1981). This monitoring role means that auditors are used as a mechanism to enhance credibility of the financial statements so that the public who are not involved in the day to day running of the organization can have some level of confidence in the reported financial position. The willingness of internal auditors to report a discovered breach depends on a number of factors including; the level of independency accorded by the management. Audit independence must be viewed within the totality of corporate governance and the accountability of organizations to their stakeholders (Raja, 2002). The audit Committee must closely monitor the auditor's relationship with the company's management. For this to be done effectively, a membership of the Audit committee is required which together is sufficiently independent of executive management, has a minimum level of financial literacy and has the ability to ask perceptive questions which are

pursued diligently (Sarens, 2006). Chartered institute of management accountants recommends a guide to best practice for audit committees and has separately recommended to the treasury select committees for there to be a code of best practice for non-executive directors. The research is conducted against the backdrop of increased regulation of public audit Act Kenya (2003), and other corporate Governance issues addressing the widespread public outcry on financial mismanagement. This research has undertaken a critical survey of existing analysis as concerns the relationship between the organization and its internal auditors within the context of the totality of corporate governance. The review has been expanded to international experience and studies where appropriate.

Auditor's independence in an organization has been termed as the cornerstone of the auditing profession since their opinion shades light to the management whether the financial statements for a given period depicts a fair and true position of the financial status of the organization (Craswell & Allen, 2001). Auditor's independence could mean that the auditor has full control or influence in the matter of his operation, action, conduct and opinion on his findings (American Accounting Association, 1973). Auditor's independence in an organization has been termed as the cornerstone of the auditing profession since the opinion of the auditor shades light to the management whether the financial statements for a given period depicts a fair and true position of the financial status of an organization (Caswell& Allen 2001). The management as the users of the

financial statements usually rely on the internal audit reports for quality audits especially where independence was accorded to the auditors in the organization. Independence permits internal auditors to render the impartial and unbiased judgments essential to the proper conduct of engagements. Over the years, several major instances of misstated earnings have been reported over the past years.

### **1.1.2 Small and Medium Enterprises (SMEs) in Mombasa County**

The definition of small and medium enterprises varies between one country and another. However, generally small and medium enterprises (SMEs) are companies which deal with various industries in an economic sector with personnel numbers which fall below certain limits. Small and medium enterprises exceed large companies by a wide margin and also employ many more people and are involved in developing innovations and competition in different economic sectors (Bo, R. 1992). SMEs are of different categories depending on the type of business one is engaged. Most SMEs are entities owned by individuals or family members and that there are no shareholders (Carey, 2000). In any country around the globe, SMEs are of major contribution in terms of backing the economy, giving it both the boost and the stability, as they collectively form the major chunk of the economy. In most cases, SMEs encounter limited financial as well as non-financial resources, which make them depend upon the credit agencies such as banks and other financial institutions (Levitt, 2000). In this regard, banks have become one of the major sources of funds for SMEs, which makes them fulfill their financial requirements. However, such financial institutions are reluctant to

give out loans without any reasonable assurance of credit worth of the firms, which should be portrayed on their financial statements. Consequently, they do prefer credible audited financial statements by independent auditors as a matter of assurance that the books of account were well kept as per the accounting reporting standards (Johnsone , 2001). Most banks view auditing as a guarantee for the quality of information disclosed in companies as well as a foundation for their credit rating process. Banks and other creditors believe that the credit rating should be supported by the audit obligation (Ebaid, I., 2011).

### **1.1.3 Construction Industry in Mombasa County, Kenya**

The term construction implies an art and science involved in the formation of material or immaterial objects and or systems. Construction could be for a building, road, bridge or any structure that would require designing, planning and building using scientific principles (Bon, 1992). In the construction industry in Mombasa County, there are three categories namely; Contractors (Buildings), Specialist Contractors and Roads and other Civil Works. There are eight classes in each of the above categories according to financial capability. Class 8 is the lowest with a maximum financial capability of Kshs 10 million and class National construction authority 1 is the highest with a minimum financial capability of Kshs 500 Million. The construction industry in Mombasa County plays an important role of providing the physical infrastructure as may be required in the economy of a country (Hillebrandt, 2000). Statistics depict that construction industry in Kenya

contributes about 40% of the Gross Capital Formation and about 4% of the Gross Domestic Product, and has managed to employ over 80,000 workers in Kenya (Mugenda & Mugenda, 2003).

#### **1.1.4 Financial Performance of SMEs**

Financial performance in an organization measures the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's Sales growth, increase in profit, losses, investment and share capital in the last four years. It is a subjective measure of how well a firm can use assets from its return on assets, value added, etc. It is also a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Meckling, 2000). There are many different ways to measure financial performance by small and medium enterprises in different industries, though all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt (MacDonald, 2000). Financial performance is normally derived from sound financial statements as determined by the auditors on independence basis (Johnsone, 2001).

#### **1.2 Statement of the Problem**

Due to increase in various industries in Kenya, there was need for an independent internal audit function in the economy, which should polish the financial records

of organizations. Internal audit independence is in an organization to enhance the effective control measures for the management to provide financial reports which will depict the true position as pertains to the financial statements (Sharma, D., 2005). In various industries, internal auditors face several obstacles including lack of independence, limited access to records support and recognition by the management. Sulton (1997) consented that auditor independence is a cornerstone of the auditing professional, crucial element in the statutory corporate reporting process and a key prerequisite for the adding of value to an audited financial statement. The economic dependence resulting from the provision of non- audit services and personal relationships built through alumni employees have been alleged to contribute to the erosion of internal auditor independence. Internal audit independence and the financial performance have caused conflict and uncertainty in the organization's financial reports since the management is unwilling to fully support the internal audit function (Mcgraph *et al.*, 2001).

Other researchers carried out their work on internal audit independence. Sarens *et al.* (2006), in a survey of United States chief internal auditors, assessed the joint effect of audit committee independence and expertise on the committee's interaction with internal audit. They found that, independent committees with at least one member with accounting or finance expertise had longer meetings and more private meetings with the chief internal auditor. Goodwin and Yeo (2001) surveyed chief internal auditors in Singapore and found that audit committees that



comprised solely of independent directors had more frequent meetings and more private meetings with the chief internal auditor thus denying him the expected independence. Goodwin (2003) obtained similar results in a survey of chief internal auditors from Australia and New Zealand. Based on the above arguments, internal audit independence has no deep root on the financial performance of the Small and Medium Enterprises (Abubakar, N., 2006). Empirical evidence suggest that if left unexploited audit independence is most likely to adversely affect the financial performance of SMEs (Goodwin & Yeo, 2001). The research was conducted against the backdrop of increased regulation of public audit Act Kenya (2003), and other corporate Governance issues addressing widespread public outcry on financial mismanagement. Corporate local scandals in both public and private firms have led to ill-informed comments on the audit profession, particularly as regards to internal audit independence.

The recent demand by the Government on all business oriented organizations for greater accountability from management to register and pay taxes appropriately, will likely further argument the services of internal audit functions. Despite all of the above, internal auditors in practice in private sector are falling short of expectations in executing their duties independently as they lack full support of the management since they may be forced to work in favour of them (Institute of internal audit research foundation, 2007). In this regard therefore, the researcher carried out the study dealing with the influence of internal audit independence on

the financial performance of Small and Medium Enterprises in the construction industry in Mombasa County (Anita, 1998). This has been an important unresolved issue and one that was further explored in this study. This study focused on the relationship among records accessibility, reporting structure, internal auditor qualifications, internal audit roles and the financial performance of SMEs in the construction Industry in Mombasa County (Bon, 1992).

### **1.3 Objective of the Study**

The study was informed by the following objectives:

#### **1.3.1 General Objective**

The main objective of this study was to examine the influence of internal audit independence on the financial performance of small and medium enterprises in the construction industry in Mombasa County, Kenya.

#### **1.3.2 Specific Objectives**

The study was guided by the following specific objectives:

- 1) To determine the effect of records accessibility on the financial performance of small and medium enterprises in the construction companies in Mombasa county, Kenya.
- 2) To determine the effect of the reporting structure on the financial performance of the small and medium enterprises in the construction industry in Mombasa county, Kenya.

- 3) To determine the effect of the internal auditors qualification on the financial performance of small and medium enterprises in the construction industry in Mombasa county, Kenya.
- 4) To determine the effect of internal audit roles on the financial performance of the small and medium enterprises in the construction industry in Mombasa county, Kenya.

#### **1.4 Research Questions**

1. How does records accessibility by internal audit affect the financial performance of SMEs at the construction industry in Mombasa County, Kenya?
2. How does the reporting structure of internal audit affect the financial performance SMEs at the construction industry in Mombasa County, Kenya?
3. How does the qualification of internal auditors affect the financial performance of SMEs at the construction industry in Mombasa County, Kenya?
4. How does internal audit roles affect the financial performance of SMEs at Construction Industry in Mombasa County, Kenya?

#### **1.5 Significance of the Study**

The study will be useful to the scholars, business journalists, managers, small and medium size business owners in the construction industry and other industries

since they will be able to use the findings and recommendations made to support internal audit independence for better financial performance of SMEs. It will also be important to other academic researchers, as the information provided will assist in developing research papers and policies for SMEs in the construction industry. The study will also benefit the society, as they will know about internal auditors and SMEs and appreciate their roles in the economy in different countries. In addition, the study will assist the policy makers and other relevant international accounting agencies in their attempt towards the international harmonization of auditing standards and making policies regarding internal audit independence.

### **1.6 Scope of the Study**

The study was restricted to the influence of internal audit independence on the financial performance of Small and medium enterprises in the Construction industry in Mombasa County, Kenya. The study was carried out among Small and medium enterprises in the construction companies in Class NCA 8 (Appendix A) that are operating within Mombasa County, Kenya. The study focused on the construction companies in class NCA 8 because they fall within Small and medium enterprises due to their financial capability of between Kshs 10 Million and below. Construction class NCA 8 is the lowest in the construction industry while class NCA 1 is the highest in terms of financial capability.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The chapter summarized the purpose of this study and a comprehensive theoretical framework with regard to internal audit independence. In addition, it also highlighted the conceptual framework to critically depict the relationships between the independent variables and the dependent variable under consideration. Lastly, the chapter highlighted the research gaps to be filled by the study.

#### **2.2 Theoretical Framework**

The topic on internal audit independence has attracted a lot of interest from many researchers across the world who studied it in different perspectives. Different theories related to the study were elaborated regarding the internal audit independence and the financial performance of SMEs. The theories are the Agency theory, the Theory of inspired confidence and the Lending credibility theory.

##### **2.2.1 Agency Theory**

According to Meckling and Jensen (2000), agency relationship contract exists between one or more persons-the principal

(s) and another person (agent) to perform some service on their behalf, which involves delegating some decision making authority to the agent. Agency theory

evolution also owes much to the corporate governance literature, which analyzes the problem of separation of ownership and control (Grabling *et al.*, 2004). In the construction industry, internal audit independence plays an important role in reducing both information asymmetry by empirically confirming the validity of financial statements and agency problems. The principal- agent conflict is illustrated in agency theory, where principal (owner) lacks reasons to believe their agents (managers) due to information asymmetries and contradictory motives (Hillebrandt, 2000). The first proposers of the Agency theory were the Scholars Mitnick and Ross (2006). In their working paper Series University of Pittsburg they proposed that, a theory of agency be created and to actually begin its creation, independently and roughly concurrently. Ross is responsible for the origin of the economic theory of agency, and Mitnick for institutional theory of agency.

### **2.2.2 Theory of Inspired Confidence**

The demand for audit services is the direct consequence of the participation of third parties in the company in which they demand accountability from the management, in return for their investments in the company (Sarens & Beelde, 2006). The theory of inspired confidence addresses both the demand and supply for audit services. Accountability in the construction industry may be realized through the issuance of periodic financial reports concerning the financial performance of various construction companies in Mombasa County, Kenya. However, since this information provided by the management may be biased and outside parties have no direct means of monitoring, an audit is required to assure

the reliability of this information. With regard to the supply of audit assurance, the auditor should always strive to meet public expectations (Limperg, 1985).

### **2.2.3 Lending Credibility Theory**

The primary function of audit activity is to add credibility to the financial statements as suggested by the theory of lending credibility (Hayes & Knechel, 2006). Lending credibility theory is used by the management on the firm's audited financial statements to assure the stakeholder's of quality in management's leadership. In this view, the service that the auditors are selling to the clients is credibility (Watts, 2010). In the construction industry, audited financial statements are seen to have elements that increase the financial statement users' confidence in the figures presented by the management (Hillebrandt, 2000). The users' are perceived to gain benefits from the increased credibility. These benefits consider the quality of investment decisions improve when they are based on reliable information (Bon, 1992).

### **2.3 Empirical Review of the Literature**

In this part, the empirical review looked at the previous researches conducted in on internal audit independence and the financial performance in different Industries. According to Goodwin (2010), in more recent years there has been heightened interest in issues associated with the independence and objectivity of internal audit. Thus, internal auditors are in a unique situation as providers of both assurance services within the organization and consultancy services to managers

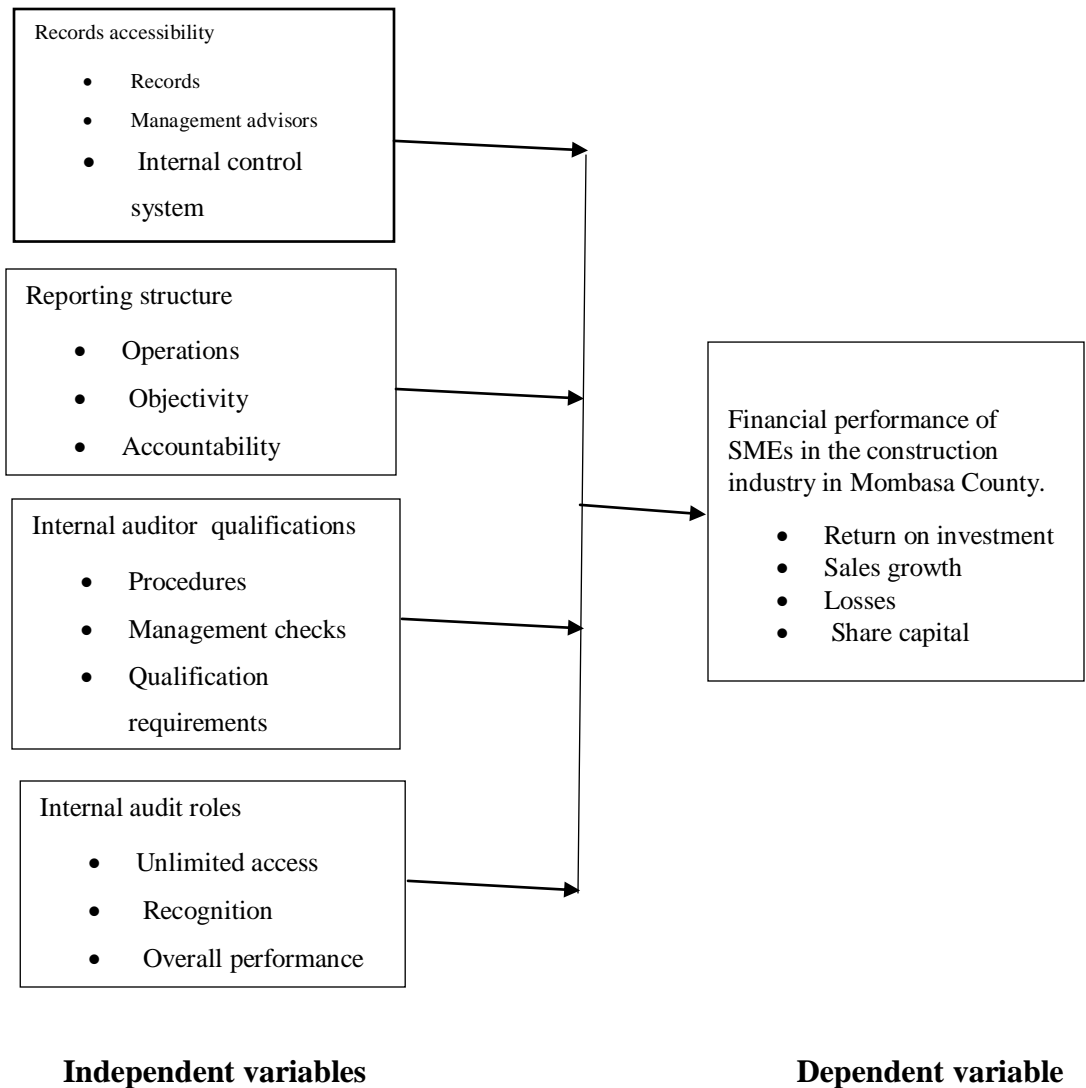
(Morgan, 1979). With the current emphasis on corporate sustainability and the need to mitigate and adapt to climate change, many organizations are producing sustainability reports, which contain a mix of quantitative and qualitative data (Monks, 2001). The study revealed that a multitude of individual and organizational-related factors potentially affect and are affected by internal auditors' independence and objectivity (Kotler, 2000). The study contributed to the internal auditing literature by providing an in-depth analysis of key issues that impact independence and objectivity in the current governance environment (Kotler, 2000). According to Yan (2013), internal audit independence is significant to the financial performance of an organization.

Kibet (2008) revealed that there was greater variation in financial performance of commercial banks due to changes in internal audit standards, independence of internal audit, professional competency and internal control. This shows that changes in financial performance of commercial banks could be accounted for by changes in internal audit standards, independence of internal audit, professional competency and internal control. It was also established that there was a strong positive relationship between financial performance of commercial banks and internal audit standards, independence of internal audit, professional competency and internal control (Limperg, 1985)



## **2.4 Conceptual Framework**

According to Kotler (2000), a conceptual framework is a basic structure that consist of certain abstract blocks, which represent the observational, the experimental and the analytical aspects of a process or system being conceived. The interconnection of these blocks completes the framework expected outcomes. For the purpose of this research, the independent variables were the indicators influencing internal audit independence on the financial performance of SMEs in the construction industry in Mombasa county, Kenya. The variables included records accessibility, reporting structure, internal auditor qualifications and internal audit roles while the dependent variable was financial performance. Figure 2.1 below depicts the independent variables and the indicators and also the dependent variable and the expected indicators.



**Figure 2.1 Conceptual framework**

### 2.5.1 Records Accessibility

The auditor may be denied access to some records thus unable to audit some areas of the accounting records. Although some accounting records cannot be verified, the rest of the accounting records are audited and they conform to the Generally Accepted Accounting Principles (Simunic, 1984). Consequently, the financial

statements would not reflect the true position of the financial performance of the organization. An example is a case where the auditor cannot be able to observe and test a company's bank accounts. If the auditor checked the rest of the financial records and is satisfied that they conform to generally accepted accounting principles, then he simply states that the financial statements are fairly presented, with the exception of the bank accounts that could not be audited due to lack of accessibility (Millichamp, 2008).

Internal auditors are required to assess and monitor various governance decisions made by management and to advice on the adequacy and effectiveness of internal controls (Sarens, 2006). In this regard, the internal auditors can face considerable familiarity and social pressure threats emanating from their relationship with management. In many organizations, audit committees have been formed to undertake the governance role in coordinating and overseeing the relationships between, customers, internal auditors, management, employees and external auditors. According to Grambling *et al.* (2004), a quality relationship between the internal audit function and the audit committee also works towards providing the internal audit function with an appropriate environment and support system for carrying out its own governance related activities such as, risk assessment, control assurance and compliance work. In addition, corporate governance guidelines and listing rules explicitly recognize the management, external auditors and internal auditors (Smith, 2003). As such, audit committees can be viewed as a key

safeguard mechanism for internal auditors in managing their professional affairs. According to Borg W. (1989), the scope of internal audit generally includes examination of the effectiveness of the internal control systems with the use of the financial management information systems to check the accuracy and reliability of the accounting records in use by the organization. The internal auditors would thus be required to carry out special investigations to ensure that all operations were correctly done (Gramling, 2004).

### **2.5.2 Reporting Structure**

Management of various organizations always seek help from internal auditors to provide them with assurance that , risks are effectively identified and monitored, organizational process are effectively controlled, and Organizational processes are efficient or effective. In this structure, the internal audit function plays a unique role in organizations (Messier, 2011). According to Levitt (2000), the past internal audit literature often portrayed internal auditors as the representatives of the management on all financial matters. Internal control has taken on a broader meaning to include the crucial role played by top management in setting the tone at the top. Thus, internal auditors may find themselves conflicted in helping management to assess the effectiveness of their governance processes while reporting to the audit committee. The internal audit function has evolved in many organizations to a position where it is often called upon to take leadership in helping the organization implement, assess, or conceptualize risk management and control processes within an organization (Malan, 1991). In some parts of the

world such as United Kingdom and United States, recent legislation and stock exchange, proposals on better corporate governance have elevated the role of the audit committee to a prominent role in monitoring and reporting on the effectiveness of corporate governance. This has led to various recommendations that the internal audit function report directly to the audit committee, not to the management (Meckling, 2000).

The recommendation may create tension with the more traditional role of internal audit acting as representatives of the management. It is a common believe that the nature of that tension and the impact of such tension on both the nature of the internal audit activity and its contribution to the organization should be examined (Kevin, 1992). Researchers should examine whether internal audit function activities focusing on audit committee needs create positive or negative tension with the internal audit function's auditor roles in the risk and governance arena (Gramling, 2004). In a few cases, internal audit is performing management functions that could impair the independence and objectivity of the internal audit department. There are also some cases where internal audit departments' independence is compromised as internal audit leaders either do not report directly to audit committees, or do not meet regularly with their audit committees (Gable, 1994). Internal audit departments should be organizationally independent of management and report directly to audit committees (O'Malley, 1993)

### **2.5.3 Internal auditors' qualifications**

In cases where internal auditors do not meet the required qualifications, they may not perform their audit duties effectively hence, this may compromise their independence in the organization. This is because they will do shoddy jobs to correct and cover up clients who are implicated by the audit reports in the organization. The internal audit professionals are expected to provide recommendations for improvement in those areas where opportunities or deficiencies are identified. The management is responsible for internal controls while the internal audit operation provides assurance to management and the audit committee that internal controls are effective and working as intended (Ebaid, I. 2011). Internal auditing is an advisory function, not an operational one therefore internal auditor should possess the required skills to enable them tackle their duties diligently through independent evaluations (Sawyer, 2003).

### **2.5.4 Internal Audit Roles**

Traditionally, people understand internal audit as an activity of self-imposed internal check and audit, which also supposedly involved the activity of going around telling people were wrong (Morgan, 1979). However even if it is seen as a minor thing, the contribution of the activity of internal audit is potentially of major importance as an effective internal audit system leads to improved accountability, ethical and professional practices (Yan, 1979) . In organizations, effective risk management as embossed by the internal auditors improves quality of output and supports decision doing making and performance tracking (Kevin, 1992).

Historically, it was always held that internal auditing is confined to merely ensuring that the accounting and allied records have been properly maintained, the assets management system was in place in order to safeguard the assets and also to see whether policies and procedures were in place and were dully being complied with (Mcgrath, 2001). Nevertheless, with changing times this concept has undergone a deep change with regard to its definition and scope of coverage.

Modern approach suggests that it should not be restricted to financial issues alone but also on issues such as cost benefit analysis, resource utilization and their deployment, matters of property, effectiveness of the management (Monks, 2001). The major role of internal audit is to assist the management and its audit committee in discharging its governance responsibilities by offering advises on the financial records of the organization (Messier, 2011). The auditors do this through an objective evaluation of the existing risk and internal control framework, systematic analysis of business processes and associated controls. The auditors also review the existence and value of assets, a source of information on major frauds and irregularities, ad hoc reviews of other areas of concern, including unacceptable levels of risk, reviews of the compliance framework and specific compliance issues, reviews of operational and financial performance (Sarens, 2006).

Recommendations for more effective and efficient use of resources, assessments of the accomplishment of corporate goals and objectives, feedback on adherence to the organization's values and code of ethics. Internal audit function normally provides assurance and recommendation to management and the audit committee that internal controls are effective and working as intended (Gable, 1994). The internal audit activity is led by the chief audit professional, who delineates the scope of activities, authority, and independence for internal auditing is a valuable resource for management and the board or its equivalent (Kevin, 1992). An effective internal audit activity can provide assurance to interested parties such as regulators, employees, financial institutions, and shareholders (institute of internal audit research foundation, 2004).

### **2.5.5 Financial Performance**

Financial performance measures the results of a firm's policies and operations in monetary terms (Johnsone, 2001). These results are reflected in the firm's Sales growth, increase in profit, Losses, investment and share capital in the last four years. It is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (MacDonald, 2000). This term is also used as a general measure of a firm's overall financial health over a given period, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. According to Mugenda and Mugenda, (2003) there are many different ways to measure financial performance but all measures should be taken in aggregation. Line items such as revenue from operations,



operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investor may wish to look deeper into financial statements and seek out margin growth rates or any declining debt (Wines, 1994). The following are some of the measures of financial performance: Earnings per share, Return on investment, Profit Margin on sales, Return on equity employed and so on.

## **2.6 Critique of the Existing Literature**

There are certain issues that exist in the independence of internal auditors on the financial performance of SMEs. In order to make audit independence successful such issues have to be properly addressed. The literature review in this study points out different authors who have highlighted barriers to audit independence in SMEs. This study analyzed the problems such as record accessibility, reporting structure, internal audit qualifications and internal audit roles that deter internal audit independence in SMEs. Previous authors have pointed out that internal audit function is important to SMEs. However, there are a few empirical studies on the internal audit independence in relation to the financial performance of SMEs. The problem is that the owners who have a lot of privacy and even lack the understanding of the audit function manage the SMEs.

Various researchers have carried several studies on internal auditing out both globally and locally. Mugo and Mugo (1988), in his study aimed to determine the scope and independence of internal audit function in the publicly quoted

companies in Kenya. The results of the study indicated that the scope of internal audit was not wide enough to cover not only financial data but also the data from other operations of the organization. Independence from operations in terms of objectivity was found to be quite high unlike in terms of organizational status, which was found to be moderately high. The study concluded that the accounting discipline remained the source of internal audit staff and recommended information technology specialists in. Wines (1994) in his study concluded that internal audit function played a role in corporate governance despite many organizations not appreciating that. Thus, it is important to enhance internal audit independence in small and medium enterprises with qualified auditors and government intervention. The owners and managers of SMEs need to attend seminars and workshops to gain knowledge about the importance of internal audit independence in their respective firms (Limperg, T., 1985).

## **2.7 Summary**

This part gives a summary of existing literature review on the internal audit independence on the financial performance of SMEs in the construction industry in Mombasa county. Literature from published books, journals and dissertations were reviewed to the topic under study. The literature in this study provides a theoretical framework that forms the foundation of future chapters in the study. It has been seen from previous studies that internal auditors in different industries have not been given the independence they deserved. Internal auditors have been

denied full access to records in some organizations, which has resorted to poor advice to the management and other stakeholders of such organizations.

The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relations to; effectiveness and efficiency of operations, reliability and integrity of financial and operational, safeguard of assets and compliance with laws, regulations and contracts. Based on the result of the risk assessment, the internal auditors evaluate the adequacy and effectiveness of how risks are identified and managed in the above areas. In the construction industry in Mombasa county, internal auditors needed to consider aspects such as ethics and values within the organization, performance management, communication of risk and control information within the organization in order to facilitate a good governance process.

## **2.8 Research Gaps**

The researcher has established that there exists a gap in knowledge on the internal audit independence in small and medium enterprises, which he sought to critically examine and fill. In most organizations, the internal auditors were unable to express positive opinion on the financial statements before the irregularities were brought to light. This prompted many, to question the effectiveness of certain aspects of the audit function, particularly issues related to internal audit independence on financial performance. Internal audit independence on financial performance of SMEs especially construction industry was an important, unresolved issue, and one that was further explored in this study.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

This chapter discusses the methodology that was used in gathering, analyzing and reporting the data. This section is an overall scheme, plan or structure conceived to aid the study in answering the raised research question. Specifically the following subsections will be included; research design, target population, data collection instruments, data collection procedures and finally data analysis. Purposive sampling technique was used to get respondents from internal auditors, audit assistants and audit committee members in the construction companies in Mombasa county, Kenya.

#### **3.2 Research Design**

The design used in this study was a survey where use of methods such as questionnaires and published data was made (Gable, 1994). The procedure involved an arrangement of conditions for collection and analysis of data in a manner that aimed to combine relevance to the research purpose with economy in procedure.

The study involved a large and scattered population of construction companies in Mombasa County. Respondents were picked from internal auditors, assistant

auditors and members of the audit committee in the construction companies in Mombasa county since they were knowledgeable on audit matters in different companies. Thus, it was advantageous to use survey method since it was significant to this study.

### **3.3 Population and Target Population**

Generally, a population is a sum of all the organisms of the same group who live in the same area. In this study, a population was internal auditors, audit assistants and audit committee members in various construction companies in Mombasa County, Kenya (Mugenda & Mugenda, 2003). Population could also imply an entire group of individuals, objects or items from which the researcher wants information about (Kumar, 2005). The target population of the study comprised of the internal auditors, audit committee members and audit assistants in the 65 construction companies in Mombasa County, Kenya (Appendix C).

In construction industry, there are three categories of registered construction companies namely; Building Contractors, Specialist contractors and Roads and other civil works. In each of the above categories, there are eight classes where by the highest class is NCA1 and the lowest is NCA 8. A list of 65 (Appendix C) contractors class NCA 8 was obtained from the National Construction Authority report of September 2014 through their website [www.nca.go.ke](http://www.nca.go.ke) NCA 8 class of contractors was chosen because it had the lowest financial capability limit of between Kshs 5million to Kshs10 million. The above limit suited SMEs and it

was represented in all the above three categories of the construction companies. Thus, the population was 65 construction companies (Appendix C).

### **3.4 Sample and Sampling Technique**

Kombo and Tromp (2006) defined a sample as a finite part of a statistical population whose properties are studied to gain information about the whole sample. Saunders et al. (2003), defined sampling as the process of selecting a number of individuals for a study from the larger group referred to as the population. Sample of responding staff was drawn from the internal auditors, audit committee members and audit assistants of the construction companies in class NAC 8 (Appendix C) within Mombasa County. Purposive sampling technique was used to select respondents from internal auditors, audit assistants and audit committee members in the construction companies in Mombasa County. In purposive sampling, the targeted individuals are the ones believed to be reliable for the study. The unit of analysis in this study was construction companies in Class NCA 8 in Mombasa county. The respondents were the key source of information since they had the requisite knowledge about internal audit independence in the construction industry (Hillebrandt, 2000).

### **3.5 Sample Frame**

A sample frame is a list of all those within a population who can be sampled and should reflect the whole population. A sampling frame was internal auditors, audit committee members and audit assistants of the various construction companies in

class NAC 8 (Appendix E) in Mombasa County. Cooper and Schindler (2003) argued that if well chosen, samples of 10% to 30% of a population could often give good reliability. The researcher used 50% of the population, which exceeded the above recommended sample, was for thirty-two (32) construction companies. Systematic random sampling technique was used to determine the sample size for this study (Appendix E). The sample size was 32 audit Professionals in the construction industry in class NCA 8 construction companies derived from the above method.

### **3.6 Research Instruments**

The study collected data with questionnaires, which was both structured and unstructured. According to Mugenda and Mugenda (2003), a structured questionnaire was used to collect quantitative data, which included designs measures and techniques that produced discrete numerical data. An unstructured questionnaire was used to collect the qualitative data, which provided a thorough detailed description of experience, opinions and perceptions of the respondents.as the main instruments for carrying out this research and interviews with individual respondents. From preliminary investigations, it was found that most of the sample elements were employees knowledgeable and capable of responding well to a questionnaire. The questionnaires were used in this study since they saved time and could enable information be gathered within the shortest possible time, it facilitated the collection of potential information from a large sample of respondents and it enabled the responses to be gathered in standardized way. The

questionnaire consisted of both open ended and closed ended types of questions intended to provoke the respondents with specific responses. In order to support the research findings the researcher also observed in the course of the study.

### **3.7 Data Collection Procedure**

A case survey approach was used which involved use of methods such as questionnaires and published data (Gable, 1994). The researcher used both primary and secondary data, which was obtained from construction companies' internal auditors, audit assistants and audit committee members with questionnaires, which were given to them at workplace. The researcher used the drop-and pick-later technique. Purposive sampling technique was used to get respondents from internal auditors, audit assistants and audit committee members in the construction companies in Mombasa County. Each questionnaire was coded and only the researcher knew which person responded. The coded technique was only used for matching returned, completed questionnaires with those delivered to the respondents. Secondary data was obtained from National construction authority website [www.nca.go.ke](http://www.nca.go.ke) 2014

### **3.8 Data Processing and Analysis**

.After data was collected it was then organized to identify errors before it was coded and stored in appropriate form (Kombo & Tramp, 2006). The completed questionnaires were carefully checked to ensure completeness, consistency to enable coding, and tabulation (Kothari, 2005). The collected data was



descriptively analyzed to establish the association between various independent variables and a dependent variable. The descriptively analyzed data was in accordance with records accessibility, reporting structure, audit qualifications, audit roles and financial performance and presented in form of tables, bar charts, pie charts and graphs (table 4.1-4.20). The tables, graphs and charts were labelled and presented for readers to easily understand them. According to Mugenda (2006), Likert responses were treated as ordinal data and then collated into tables, bar charts, pie charts and graphs. Data was then coded to enable the responses be grouped into various categories. The variables used in the study were the reference points used in order for the researcher to find out if the objectives would be achieved from conducting the study. The data collected was thereafter analyzed using statistical package for Microsoft Excel.

### **3.9 Ethical Considerations**

The researcher expressed honesty, objectivity, integrity, care, openness, confidentiality and respect in reported data, results, methods and procedures, and did not fabricate, falsify, or misrepresent data. The researcher has Published and would continue publishing journal articles in order to advance research and scholarship. The researcher strived to promote social good and prevent or mitigate social harms through research, public education, and advocacy. The researcher has voided discrimination against colleagues or students on the basis of sex, race, ethnicity, or other factors that are not related to their competence and integrity. The researcher would Maintain and improve his own professional competence and

expertise through lifelong education and learning; take steps to promote competence in finance as a whole, know and obey relevant laws, institutional and governmental policies.

### **3.10 Reliability and Validity**

According to Kuder and Richard (1937), reliability is the extent to which a questionnaire, test, observation or any measurement procedure produce the same result on repeated trials. In this study the questionnaire was pre-tested through to ascertain reliability of instrument in the required information collected. Reliability of the data collection instrument was established through test re-test method. Validity test refers to the degree of success of an instrument in measuring what it is set out to measure so that differences in individual scores can be taken as representing true references in the characteristics under study (Mugenda & Mugenda, 2003). Thus, in this study content validity was used in determining the validity of the instruments.

## CHAPTER FOUR

### RESULTS AND DISCUSSIONS

#### 4.1 Introduction

This chapter contains the results of the primary and secondary data collected by use of questionnaires and informal interviews and an analysis of the findings. Data was analyzed and presented by use of tables, pie charts, graphs, and bar charts.

#### 4.2 Response Rate

The categories of respondents included in the research in table 4.1 below.

**Table 4.1: Categories of Respondents**

<b>CATEGORY</b>	<b>TARGET POPULATION 32</b>	<b>COUNT</b>	<b>PERCENTAGE</b>
<b>AUDITOR</b>	<b>14</b>	<b>12</b>	<b>44.4</b>
<b>AUDIT ASSISTANTS</b>	<b>10</b>	<b>9</b>	<b>33.3</b>
<b>AUDIT COMMITTEE MEMBERS</b>	<b>8</b>	<b>6</b>	<b>22.2</b>
<b>TOTAL</b>	<b>32</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the above table 4.1, twenty seven questionnaires were received out of the 32 administered. Out of the total responses received, the contributions were; auditors

(44.4%), audit assistants (33.3%) and audit committee members (22.2%) of construction companies respectively.

### **4.3 Demographic Characteristics.**

The section presents results on demographic information such as gender, age, duration of service and level of education and profession by the respondents.

#### **4.3.1 Gender of respondents**

**Table 4. 2: Gender of respondents**

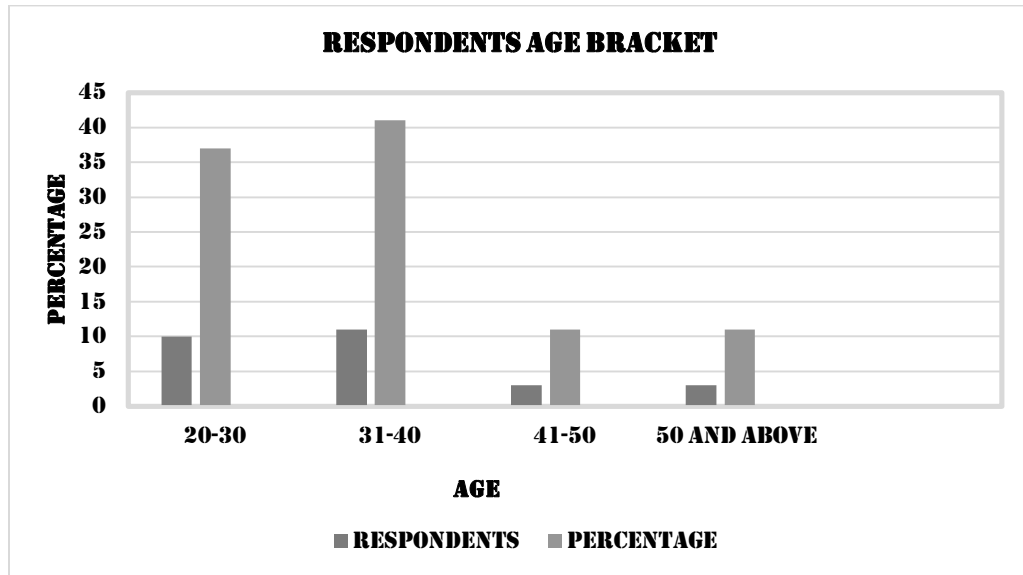
<b>SEX</b>	<b>NO</b>	<b>PERCENTAGE</b>
<b>MALE</b>	<b>14</b>	<b>52</b>
<b>FEMALE</b>	<b>13</b>	<b>48</b>
<b>TOTAL</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the above table 4.2, the number of male respondents was 14 while that of female respondents was 13 in the percentages 52% and 48% respectively. The male respondents were more than the female respondents by 4% implying that the male respondents were pro-active than the female respondents on the research work.

#### **4.3.2 Age Bracket of Respondents**

The researcher sought to know the ages of employees in different organizations



**Figure 4.2 Respondents Age Profile**

From the above figure 4.3.2, it was observed that respondents in the ages from 20-30 years and up to 50 years and above contributed. Respondents at the age between 20-30 were 37%, 31-40 years were 11, which was 41%, 41-50 were three, which was 11% and 50 years and above were three, which represented 11% of the total respondents.

#### **4.3.3 Duration of Service and Designation of Respondents.**

Under this section, the researcher sought to know the duration served by the respondents in the organization and their designations.

**Table 4.3: Duration of Service**

<b>YEARS</b>	<b>IN THE ORGANIZATION</b>	<b>%</b>	<b>CURRENT POSITION IN THE ORGANIZATION</b>	<b>%</b>
<b>BELOW 2</b>	<b>6</b>	<b>22</b>	<b>7</b>	<b>26</b>
<b>3-5</b>	<b>13</b>	<b>48</b>	<b>12</b>	<b>44</b>
<b>6-8</b>	<b>4</b>	<b>15</b>	<b>8</b>	<b>30</b>
<b>ABOVE 9</b>	<b>4</b>	<b>15</b>	<b>-</b>	<b>-</b>
<b>TOTAL</b>	<b>27</b>	<b>100</b>	<b>27</b>	<b>100</b>

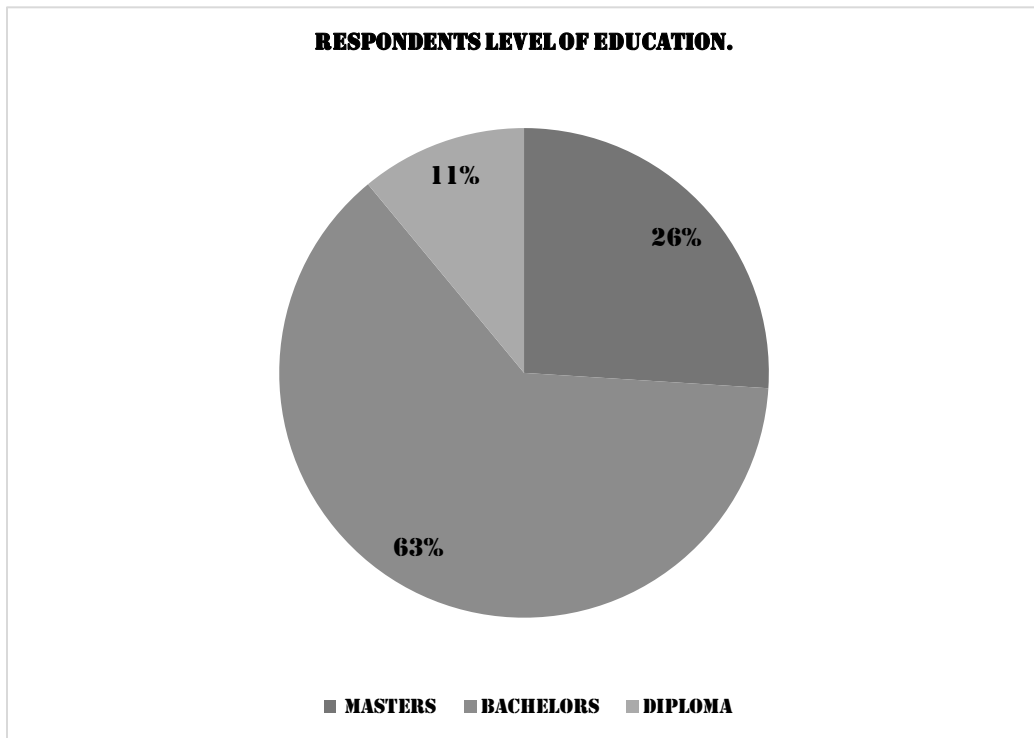
**Source:  
Research**

**data 2015.**

From the table 4.3 above, the respondents who served in the organizations for a duration of between 2 and 8 years were 23, which is 85%, and those who served for over 9 years were four, which was 15%. Respondents who served in the current position within the organization for a period of between 2 and 8 years were 27, which was 100%. The respondents should have gained enough experience for the work thus could give appropriate information needed for the research.

**4.3.4 Educational Level of Respondents**

The researcher sought to know the level of education of audit professionals from the respondents.



### **Figure 4.3: Respondents' Level of Education**

As per the figure 4.2.3 above, respondents had Masters, Bachelors and Diploma Certificates. Those with masters were seven representing 26%, Bachelors were 17 representing 63% and Diploma 3 representing 11%. The respondents held a standard level of education where the least was a diploma and the highest qualification was Masters Degree. This proved that the respondents were knowledgeable in tasks assigned to them both at work place and elsewhere.

### **4.3.5 Professional Qualification of respondents.**

The researcher sought to know the professional qualifications of the respondents.

The aim was to ascertain if the firms employed audit professionals with the required qualifications.

**Table 4. 4: Professional qualifications**

<b>PROFESSION</b>	<b>RESPONDENT</b>	<b>PERCENTAGE</b>
<b>CPA</b>	<b>23</b>	<b>85</b>
<b>ACCA</b>	<b>3</b>	<b>11</b>
<b>CCP</b>	<b>1</b>	<b>4</b>
<b>TOTAL</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

All the 27 respondents who filled and returned the questionnaires held professional qualifications. Twenty three respondents had CPA Qualifications, three respondents had ACCA and one respondent had CCP (table 4.4 above). This was in the percentage of 85%, 11% and 4%, respectively. The qualifications indicated by the respondents proved that they were professionals.

#### 4.4 Knowledge of Records Accessibility

Under this section, the researcher sought to find out the respondents' knowledge of accessibility of financial records provided by the organization in preparing audit reports. Whether the internal auditors were considered as advisors to the management, evaluation of internal control systems and the audit committee and internal audit function independence contribute to the financial performance of construction companies.

##### 4.4.1 Records provided for compiling audit reports.

The researcher sought to know whether records for compiling audit reports were provided. Such records could include all bank statements, payment vouchers, registration certificates, investment documents, shares certificates, motor vehicle logbook and others.

**Table 4.5: Records provided by the organization for compiling audit records.**

RECORDS PROVIDED	AUDITOR		AUDIT ASSISTANT		AUDIT COMMITTEE MEMBER	
	COUNT	%	COUNT	%	COUNT	%
YES	11	92	8	100	7	100
NO	1	8	-	-	-	-
TOTAL	12	100	8	100	7	100

**Source: Research data 2015.**

From the above table 4.5, out of the 12 auditors who responded, 11 accepted that all records required for compiling audit reports were provided. This represented 92% of the auditors. Only one auditor mentioned that not all records were



provided and this was 8% of all the 12 auditors. The audit assistants who accepted that records were provided were eight and this represented 100% since no one disagreed. Seven audit committee members also accepted that records were provided and this was 100% since no one disagreed. Most respondents who returned their questionnaires accepted that they were provided with the appropriate records to enable them compile audit reports. However only one respondent denied that all records were provided. That was evident that not all construction companies provide records to the internal auditors.

#### **4.4.2 Internal Auditors as Advisors to the Management.**

The researcher sought to know the extent to which internal auditors are considered as the advisors to the management on matters related to financial reports and policies. The respondents were asked to indicate if strongly considered, sometimes considered, ignored, sometimes ignored and strongly ignored.

**Table 4.6: Internal Auditors as Advisors to the Management.**

<b>CONSIDERATION AS ADVISORS TO MANAGEMENT</b>	<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>			
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>		
<b>STRONGLY CONSIDERED</b>	<b>8</b>	<b>67</b>	<b>6</b>	<b>67</b>	<b>3</b>	<b>50</b>	<b>17</b>	<b>63</b>
<b>SOMETIMES CONSIDERED</b>	<b>3</b>	<b>25</b>	<b>2</b>	<b>22</b>	<b>3</b>			<b>29</b>
<b>SOMETIMES IGNORED</b>	<b>-</b>		<b>1</b>	<b>11</b>	<b>-</b>		<b>1</b>	<b>4</b>
<b>IGNORED</b>	<b>1</b>	<b>8</b>	<b>-</b>		<b>-</b>		<b>1</b>	<b>4</b>

<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>
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**Source: Research data 2015.**

From the table 4.6 above, 92% of the respondents selected strongly considered and sometimes considered. 8% of the respondents selected sometimes ignored and ignored. The audit professionals based their judgments on their experience with the organizations on the consideration accorded to them by the management as advisors on financial matters and policies

#### **4.4.3 Organization’s Internal Control System**

The researcher sought to know if the internal auditor would identifies and evaluate the internal control system of the organization they are working for as a basis for reporting its adequacy and effectiveness. The respondents were required to indicate if strongly agree, agree, not sure, disagree and strongly disagree.

**Table 4.7 Internal Control System**

<b>EVALUATION OF INTERNAL CONTROL SYSTEM</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONGLY AGREE</b>	<b>7</b>	<b>58</b>	<b>2</b>	<b>22</b>	<b>2</b>	<b>33</b>	<b>11</b>	<b>41</b>
<b>AGREE</b>	<b>5</b>	<b>42</b>	<b>7</b>	<b>78</b>	<b>4</b>	<b>67</b>	<b>16</b>	<b>59</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

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**Source: Research data, 2015.**

From the above table 4.7, 41% of the total respondents strongly agreed that internal audit identifies and evaluates the organization’s internal control systems as a basis for reporting upon its adequacy and effectiveness. At the same time, 59%

of the respondents agreed without strong feeling and none was not sure, disagreed or strongly disagreed. As per the above findings, majority of audit professionals have had no strong support on identification and evaluation of internal control systems in their organizations. This therefore implied that there was need to carry out research to strengthen internal auditors operations on the same.

#### 4.4.4 Audit Committee and Audit Functions

This section examined whether the audit committee and the internal audit functions independence contributed to the financial performance of their organizations. The respondents were asked to indicate whether to agree, somehow agree or disagree.

**Table 4.8: Audit Committee and the Internal Audit Functions**

LEVEL OF CONSIDERATION	AUDITOR		ASSISTANT AUDITOR		AUDIT COMMITTEE MEMBER		TOTAL	
	COUNT	%	COUNT	%	COUNT	%	COUNT	%
<b>AGREE</b>	<b>10</b>	<b>91</b>	<b>7</b>	<b>78</b>	<b>4</b>	<b>57</b>	<b>21</b>	<b>78</b>
<b>SOMEHOW AGREE</b>	<b>-</b>	<b>-</b>	<b>2</b>	<b>22</b>	<b>3</b>	<b>43</b>	<b>5</b>	<b>18</b>
<b>DISAGREE</b>	<b>1</b>	<b>9</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>4</b>
<b>TOTAL</b>	<b>11</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>7</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

Out of 27 respondents, 21 agreed that audit independence contributed to the financial performance of organizations. This translated to 78% of the respondents. 18% of the respondents somehow agreed while 4% disagreed as can be seen on the table 4.8 above. The respondent's responses were based on their circumstances

and opinions as well as expertise. According to the respondents, the contribution of audit independence to the financial performance is volatile. This validates the literature as regards the need for internal audit independence in the construction industry.

#### 4.5 Reporting Structure in the Organization

Under this section, the researcher sought to know if the internal auditors were operating independently without interference from the management and that their structure was separate from that of the management in the organization.

##### 4.5.1 Operations and Structure in the Company

Respondents were asked to rate the level of internal auditor's independence in the operations and structure in the company. They were to say whether in their opinion it was very independent, somehow independent and not independent.

**Table 4.9 Operations and Structural in the Organization**

<b>LEVEL OF INDEPENDENCE IN TERMS OF OPERATIONS AND STRUCTURE IN THE ORGANIZATION</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>VERY INDEPENDENT</b>	<b>9</b>	<b>75</b>	<b>5</b>	<b>56</b>	<b>3</b>	<b>50</b>	<b>17</b>	<b>63</b>
<b>SOMEHOW INDEPENDENT</b>	<b>2</b>	<b>17</b>	<b>4</b>	<b>44</b>	<b>2</b>	<b>33</b>	<b>8</b>	<b>30</b>
<b>NOT INDEPENDENT</b>	<b>1</b>	<b>8</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>17</b>	<b>2</b>	<b>7</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

Source: Research data 2015.

From the above table 4.9, 17 respondents (63%) agreed that internal auditors were very independent in the organizations. 8 respondents representing 30% agreed that internal auditors were somehow independent while two respondents (7%) consented that there was no independence. As per the above findings, 37% of the respondents were not satisfied with the internal auditors' independence in the construction companies. However, 63% of the respondents were satisfied that there was independence. 37% is substantial for the researcher to carry out this study to investigate the internal audit structure and operations and give the way forward.

#### 4.5.2 Structure of Internal Audit

The respondents were asked to assess the structure of internal audit in terms of enhancing its objectives in the organization. They were asked to provide answers whether the structure was strong, not very strong or weak.

**Table 4. 10: Structure of Internal Audit**

<b>ASSESSING THE STRUCTURE OF INTERNAL AUDIT IN TERMS OF OBJECTIVITY</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>16</b>	<b>100</b>	<b>4</b>	<b>56</b>	<b>3</b>	<b>50</b>	<b>23</b>	<b>63</b>
<b>NOT VERY STRONG</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>44</b>	<b>2</b>	<b>33</b>	<b>3</b>	<b>30</b>
<b>WEAK</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>17</b>	<b>1</b>	<b>7</b>
<b>TOTAL</b>	<b>16</b>	<b>100</b>	<b>5</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

Out of all the 27 respondents, 23 respondents agreed that there was strong structure of internal audit in terms of its objectivity. Three respondents agreed that the structure of internal audit was not very strong while one respondent agreed that there was a weak internal audit structure in enhancing objectivity ( table 4.10 above). As per the findings on table 4.10 above, majority of the respondents agreed that there was strong internal audit structure in enhancing its objectivity in the organization. However, four respondents indicated that the internal audit structure was not strong in the organizations.

#### 4.5.3 Accountability to the Audit Committee

In this area, the researcher sought to know from the respondents whether internal audit recognizes its accountability to the audit committee. The respondents were asked to indicate whether strong, in adequate and or, needs improvement.

**Table 4.11: Accountability to the Audit Committee**

<b>DOES THE INTERNAL AUDIT DEMONSTRATE THAT IT RECOGNIZES ITS ACCOUNTABILITY TO THE AUDIT COMMITTEE?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>9</b>	<b>75</b>	<b>4</b>	<b>44.44</b>	<b>2</b>	<b>33</b>	<b>15</b>	<b>56</b>
<b>INADEQUATE</b>	<b>3</b>	<b>25</b>	<b>2</b>	<b>22.22</b>	<b>1</b>	<b>17</b>	<b>6</b>	<b>22</b>
<b>NEEDS IMPROVEMENT</b>	<b>-</b>	<b>-</b>	<b>3</b>	<b>33.33</b>	<b>3</b>	<b>50</b>	<b>6</b>	<b>22</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

Table 4.11 above shows that 15 out of 27 respondents in all the three categories agreed that internal audit recognized its accountability to the audit committee. Six

respondents indicated inadequate demonstration while six felt that there was need for improvement. 56% of the respondents found that the internal audit recognition of accountability was strong while 44% indicated that the recognition for accountability was inadequate and it needed improvement. From the findings above, it was noted that while some respondents were satisfied with the internal recognition of the audit committee other respondents were not satisfied and did not recognize the accountability to the audit committee by some organizations.

#### **4.5.4: Internal Auditor’s Previous Findings and Recommendations.**

In this section, the researcher sought to know whether the management has been responsive to the internal auditors’ previous findings and recommendations. The respondents were asked to indicate whether strongly, partially and or, not at all.

**Table 4.12: Internal Auditor’s Previous Findings and Recommendations**

<b>HAS MANAGEMENT BEEN RESPONSIVE TO INTERNAL AUDITOR’S PREVIOUS FINDINGS AND RECOMMENDATIONS?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>7</b>	<b>58</b>	<b>5</b>	<b>56</b>	<b>3</b>	<b>50</b>	<b>15</b>	<b>56</b>
<b>PARTIALLY</b>	<b>5</b>	<b>42</b>	<b>4</b>	<b>44</b>	<b>3</b>	<b>50</b>	<b>12</b>	<b>44</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the table 4.12 above, respondents had different opinions, where 15 of them, which represented 56%, indicated that they strongly agreed that management was responsive to the internal auditors’ previous findings and recommendations. The remaining 12 representing 44% indicated that they partially agreed. However,

from the findings above a slightly higher number of respondents, fifteen felt that the management was strongly responsive on the internal auditor’s previous findings and recommendations; a lesser number of respondents twelve was of the view that not all companies were positive on the same issue. This proved to the researcher that, management in some organizations was reluctant in responding to internal auditor’s previous findings and recommendations, which could adversely affect the organizations financial performance.

#### 4.6 Internal Audit Qualifications

Under this section, the researcher sought to know whether internal auditor’s qualifications were considered in different perspectives in the organizations.

##### 4.6.1 Internal Auditor Qualifications

The respondents were required to indicate their preference in terms of as strong, partially strong and very weak.

**Table 4.13: Internal Auditor Qualifications**

<b>ARE INTERNAL AUDITOR’S QUALIFICATION CONSIDERED IN YOUR ORGANIZATION?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>8</b>	<b>67</b>	<b>8</b>	<b>89</b>	<b>5</b>	<b>83</b>	<b>21</b>	<b>78</b>
<b>PARTIALLY</b>	<b>4</b>	<b>33</b>	<b>1</b>	<b>11</b>	<b>1</b>	<b>17</b>	<b>6</b>	<b>22</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the above table 4.13, 21 respondents, representing 78% agreed that internal auditors’ qualifications were being considered in the organizations. The above



respondents comprised of eight auditors, eight audit assistants and five audit committee members. 22% of the respondents partially agreed that internal audit qualifications were considered in the organizations. Though a bigger percentage depict that internal audit qualifications were considered in the organizations, there was also views from six respondents, which represented 22% that it was partial in some organizations. Internal audit qualification contributes a lot to the organizations operations as it helps in producing sound financial statements.

#### 4.6.2: Internal Auditor’s Qualifications

The researcher sought to know from the respondents if there laid down procedures for checking internal auditors’ qualifications. The respondents were required to indicate whether strong weak or poor.

**Table 4.14: Internal Auditors’ Qualifications Checks.**

<b>PROCEDURES IN PLACE FOR CHECKING INTERNAL AUDITORS QUALIFICATIONS IN THE ORGANIZATION?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>9</b>	<b>75</b>	<b>5</b>	<b>56</b>	<b>4</b>	<b>66</b>	<b>18</b>	<b>67</b>
<b>WEAK</b>	<b>2</b>	<b>17</b>	<b>4</b>	<b>44</b>	<b>1</b>	<b>17</b>	<b>7</b>	<b>26</b>
<b>POOR</b>	<b>1</b>	<b>8</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>17</b>	<b>2</b>	<b>7</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the above table 4. 14, eighteen respondents, which represented 67% of the respondents, agreed that there was strong procedures for checking internal auditors qualifications in the organizations. 33% of the respondents which was nine

respondents felt that the procedures for checking internal auditor independence was either weak or poor. The percentage that agreed that there were no adequate procedures for checking internal audit independence was substantial thus wanting the researcher's interest on the same.

#### 4.6.3: Internal Audit Frequency Checks for Qualification

The researcher sought to know from the respondents if there were qualification checks in place by the management. The respondents were required to give answers as frequent, rarely or not at all.

**Table 4.15: Internal Audit Checks for Qualifications**

<b>HAVE YOU BEEN CHECKED FOR QUALIFICATION BY THE MANAGEMENT IN YOUR ORGANIZATION?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>FREQUENT</b>	<b>8</b>	<b>67</b>	<b>5</b>	<b>56</b>	<b>3</b>	<b>50</b>	<b>16</b>	<b>59.2</b>
<b>RARELY</b>	<b>3</b>	<b>25</b>	<b>4</b>	<b>44</b>	<b>2</b>	<b>33</b>	<b>9</b>	<b>33.3</b>
<b>NOT AT ALL</b>	<b>1</b>	<b>8</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>17</b>	<b>2</b>	<b>7.4</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From table 4.15 above, in some organizations, there were frequent checks by the management on the internal auditors' qualification updates. Out of 27 respondents, 16 respondents agreed that there were no frequent audit qualification checks and this was 59.2%. However, 40.7% of the respondents indicated that the checks were either rare or not there at all. In cases where qualifications were not

checked could mean that unqualified internal auditors could be employed to perform audit work, which could result to sub-standard practices. However, the companies which checked their internal auditors benefitted from quality work.

#### 4.6.4 Internal Audit Staff Remaining Current

The researcher wanted to know from the respondents how they remained current with changes in accounting and financial requirements. The respondents were required to answer with, very well, well or poor.

**Table 4.16: Internal Audit Staff Remained Current**

<b>HOW IS THE INTERNAL AUDIT STAFF REMAINING CURRENT WITH RESPECT TO CHANGES IN ACCOUNTING AND FINANCIAL REPORTING REQUIREMENTS?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>VERY WELL</b>	<b>5</b>	<b>42</b>	<b>2</b>	<b>22</b>	<b>3</b>	<b>50</b>	<b>10</b>	<b>37</b>
<b>WELL</b>	<b>6</b>	<b>50</b>	<b>7</b>	<b>78</b>	<b>3</b>	<b>50</b>	<b>16</b>	<b>59</b>
<b>POOR</b>	<b>1</b>	<b>8</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1</b>	<b>4</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the above table 4.16 out of the 27 respondents, ten agreed that they updated themselves with the current changes in accounting and reporting requirements, 16 respondents did not remain very well and one respondent was poor in updating with the current accounting and financial reporting requirements. This were in 37%, 59% and 4% respectively. A bigger percentage (63%) of internal auditors in the construction companies did not update themselves with the current changes in

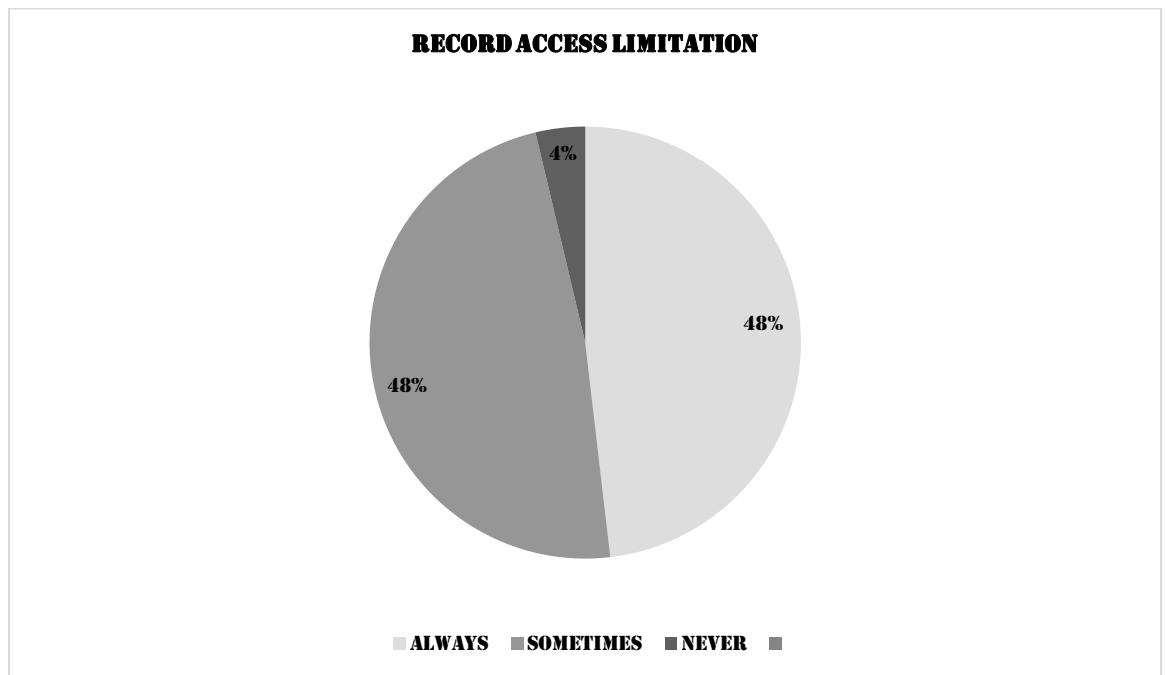
accounting and reporting requirements appropriately. Only 37% remained current with respect to changes in accounting and financial reporting requirements.

#### **4.7 Internal Audit Roles**

In this section, the researcher sought to know the different roles played by the internal auditors in the organization

##### **4.7.1 The Internal Auditors' Unlimited Access to Information**

The researcher wanted to know from respondents whether internal auditors could access the records they were to audit without any limitation. The respondents were to answer with always, sometimes or never.



**Figure 4.4: Internal Auditor's Records Access Limitation.**

Generally, from figure 4.2.4 above, 13 out of 27 respondents agreed that there was unlimited access to information they were supposed to audit before. Other 13 respondents gave information that their access was not unlimited but sometimes respondents consented that they never had access to information they were supposed to audit before. Thus 48% of the respondents agreed for unlimited access, 48% of the respondents did not fully agree and 4% said they never had access. From the findings above, not all organizations allowed unlimited access of information to their internal auditors.

#### 4.7.2 Importance of Internal Auditor in the Organization.

The researcher sought to know from the respondents whether the internal auditors were recognized as important in the organization. Answers were important, somehow important and not important.

**Table 4.17: Importance of Internal Auditors in the Organization.**

<b>HOW IMPORTANT DO YOU THINK THE INTERNAL AUDITOR IS TO YOUR RECOGNITION?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>VERY IMPORTANT</b>	<b>11</b>	<b>92</b>	<b>8</b>	<b>89</b>	<b>5</b>	<b>83</b>	<b>24</b>	<b>89</b>
<b>SOMETIMES IMPORTANT</b>	<b>1</b>	<b>8</b>	<b>1</b>	<b>11</b>	<b>1</b>	<b>17</b>	<b>3</b>	<b>11</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

The above table 4.17, out of 27 respondents, 24 respondents indicated that internal auditors are very important in the organization. This translated to 89% of the respondents. Three respondents somehow agreed. From the findings above, a

great number of respondents have indicated that internal auditors are important in an organization. This implies that internal audit services in SMEs especially in the construction industry are important and required.

#### 4.7.3 Internal Audit Independence on the Financial Performance

Under this section, the researcher sought to know from respondents the extent to which internal audit independence affects financial performance of an organization from the activities it audits. The respondents were asked to indicate whether strong, adequate or needs improvement.

**Table 4.18: Internal Audit Independence on the Financial Performance**

<b>EVALUATE INTERNAL AUDIT INDEPENDENCE ON THE FINANCIAL PERFORMANCE FROM THE ACTIVITIES IT AUDITS</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>6</b>	<b>50</b>	<b>5</b>	<b>56</b>	<b>-</b>	<b>-</b>	<b>11</b>	<b>41</b>
<b>ADEQUATE</b>	<b>6</b>	<b>50</b>	<b>4</b>	<b>44</b>	<b>4</b>	<b>67</b>	<b>14</b>	<b>52</b>
<b>NEEDS IMPROVEMENT</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2</b>	<b>33</b>	<b>2</b>	<b>7</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the table 4.18 above, 11 out of 27 respondents considered internal audit independence on the financial performance of an organization as strong. This was 41% of the respondents. Fourteen respondents indicated that internal audit independence was adequate to the financial performance of organizations while two respondents indicated that there was need for improvement. The percentage of 52% and 7% of the respondents indicated that internal audit independence was

not strong on the financial performance from the activities it audits. From the above findings, it has been observed that internal audit independence affects the financial performance of organizations on the activities it audits thus it needs some improvement.

#### 4.7.4 Assessing Internal Auditor’s Overall Performance

The researcher sought to know from the respondents the overall performance of internal auditors in the organizations. The respondents were asked to rate as strong, adequate or needs improvement.

**Table 4.19: Assessment of Internal Auditor Performance**

<b>HOW WOULD YOU ASSESS INTERNAL AUDITORS OVERALL PERFORMANCE IN YOUR COMPANY?</b>	<b>AUDITOR</b>		<b>ASSISTANT AUDITOR</b>		<b>AUDIT COMMITTEE MEMBER</b>		<b>TOTAL</b>	
	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>	<b>COUNT</b>	<b>%</b>
<b>STRONG</b>	<b>6</b>	<b>50</b>	<b>4</b>	<b>44.4</b>	<b>2</b>	<b>33.3</b>	<b>12</b>	<b>44</b>
<b>ADEQUATE</b>	<b>5</b>	<b>42</b>	<b>4</b>	<b>44.4</b>	<b>2</b>	<b>33.3</b>	<b>11</b>	<b>41</b>
<b>NEEDS IMPROVEMENT</b>	<b>1</b>	<b>8</b>	<b>1</b>	<b>11.1</b>	<b>2</b>	<b>33.3</b>	<b>4</b>	<b>15</b>
<b>TOTAL</b>	<b>12</b>	<b>100</b>	<b>9</b>	<b>100</b>	<b>6</b>	<b>100</b>	<b>27</b>	<b>100</b>

**Source: Research data 2015.**

From the above table 4.19, twelve respondents agreed that internal auditors’ performance was strong in organizations. This was 44% of the 27 respondents. Eleven respondents indicated that it was adequate and this was 41% of the total respondents. Four respondents felt that there was need for improvement and this was 15% of the total respondents. From the above findings it seemed that, a

bigger percentage of respondents (56%) were not fully satisfied with the internal auditors overall performance in organizations and 44% agreed to it.

#### **4.8 Measuring the Financial Performance of Organizations**

The researcher sought to know from the respondents the rating of the financial performance of their organizations. The respondents were asked to use attributes to rank the performance. The highest attribute was one and the lowest was four; 1=improving fast, 2=improving slowly, 3=neutral, 4=declining. The data was analyzed using Microsoft Excel and rankings done through mean and standard deviation.

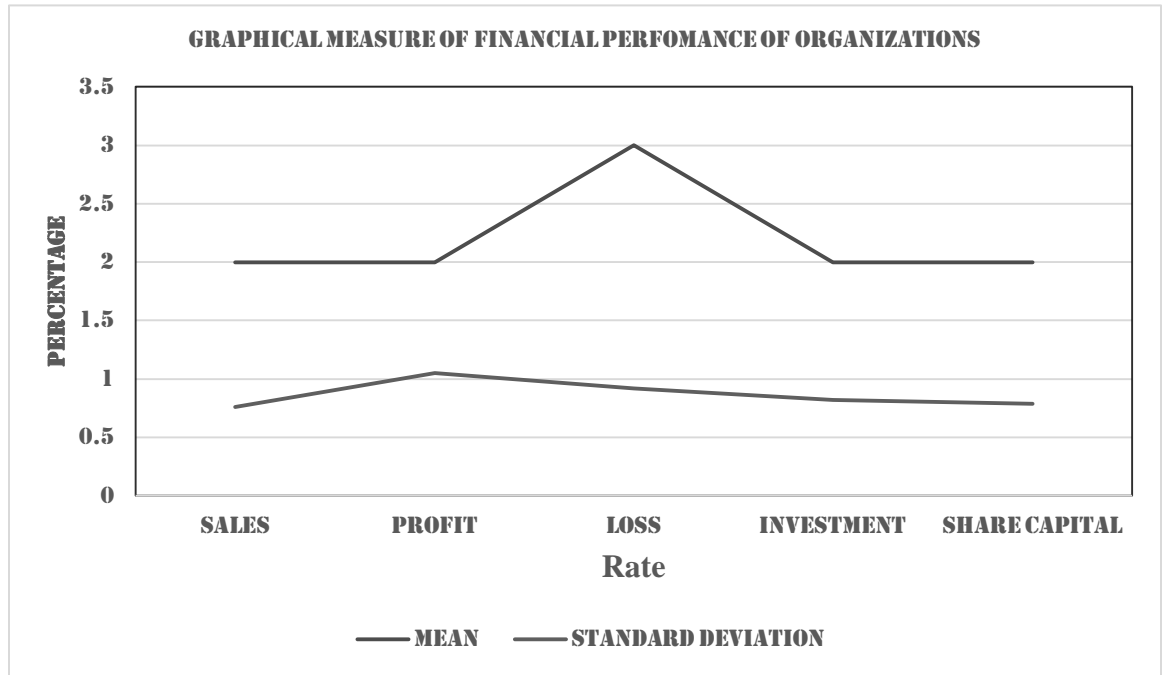
**Table 4. 20: Measuring the Financial Performance**

<b>INDICATORS</b>	<b>MEAN</b>	<b>RANK</b>	
			<b>STANDARD DEVIATION</b>
<b>SALES GROWTH FOR THE LAST FOUR YEARS</b>	<b>2</b>		<b>0.76</b>
<b>INCREASE IN PROFIT FOR THE LAST FOUR YEARS</b>	<b>2</b>		<b>1.05</b>
<b>LOSSES IN THE LAST FOUR YEARS</b>	<b>3</b>		<b>0.92</b>
<b>INVESTMENTS FOR THE LAST FOUR YEARS</b>	<b>2</b>		<b>0.82</b>
<b>SHARE CAPITAL FOR THE LAST FOUR YEARS</b>	<b>2</b>		<b>0.79</b>

**Source: Research data 2015.**

From table 4.20 above, the mean rank for indicators, sales growth, profit increase, losses, investment and share capital was 2 and the standard deviation was 0.76,1.05,0.92,0.82 and 0.79 respectively.





**Figure 4.5 Measuring Financial Performance of Organizations**

From table 4.20 and figure 4.2.5 above, respondents indicated that sales, profits, investments and share capital of the companies were growing slowly. Losses in most companies were neutral. There was no decline in any of the measures above. The standard deviations were, sales 0.76, profit 1.05, loss 0.92, investment 0.82 and share capital 0.79. From the above findings although fast growth was not pointed out, gradual growth was indicated. There was need for the internal auditors to strengthen some policies in the organization for faster growth of the firms.

#### **4.8 Summary of Key Findings**

The research was conducted from the male and female respondents who had served in auditing of the various construction companies in Mombasa county for a duration of between two and eight years. The researcher found that the internal auditors were not fully recognized by the management of the organizations they served. Despite the internal auditors having the required qualifications the organizations did not accord them the independence they deserved. The government should assist the auditor professionals by organizing seminars and workshops for SMEs in Mombasa county and the country as a whole.

## **CHAPTER FIVE**

### **CONCLUSION AND RECOMMENDATIONS**

This chapter presents the discussions of the research findings together with the conclusions drawn to facilitate future research in the area and provide possible solutions to some problems identified from undertaking the research.

#### **5.1 Conclusions**

From the research, it was evident that some construction companies within Mombasa county did not accord the internal auditors the independence they deserved to effectively give their opinion on the financial statements of the organizations. Some records in some organizations were not accessed by the auditors to enable them perform their work comprehensively. In some companies the auditors were treated as part of the management thus making it difficult for them to form an independent opinion on the financial statements. Although the auditors had the required qualifications in some cases, the management of the organizations did not appreciate that. The auditors had their roles of ensuring that the management of the firms discharged their responsibilities through giving them the required advices. However, the study showed that some construction companies were generally precognitive of the internal audit function independence. It was found that records for compiling audit reports were provided in most companies. Some major areas such as, internal control systems and contribution of financial performance by both audit committee members and the

internal auditors' functions independence were found to be weak during the study in operations, objectivity and accountability in the organizations. The reporting structure in some construction companies was generally weak thus affecting the internal auditors' independence. In most organizations, internal auditors were not fully recognized for their important roles of checking and reporting on the financial records of the organizations. According to the study, the general level of internal audit independence in the construction companies is relatively weak and in some cases non-existence.

## **5.2 Recommendations**

The researcher found that there was need for construction companies in Mombasa county to accord the internal auditors the independence they required in forming their opinion on the financial statements. The government needs to intervene so as to save the internal audit profession. This can be done through public education where, the minister for commerce and industry should coordinate with the relevant professional bodies like to educate the management of companies in the construction industry on the importance of internal audit independence.

The construction industry in Mombasa county should be sensitized through seminars, workshops and media on the benefits that will accrue to their business if they allowed the auditors to prepare sound financial statements. The companies should employ competent internal auditors at affordable fee or pay to ensure that the management was advised properly. The audit firms should also establish a

department dedicated to providing accounting services to the construction companies at a relatively cheaper cost since they are increasing on a daily basis. The government should establish an internal audit unit, which should be independent to ensure that all SMEs in Kenya comply with the laid down audit procedures and rules. This is because the government has not been keen on the operations of SMEs in all industries especially internal auditing. The internal audit unit should come up with modalities and policies on how to monitor the activities of the SMEs especially preparation of financial statements.

### **5.3 Limitations of the Study**

The researcher encountered problems in getting some respondents at their workplace since they were in different organizations. The research could trace some respondents from far places as some could either be on leave or away from their work stations on official duties. The researcher countered this limitation by consistently liaising with the respondents at their places of work and at any other place where they could be found. In addition, some respondents were reluctant in giving information fearing that the information asked may be used to intimidate them or print a negative image about them. The researcher handled this problem by carrying with him an introduction letter from the University in order to assure the respondents that the information they gave was to be treated with confidentiality and it was to be used purely for academic purposes. It was also anticipated that respondents could delay in filling in the questionnaires since it was a voluntary business. The researcher tackled that using a persuasive language and

frequent visits to the respondents. It was also an expensive and tiresome exercise since the researcher had to commute and communicate frequently to follow the respondents.

#### **5.4 Areas for Future Research**

The future researchers on the same or related research project should focus on the effects of Public Education on internal audit independence in private sector. Another area could be the effect of strengthening internal audit unit for better financial performance in private sector. If undertaken any of the above researches would further enlighten the interested parties on the financial statements of organizations. They would give an overview of the expected results of the conclusions and recommendations to be derived from the future research.

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## **APPENDICES**

### **Appendix A: Letter to Respondents**

Dear sir/madam,

RE: Research Questionnaire

I am a student of Masters in Business Administration-Finance option degree at The Technical University of Mombasa main campus (TUM). In partial fulfillment of the course, I am currently carrying out a research study on the influence of internal audit independence on the financial performance of small and medium enterprises in the construction industry in Mombasa County. Attached please find an introduction letter from TUM.

I would appreciate if you participate in the study as a respondent. The information you provide shall be treated entirely for academic purposes and shall strictly be treated as private and confidential. Your participation will make this study a success and will also help in improving the financial performance of the construction industry in Mombasa County.

Your co-operation will be highly appreciated.

Yours sincerely,

**Harrison Mwinzi Kiema**

**Student No. MBA/0006/2012**



Diploma.....

Certificate.....

Any other-----

9. Which professional course have you attained and what level? Tick the appropriate and specify the level

i. CPA [ ]-----

ii. ACCA [ ]-----

iii. CCP [ ]-----

iv. Others

(specify)\_\_\_\_\_

**PART 2 – Influence of Internal Audit Independence on Financial Performance**

**10. Records Accessibility**

i) In your organization, are you provided with all records for compiling audit reports?

Yes [ ]

No [ ]

If no, which areas that you do not access for verification when doing auditing?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

ii) Are internal auditors considered as advisors to management on matters related to internal controls and governance?

1	2	3	4	5
<b>Strongly consider</b>	<b>Sometimes consider</b>	<b>Ignored</b>	<b>Sometimes ignore</b>	<b>Strongly ignored</b>

iii) Does internal audit identify and evaluate the organization's internal control system as a basis for reporting upon its adequacy and effectiveness?

	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
<b>Strongly agree</b>	<b>Agree</b>	<b>Not sure</b>	<b>Disagree</b>	<b>Strongly disagree</b>

iv) Do audit committee and internal audit functions independence contribute to the financial performance of your organization?

Agree [ ]

Somehow agree [ ]

Disagree [ ]

### 11. Reporting Structure

i) How do you rate the independence of internal auditors in terms of operations and structural in your company?

Very independent [ ]

Somehow independent [ ]

Not independent [ ]

ii) How would you assess the structure of internal audit in terms of enhancing its objectivity?

Strong [ ]

Not very strong [ ]

Weak [ ]

iii) How well does the internal audit demonstrate that it recognize its accountability to the audit committee?

Strong [ ]

In adequate [ ]

Needs improvement [ ]

iv) Has management been responsive to internal auditor's previous findings and recommendations

Strongly [ ]

Partially [ ]

Not at all [ ]

## 12. Internal Auditors' Qualifications

i) Is internal auditors' qualification considered in your organization?

Strongly [ ]

Partially [ ]

ii) Are there procedures in place for checking auditors' qualifications by the management?

Strong [ ]

Weak [ ]

Poor [ ]

iii) Have you ever been checked for qualifications by the management in your organization?

Frequently [ ]

Rarely [ ]

Not at all [ ]

iv) How is the internal audit staff remaining current with respect to changes in accounting and financial reporting requirements?

Very well [ ]

Well [ ]

Poor [ ]

### 13. Internal Audit Roles

i) Does the internal auditor have an un-limited access to information they are supposed to audit before?

Always [ ]

Sometimes [ ]

Never [ ]

ii) How important do you think the internal auditor is to your recognition?

Very important [ ]

Somehow important [ ]

Not important [ ]

iii) Evaluate internal audit independence on the financial performance from the activities it audits?

Strong [ ]

Adequate [ ]

Needs improvement [ ]

iv) How would you assess internal audit's overall performance in your organization?

Strong [ ]

Adequate [ ]

Needs improvement [ ]

### 14. Measuring the Financial Performance of the Firm. How would you rate the Financial Performance of your Company?

1=improving fast, 2=improving slowly, 3=neutral, 4=Declining

Use the above attributes to answer the questions below (tick).



(i)	Sales growth for the last 4 years	1	2	3	4
(ii)	Increase in profit	1	2	3	4
(iii)	Losses	1	2	3	4
(iv)	Investments	1	2	3	4
(v)	Share capital	1	2	3	4

### Appendix C: Target Population

Construction Companies Class NCA 8 in Mombasa County, Kenya.

<b>S/NO</b>	<b>Construction co. name</b>	<b>Category</b>
1	Abeid Gen Cont & Supp ltd	Building
2	Afro Real Investments	civil
3	Akinsy ltd	Electrical services
4	Ayhaw Enterprise Limited	Civil
5	Baldeshvar Builders limited	Building
6	Cadtech Global Services ltd	Building
7	Cariser Mura enterprises	Building
8	Coast waves cont and Suppliers	Electrical services
9	Cogler Investment ltd	Civil
10	Decker Court	Road works
11	Digajj enterprises	Building
12	Doorway construction ltd,	Building
13	Eimara Investment	Water Works
14	Eritosa	Civil
15	Famwako Enterprises & General Contractors	Roads Works
16	Fardan Construction Co. ltd	Building
17	Finotech Agencies limited	Road Works
18	Gemini Logistics	Civil
19	Halikii enterprises	Water works
20	Harshita Builders	Civil
21	Havilah Precision ltd	Building
22	Immaculate Solutions ltd	Civil
23	Iranya General Contractors	Building
24	Ishara Construction	Civil
25	Jasteve General Contractors LTD	Building
26	Jaywatt Enterprises	Road works

27	Jeel Enterprises Co.	Mechanical works
28	Jesto Techno Serve	Building
29	Jomiste Agencies	Civil
30	Jomonel Co. Ltd	Building
31	Kalambeyu Enterprises	Civil
32	Karukungu Auto Ent ltd	Building
33	Kenzam Engineering Co. Ltd	Civil
34	Kipoko Gen. Construction Co. Ltd	Building
35	Kivipi Investment ltd	Building
36	Kizuri Enterprises Ltd	Road works
37	Lajaz contractors Ltd	Civil
38	Laza Holdings Ltd	Building
39	Lugis Home Invest Ltd	Civil
40	Magline international Limited	Water works
41	Marjok Construction Limited	Building
42	Mazoea General Agencies Limited	Building
43	Motown	Mechanical Services
44	Precise	Civil
45	Preet Builders.	Building
46	Prestige Security Solutions ltd	Electrical Services
47	Rasilkhema Construction Co. ltd	Civil
48	Rasini Building Contractors	Building
49	Realtimers General Suppliers	Roads works
50	Real Tech Construction	Civil
51	Ruwi International Co. Ltd	Building
52	Salvin Contractors Services Ltd.	Civil
53	Samjul Enterprises Limited	Building
54	Samkon Construction and Civil Eng.	Civil
55	Sera Electrical Eng. Co. Ltd	Electrical services
56	Shakazulu Investments	Civil
57	Shivam Timber Mart	Building

58	SMS & Track (Africa )ltd	Civil
59	The Possible Ventures Ltd.	Building
60	Tsugasta Enterprises	Civil
61	Vibgyor Enterprises Ltd	Building
62	Vick Construction &Mgt	Building
63	Yasmin Ventures	Road works
64	Zanny Traders	Road works
65	Zarero Kenya Ltd	Civil

SOURCE: National Construction Authority 2014

### Appendix D: Sample Size

Construction Companies Class NCA 8 in Mombasa County, Kenya.

S/N o	Construction Co. Name	Category	Auditor	Audit assist ant	Audit committ ee member
1	Akinsy ltd	Electrical services	1	-	-
2	Baldeshvar Builders ltd	Building	-	1	-
3	Cariser Mura enterprises	Building	-	-	1
4	Cogler Investment ltd	Civil	1	-	-
5	Digajj enterprises	Building	-	-	1
6	Eimara Investment	Water Works	1	-	-
7	Famwako Enterprises & General Contractors	Roads Works	-	1	-
8	Finotech Agencies limited	Road Works	-	-	1
9	Halikii enterprises	Water works	1	-	-
10	Havilah Precision ltd	Building	-	1	-
11	Iranya General Contractors	Building	1	-	-
12	Jasteve General Contractors LTD	Building			
13	Jeel Enterprises Co.	Mechanical works	-	1	-
14	Jomiste Agencies	Civil	1	-	-
15	Kalambeyu Enterprises	Civil	-	-	1
16	Kenzam Engineering Co. Ltd	Civil	-	1	-
17	Kivipi Investment Ltd	Building	1	-	-
18	Lajaz contractors Ltd	Civil	-	-	1
19	Lugis Home Invest Ltd	Civil	1	-	-
20	Marjok Construction Limited	Building	-	1	-

21	Motown	Mechanical Services	1	-	-
22	Preet Builders.	Building	-	1	-
23	Rasilkhema Construction Co. ltd	Civil	-	-	1
24	Realtimers General Suppliers	Roads works	1	-	-
25	Ruwi International Co. Ltd	Building	-	1	-
26	Samjul Enterprises Ltd	Building	1	-	-
27	Sera Electrical Eng. Co. Ltd	Electrical services	-	-	1
28	Shivam Timber Mart	Building	1	-	-
29	The Possible Ventures Ltd.	Building	-	1	-
30	Vibgyor Enterprises Ltd	Building	-	-	1
31	Yasmin Ventures	Road works	1	-	-
32	Zarero Kenya Ltd	Civil	-	1	-
	Total		14	10	8

Source: National Construction Authority 2014

**END**