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INTERNAL CONTROLS AND FINANCIAL REPORTING QUALITY IN COASTAL COUNTY GOVERNMENTS IN KENYA

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ABSTRACT

This study determined the internal controls and financial reporting quality of county governments in Coast region. The study was grounded on technology acceptance model, agency theory, Stewardship theory, positive accounting theory and performance maximization theory. This study adopted cross-sectional descriptive survey research design. The target population was six County governments in the Coast region which forms the study's unit of analysis. The unit of observation was finance and economic planning officers drawn from the six target county governments. The study used census technique due to small number of state corporations. Primary data was collected by use of structured questionnaires while Secondary data was collected from performance reports and relevant documents using secondary data collection sheet. The study conducted pilot test before data collection. The collected data was analysed, summarized and tabulated by use of SPSS software version 29. Descriptive analysis and inferential analysis was used to summarize the results for each of the study objectives. The findings from this study indicated that internal audit, risk assessment, automation, and monitoring all significantly contribute to improving the financial reporting quality of Coastal county governments. It was concluded that the county governments have established internal audit teams that are competent and composed diversely, contributing positively to the effectiveness of their financial controls. Additionally, the management's consideration of fraud risks during the assessment process positively influences financial reporting. It was concluded that automation plays a crucial role in maintaining secure and up-to-date access to critical financial systems. However, it remains unclear whether the county governments have established a comprehensive baseline for internal control performance to measure improvements over time. The study recommended that county governments should work towards ensuring that the internal audit team operates with minimal influence from management to maintain objectivity in their work. Additionally, regular fraud risk assessments should be conducted to safeguard against financial misconduct.

Key Words: *Internal Audit, Risk Assessment, Automation, Monitoring*

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INTRODUCTION

World over, regulators, professional accountants, and other users of financial information continue to place a high priority on the quality of financial reports. Because they relate to how public sector entities provide management accountability for public funds and other assets entrusted to them, high-quality financial reports have the potential to positively and significantly impact all organizational stakeholders. This is because they can assist public money providers like donor agencies, local and foreign investors, taxpayers, and others in making crucial decisions and achieving other goals (Muraina & Dandago, 2020). Providing information on the entity's financial statements that is helpful for making economic decisions is the primary goal of financial reporting (FASB, 2017; IASB, 2018). Management continuously assesses its internal control system to ensure that it is efficient and updated as needed, as programs change and entities work to enhance operational procedures and adopt new technologies.

In Malaysia, according to a survey report by PricewaterhouseCoopers (PwC) (2018), the number of Malaysian organizations' fraud victims that reported losses exceeding US$1m had increased by 9% as the percentage showed 22% during the year 2018 compared to 13% in the year 2016. PwC's report in (2020) also indicated that the incident of fraud in Malaysia remains high with almost half of their survey respondents being a victim of fraud. The report reveals that in 2020, Malaysia was ranked the fifth highest in the count of fraud in the Asia Pacific region and surprisingly, the percentage increased in 2022 which makes Malaysia ranked third with the highest count of fraud in Asia Pacific region (PwC, 2022). The report highlighted that the incident of fraud in Malaysia is 41% in the year 2018 and increased to 54% in 2021. This is worrying enough as other Southeast Asian countries showed a decrease in the level of fraud (from 40% to 29%) between 2020 and 2022.

In South Africa, accounting scandals have been reported in Randgold and Exploration companies (Kinyua, Gakure, Gekara, & Orwa, 2017). In Nigeria, Muraina and Dandago (2020) study concluded that standard accounting has improved the level of accountability, which in turn improved Nigeria's financial reporting quality. Cadbury Nigeria's managing director and chief financial officer were fired in 2006 for inflating the company's profits for several years before the company's foreign partner acquired a controlling interest. These scandals highlight the importance of evaluating, scrutinizing, and developing systems of checks and balances to guide corporate executives in decision-making. These executives have a legal and moral obligation to produce honest, reliable, accurate, and informative corporate financial reports on a regular basis (Kijjambu & Kyomuhendo, 2022).

In an effort to improve accountability and service delivery, Kenya's public sector has implemented public finance management reforms. These reforms aim to make public financial management more effective, efficient, transparent, and participatory (Society for International Development, 2018). Following the adoption of the Public Finance Management (PFM) Act in 2012 and the promulgation of the new Constitution in 2010, Kenya implemented Public Financial Management (PFM) reforms, which included the establishment of the Public Sector Accounting Standards Board. The PFM Act of 2012 created the PSASB, a statutory organization responsible for defining standards.

The Kenyan county governments' financial accounts for the fiscal year 2013–2014 had a disclaimer of opinion in 100% of them, according to the Auditor General. The 2020–2021 FY saw a continuation of this pattern, and the 2021–2022FY witnessed six county governments receive qualified audit opinions and the remaining counties receive disclaimers of opinion. This demonstrates unequivocally that Kenyan county governments have had difficulty providing sufficient financial reports.

County government financial reports are basically assertions or statements from county government management that inform other parties, namely existing stakeholders, about the county government's financial condition. The accounting and financial reporting in the counties have their basis in Article 226 of the Constitution of Kenya which mandated parliament to enact laws to guide the practices. Public Finance Management (2019) was thus enacted replacing The PFMA of 2012. The Act provides that all of the 47 Kenyan Counties to publish all the info related to the County's budgeting cycle from formulation, approval, implementation to auditing (Were, 2017)

Statement of the Problem

The Public Finance Management Act, 2012, which was enacted by the Kenyan parliament to serve as a guide for financial management practices, along with other financial regulations and procedures, have not gone far enough to address the inadequate financial reporting of the public sector. The quality of accounting records and financial reporting has continuously been deemed subpar by Kenya's Auditor General (ICPAK, 2022). According to Richman and Richman (2018), accurate financial disclosures and a decrease in material errors can be achieved by effective internal control.

Research on the quality of financial reporting in the county government sector has not been as much as in other public entities. Moreover, several studies have examined the relationship between internal controls and financial performance of different sectors and regions and very few have focused on financial reporting quality. For instance, Abu Hamour, Massadeh, and Bshayreh, (2023) found a positive relationship between COSO's components and financial performance of Jordanian banks. Similarly, Chowdhury (2021) found that monitoring and information and communication components positively impacted the financial performance of Bangladeshi banks. Hanoon, Khalid, Rapani, Aljajawy, and Al-Waeli (2021) investigated the internal control system relationship with the financial performance of Iraqi banks using the ROE metric only and found a positive relationship. Emmy and Gladys (2018) researched on internal control systems and financial performance of Jomo Kenyatta Foundation. However, the reviewed studies have given a wide berth on internal controls in the context of County governments' financial reporting quality. Thus, the study sought to fill the research gaps by establishing the effect of internal controls on financial reporting quality in coastal county governments, Kenya.

Objectives of the Study

The general objective was to investigate the internal controls and financial reporting quality in coastal county governments, Kenya. The study was based on the following specific objectives:

- To establish the effect of internal audit on financial reporting quality in coastal county governments, Kenya.
- To determine the effect of risk assessment on financial reporting quality in coastal county governments, Kenya.
- To determine the effect of automation on financial reporting quality in coastal county governments, Kenya.
- To find out the effect of monitoring on financial reporting quality in coastal county governments, Kenya.

LITERATURE REVIEW

Theoretical Review

Positive Accounting Theory

The purpose of positive accounting theory is to explain (to explain) and predict (to predict) accounting practices. Explanation means giving reasons for the observed practice. For example, positive accounting theory seeks to explain why companies continue to use historical cost accounting and why certain companies change their accounting techniques. While predictions of accounting practices mean the theory tries to predict phenomena that have not been observed.

According to PAT, the information can be distorted based on the management motive in several ways (Oluoch, 2014). The management has information advantage over other stakeholders and may seek to influence the reporting of earnings in financial reports due to conflict of interest between the managers (agents) and owners of the firm (principals). PAT therefore seeks to explain the manager's choice of accounting methods in terms of self-interest and relationship between stakeholders. This theory is relevant to this study because it explains why preparers of financial statements will pick one accounting method over the other. The theory supports risk assessment variable in the study.

Technology Acceptance Model

Davis was a TAM proponent in 1986. The theory states that emerging technologies will not be able to improve organizational performance and effectiveness if consumers do not accept the change. This concept makes it clear that users' attitudes and perceptions of the benefits of the system affect how they adopt and use new technology. Adopting any breakthrough using information technology, in particular, requires spending money on computer-based tools that support planning, decision-making, and communication. However, these systems could be hazardous. Because of this, it is essential that the systems be explained in terms of organizational logic and desire. It's also critical to acknowledge the potential for opposition to technological progress. Understanding the causes of people's reluctance to change as well as possible fixes for these issues must be attempted. The proper organizational culture must become deeply embedded, and any changes must be made gradually and transparently. Everyone involved needs to be made aware of their duties and given the power to fulfill them (Kamel, 2014).

Agency Theory

Agency theory is a concept that explains the contractual relationship between principals and agents. The principals are the parties who give the mandate to other parties, namely agents, to carry out all activities on behalf of the principals in their capacity as decision makers (Jensen and Meckling, 1976). In the context of the public sector, the relationship between the community and government is similar to the relationship between principals and agents.

The community requires the government to be responsible through the reporting mechanism and the community through the legislature, can measure, assess and monitor the performance of the government to what extent the government has acted to improve the welfare of the community in a transparent and accountable manner. Mardiasmo (2018) explains that the notion of public accountability is the obligation of the trustee (agent) to provide accountability, present, report, and disclose all activities and activities that are their responsibility to the trustee (principal) who has the right to demand such accountability. The practice of financial reporting in public sector organizations is a concept based on agency theory. Transparency and disclosure of reliable information to outsiders is a key aspect for public sector institutions. Under the agency theory approach, transparency and information are useful in controlling managers and making them responsible for their decisions, as well as overall organizational performance (Garcia-Lacalle and Torres, 2021). Agency theory predicts that financial reporting quality increases with increased monitoring because of reduced information asymmetry. Thus, the theory supports monitoring variable in the study.

Stewardship Theory

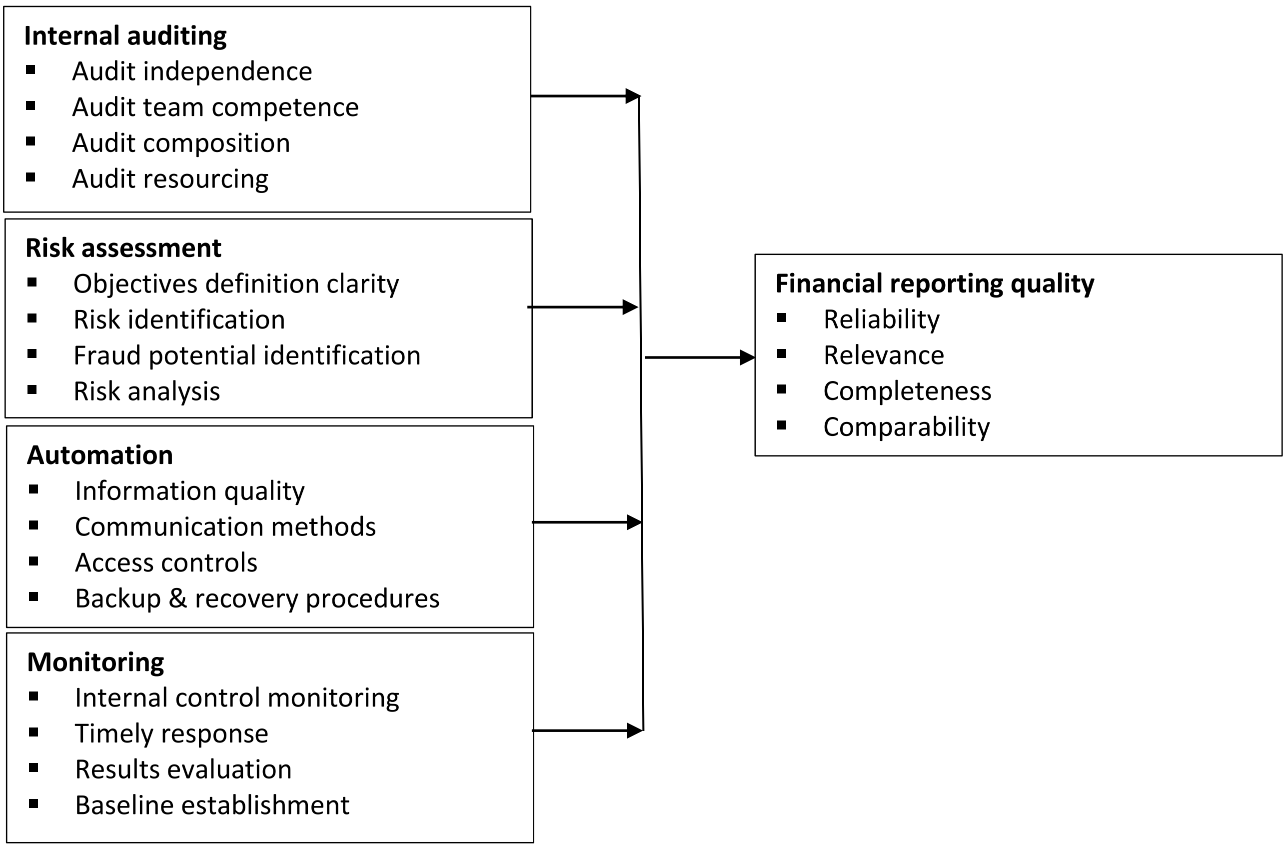
The theory rests on several key assumptions. Firstly, it assumes that goal congruence exists between agents and principals. Managers, as stewards, inherently strive to achieve what is best for the organization because they identify with its goals. Secondly, stewardship theory assumes that stewards are motivated by intrinsic rewards, such as a sense of achievement, responsibility, and organizational loyalty, rather than by extrinsic factors like financial incentives. Thirdly, the theory posits that stewards perform best when they are given autonomy and trust by the principals. Empowerment, rather than control or monitoring, is the key to enabling stewards to achieve their full potential and make decisions that align with the organization's goals. Finally, the theory assumes that agents are committed to the organization and will act in ways that prioritize its long-term success (Schillemans & Bjurstrøm, 2019).

In the context of internal controls and financial reporting quality, stewardship theory provides an important alternative to more control-focused theories like agency theory. Stewardship theory implies that when managers are viewed as stewards, they are more likely to take ownership of the financial reporting process. In a county government setting, for example, financial officers and managers who see themselves as stewards of public resources are likely to ensure that financial reports are accurate and transparent because they feel a strong sense of responsibility to serve the public interest. The theory supports audit team competence sub-variable in the study.

Performance Maximization Theory

The main reason this hypothesis has been criticized is because of its presumptions. According to the profit maximization theory, for instance, companies are assured of making their highest possible profit. On the other hand, because profits are determined by deducting expenses from future revenues, they are highly uncertain. Therefore, it is unacceptable for companies to raise earnings during erratic periods (Dabholkar, 2016). Furthermore, the internal organization of the corporation is mostly independent of the firm's aim. To enhance the wealth or income of the company's owners, for instance, certain managers appear to spend more than is necessary. It is discovered that they prioritize the firm's profitability and total assets highly (Rishi & Saxena, 2014). The financial reporting quality is linked to the theory.

Conceptual Framework



Independent Variables **Dependent Variable**

Figure 1: Conceptual Framework

Empirical Review

Kaawaase, Nairuba, Akankunda, and Bananuka, (2021) investigated corporate governance, internal audit quality and financial reporting quality of financial institutions in Uganda. This study research design is cross sectional and correlational. The study used a questionnaire survey of Chief Finance Officers, Senior Accountants and Internal audit managers of financial institutions in Uganda. Data were analyzed with the help of Statistical Package for Social Sciences. Results indicate that board expertise and board role performance are significantly associated with financial reporting quality. Also, internal audit quality is significantly associated with financial reporting quality. Board independence is not a significant predictor of financial reporting quality.

Hamed (2023) investigates the influence of internal control systems (ICS) compliance on banks' financial performance sustainability (FPS) in the Amman Stock Market. Using a questionnaire survey of sixteen listed banks, the extent of ICS compliance and its impact on various indicators of financial performance is examined, such as profitability, earnings, and returns on sustainability initiatives. It is found that the banks comply with ICS requirements and that ICS compliance positively and significantly affects their financial sustainability. In particular, this study shows that the control activities, information and communication, and monitoring components of ICSs are key drivers of bank performance.

Zheng, Liu, and Sial (2018) researched on the effectiveness of internal control and Corporate Social Responsibility in Chinese Capital Market. The paper analyzed comparatively the influences of internal control on the assumption of corporate social responsibility (SCPS) from the accrual basis, and the fulfillment of corporate social responsibility (CSRF) from the cash flow system respectively. Using a sample of 1767 firms listed in China between 2011 and 2016, we find that effective internal control has significantly promoted enterprises to assume social responsibilities. Meanwhile, effective internal control substantially improves the fulfillment of corporate social responsibility.

Soetedjo and Sugianto, (2018) conducted research on the Application of the COSO ERM Integrated Framework in Supporting Forensic Audits to Overcome Fraudulent Acts. The research method used is literature review. The results of the research show that information relating to the achievement of company goals is identified whether it has a direct impact or not, grouped into various types, and distributed or communicated through the right communication media at the right time so that each individual company can carry out their duties and responsibilities more effectively good.

Ntahondereye, Opuodho, and Muigai, (2024) assessed the effect of risk assessment as an element of internal control system on the quality of financial reporting information in local governments of Rwanda. The study was conducted in the 30 districts of Rwanda. Primary data was collected using the questionnaire, and the reports of the Office of General Auditors of Rwanda were consulted to collect secondary data. The results showed that risk assessment quality has significant effect on financial reporting information.

Bett and Memba (2017) investigated the impact of internal control systems on the financial performance of Kenya's Menengai Oil Company. The study's specific objectives were to determine the effect of control environment on Menengai Company's financial performance, to determine the influence of risk assessment on Menengai Company's financial performance, and to establish the influence of information systems on Menengai Company's financial performance. A survey research design was used for the study. The study relied on a survey of 189 people. The collected data were tabulated first, then analyzed using descriptive and inferential statistics. The findings were presented in the form of charts, tables, and graphs. Control environment, risk assessment, and information all have a significant impact on financial performance, according to ANOVA tests.

Mariam and Onyiego (2018) investigated the impact of risk assessment on the financial performance of Kenyan commercial banks: A Case Study of Commercial Banks in Mombasa County. The study concluded that operational risk management was the most important factor influencing commercial bank performance in Kenya. The study also concluded that credit risk management has a significant impact on commercial banks' financial performance as a result of counterparties' failure to meet their obligations. The study's findings also established that liquidity risk management has a significant impact on commercial banks' financial performance.

Oktora and Marlina, (2022) researched on the Role of Internal Audit in Internal Control of Receivables at PT. Pos Indonesia (Persero) Meulaboh Branch. The research method used is descriptive qualitative method, the type and source of data used is primary data, namely the source of data obtained directly from the company. The results of this research show that the role of internal audit influences the control of receivables at PT Pos Indonesia Meulaboh. The role of the company's internal auditors as supervisors of business continuity is very good. Internal audit's organizational structure is similar to that of other managers. There is administrative support for internal audits.

Mardiana and Dianata (2018) investigated the impact of risk assessment on financial performance using good corporate governance as a moderating variable. The data used comes from the Financial Statements of Sharia Banking Companies Listed on the Indonesia Stock Exchange from 2011 to 2016. Following the stage of purposive sampling, the worthy of used sample is 5 Companies. The findings revealed that Capital Adequacy Ratio (CAR) and Non-Performing Loan (NPL) had a negative and insignificant effect on Return on Asset (ROA), while operating efficiency had a negative and significant effect on Return on Assets (ROA).

Asiligwa and Rennox (2017) conducted research to determine the effect of internal controls on financial performance of Kenyan Commercial Banks. Internal controls were measured using the five elements of internal control specified by the Committee of Sponsoring Organizations of the Treadway Commission framework of internal controls, whereas financial performance was measured using the historical average of Return on Equity. Because of its ability to describe the relationship between elements of Internal Controls and Financial Performance, a descriptive research design was chosen. The 43 Kenyan commercial banks were used in the study. A structured questionnaire was used to collect primary data. Frequency tables were used to present descriptive statistics derived from data analysis, while correlation and regression tables were used to present inferential data findings. The study's findings revealed that the banking sector has strong financial performance, which is due in part to the implementation and maintenance of effective internal controls.

METHODOLOGY

This study adopted cross-sectional survey research design. Cooper and Schindler (2016) posit that cross sectional descriptive survey design as being involved in understanding a phenomenon at a specific point in time. The definite feature in a cross-sectional research design is that it compares different variables at the same time, which was the case in this study. It also provides definite information about cause and effect and that way minimize the possibility of bias (Kothari, 2014).

In Kenya, there are 42 County governments, amongst these, six are in the Coast region of the country. The current study focuses on the six County governments in the Coast region which formed the study’s unit of analysis. The unit of observation was finance and economic planning officers drawn from the six target county governments. The choice of the six Coastal County governments is justified in that Auditor General raised red flags on financial reporting quality.

Finance & economic planning officials from each of the six county governments in the Coast area made up the sample frame for this study.

The sample size was calculated based on Yamane (1967) formula at 95% confidence level and at a 0.05 level of significance.

The study used a structured questionnaire to get primary data from the participants. 1 on the questionnaire denotes a low opinion and is the lowest rating, while 5 is the highest rating and denotes a positive view. There was three sections in the questionnaire. The first segment asked questions about demographics, the second section asked questions about thematic areas of internal controls, and the third section asked questions about financial reporting quality (see appendix II). The "drop and pick later" approach was used to administer the questionnaires. Two weeks was allocated to respondents to complete and submit surveys.

Eight respondents selected from the Makueni County administration will take part in a pilot test conducted by the researcher. The final research results did not includ the pilot data. Riel (2010) states that if a pilot test is conducted on a minimum of 10% of the population, it may be adequate. The researcher made adjustments to the data collecting tool following the pilot test to make sure it is valid and dependable before the real data collection.

The data collected was coded and analyzed using descriptive statistics and inferential statistics as data analysis techniques. The study generated both descriptive statistics and inferential statistics. Descriptive analysis on collected primary data was done to give mean and standard deviation to be adopted as central tendency measures and measures of dispersions respectively. Inferential statistics involved regression analysis and correlation analysis (Creswell, 2014). Analyzed data was presented in frequency distribution tables so as to make it easy for research results description and explanation. The data analysis tool used in the study was Statistical Package for Social Sciences (SPSS version 29).

RESULTS AND FINDINGS

Response Rate

Out of 66 questionnaires administered, 61 of them were filled out and returned. This translates to 92.4% of the questionnaires. This is within Mugenda & Mugenda’s (2012) significant response rate which they established at a minimal value of 50%.

Descriptive Analysis

Descriptive analysis was conducted on the study variables to check the mean and standard deviation. The results are presented in the following tables.

Internal Audit

The researcher asked respondents to rate their agreement or disagreement on the various aspects of internal audit. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 1.

Table 1: Internal Audit

	Mean	Std. Deviation
The county government has an internal audit team	4.89	.211
The internal audit team has access to the necessary tools and technology to conduct comprehensive audits.	3.17	.907
The internal audit team is competent in its function	4.36	.562
The internal audit department is provided with sufficient financial resources to perform its duties effectively.	2.10	.373
The audit team in the county government divergently composed	4.91	.664
The audit team in our organization operates without undue influence from management.	2.84	.245
The internal audit team in our organization possesses the necessary skills and expertise to effectively carry out audits.	4.68	.139
Continuous training and development programs are provided for the internal audit team.	4.20	1.062

The results in Table 1 indicated that respondents strongly agreed with the statement that the county government has an internal audit team, as shown by a high mean of 4.89 and a low standard deviation of 0.211. Similarly, respondents agreed that the internal audit team is competent in its function, with a mean of 4.36 and a standard deviation of 0.562. In addition, the results show strong agreement that the audit team is divergently composed, as indicated by a mean of 4.91 and a standard deviation of 0.664. There was also agreement that the internal audit team possesses the necessary skills and expertise to effectively carry out audits, with a mean of 4.68 and a standard deviation of 0.139.

Respondents were neutral regarding whether the internal audit team has access to the necessary tools and technology to conduct comprehensive audits, as reflected by a mean of 3.17 and a standard deviation of 0.907. They were also indifferent toward the statement that the audit team operates without undue influence from management, as shown by a mean of 2.84 and a standard deviation of 0.245. However, respondents disagreed that the internal audit department is provided with sufficient financial resources to perform its duties effectively, as shown by a low mean of 2.10 and a standard deviation of 0.373. There was also agreement, to some extent, that continuous training and development programs are provided for the internal audit team, with a mean of 4.20 and a relatively higher standard deviation of 1.062. These findings are supported by the empirical study of Mihret and Yismaw (2007), which emphasizes that the effectiveness of internal audit functions in the public sector is highly dependent on resource availability, audit independence, and staff competency.

Risk Assessment

The study respondents were asked to rate their agreement or disagreement on the various aspects of risk assessment. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 2.

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Table 2: Risk Assessment

	Mean	Std. Deviation
The leadership defines objectives clearly	4.76	.499
There is clear definition of risk tolerance in the county government	4.61	.968
The management identifies risks related to achieving the defined objectives	4.04	.897
The management considers the potential for fraud during risk analysis	4.53	.910
The management identifies and responds to changes that could impact internal control system	3.45	.635
Our organization has a clearly defined process for identifying potential risks to financial performance.	4.34	1.174
Fraud detection measures are thoroughly integrated into the organization's risk management process.	4.39	.638
The identified risks are regularly analyzed to assess their potential impact on financial performance.	4.10	.487

The results in Table 2 indicated that respondents strongly agreed with the statement that the leadership defines objectives clearly, as reflected by a high mean of 4.76 and a low standard deviation of 0.499. Similarly, there was strong agreement that there is a clear definition of risk tolerance in the county government, with a mean of 4.61 and a standard deviation of 0.968. Respondents also agreed that the management considers the potential for fraud during risk analysis, as shown by a mean of 4.53 and a standard deviation of 0.910. Additionally, there was agreement that fraud detection measures are thoroughly integrated into the organization's risk management process, with a mean of 4.39 and a standard deviation of 0.638.

Furthermore, respondents agreed that their organization has a clearly defined process for identifying potential risks to financial performance, indicated by a mean of 4.34 and a standard deviation of 1.174. There was also agreement that the management identifies risks related to achieving the defined objectives, with a mean of 4.04 and a standard deviation of 0.897. Similarly, respondents agreed that the identified risks are regularly analyzed to assess their potential impact on financial performance, as shown by a mean of 4.10 and a standard deviation of 0.487. However, respondents were relatively neutral on whether the management identifies and responds to changes that could impact the internal control system, as indicated by a lower mean of 3.45 and a standard deviation of 0.635. These findings are consistent with the study by Beasley, Clune, and Hermanson (2005), which found that organizations with clear risk governance frameworks and leadership support are more effective in identifying, analyzing, and managing risks.

Automation

The study respondents were asked to rate their agreement or disagreement on the various aspects of automation. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 3.

Table 3: Automation

	Mean	Std. Deviation
Regular reviews are conducted to ensure that access rights to critical financial systems are up-to-date.	4.68	.211
Our organization has well-documented backup procedures to safeguard financial data in case of system failures	3.19	.816
The methods used to communicate risk and control information within the organization are efficient and clear.	4.00	.895
Our organization has effective communication channels to relay internal control issues to management.	4.53	.512
The access control mechanisms in our organization ensure that only authorized personnel can access sensitive financial information.	4.29	.126
Management designs control activities over access to protect an entity from inappropriate access and unauthorized use of the system	4.11	.539
The information generated by the internal control system is accurate and reliable for decision-making.	4.50	.661
The recovery process after data loss or system failure is efficient and ensures minimal disruption to financial operations.	2.76	.399

The results in Table 3 indicate that respondents strongly agreed that regular reviews are conducted to ensure that access rights to critical financial systems are up-to-date, as shown by a high mean of 4.68 and a very low standard deviation of 0.211. There was also strong agreement that the organization has effective communication channels to relay internal control issues to management, with a mean of 4.53 and a standard deviation of 0.512. Respondents further agreed that the information generated by the internal control system is accurate and reliable for decision-making, as indicated by a mean of 4.50 and a standard deviation of 0.661. Similarly, there was agreement that access control mechanisms ensure only authorized personnel can access sensitive financial information, with a mean of 4.29 and a very low standard deviation of 0.126. Management's role in designing control activities over system access was also affirmed, with a mean of 4.11 and a standard deviation of 0.539.

There was general agreement that the methods used to communicate risk and control information within the organization are efficient and clear, as shown by a mean of 4.00 and a standard deviation of 0.895. However, respondents were neutral regarding the presence of well-documented backup procedures to safeguard financial data in case of system failures, as reflected by a mean of 3.19 and a standard deviation of 0.816. Notably, respondents leaned toward disagreement on the efficiency of the recovery process after data loss or system failure, with a low mean of 2.76 and a standard deviation of 0.399. These findings are supported by the study of Hunton, Bryant, and Bagranoff (2004), which emphasizes that while automation can enhance internal controls, organizations must complement it with robust backup and disaster recovery plans to safeguard financial data integrity.

Monitoring

The study respondents were asked to rate their agreement or disagreement on the various aspects of monitoring. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 4.

Table 4: Monitoring

	Mean	Std. Deviation
Our organization regularly monitors the effectiveness of its internal control systems.	4.61	.509
The internal audit function consistently reviews and reports on the performance of internal controls.	4.75	.364
The organization promptly responds to identified control deficiencies and risks.	4.78	.701
The county leadership has developed and maintains documentation of internal control system	4.63	.208
Management establishes a baseline to monitor the internal control system.	4.06	.982
The outcomes of internal control assessments are thoroughly evaluated to improve system performance	4.10	.773
Corrective actions are taken immediately after weaknesses in internal controls are discovered.	4.89	.311
Our organization has established a baseline for internal control performance to measure improvements over time.	2.11	.945

The results in Table 4 indicate that respondents strongly agreed that their organization promptly responds to identified control deficiencies and risks, as shown by a high mean of 4.78 and a standard deviation of 0.701. Similarly, there was strong agreement that corrective actions are taken immediately after weaknesses in internal controls are discovered, as reflected by an even higher mean of 4.89 and a standard deviation of 0.311. Respondents also strongly agreed that the internal audit function consistently reviews and reports on the performance of internal controls, with a mean of 4.75 and a low standard deviation of 0.364. There was additional agreement that the organization regularly monitors the effectiveness of its internal control systems, indicated by a mean of 4.61 and a standard deviation of 0.509, and that the county leadership has developed and maintains documentation of the internal control system, as shown by a mean of 4.63 and a standard deviation of 0.208.

There was moderate agreement that management establishes a baseline to monitor the internal control system, with a mean of 4.06 and a relatively higher standard deviation of 0.982. Similarly, respondents agreed that the outcomes of internal control assessments are thoroughly evaluated to improve system performance, reflected by a mean of 4.10 and a standard deviation of 0.773. However, respondents disagreed that their organization has established a baseline for internal control performance to measure improvements over time, as shown by a low mean of 2.11 and a standard deviation of 0.945. These findings are consistent with the empirical study by De Simone, Ege, and Stomberg (2014), which found that while many organizations effectively monitor internal controls and take timely corrective actions, the absence of performance baselines often limits their ability to assess long-term improvements.

Financial Reporting Quality

The study respondents were asked to rate their agreement or disagreement on the various aspects of financial reporting quality. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 5.

Table 5: Financial Reporting Quality

	Mean	Std. Deviation
The county financial reports are been reliable	4.21	.736
The county financial reports are comparable	2.12	.973
The county financial reports are timely	4.70	.209
The county financial reports are prepare in good faith	4.01	1.014
The financial reports generated by our organization are free from material errors and inaccuracies.	3.61	.138
Our organization's financial statements comply with relevant accounting standards and regulatory requirements.	4.92	.661
Financial reporting in our institution provides a true and fair view of the financial position and performance.	4.90	.318
Timely and accurate financial reports are regularly submitted to management and stakeholders.	4.83	.229

The results in Table 5 indicated that respondents strongly agreed that the county financial reports are timely, with a mean of 4.70 and a low standard deviation of 0.209. Respondents also overwhelmingly agreed that their organization's financial statements comply with relevant accounting standards and regulatory requirements, as shown by a high mean of 4.92 and a standard deviation of 0.661. Similarly, there was strong agreement that financial reporting provides a true and fair view of the organization's financial position and performance, reflected by a mean of 4.90 and a standard deviation of 0.318. Additionally, respondents agreed that timely and accurate financial reports are regularly submitted to management and stakeholders, with a mean of 4.83 and a standard deviation of 0.229.

Respondents agreed, to a lesser extent, that the county financial reports are reliable, indicated by a mean of 4.21 and a standard deviation of 0.736. There was also agreement that the reports are prepared in good faith, as shown by a mean of 4.01 and a higher standard deviation of 1.014. On the other hand, respondents were neutral to slightly positive regarding the accuracy of financial reports in terms of freedom from material errors, with a mean of 3.61 and a low standard deviation of 0.138. However, respondents disagreed with the statement that the county financial reports are comparable, as reflected by a low mean of 2.12 and a standard deviation of 0.973. These findings are supported by the study of Barth, Landsman, and Lang (2008), which emphasizes that while reliability, timeliness, and compliance with standards are critical indicators of high-quality financial reporting, comparability is often overlooked, especially in decentralized public sector entities.

Correlation Analysis Results

Correlation analysis was done to determine the correlation between the internal controls and financial reporting quality using the Pearson's product moment correlation analysis. The results are shown in Table5.

Table 5: Correlation Results

		Internal audit	Risk assessment	Automation	Monitoring	FRQ
Internal audit	Pearson Correlation	1				
	Sig. (1-tailed)					
	N	61				
Risk assessment	Pearson Correlation	.702	1			
	Sig. (1-tailed)	.008				
	N	61	61			
Automation	Pearson Correlation	.239*	.618	1		
	Sig. (1-tailed)	.031	.026			
	N	61	61	61		
Monitoring	Pearson Correlation	.437*	.058	.511	1	
	Sig. (1-tailed)	.036	.013	.042		
	N	61	61	61	61	
Financial reporting quality	Pearson Correlation	.502	.314*	.559	.483	1
	Sig. (1-tailed)	.000	.041	.000	.000	
	N	61	61	61	61	61

*. Correlation is significant at the 0.05 level (1-tailed).

The bivariate correlation analysis revealed that Automation has the strongest positive correlation with financial reporting quality, with a correlation coefficient of 0.559 and a p-value < 0.05. This indicates that higher levels of automation are associated with improved financial reporting quality. These findings are consistent with the study by Hunton, Bryant, and Bagranoff (2004), which highlighted that automation enhances the accuracy, timeliness, and reliability of financial data, leading to better financial reporting outcomes.

Internal Audit also showed a moderately strong positive correlation with financial reporting quality, with a coefficient of 0.502 and a statistically significant p-value < 0.05. This implies that effective internal audit practices contribute positively to the quality of financial reporting. The results align with the findings of Mihret and Yismaw (2007), who emphasized that internal audits strengthen internal controls, reduce errors, and improve the credibility of financial reports.

Monitoring demonstrated a moderate positive correlation with financial reporting quality, with a correlation coefficient of 0.483 and a significant p-value < 0.05. This suggests that continuous monitoring of internal controls is important for maintaining high standards in financial reporting. This supports the findings by De Simone, Ege, and Stomberg (2014), who found that consistent monitoring improves the responsiveness to control deficiencies, thereby enhancing reporting accuracy and reliability. Finally, risk assessment showed a weaker yet statistically significant positive correlation with FRQ, with a coefficient of 0.314 and a p-value < 0.05. This result is supported by Beasley, Clune, and Hermanson (2005), who noted that proactive risk identification and management can prevent financial misstatements and promote more trustworthy reporting.

Diagnostic Tests

The study conducted diagnostic tests to ensure that the assumptions of ordinary least square are adhered to before running the regression models as

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well as to make sure that the data was suitable to be used for inferential analysis.

Homoscedasticity Test

The homoscedasticity test was used to determine whether the variance of errors was the same across all levels of the independent variables (homoscedasticity) (heteroscedasticity). Using the standardized predicted values, a scatter plot of the distribution of the standardized residuals (errors) was created (Huizingh, 2007).

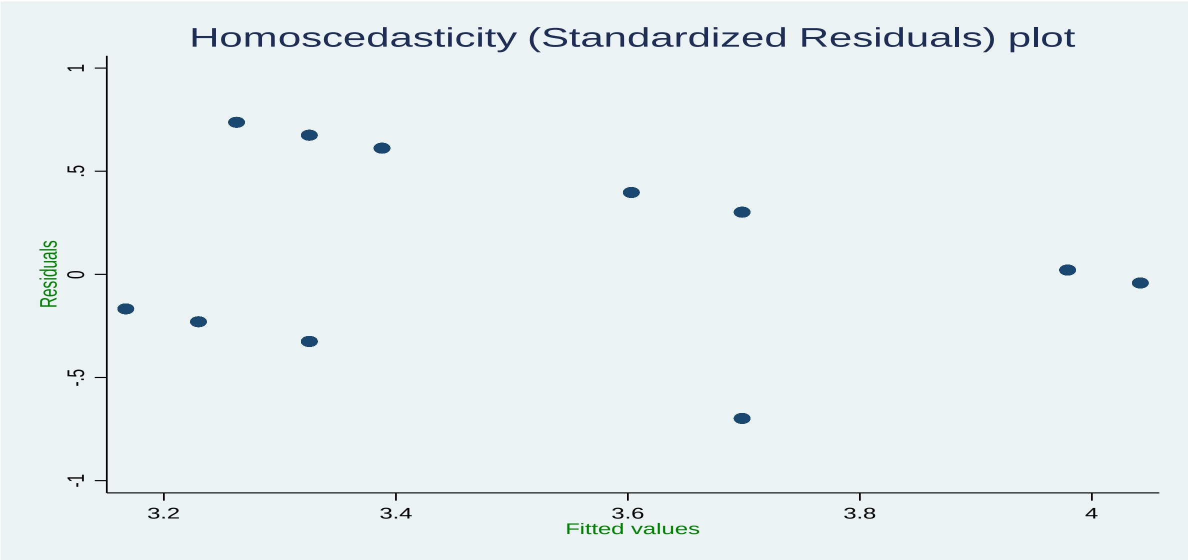

Figure 2: Homoscedasticity Test Results

Figure 2 shows that residuals or errors were randomly clustered near the trend line, indicating that they were evenly distributed.

Test of Multi-collinearity

A multi-collinearity diagnostic yielded variance inflation factors (VIF) ranging from 1.341to 2.179, which were within the acceptable range of 1 to 10 (Morrison, 2003). Tolerance values (TV) ranged between 0.501 and 0.649, well within the 0.2 to 1 range (Morrison, 2003). Table 6 shows the results.

Table 6: Test of Multicollinearity

	Collinearity Statistics	
Constructs	**Tolerance**	**VIF**
Internal audit	0.577	1.341
Risk assessment	0.610	1.408
Automation	0.501	2.179
monitoring	0.649	1.625

a. Dependent Variable: Financial reporting quality

The results in Table 6 show that there was no multi-collinearity among the explanatory variables, indicating that the requisite assumption was met.

Multiple Regression Analysis Results

Regression analysis was used to understand the relationship between internal controls and financial reporting quality. Results are presented in the following tables.

Table 7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.785[a]	.616	.589	0.5688016

a. Predictors: (Constant), Monitoring, Automation, Internal audit, Risk assessment

The model summary results in Table 7 shows coefficient of determination (R2) value of 0.616 which reveals that approximately 61.6% of the variation in financial reporting quality is accounted for by the combined effect of the four internal controls dimensions (Risk assessment, automation, monitoring and internal audit). The remaining 0.384 is due to the other factors not considered in the model.

Table 8: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	29.063	4	7.266	22.426	.001[b]
	Residual	18.118	56	.324		
	Total	47.181	60			

a. Dependent Variable: Financial reporting quality

b. Predictors: (Constant), Monitoring, Automation, Internal audit, Risk assessment

The ANOVA results show that the regression model is highly significant, with an F-statistic of 22.426 and a p-value of 0.001. This indicates that the independent variables (Risk assessment, automation, monitoring and internal audit) collectively explain a significant portion of the variance in financial reporting quality. The model is statistically significant and the predictors are collectively significant in explaining the financial reporting quality of Coastal county governments.

Table 9: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.974	.338		2.882	.000
	Internal audit	.476	.216	.314	2.204	.019
	Risk assessment	.259	.104	.092	2.490	.002
	Automation	.513	.221	.417	2.321	.013
	Monitoring	.412	.169	.299	2.438	.008

a. Dependent Variable: Financial reporting quality

The optimal regression model is:

$Y = .974 + .476X_1 + .259X_2 + .513X_3 + .412X_4$

The regression analysis presented in Table 9 indicates that all four independent variables (internal audit, risk assessment, automation, and monitoring) have a statistically significant influence on financial reporting quality, as evidenced by their p-values being less than 0.05. Specifically, holding all other factors constant, the baseline financial reporting quality is estimated at 0.974. Further, it was revealed that a one-unit increase in automation is associated with a 0.513 unit increase in financial reporting quality, a one-unit increase in internal audit contributes to a 0.476 unit increase in financial reporting quality, a one-unit enhancement in monitoring leads to a 0.412 unit increase in the quality of financial reporting and finally, a one-unit improvement in risk assessment corresponds to a 0.259 unit increase in financial reporting quality.

Discussion of Key Findings

The first objective of the study sought to determine the effect of internal audit on the financial reporting quality of Coastal county governments in Kenya. Regression analysis revealed a positively significant effect of internal audit on financial reporting quality, as indicated by the value of β = 0.476, with a p-value of 0.019, which is less than 0.05. This suggests that a unit change in internal audit practices would lead to a 0.476 unit increase in the financial reporting quality. The results align with studies such as those by Sweeney and McFadden (2016), who emphasized that a well-structured internal audit function contributes to improved financial reporting by ensuring that processes are transparent and controls are effective.

The second objective of the study aimed to establish the effect of risk assessment on financial reporting quality. Regression analysis confirmed a positively significant effect of risk assessment on financial reporting quality, with β = 0.259 and a p-value of 0.002. This implies that a unit change in risk assessment would result in a 0.259 unit increase in the financial reporting quality of Coastal county governments. This finding supports the view expressed by AICPA (2008), which noted that effective risk assessment processes help identify potential financial reporting issues early, ensuring that appropriate actions are taken to mitigate risks and enhance report accuracy.

The third objective of the study investigated the effect of automation on financial reporting quality. The regression analysis revealed a significant positive effect of automation, with β = 0.513 and a p-value of 0.013. This indicates that a unit change in automation would lead to a 0.513 unit increase in financial reporting quality. This finding is in line with the research by Gupta and Sharma (2016), who found that automation in financial reporting improves efficiency, accuracy, and transparency, all of which contribute to better financial outcomes for organizations.

Lastly, the study sought to explore the effect of monitoring on financial reporting quality in Coastal county governments. The regression analysis showed a positively significant effect of monitoring with β = 0.412 and a p-value of 0.008, indicating that a unit change in monitoring practices leads to a 0.412 unit increase in financial reporting quality. This outcome is consistent with studies such as those by Dhaliwal et al. (2014), who highlighted that regular monitoring and review of internal controls play a critical role in identifying weaknesses and ensuring the reliability of financial reports.

CONCLUSION AND RECOMMENDATIONS

The study concluded that internal audit has a significant and positive effect on the financial reporting quality of Coastal county governments in Kenya. It is concluded that the county governments have established internal audit teams that are competent and composed diversely, contributing positively to the effectiveness of their financial controls. However, it remains unclear whether the internal audit teams have sufficient access to necessary tools and technology to conduct comprehensive audits.

The study concluded that risk assessment has a significant and positive effect on the financial reporting quality of Coastal county governments. It is concluded that county governments have clearly defined objectives and risk tolerance, and that management effectively identifies risks related to achieving those objectives. Additionally, the management's consideration of fraud risks during the assessment process positively influences financial reporting.

The study concluded that automation has a positive and significant effect on the financial reporting quality of Coastal county governments. It is concluded that automation plays a crucial role in maintaining secure and up-to-date access to critical financial systems and ensuring clear communication within the organization regarding internal controls. However, it remains uncertain whether county governments have fully documented backup procedures to safeguard financial data in case of system failures.

The study concluded that monitoring significantly and positively affects financial reporting quality of Coastal county governments. It is concluded that monitoring practices, such as regularly assessing the effectiveness of internal controls and promptly responding to control deficiencies, enhance the overall reliability of financial reporting. However, it remains unclear whether the county governments have established a comprehensive baseline for internal control performance to measure improvements over time.

The study recommended that the Coastal county governments should support internal audit teams through provision of latest auditing tools and technology. The audit function should be adequately resourced. Additionally, it is recommended that training and development programs should be implemented to ensure that audit teams stay updated with best practices.

It was recommended that Coastal county governments strengthen their risk assessment frameworks by ensuring a more proactive approach to identifying and responding to risks. Leadership of the counties should focus on continually assessing changes that could impact the internal control systems. Additionally, regular fraud risk assessments should be conducted to safeguard against financial misconduct.

It was recommended that Coastal county governments should implement the documentation and implementation of backup procedures for safeguarding financial data in the event of system failures. Automation in financial reporting should be further expanded to ensure data accuracy, efficiency, and security. Additionally, the county governments should invest in advanced automation tools and software to streamline internal control processes.

It was recommended that Coastal county governments establish a baseline for internal control performance for tracking improvements over time. Regular monitoring and assessment of internal controls should be institutionalized and corrective actions should be standardized and implemented.

Recommendation for Further Research

Future research could examine the extent to which the independence of internal audit teams affects the financial reporting quality in Coastal county governments. This would help to understand whether stronger autonomy in audit functions leads to more reliable financial reports. A comparative study between Coastal county governments and other counties in Kenya could provide insights into best practices in internal controls and financial reporting.

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