

## Organization Structure and Financial Performance of Savings and Credit Co-Operatives in Western Region, Kenya

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### Abstract

The organization structure is the foundation of an effective system of internal control. Most of the well-publicized failures including not only Enron and WorldCom, but also the governance failures that led to the 2008 financial crisis were, at least in part, the result of weak control environments. In the absence of a demonstrably effective control environment, no level of "design and operating" effectiveness of controls within business and IT processes can provide meaningful assurance to stakeholders of the integrity of an organization's internal control structure. The main objective of the study was to examine to establish the influence of organizational structure on the financial performance of SACCOs in Western region. The study adopted a cross section research design using the quantitative approach. The target population was 177 senior members in nine licensed SACCOs operating in Western Region. A sample of 123 respondents was selected by use of stratified random sampling out of which a response rate of 110 was obtained. Both primary and secondary data were collected with the aid of structured questionnaires and document analysis. Validity of the research instruments was determined using expert judgment while Cronbach's alpha coefficient was used to measure internal consistency with the alpha coefficient of above 0.976 thus considered reliable. Data was analyzed by use of descriptive and inferential statistics. Multiple regression and Pearson correlation were used for inferential statistics. Data was presented by use of tables and figures. The study found out that organization structure had a positive and significant effect of financial performance of SACCOs. The study concluded that organization structure lead to more financial growth of SACCOs. The study thus recommended that for increase in financial performance of SACCOs, more resources should be diverted in expansion of SACCOs, putting up an elaborate and functioning organization structure and increasing the level of integrity and ethical values within the SACCOs.

**Keywords:** Organization structure, SACCOs, Financial Performance, Internal control environment

### 1. Introduction

#### 1.1 Research objective

To establish the influence of organizational structure on the financial performance of SACCOs in Western region, Kenya

#### 1.2 Research hypothesis

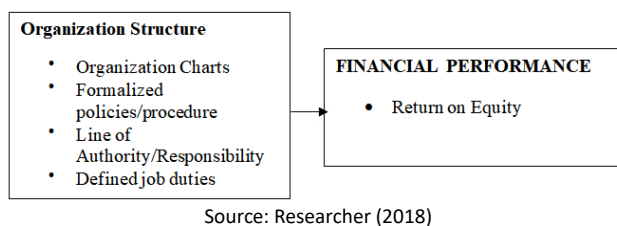
H<sub>0</sub>. Organizational structure has no significant influence on financial performance of Sacco's in Western region, Kenya.

#### 1.3 The Scope of the study

This study established the influence of internal control environment, organisation on financial performance of licenced SACCOs in western region of Kenya. The SACCOs in Western region of Kenya that are of interest to this proposed study are those found Kakamega, Busia and Bungoma counties. The study was limited to studying the influence of internal control environment constructs (integrity and ethical values, commitment to competency, management philosophy and operating style and organizational structure) on financial performance of SACCOs in Western region of Kenya. The target population of 177 respondents was drawn nine from licenced SACCOs registered by SASRA as at January 2017. The study was limited to all management staff, board of directors and supervisory committee members of the licenced SACCOs. The study was carried out for a period of (6) months between February and July 2018.

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## 1.4 Conceptual framework



**Figure 1:** Conceptual Framework

## 2.1 Literature Review

### 2.1.1 Organizational Structure

Organizational structure is defined as a grouping of people and tasks into different units to boost coordination of communication, decisions, and actions. Realizing the close connection between the processes taking place inside an organization makes it easier to understand the intricate task of directing an efficient organization. According to Akinyele (2011) the organizational structure and strategies adopted by oil and gas marketing companies affect market share positively. Lavies (2006) gave evidence that the level of organizational structure and strategies is positively related to company effectiveness. Grewal and Tansuhaj (2001) reported that more successful companies have well defined organizational structures in sharp contrast to less successful companies. Focusing on large firms (Ekpu, 2004) found a positive relationship between the unstructured organizational patterns and large firm financial performance. Saleemi (1989) refers to plan of organization as an organization chart showing the organization structure of a company. The purpose of this chart is to show how the company has been divided into departments and departments into sections and most important to show what responsibilities and duties are assigned to each officer. Authority and responsibilities are clearly defined. Employees perform their duties according to the organization plan. This plan allocates and defines responsibilities and identifies lines of reporting for all aspects of business operations. The plan of organization is needed for effective internal control.

The organizational structure is important in contributing to the SACCOs ability to meet their objectives by providing an overall framework for planning, executing, controlling and monitoring the SACCO's activities. Developing an organizational structure for an entity involves determining the key areas of authority and responsibility and appropriate lines of reporting. The assignment of authority and responsibility is an extension of the development of an organizational structure. It includes the particulars of how and to whom authority and responsibility is assigned, and should enable each individual to know: i) how his or her actions contribute to the achievement of the entity's objectives;

ii) for what he or she will be held accountable of duties and supervisory controls. In practice auditors assess the above factors as part of each separate accounting system (COSO, 2013). An company's board of directors should therefore comprise of individuals each with a different mind – set as to philosophy and operating style, manifested in characteristics such as their approach to taking and managing business risk, attitudes and actions toward financial reporting and attitudes toward information and accounting and functions personnel.

## 2.2 Empirical literature

### 2.6.4 Organizational structure and financial performance

Kakucha (2009) assessed the level of effectiveness of internal controls of enterprises operating in Nairobi. The study was quantitative using a sample of 30 small businesses as listed in the National Social Security Fund (NSSF) Register of Kenya. Primary data was collected from the managers of the small business using interviews and examination of documents pertaining to internal controls. The study established that there are deficiencies in the systems of internal controls, with the degree of deficiencies varying from one enterprise to another. The components of internal control that were missing in most businesses surveyed were: firstly, risk analysis, and secondly lack of proper flow of information. In addition, the study established that the sample population had limited awareness of what constituted an effective system of internal control. The study also found that there is a negative relationship between the age of an enterprise and the effectiveness of its system of internal control while a negative correlation between the resources held by an enterprise and its internal control system weaknesses exists. The study recommended that there was need to enlighten the operators of small business of what constitutes an efficient and effective system of internal control through forums and seminars. Amudo and Inanga (2009) carried out a study in Uganda to evaluate the internal control systems that the regional member countries of the African Development Bank Group institute for the management of the Public Sector Projects that the Bank finances. There are 14 projects of the bank's public sector portfolio in Uganda. The data received and analyzed was for eleven projects. Three projects were omitted because they were not fully operational to install effective internal control systems. The study identified the following six essential components of an effective internal control system: internal control environment, risk assessment, control activities, information and communications, monitoring and information technology. The outcome of the evaluation process was that some control components of effective internal control systems were lacking in those projects. These rendered the control structures ineffective.

Jones (2008) compared internal control, accountability and corporate governance in medieval and modern Britain. He used a modern referential framework (control environment, risk assessment, information and communication, monitoring and control activities) as a lens to investigate medieval internal controls used in the twelfth century royal exchequer and other medieval institutions. He demonstrated that most of the internal controls found today were present in medieval England. Stewardship and personal accountability were found to be the core elements of medieval internal control. The recent recognition of the need for the enhanced personal accountability of individuals is reminiscent of medieval thinking. A study conducted by Wainaina (2011), examined the internal control function. The study established that, other than the prevention and detection of fraud, internal controls should reflect the strength of the overall accounting environment in an organization as well as the accuracy of its financial and operational records.

Kinyua (2016) examined the effect of internal control systems on financial performance of companies quoted in the Nairobi Securities Exchange. The study concluded that internal control should provide for an assessment of the risks the agency faces from both internal and external sources. Once risks have been identified, they should be analysed for their possible effect. Management then has to formulate an approach for risk management and decide upon the internal control activities required to mitigate those risks and achieve the internal control objectives of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations of managing these risks

Ashbaq *et al.*, (2006) in their research showed that firms that have reported internal control weaknesses have more complex operations, changes in organizational structure, exposure to increased accounting risks, and fewer resources for investment in the internal control.

### 3. Research Methodology

#### 3.1 Research design

A research design establishes of variables, the sample selection, data collection, A research design is the logical sequence or blue print that connects the empirical data to a study's initial research questions and, ultimately, to its conclusions (Yin, 2003). This study was conducted using a cross sectional study design. The cross sectional design involves making observations of a population or sample of the study at one point in time (Babbie, 2012). The design is useful in identifying characteristics of an observed phenomenon or exploring possible correlations among two or more phenomenon (Leedy 2001).

#### 3.2 Target population

The target population refers to the population to which the researcher wants to generalize the results of the

absolute population of a study (Mugenda and Mugenda, 2003). The target population for this study comprised of 177 employees drawn from nine licensed SACCOs in Western region. The population of interest includes members from the board of directors, supervisory committee members and the management staff of the nine licenced SACCOs.

**Table 3.1** Target Population

| County       | Sacco        | Management | Board of  | Supervisory | Total      |
|--------------|--------------|------------|-----------|-------------|------------|
|              |              | Staff      | Directors | Committee   |            |
| Kakamega     | IG           | 16         | 9         | 3           | 28         |
|              | Sukari       | 5          | 9         | 3           | 17         |
|              | Nitunze      | 6          | 9         | 3           | 18         |
|              | Mudete       | 7          | 9         | 3           | 19         |
|              | Wevarcity    | 5          | 9         | 3           | 17         |
| Busia        | Faridi       | 7          | 9         | 3           | 19         |
|              | Ng'arisha    | 9          | 9         | 3           | 21         |
| Bungoma      | Metropolitan | 8          | 9         | 3           | 20         |
|              | Elgon        | 6          | 9         | 3           | 18         |
| <b>Total</b> |              | <b>69</b>  | <b>81</b> | <b>27</b>   | <b>177</b> |

Source: SASRA (2017)

#### 3.3 Sampling design and sample size

The sample size for this study was calculated using the formula for finite population as proposed by Yamane (1967) which was a well-established scientific formula for determining sample sizes. 123 employees was selected as respondents for the study. The number of respondent in each category in the sample population will be arrived at by considering the proportion of each stratum to the study population (see Table 3.2). For example the first category in the sample table was arrived at by dividing the number of respondents in category one by the total population and then multiplying the result by the total sample population.

**Table 3.2** Sample Size

| County       | Sacco        | Management | Board of  | Supervisory | Total      |
|--------------|--------------|------------|-----------|-------------|------------|
|              |              | Staff      | Directors | Committee   |            |
| Kakamega     | IG           | 12         | 6         | 2           | 20         |
|              | Sukari       | 4          | 6         | 2           | 12         |
|              | Nitunze      | 4          | 6         | 2           | 12         |
|              | Mudete       | 5          | 6         | 2           | 13         |
|              | Wevarcity    | 4          | 6         | 2           | 12         |
| Busia        | Faridi       | 5          | 6         | 2           | 13         |
|              | Ng'arisha    | 7          | 6         | 2           | 15         |
| Bungoma      | Metropolitan | 6          | 6         | 2           | 14         |
|              | Elgon        | 4          | 6         | 2           | 12         |
| <b>Total</b> |              | <b>51</b>  | <b>54</b> | <b>18</b>   | <b>123</b> |

Source: Researcher, 2017

#### 3.4 Data collection tools

The study used questionnaires and interview schedule for data collection.

#### 3.5 Pilot study

Prior to the main study, the researcher conducted a pilot study at Vihiga County Sacco Society Ltd. The clarity of

the instrument items to the respondents was established so as to enhance the instrument’s validity and reliability (Mugenda&Mugenda, 2007), declared that validity enhances reliability of an instrument.

The results of the pilot study were tested and determined as follows:

**Table 3.3:** Reliability Statistics of study

| Cronbach's Alpha | N of Items |
|------------------|------------|
| .976             | 6          |

Source: Field Data (2018)

Table 3.3 shows that the overall reliability test was above (0.976) the accepted Cronbach Alpha of 0.7 showing that there was internal consistency of the research instruments thus deemed

### 3.8 Data analysis and presentation

To establish the main characteristics of the study variables, descriptive statistics, factor analysis using principal component method with varimax rotation and Pearson correlations analysis was done and relevant tests conducted. Descriptive statistics involved computation of mean scores, standard deviation, percentages, cross tabulation and frequency distribution which describes the demographic characteristics of the organization and the respondents. Inferential statistics were used to determine the relationships between internal control environment, firm size and financial performance of SACCOs as well as testing the hypotheses. Correlation analysis by means of Pearson Product Moment Correlation Coefficient technique was used to determine nature and magnitude of the relationships between the study variables. This was to facilitate selection of measures used to represent the variables. To establish the statistical significance of the respective hypotheses, ANOVA of F-tests as well as multiple linear regression analysis was conducted, appropriate at 95 percent confidence level (  $\alpha=0.05$ ). The questionnaire returned from the field were coded, edited and keyed into the computer to facilitate statistical analysis. Statistical package for social sciences (SPSS) version 20 was used to assist in analysis.

## 4. Results and Discussions

### 4.1 Response rate

This section is of great importance because it forms the basis under which the study results were interpreted based on a total of 110 respondents.

**Table 4.1:** Respondents response rate

| Response     | f   | %     |
|--------------|-----|-------|
| Successful   | 110 | 89.4% |
| Unsuccessful | 13  | 10.6% |
| Total        | 123 | 100%  |

Source: Field Data (2018)

The researcher administered 123 questionnaires out of which 110 questionnaires were completely filled and collected back as shown in Table 4.1. The results represent a 89.4% response rate which is very good for subsequent data analysis and interpretation as asserted by Bebbie (2004) that a response rate of 70% and above is very good.

### 4.2 Organizational Structure

Organizational structure is defined as a grouping of people and tasks into different units to boost coordination of communication, decisions, and actions. Lavies (2006) gave evidence that the level of organizational structure and strategies is positively related to company effectiveness. Grewal and Tansuhaj (2001) reported that more successful companies have well defined organizational structures in sharp contrast to less successful companies. As part of the study objectives, the study sought to establish the influence of organizational structure on the financial performance of SACCOs in Western region, Kenya. Table 4.2 illustrates the results.

**Table 4.2:** Organizational Structure

| D | Organizational Structure   | Mean   | SE Mean | St Dev | CoefVar | Skewness | Kurtosis |
|---|--|--------|---------|--------|---------|----------|----------|
| 1 | My Sacco has an organization chart clearly defining the lines of management authority and responsibility | 4.4091 | 0.0969  | 1.0163 | 23.05   | -1.80    | 2.57     |
| 2 | The organization chart is current and accurate   | 4.2182 | 0.0908  | 0.9519 | 22.57   | -1.75    | 3.44     |
| 3 | My Sacco's organizational structure is appropriate for the size and complexity of the entity             | 4.282  | 0.107   | 1.126  | 26.30   | -1.64    | 1.92     |
| 4 | My Sacco has formalized policies and procedures for all major operations of the entity                   | 4.136  | 0.107   | 1.121  | 27.10   | -1.19    | 0.41     |

|   |  |        |        |        |       |       |      |
|---|--|--------|--------|--------|-------|-------|------|
| 5 | The policies and procedures for authorizations are established at a reasonably high level      | 4.082  | 0.107  | 1.126  | 27.59 | -1.30 | 0.93 |
| 6 | My Sacco's governing body and management stress adherence to such policies and procedures      | 4.209  | 0.110  | 1.158  | 27.51 | -1.65 | 1.86 |
| 7 | specific line of authority and responsibility established to ensure compliance with state laws | 4.309  | 0.108  | 1.131  | 26.25 | -1.80 | 2.35 |
| 8 | My Sacco organization structure make it easy for planning, control and evaluation processes    | 4.2083 | 0.0918 | 0.9419 | 23.67 | -1.45 | 3.41 |

Source: Field data (2018)

Table 4.2 results indicate that organization structure of SACCOs has an impact on performance thus the sampled SACCOs had an effective structure attributed to financial performance. This was depicted by the agreement (mean=4) to the researcher questions concerning organization structure and financial performance of SACCOs.

### 4.3 Correlation analysis

#### 4.3.1 Relationship between organization structure and financial performance

Results in Table 4.3 show the correlation between organization structure and financial performance. The table was used to provide an answer to the research objective, that is, to establish the influence of organizational structure on the financial performance of SACCOs in Western region, Kenya.

Table 4.3: Organization structure and financial performance

|                        |                     | Organization structure | Financial performance |
|------------------------|---------------------|------------------------|-----------------------|
| Organization structure | Pearson Correlation | 1                      | .897**                |
|                        | Sig. (2-tailed)     |                        | .000                  |
|                        | N                   | 110                    | 110                   |
| Financial performance  | Pearson Correlation | .897**                 | 1                     |
|                        | Sig. (2-tailed)     | .000                   |                       |
|                        | N                   | 110                    | 110                   |

\*\* . Correlation is significant at the 0.01 level (2-tailed).

Source: Field data (2018)

Study findings result in Table 4.3 show that there is a positive and significant relationship between organization structure and financial performance at 99% confidence level (r=0.897,  $\alpha=0.000$  and p-value=0.01 thus  $\alpha < p$ -value). The results reveal that organization with a good organization structure report improvement in their

financial performance. Past study findings support this assertion, for example, Akinyele (2011); Lavies (2006); Grewal & Tansuhaj (2001); and Ekpu (2007) found out that there is a positive and significant correlation between organization structure and financial performance.

### 4.4 Regression analysis

Table 4.4: Regression results on organization structure and financial performance

| Model Summary                                     |                        |                             |                   |                            |         |                   |
|---|------------------------|-----------------------------|-------------------|----------------------------|---------|-------------------|
| Model   | R                      | R Square                    | Adjusted R Square | Std. Error of the Estimate |         |                   |
| 1   | .897 <sup>a</sup>      | .805                        | .803              | .38576                     |         |                   |
| a. Predictors: (Constant), Organization structure |                        |                             |                   |                            |         |                   |
| ANOVA <sup>a</sup>                                |                        |                             |                   |                            |         |                   |
| Model   |                        | Sum of Squares              | Df                | Mean Square                | F       | Sig.              |
| 1   | Regression             | 66.390                      | 1                 | 66.390                     | 446.131 | .000 <sup>b</sup> |
|   | Residual               | 16.072                      | 108               | .149                       |         |                   |
|   | Total                  | 82.462                      | 109               |                            |         |                   |
| a. Dependent Variable: Financial performance      |                        |                             |                   |                            |         |                   |
| b. Predictors: (Constant), Organization structure |                        |                             |                   |                            |         |                   |
| Coefficients <sup>a</sup>                         |                        |                             |                   |                            |         |                   |
| Model   |                        | Unstandardized Coefficients |                   | Standardized Coefficients  | t       | Sig.              |
|   |                        | B                           | Std. Error        | Beta                       |         |                   |
| 1   | (Constant)             | .022                        | .203              |                            | .108    | .914              |
|   | Organization structure | .988                        | .047              | .897                       | 21.122  | .000              |

a. Dependent Variable: Financial performance

Source: Field data (2018)

Table 4.4 results on model summary show R-Square is 0.805 that organization structure accounts for 80.5% of the variability in SACCOs financial performance. The results also show that there is a positive influence of organization structure on financial performance (r=0.897). ANOVA results show that F=446.131,  $\alpha=0.000$  which is less than p-value of 0.05. The results reveal that the overall regression model was significant in determining the applicability of the model to measure the study variables. This means that there is a satisfactory goodness of fit between organization structure on financial performance. The use of regression model to either accept or reject the research hypothesis is thus justified.

The study results in Table 4.4 show regression coefficient that reveals to what extent organization structure predict financial performance. Based on the results, the equation for linear regression model can be written as;  $Y=0.022+0.988X+e$ . Where Y represents financial performance and X<sub>4</sub> represents organization structure and e represents error term. A beta of 0.988 means that every 0.988 units of use of organization structure contribute to a corresponding 1 unit in financial performance. The results also show that organization structure is statistically significant ( $\alpha=0.000$  and p-value=0.05 thus  $\alpha < p$ -value) in explaining financial performance in SACCOs. The results of the regression in Table 4.4 used regression coefficient to test the research

hypothesis, “**Ho:** Organization structure has no significant influence on financial performance of SACCOs in Western region, Kenya.” The null hypothesis of the study was therefore rejected at 0.05 significant level since the beta value was not equal to 0 ( $\beta \neq 0$ ,  $0.988 \neq 0$ ) hence the study concluded that there is a positive and significant relationship between organization structure and financial performance of SACCOs. These research findings concur with past research findings which found out that organization structure contribute to organization financial performance (Ekpu, 2007; Grewal & Tansuhaj, 2001; Kakucha, 2009; and Lavies, 2006).

## 5. Summary of Study Findings and Conclusion

### 5.1 Summary of the findings

The study found out that organization structure is a major factor in the internal control environment as illustrated by a mean of greater than 3.5. The correlation results reveal that there is a positive and significant relationship between organizational structure and financial performance at 99% confidence level thus SACCOs that have an elaborate organization structure have improvements in their financial performance. ANOVA results reveal that the overall regression model was feasible in measuring organizational structure and financial performance. Regression analysis results also confirm that organization structure predict financial performance because the beta coefficient was not equal to zero. The study thus rejected the null hypothesis and concluded that there is a significant and positive relationship between organizational structure and financial performance at 95% confidence level.

### 5.2 Conclusions

Based on the findings of the study, it can be concluded that the sampled SACCOs in Western Kenya have put in place mechanisms to ensure that they have an elaborate organization structure in order to realize improved financial performance. Organization structure was found to accounts for 80.5% of the variability in SACCOs financial performance.

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