

**INTERNAL AUDITING AND FINANCIAL MANAGEMENT IN SELECTED
PRIVATE ELECTRICITY SUPPLY COMPANIES IN
PUNTLAND, SOMALIA**

A Thesis

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Master of Business Administration in Finance and Accounting

By:

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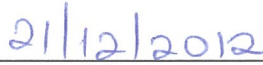


DECLARATION A

I, Deqa Abdulkadir Islan hereby declare that this thesis is my original work and has not been submitted to any other University or Institution of higher learning for any academic award.



Name and Signature of Candidate



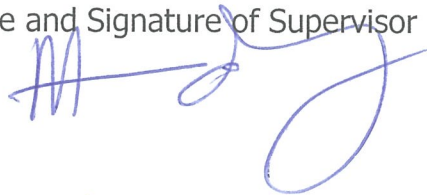
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DECLARATION B

"I confirm that the work reported in this thesis was carried out by the candidate under my supervision".

Dr. Sendagi Mohamed PhD

Name and Signature of Supervisor



21 Dec-2012

Date

DEDICATION

I dedicate this thesis to my beloved parents; my father Abdulkadir Islan Mohamed, my mother Asha Sheikh Mohamed, and my sister Nasra Abdulkadir Islan, my brothers Mohamed Abdulkadir Islan and Mohamud Abdulkadir Islan, my cousins, my uncles and my aunts; because without their presence, support, and comprehension I would have not achieved my goal.

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ABSTRACT

The study was carried out to investigate the Relationship between Internal Auditing and Financial Management of three private electricity supply companies selected purposively and 122 employees in those companies selected by systematic method of sampling. This study was based on four objectives that were; 1) To determine the profile of the respondents in terms of gender, age, marital status, educational level, position in the company, number of years in the company and employment status. 2) To determine the level of internal auditing. 3) To determine the level of financial management. 4) To establish if internal auditing is significantly correlated with financial management.

Key findings from the study were: (1) The profile of the respondents revealed that male employees (61.5%) dominated female (38.5%); Age, age bracket between 20-25 years old (45.1%), 26-35 years old (27.9%), 36-45 years old (18.0), 46-55 years old (5.7%) and above 55 years old (3.3%); Marital status, single workers (31.1%), married workers (53.3%), divorce workers (4.9%) and widow workers (10.7%); Education level, secondary level (9.8%), diploma (21.3%), degree holders (29.5%), masters (24.6%) and PhD (14.8%); Position level, member of board of directors (41.0%), senior management (9.0%), internal auditor (8.2%), accountant (8.2%), Treasury (8.2%), and cashier (25.4%) ; number of years working, below one year (13.1%), 1 to 2 years (13.1%), 3 to 4 years (17.2%), 5 to 6 years (25.4%) and over 6 years (31.2%) ; employment status, full time working employees (68.0%), and part time working employees (32.0%). (2) The overall level of internal auditing was found good (mean=2.86). (3) The overall level of financial management was also found good (mean =2.86). (4) The study also found that there was a significant positive correlation between internal auditing and financial management.

It was concluded that there is a significant relationship between the level of internal auditing and financial management in the selected private electricity supply companies in Puntland Somalia, and also internal auditing contributes 60% in the variation of the level of financial management. Based on the findings, it was recommended that top management should give input for internal audit department in selected private electricity supply companies in Puntland, Somalia and Internal audit function in selected private electricity supply companies should be independent in order to have effective financial management.

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LIST OF ACRONYMS/ABBREVIATIONS

CAE	Chief Audit Executives
CVI	Content Validity Index
IIA	Institute of Internal Auditor
NEC	Nugal Electricity Company
NEPCO	Nugal Electric Power Cooperation

CHAPTER ONE

THE PROBLEM AND ITS SCOPE

Background of the Study

Universally, Internal auditing as noted in The Institute of Internal Auditors (1999), formal definition is about adding value and improving an organization's operations. Few would argue with the assertion that such objectives have never been more critical than in the current business environment, where virtually every organization worldwide is facing unprecedented challenges. Yet there are signs progress is being made, especially when considering the current global crisis from an internal audit perspective. During these uncertain times, internal audit leaders and their teams have a unique opportunity to help their management and board of directors understand their risks and build controls necessary for their companies to run more effectively and improve their financial management.

According to Mautz (1964), within a span of a couple of centuries, the European systems of bookkeeping and auditing were introduced into the United States. As business activities grew in size, scope, and complexity, a critical need for a separate internal assurance function that would verify the (accounting) information used for decision-making by management emerged. Management needed some means of evaluating not only the efficiency of financial management of the companies. Around the turn of the 20th century, the establishment of a formal internal audit function to which these responsibilities could be delegated was seen as the logical answer. In due course, the internal audit function became responsible for improving the efficiency of financial management to enable management to keep track of

significant business developments, activities, and results from diverse and voluminous transactions.

In Africa, the need of internal auditing is a relatively young and rapidly growing profession and the importance of effective financial management is increasing. The rapid growth of the internal audit profession is firstly attributable to the mandatory requirement for an Internal Audit Function by South African public sector legislation (SA, 2000; SA, 2003) and secondly the recommendation of the King Reports on Corporate Governance (IOD, 2009) for the private companies. The rapid growth in the profession prompted the IIA, an international body, concerned with the continuing professional development of the individual internal auditor and the internal auditing profession (Coetzee and Du Bruyn, 2001). The rapid growth in the profession prompted the IIA, an international body, concerned with the continuing professional development of the individual internal auditor and financial management of the company (Coetzee and D Bruyn, 2001).

Despite the absence of a central Somali state and its financial, economic and social companies, combined with other challenges, the traditional Somali spirit of entrepreneurship remains strong and the private companies resilient and robust. Indeed, the private companies has managed to grow impressively in the decade since the onset of the civil war, particularly in the areas of trade, commerce, transport, remittance services, electricity services and telecommunications, as well as in the primary sectors, notably in livestock, agriculture and fisheries (Khalid 2000).

Financial management is crucial for the continuity of private companies. The growing importance of this issue raises interesting questions whether companies are improving their abilities to have effective financial management and implementing changes that will

enable them to analyze results, to interpret, to forecast future performance and improve their business decisions (Barker 2003).

Since the collapse of Somalia's central government, the competition in private companies seems to call for an investigation towards the effectiveness of financial management. Furthermore, business planning and strategies are depending on effective financial management. Therefore, this study on financial management covers the issue of hiring internal auditing for business decision. Shahwan *et al.*, (2008) argued that users of financial report should be able to make decision about resource allocation and are capable to manage the resources.

Sound Internal audit is one of the principal means by which financial management is improved. According to Flesher (1996), the internal audit activity should monitor and evaluate the effectiveness of the organization's financial management.

Since the business decisions are based on effective financial management, the demand for internal auditing is sourced in the need to have some means of independent verification to reduce record-keeping errors, asset misappropriation, and fraud within private companies. The roots of auditing, in general, are intuitively described by accounting historian Richard Brown (1905, quoted in Mautz & Sharaf, 1961) as follows: "The origin of auditing goes back to times scarcely less remote than that of accounting. Whenever the advance of civilization brought about the necessity of one man being entrusted to some extent with the property of another, the advisability of some kind of check upon the fidelity of the former would become apparent."

Statement of the Problem

Since the growth of number of private electricity supply companies in Puntland have increased, there is also increasing poor financial management. The poor financial management results into losses, fraud and misappropriation of funds.

Despite the fact that these private electricity supply companies play a vital role in the society, the private electricity supply companies are characterized by inadequate business process, poor accounting skills, incompetent and unqualified staff, weak or no internal auditing.

Though poor financial management is a result of many factors, internal auditing may have played a big role. It is against such a background that the researcher wanted to investigate the influence of internal auditing on financial management.

Purpose of the Study

The study was pursued for the following reasons:

1. To test the hypothesis of no significant relationship between the variables in this study.
2. To validate the theory Agency theory by Jensen & Meckling, 1976.
3. To generate new information and knowledge based on the findings of this study.
4. To bridge the gaps identified from the related literature review and related studies.
5. To refine the existing information about the variables in this study.

Research Objectives

General: The study determined the relationship between internal auditing and financial management in selected private electricity supply companies in Puntland, Somalia.

Specific:

Specifically the study set out to:

1. To determine the profile of the respondents in terms of;
 - 1.1 Gender
 - 1.2 Age
 - 1.3 Martial Status
 - 1.4 Level of education
 - 1.5 Position in the company
 - 1.6 Number of years in the company
 - 1.7 Employment status
2. To determine the level of internal auditing in selected private electricity supply companies in Puntland, Somalia.
3. To determine the level of financial management in selected private electricity supply companies in Puntland, Somalia.
4. To establish if there is a significance relationship between the level of internal auditing and financial management in selected private electricity supply companies in Puntland, Somalia.

Research Questions

1. What are the profiles of the respondents in terms of;
 - 1.1 Gender?
 - 1.2 Age?
 - 1.3 Marital Status?
 - 1.4 Level of education?
 - 1.5 Position in the company?
 - 1.6 Number of years in the company?
 - 1.7 Employment status?
2. What is the level of internal auditing in selected private electricity supply companies in Puntland, Somalia?
3. What is the level of financial management in selected private electricity supply companies in Puntland, Somalia?
4. Is there is a significance relationship between the level of internal auditing and financial management in selected private electricity supply companies in Puntalnd, Somalia.

Null Hypothesis

Ho: There is no significant relationship between the level of internal auditing and financial management.

Scope

Geographical Scope

The study took place in Somalia particularly in Puntland the researcher only focused on selected three private electricity supply companies namely, Nugal Electricity Company (NEC), National Electricity Power Company (NEPCO), and Aneeyo Electricity Company currently operating in Puntland especially the three big and most populated cities Garowe, Galkaio and Bosaso.

Theoretical Scope

As stated in the work of Jensen and Meckling (1976), Agent Theory concerning the relationship between a principal (shareholder) and an agent of the principal (company's managers) the study was confined to the Agent Theory to explain the effect of the internal auditor's ability to assess the effectiveness of financial management.

Content Scope

The study investigated the level of internal auditing and financial management and effect relationship between the independent variable (internal audit) and dependent variable (financial management).

Time Scope

The study was conducted on a period of ten months that is from March 2012 and December, 2012.

Significance of the Study

The research finding and conclusions of this study were beneficial to the following people in the following ways:

Managers and Shareholders

The study was significant to the managers of the private electricity supply companies who were the implementers of the policy to have a good understanding on how effective financial management is utilized in decision making.

Accountants

The study was beneficial to the accountant of the private electricity supply companies by enabling them to foresee and realize the importance of having internal auditing which contributes to systematic and complete financial management.

Future researchers

The research will also help the future researchers to know and understand the procedures to follow when carrying out a study.

The researcher

The study was significant to the researcher as it helped the contribution to the existing knowledge of the internal auditing and financial management in selected private electricity supply companies in Puntland, Somalia.

Operational Definitions of Key Terms

Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. Internal Auditing helps an organization or a company to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Financial Management is concerned with raising the funds needed to finance the enterprise's assets and activities, the allocation of the scarce funds between competing uses, and with ensuring that the funds are used effectively and efficiently in achieving the company's goal.

Independence is the freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional and organizational levels.

Liquidity management ensures that the company's obligations (wages, bills, loan repayments, tax payments, etc.) are paid. The manager wants to avoid any damage at all to a company's credit rating, due to a temporary inability to meet obligation by: anticipating cash shortages, maintaining the confidence of creditors, bank managers, pre-arranging finance to cover cash shortages. On the other hand, liquidity management minimizes idle cash balances, which could be profitable if they are invested.

Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others.

Profitability management is concerned with maintaining or increasing a company's earnings through attention to cost control, pricing policy, sales volume, stock management, and capital expenditures. This objective is also consistent with the goal of most companies.

Private electricity supply companies are those companies who provide electricity to the society by charging fees.

Demographic Profile of the respondents are attributes looked for in this study in terms of gender, age, marital status, educational level, position in the company, number of years in the company and employment status.

CHAPTER TWO

REVIEW OF RELATED LITERATURE

Concepts, Opinions, Ideas from Authors/ Experts

According to Gleim (2004), internal auditing is a management-oriented discipline that has evolved rapidly since the Second World War. Once a function primarily concerned with financial and accounting matters, internal auditing now addresses the entire range of operating activities and performs a correspondingly wide variety of assurance and consulting services. The development of internal auditing was fostered by the increased size and decentralization of organizations, the greater complexity and technological sophistication of their operations, and the resulting need for an independent, objective means of evaluating and improving their risk management, control and governance processes.

Gleim (2004) provides the official IIA definition with its source: internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance.

Courtemanche (1986) states that until recently, there were two basic conceptions of internal auditing: the traditional and the modern. The traditional conception of internal auditing views accounting as its true discipline, accounting control as its true concern and the board's audit committee as its true client. The modern conception of internal auditing does not reject the substance of the traditional conception,

but seeks to extend it beyond its narrow confines. Modern internal auditing claims an unlimited scope, reserves the freedom to borrow from many disciplines and recognizes senior management as additional clients more or less distinct from the board's audit committee.

The development of internal auditing

Pickett (2005) is of the opinion that internal auditing is now a fully developed profession. An individual employed in internal audit ten years ago would find an unrecognizable situation in terms of internal audit's role, the services provided and the approach followed. For full appreciation of internal auditing, it is necessary to trace these developments back and extend trends into the future. It is important to understand the roots of internal auditing and the way it has developed over the years. Internal auditing developed as an extension of the external auditing role in testing the reliability of accounting records that contribute to published financial statements.

Cascarino and Van Esch (2005) state that the profession of internal auditing, as many other professions, has its roots in the Industrial Revolution of the nineteenth century. The enormous growth of the business sector found existing professionals scrambling to keep up. Specialists appeared, coping with such innovations as corporate law, banking provisions and bankruptcies.

Internal Auditing, according to the Institute of Internal Auditor's (IIA), (1999), the starting place for internal audit theory is the definition of internal audit. A standard definition is made up of important issues that form the basic framework of internal audit

principles. The Institute of Internal Auditors' (IIA), 1999 definition appears once again: Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Internal auditing the service is provided within the company and is distinct from the external audit role. Years ago the IIA considered changing the name of internal auditing to reflect the modern and increasingly professional approach. No alternative was forthcoming and the idea was dropped (Abbott *et al.*, 2000).

Independent the concept of independence is fundamental. Internal auditing cannot survive if it is not objective. All definitions of internal audit feature an element of independence, although its extent, and how it is achieved, is a topic in its own right. The audit function must have sufficient status and be able to stand back from the operation under review for it to be of use. If this is not achieved, then this forms a fundamental flaw in the audit service and some internal audit functions may not be able to subscribe to the standards (Anderson *et al.*, 1993).

Assurance and consulting this part of the definition refers to the fundamental shift in the role of internal audit. The shift makes clear that the past played with the advice and consulting aspect of auditing is now a full-blown additional consultancy arm of the function. Internal audit may provide advice and assistance to management in a way that best suits each manager's needs. Even consulting work

should take on board the impact of risks and IIA Implementation Standard 2110.C1 says that: 'during consulting engagements, internal auditors should address risk consistent with the engagement's objectives and should be alert to the existence of other significant risks' (IIA, 1999).

Meanwhile the primary role of internal audit is to provide independent assurances that the organization is, or is not, managing risk well. Internal audit can provide assurance on the extent to which controls are able to address risks but cannot give any absolute guarantees. There is help at hand and Implementation Standard 1220.A3 clarifies this point by saying that: 'The internal auditors should be alert to the significant risks that might affect objectives, operations, or resources. However assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

Activity the fact that the internal audit function is an activity is important. This means it is a defined service, although not necessarily located within the organization (Flesher, 1996).

Internal Auditing was designed to add value as a service, auditing has to form a client base and understand the needs of the organization. Here the service role should lead to a defined benefit to the organization rather than internal audit working for its own mysterious goals. Adding value should be uppermost in the minds of Chief Audit Executives (CAE) and this feature should drive the entire audit process (Birkett, 1999).

And also it improves an organization's operations this brings into play the notion of continuous improvement. The auditors are really there to make things better and not inspect and catch people out. In one sense, if the CAE cannot demonstrate how the auditors improve the business, there is less reason to resource the service (Birkett, 1999).

According to Brink and Witt (1982), Internal auditing helps an organization to accomplish its objectives the task of internal audit is set firmly around the organization's corporate objectives. Making an organization successful is the key to reach for corporate governance (a badly governed organization will not be successful), for risk management (where risks to achieving objectives are the main focus) and internal controls (that seek to ensure objectives are realized). Moreover, it is the search for long-term corporate success that must steer the internal audit shop, or there is little point setting up the team.

Systematic, disciplined approach Internal audit is now a full-blown profession. This means it has a clear set of professional standards and is able to work to best practice guidelines in delivering a quality service. One measure of this professionalism is that the organization can expect its auditors to apply a systematic and disciplined approach to its work. Be it consulting or assurance work, IIA Performance Standard 2040 requires that: 'The CAE should establish policies and procedures to guide the internal audit activity' (Flesher, 1996).

Evaluate and improve we have mentioned the need to focus on making improvements in the organization and part of this search for improvement entails making evaluations. Internal audit set what is found during an audit against what should be present to ensure good control. This necessarily entails the use of evaluation techniques that are applied in a professional and impartial manner to give reliable results. Many review teams leave out the evaluation aspect of review work and simply ask a few questions or check a few records and their results are not robust. Internal audit, on the other hand, has built into its definition the formal use of evaluation procedures to support steps to improve operations (Flesher, 1996).

Effectiveness is a bottom-line concept based on the notion that management is able to set objectives and control resources in such a way as to ensure that these goals are in fact achieved. The link between controls and objectives becomes clear, and audit must be able to understand the fundamental needs of management as it works to its goals. The complexities behind the concept of effectiveness are great, and by building this into the audit definition, the audit scope becomes potentially very wide (Walsh, 1963).

Risk management, control and governance processes these three related concepts have been covered in early chapters of the book and set the parameters for the internal audit role. (Flesher, 1996). Organizations that have not developed vigorous systems for these matters will fail in the long run and fall foul of regulators in the short term. The internal auditors are the only professionals who have these dimensions of corporate life as a living and breathing component of their role. They should therefore be the first port of call for anyone

who needs to get to grips with corporate governance and IIA Performance Standard 2130 makes it clear that the internal audit activity should assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- i. Promoting appropriate ethics and values within the organization.
- ii. Ensuring effective organizational performance management and accountability.
- iii. Effectively communicating risk and control information to appropriate areas of the organization.
- iv. Effectively coordinating the activities of and communicating information among the board, external and internal auditors and management.

The assurance role of internal auditing needs to be understood. Assurance implies a form of guarantee that what appears to be the case is in fact the case, based on a reliable source of confirmation that all is well. The more impartial and professional the source of these assurances, the more reliable they become.

Policies and procedures - A set of policies are principles, rules, and guidelines formulated or adopted by a company to reach its long-term goals and typically published in a booklet or other form that is widely accessible. Policies and procedures are designed to influence and determine all major decisions and actions, and all activities take place within the boundaries set by them. Procedures are the specific methods employed to express policies in action in day-to-day operations of the organization. Together, policies and procedures ensure that a point of view held by the governing body of a company is

translated into steps that result in an outcome compatible with that view (Adams, 1994).

Cash receipt - a simple document of a transaction that is often issued at the time of the completion of a sale. Many businesses issue cash receipt as a matter of course. While the printed document is normally a simple record of the transaction, some examples of the cash receipt can be very detailed. In general, the cash receipt serves two purposes. First, the document serves as a permanent record for the vendor. The cash receipt allows for the orderly posting of sales on a daily basis, as well as providing a document that can be used in adjusting current inventory levels. Second, the cash receipt provides the customer with a permanent record of the transaction that can be employed to keep the financial records of the client up to date (Albrecht *et al.*, 1992)

Petty cash - A small amount of cash kept on hand by a business for making immediate payments for miscellaneous small expenses. There are two reasons to keep petty cash:

- To make change for customers.
- To pay for small purchases which require cash, such as food for the office lunch or coffee supplies, or for parking. Most retail businesses keep a cash drawer.

Purchase requisition - Document generated by a user department or storeroom-personnel to notify the purchasing department of items it needs to order, their quantity, and the timeframe. It may also contain the authorization to proceed with the purchase. Also called purchase request or requisition. Purchase

Requisition is the procedural method by which departments may request the purchase of goods and/or services which require processing by Procurement Services, usually because of the dollar value, the nature of the purchase, or the type of goods and services (Barrow, 1988).

Payroll - is the sum of all financial records of salaries for an employee, wages, bonuses and deductions. In accounting, payroll refers to the amount paid to employees for services they provided during a certain period of time. Payroll plays a major role in a company for several reasons. From an accounting perspective, payroll is crucial because payroll and payroll taxes considerably affect the net income of most companies and they are subject to laws and regulations (Brigham, 1992).

Financial management is concerned with all areas of management which involve finance – not only the sources and uses of finance in the company, but also the financial implications of investment, production, marketing or personnel decisions and the total performance of the company (Meredith, 1986). Financial management is concerned with raising the funds needed to finance the company's assets and activities, the allocation of these scarce funds between competing uses, and ensuring that the funds are used effectively and efficiently in achieving the enterprise's goals (McMahon et al., 1993).

Like many other management sciences, financial management, firstly, establishes its goal and objectives. Objectives of financial management are foundations or bases for comparing and evaluating the efficiency and effectiveness of financial management. The final goal of financial management is to maximize the financial wealth of the

company's shareholders (McMahon, 1995). This general goal can be viewed in terms of two much more specific objectives: profitability and liquidity. Profitability management is concerned with maintaining or increasing a business's earnings through attention to cost control, pricing policy, sales volume, stock management, and capital expenditures (McMahon, 1995). Liquidity management is concerned with avoiding any damage at all to a business's credit rating, due to a temporary inability to meet obligation by anticipating cash shortages, maintaining the confidence of creditors, bank managers, pre-arranging finance to cover cash shortages (McMahon, 1995).

Efficient financial management, in this research, is defined as financial management that achieves financial management objectives without wasting financial resources. Conversely, **inefficient financial management** is not to achieve financial management objectives or achieve the objectives but wasting or without minimizing financial resource utilization.

In this study the context of financial management practices include accounting information systems, financial reporting and analysis, working capital management, receivable management, inventory management, fixed asset management and financial planning (Burns, 1985).

Accounting information systems – the nature and purpose of financial records, book keeping, cost accounting, and use of computers in financial record keeping and financial management (D'Amboise and Gasse, 1980).

Financial reporting and analysis – the nature, frequency and purpose of financial reporting, auditing, analysis and interpretation of financial performance (Elliott, 1972).

Cash management - Cash management is a broad term that covers a number of functions that help individuals and businesses process receipts and payments in an organized and efficient manner. Administering cash assets today often makes use of a number of automated support services offered by banks and other financial institutions. The range of cash management services range from simple checkbook balancing to investing cash in bonds and other types of securities to automated software that allows easy cash collection (Gorton, 1999).

Receivable management - includes establishing a credit and collections policy for your credit accounts, including aging accounts receivables and whether to sell on credit at all. Receivable management may be defined as the process of making decision relating to the investment of funds in the asset which will result in maximizing the overall return on the investment of the company (Grablowsky, 1976).

Inventory management - is the process of efficiently overseeing the constant flow of units into and out of an existing inventory. This process usually involves controlling the transfer in of units in order to prevent the inventory from becoming too high, or dwindling to levels that could put the operation of the company into jeopardy. Competent inventory management also seeks to control the costs associated with the inventory, both from the perspective of the

total value of the goods included and the tax burden generated by the cumulative value of the inventory (Meredith, 1986).

Fixed assets management - is an accounting process that seeks to track fixed assets for the purposes of financial accounting, preventive maintenance, and theft deterrence. The management of fixed assets such as buildings, fixtures and machinery, which cannot be converted to a fair cash value in a timely manner. Fixed assets are often managed through the use of asset tags, which are tracked through serial numbers or bar codes, for easier organization, and are filed for the purpose of accounting, maintenance and theft deterrence (Allen *et al.*, 2004).

Financial structure management – financial leverage or gearing, accounting to lenders, knowledge of sources and uses of finance, non-financial and financial considerations in financial structure decisions and non-financial and financial considerations in profit distribution decisions (Wescott, 2008).

According to Olander (2007), **financial planning and control** is financial objectives and targets, cost-volume profit analysis, pricing, financial budgeting and control, and management responsibility centers and **financial advice** is internal and external sources and types of financial advice and use of public accounting services.

Financial management expertise – informal and formal education, training and experience in financial management, relevant qualifications, and overall financial management expertise (Grablowsky, 1976).

However, the purpose of this study is not to cover all the contexts of financial management practices as indicated above but to review selected financial management practices that affect on or are related to selected private companies profitability, investments and liquidity. These include accounting information systems, financial reporting and analysis, working capital management, fixed asset management, and capital structure management (McMahon, 1995).

Financial characteristics of the company are represented by financial ratios, derived from financial statements. This information can be used to quantify the position of the private companies in terms of their profitability, liquidity, and leverage and to compare them with other or large companies. In this study, financial characteristics are measured by three variables including liquidity, financial leverage and business activity, which are derived from financial statements.

According to Meredith (1986) financial management is one of several functional areas of management but it is the central to the success of any small business. This definition emphasizes the central role and position of financial management in relation to the other specific areas of business management.

McMahon *et al.*, (1993) defined financial management based on mobilizing and using sources of funds: Financial management is concerned with raising the funds needed to finance the company's assets and activities, the allocation of these scarce funds between competing uses, and with ensuring that the funds are used effectively and efficiently in achieving the company's goal.

According to McMahon *et al.*, (1993) modern financial management involves planning, controlling and decision making responsibilities embracing:

- i. Various types and sources of finance an company may employ how these may be accessed, and how to choose among them.
- ii. Alternative ways in which finance raised may be used in a company and how to select those that are likely to prove most profitable.
- iii. Different means of ensuring that finance entrusted to specific activities realizes the returns that were anticipated on its allocation to them.

However, according to Meredith (1986) financial management is concerned with all areas of management, which involve finance not only the sources, and uses of finance in the companies but also the financial implications of investment, production, marketing or personnel decisions and the total performance of the company. English (1990) argues financial management is concerned with what is going to happen in the future. Its purpose is to look for ways to maximize the effectiveness of financial resources.

Theoretical Perspectives

According to Jensen & Meckling, 1976, over the last decade, agency theory has emerged as the dominant paradigm in the financial management literature. Complementary to previous studies applying agency theory to explain the existence of internal auditing in companies, this study illustrates that agency theory is also a relevant framework to explain the size of the internal audit function in those companies that already have an internal audit function.

Agency theory postulates that a company consists of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling

those resources (Jensen *et al.*, 1976). Agency theory is based on the idea that agents have more information than principals and that this information asymmetry adversely affects the principals' ability to monitor whether or not their interests are being properly served by agents. It also assumes that principals and agents act rationally and that they will use the contracting process to maximize their wealth. This means that because agents have self-seeking motives, they are likely to take the opportunity to act against the interests of the owners of the company.

Related Studies

Wallace *et al.*, (1991), conducted study in Australian on internal audit and fraud and found out that organizations with an internal audit function are more likely to detect and report fraud than those that do not. It is also shown that having some in sourcing is more effective in detecting and reporting fraud than completely outsourcing the internal audit function. These results are important for many groups such as investors, regulators, and corporate managers and directors because it provides evidence on the benefits and value of the internal audit function, which illustrates its importance in the corporate governance framework of an entity. This evidence on the benefits and value of internal audit relate to the area of financial management and reporting.

Olowe (1997), conducted study in Nigeria on Financial Management Practices, the findings revealed that the financial management practices of micro finance banks with a view to finding out if there exists a theory/practice gap in the way they perform the four basic financial management functions of investment, financing, dividend and liquidity. The findings of the study reveal that the financial management practices were dependent upon the nature of

the business/industry and that micro finance banks considered liquidity and financing function most important to them. This may perhaps be as a result of the fact that their business services rendered to their numerous clients are short term in nature. The study also confirms that there is no theory-practice gap in the way financial management functions are executed and that there is a hierarchy of prepotency of financial management functions in the micro finance sub-sector of the Nigerian banking industry.

Mitchell *et al.*, (2000) argued that effective internal auditing is important because it can help companies solve short term problems and assist in decision making. Generally, the success of companies in managing its business financial should be evaluated by the owner of the companies in terms of their usefulness in decision making (Shahwan *et al.*, 2008).

El Luodi (1998) explained that the unstable market conditions require private companies to have readily available information to face the oncoming problems. Because of that, these companies have to hire internal auditing carefully and find appropriate way to have good financial management hence to be able to use the information accurately.

Coram *et al.*, (2008) investigated whether companies with internal auditing were more capable of having efficient financial management than those without internal auditing. Their findings supported the hypothesis that companies with an internal auditing were more likely to have good financial management than companies that did not have an internal auditing. This suggests that internal auditing add value to their companies in terms of improving internal control procedures and presenting better financial management.

It is widely believed that internal auditing, where it exists, contributes to improved financial performance of the company. According to Bejide (2006) "an effective internal audit service can, in particular, help reduce overhead, identify ways to improve efficiency and maximize exposure to possible losses from inadequately safeguarded company assets all of which can have a significant effect on the bottom-line". Venables and Impey (1991) opined that internal audit is an "invaluable tool of management for improving performance".

To Hermanson and Rittenberg (2003) the existence of an effective internal audit department is associated with superior organizational performance. Prasad and Rao (1989) expressed similar sentiments when they observed that the internal auditor by acting as a watchdog saves the company from malpractices and irregularities thus enabling the organization to achieve its objectives of ensuring high level of productivity and profit.

CHAPTER THREE

METHODOLOGY

Research Design

This study employed the descriptive survey design specifically the descriptive co relational strategy. The descriptive correlation was used to determine the relationship between the independent variable (internal auditing) and the dependent variable (financial management) in selected private electricity supply companies.

Descriptive studies are non-experimental researches that describe the characteristics of a particular individual, or of a group. It deals with the relationship between variables, testing of hypothesis and development of generalizations and use of theories that have universal validity.

Research Population

In this study, the researcher focused on three private electricity supply companies which are Nugal Electricity Company (NEC), National Electric Power Cooperation (NEPCO), and Aneeyo Electricity Company. All those companies are located in Puntland, Somalia. The target populations of this study will be the staff of those companies.

The total population of the study was 175 employees.

Sample Size

In view of the nature of the target population was the staff of those private electricity supply companies; a sample was taken from each category. Table 1 shows the respondents of the study. The Sloven's formula was used to determine the minimum sample size.

$$n = \frac{N}{1 + N (e^2)}$$

Where **n** is the required sample size, **N** is the target population size and **e** is the standard error or level of significant, which is most known to be equal **0.05** or **5%**.

Table 1:

Showing the target respondents to be used in the study

Population Category	Population Name	Population Sample	Sample Size
National Electric Power Cooperation	Employees	52	36
Nugal Electricity Company	Employees	46	32
Aneeyo Electricity Company	Employees	77	54
Total		175	122

Source: Primary Data, 2012

Sampling Procedure

The study employed purposive sampling technique to select respondents from those three private electricity supply companies to include in the sample. This technique involves where the researcher uses his or her own judgment or common sense regarding the participant from whom information are collected.

Research Instrument

The research tools that were utilized in this study include the following: (1) *face sheet* to gather data on the profile of the respondents (gender, age, marital status, level of education, position in the company, number of years in the company and employment status); (2) two *researcher devised questionnaires*, one questionnaire was on the independent variable, that is internal auditing and another questionnaire was on the dependent variable that is financial management. The response modes and scoring were as follows: strongly agree (4); agree (3); disagree (2); strongly disagree (1). A questionnaire was often a onetime data gathering device on the variables of interest to the researcher (Amin; 2005).

Validity and Reliability of the Instrument

Validity is the quality of the test doing what is designed to do. The researcher consulted her supervisor for expert knowledge on questionnaire construction. After the assessment of the questionnaire, the necessary adjustments were made bearing in mind the objectives of the study. The formula that was used to calculate the validity of the instrument was: Content Validity Index (CVI) = No. of items declared valid/ Total No. of items, (Appendix III). The result was CVI = 0.79.

Since all variable yielded a CVI above 0.70 accepted for social sciences, it was concluded that the instrument had a good validity hence relevant.

Reliability is a measure of the degree to which a research instrument yields consistent results or data after repeated trials. Reliability of the instrument was established through a test-retest technique. To ensure reliability, the two instruments were pre-tested by administering them to 3 private electricity supply companies and 15 respondents. Pre-testing for reliability helped to reveal; 1) problem relating to answering, completing or returning the questionnaire; and 2) weaknesses in the administration, organization and distribution of the questionnaire.

Data Gathering Procedures

Before the administration of the questionnaires

1. An introduction letter was obtained from the College of Higher Degrees and Research for the researcher to solicit approval to conduct the study from respective companies.
2. After being approved, the researcher secured a list of the qualified respondents from the authorities in charge and select through systematic random sampling from this list to arrive at the minimum sample size.
3. The respondents were explained about the study and were requested to sign the Informed Consent Form (Appendix 3).
4. Reproduced more than enough questionnaires for distribution.
5. Selected research assistants who would assist in the data collection; brief and orient them in order to be consistent in administering the questionnaires.

During the administration of the questionnaires

1. The respondents were requested to answer completely and not to leave any part of the questionnaires unanswered.
2. The researcher and assistants were emphasized retrieval of the questionnaires within three days from the date of distribution.
3. On retrieval, all returned questionnaires were checked if all were answered.

After the administration of the questionnaires

The data gathered was collected, encoded into the computer and statistically treated using the Statistical Package for Social Sciences (SPSS). The researcher also used the regression analysis R^2 (coefficient to determination) that was computed to determine the influence of internal auditing on the financial management.

Data Analysis

The frequency and percentage distribution were used to determine the demographic characteristics of the respondents.

Descriptive statistics based on means and standard deviations was used to determine the levels of internal auditing and financial management. The following mean range was used to arrive at the mean of the individual response mode and interpretation:

A. For the level of internal auditing

Mean Range	Response Mode	Interpretation
3.26-4.00	Strongly Agree	Very Good
2.51-3.25	Agree	Good
1.76-2.50	Disagree	Fair
1.00-1.75	Strongly Disagree	Poor

B. For the level of financial management

Mean Range	Response Mode	Interpretation
3.26-4.00	Strongly Agree	Very Good
2.51-3.25	Agree	Good
1.76-2.50	Disagree	Fair
1.00-1.75	Strongly Disagree	Poor

The researcher used for the purposes of this study, the Pearson's Linear Correlation Coefficient to determine the relationship between internal auditing and financial management. It was used to test null hypothesis (Ho) either accept or reject.

The regression analysis R^2 (coefficient of determination) was computed to determine the influence of the independent variable (internal auditing) on the dependent variable (financial management).

Ethical Considerations

To ensure confidentiality of the information provided by the respondents and to ascertain the practice of ethics in this study, the following activities were implemented by the researcher:

1. The respondents and companies were coded instead of reflecting the names.
2. Solicited permission through a written request to the concerned managers of the companies included in the study.
3. Requested the respondents to sign in the *Informed Consent Form* (Appendix 3)
4. Acknowledged the authors quoted in this study and the author of the through citations and referencing.
5. Presented the findings in a generalized manner.

Limitations of the Study

In view of the following threats to validity, the researcher claimed an allowable 5% margin of error at 0.05 level of significance. Measures were also indicated in order to minimize if not to eradicate the threats to the validity of the findings of this study.

1. *Intervening variables:* This is where it was beyond the researcher's control such as respondents' honesty, personal biases and uncontrolled setting of the study.

CHAPTER FOUR

PRESENTATION, ANALYSIS AND INTERPRETATION OF DATA

Profile of the Respondents

Table 2 contained the profile of the respondents of the companies that participated in the study and information gives picture of the social setting of the participants.

Table 2(A):

Profile of the respondents

Category	Frequency	Percentage (%)
Gender of the respondents		
Male	75	61.5
Female	47	38.5
Total	122	100
Age of the respondents		
20-25 years	55	45.1
26-35 years	34	27.9
36-45 years	22	18.0
46-55 years	7	5.7
Above 55 years	4	3.3
Total	122	100
Marital Status of the respondents		
Single	38	31.1
Married	65	53.3
Divorce	6	4.9
Widow	13	10.7
Total	122	100

**Table 2 (B):
Profile of the Respondents**

Level of Education of the respondents		
Secondary School	12	9.8
Diploma	26	21.3
Bachelor	36	29.5
Postgraduate	30	24.6
PhD	18	14.8
Total	122	100
Position of the respondents in the company		
Member of board of Directors	50	41.0
Senior management	11	9.0
Internal Auditor	10	8.2
Accountant	10	8.2
Treasury	10	8.2
Cashier	31	25.4
Total	122	100
Number of years in the company of the respondents		
Below 1 year	16	13.1
1-2 years	16	13.1
3-4 years	21	17.2
5-6 years	31	25.4
Over 6 years	38	31.2
Total	122	100
Employment status of the respondents		
Full time position	83	68.0
Part time position	39	32.0
Total	122	100

Source: Primary Data, 2012

Table 2(A) and 2(B) are about the profile of the respondents (gender, age, marital status, level of education, position in the

company, number of years in the company and employee status of the respondents). It indicates that respondents from different companies were involved in the study; 61.5% of the respondents were male and the other 38.5% were female. It is hence clear that the majority of the respondents of the study were male.

In table 2 (A) indicates that different categories were involved in the study; 41.5% of the respondents were in the age of 20-25 years old, 27.9% of the respondents were in the age of 26-35 years old, 18.0% of the respondents were in the age of 36-45 years old, 5.7% of the respondents were in the age of 46-55 years old and 3.3% of the respondents were in the age above 55 years old. This means that the majority of the respondents were in the age of 20-25 years old and the minority of the respondents was in the age above 55 years old. This is because most of the employees in the companies are youth.

In table 2 (A), 31.1% of the respondents were single, 53.3% of the respondents were married, 4.9% of the respondents were divorced and 10.7% of the respondents were widow. This means that most of the respondents in the study were married and the least percentage of the respondents in the study were divorced.

In table 2 (B), 9.8% of the respondents were secondary school level, 21.3% of the respondents were diploma level, 29.5% of the respondents were technical bachelor level, 24.6% of the respondents were postgraduate level, and 14.8% of the respondents were PhD level.

In table 2 (B), 41.0% of the respondents were the member of board of directors, 9.0% of the respondents were the senior management, 8.2% of the respondents were the internal auditors, 8.2% of the respondents were the accountants, 8.2% of the

respondents were the treasuries and 25.4% of the respondents were cashiers. This means that most of the respondents in the study were members of board of directors since the researcher's study was about internal auditing and financial management.

In table 2 (B), 13.1% of the respondents were in the companies for below one year period, 13.1% of the respondents were in the companies for 1-2 years period, 17.2% of the respondents were in the companies for 3-4 years period, 25.4% of the respondents were in the companies for 5-6 years period and 31.2% of the respondents were in the companies for more than 6 years. That means the majority of the respondents in the study worked for the companies for more than 6 years because they knew more about the companies than the other workers.

And lastly in table 2 (B) that is within the findings of the study indicates that the majority of the respondents 68.0% worked in the full time position and 39.0% worked in the part time position. This is because most of the respondents in the study were graduates so they don't have anything else to other than working as full time workers.

Table 3(A):
Level of Internal Auditing

Indicator	Mean	Interpretation	Rank
Internal Audit Department			
Have formally recognized objectives.	3.03	Good	1
Give a true and fairness statement to stakeholders regarding the accountability they get from the managers and directors.	3.02	Good	2
Develop communication strategies to effectively communicate audit finding to stakeholders.	2.94	Good	3
Have a formal strategy.	2.82	Good	4
Have a mission statement.	2.48	Fair	5
Mean Average	2.86	Good	
Policies and Procedures			
Every department has the company's chart that clearly defines lines of authority and responsibility.	3.02	Good	1
Written Policies and procedures are maintained for all departmental functions.	2.93	Good	2
Policies and procedures are reviewed and updated annually.	2.93	Good	2
Have an update policy and procedure manual.	2.80	Good	3
Mean Average	2.92	Good	
Cash Receipts			
Deposits are made daily to the bank.	3.06	Good	1
Deliver all funds from the cashier' office to the treasury's office daily.	2.94	Good	2
Cash receipt slips are accounted and reconciled on a regular basis.	2.92	Good	3
Cash that has been received and deposited is reconciled monthly.	2.86	Good	4

Table 3(B):**Level of Internal Auditing**

Maintain a record of checks and cash received.	2.84	Good	5
Cash receipts are kept in secure storage until deposited.	2.80	Good	6
Cash handling responsibilities are turned among two or more employees when possible.	2.77	Good	7
Cash receipts are recorded and used only for the purpose for which they were received.	2.44	Fair	8
Mean Average	2.83	Good	
Petty Cash			
Petty cash funds are kept in secure storage.	2.98	Good	1
Surprise cash counts of department petty cash and change funds performed on a regular, random, and unannounced basis.	2.95	Good	2
Polices on the use of petty cash funds are followed.	2.85	Good	3
All petty cash disbursement are required original receipts for reimbursement.	2.85	Good	3
Mean Average	2.91	Good	
Purchase Requisition			
All requisitions are reviewed by the department administrator to assure reasonableness and appropriate delivery address.	2.89	Good	1
The department's ordering and receiving processes are separated to the greatest extent possible.	2.82	Good	2

Table 3(C):**Level of Internal Auditing**

All purchase requisitions of goods and services are reconciled to the monthly report of transactions and statement of account.	2.81	Good	3
Competitive bidding policies are followed on all requisitions against standing purchase orders.	2.78	Good	4
Mean Average	2.83	Good	
Payroll			
Staff vacation and sick leave reports are reviewed at each pay period by the department administrator for reasonableness.	2.84	Good	1
All staff time records are reviewed and authorized by the department administrator.	2.79	Good	2
Overtime hours reported are verified for reasonableness and proper approval.	2.77	Good	3
Pay checks are distributed by someone other than the timekeeper.	2.73	Good	4
Mean Average	2.78	Good	
Fraud Indicators			
Missing numbers in sequences of numerically are controlled documents identified and investigated immediately.	3.04	Good	1
Duties are separated in all cash handling functions.	2.95	Good	2
More than one person has access to every screen or software application in the department.	2.91	Good	3
The work of all staff member is double checked on a random and unannounced basis.	2.73	Good	4
Mean Average	2.91	Good	
Overall Mean	2.86	Good	

Source: Primary Data, 2012

Tables 3(A), 3(B) and 3(C) reveal that the level of internal auditing was good because all the mean averages (2.86, 2.92, 2.83, 2.91, 2.83, 2.78 and 2.91) were all interpreted good. In other words, on average, many companies offer internal auditing and have good financial management but the companies need to have qualified and independent internal auditors and to train their employees.

Tables 3(A), 3(B) and 3(C) consist of seven items (internal audit department, policies and procedures, cash receipt, petty cash, purchase requisition, payroll and fraud indicators) that have thirty three indicators that show the level of internal auditing arranged according to their ranks and they are as follows:

"Deposits are made daily to the bank" was ranked first by the respondents. The respondent mode to this item was "agree", the mean was 3.06 and the interpretation was good. This means that companies make the deposits to the bank daily and the companies in the study represent the other companies in Puntland state of Somalia.

"Missing numbers in the sequences of numerically are controlled documents identified and investigated immediately" was ranked second by the respondents. The respondent mode to this item was "agree", the mean was 3.04 and the interpretation was good. This means that companies controls the documents and investigate them daily.

"Have formally recognized objectives" was ranked the third by the respondents. The respondent mode to this item was "agree", the mean was 3.03 and the interpretation was good. This means that the companies have understandable, recognized and well organized objectives that all workers intend to reach. This enables the company reach the objectives.

"Every department has the company's chart that clearly defines lines of authority and responsibility" was ranked the fourth by the respondents. The respondent mode to this item was "agree", the mean was 3.02 and the interpretation was good. This means that companies' employees take orders according to the chart of the company.

"Give a true and fairness statement to the stakeholders regarding the accountability they get from the managers and directors" was ranked fifth by the respondents. The respondent mode to this item was "agree", the mean was 3.02 and the interpretation was good. This means that the financial statements of the companies show correct figures.

"Petty cash funds are kept in secure storage" was ranked sixth by the respondents. The respondent mode to this item was "agree", the mean was 2.98 and the interpretation was good. This means that companies have a limit amount of petty cash and are also kept in a safe.

"Surprise cash counts of the department petty cash and change funds performed on a regular, random and unannounced basis" was ranked seventh by the respondents. The respondent mode to this item was "agree", the mean was 2.95 and the interpretation was good. This means that companies makes cash counts to the different departments regularly.

"Duties are separated in all cash handling functions" was ranked the eighth by the respondents. The respondent mode to this item was "agree", the mean was 2.95 and the interpretation was good. This means that each department which handles cash have different duties.

"Develop communication strategies to effectively communicate audit finding to the stakeholders" was ranked ninth by the respondents. The respondent mode to this item was "agree", the mean

was 2.94 and the interpretation was good. This means that companies have good communication with their shareholders according to the financial statements they present.

"Deliver all funds from the cashier's office to the treasury's office daily" was ranked tenth by the respondents. The respondent mode to this item was "agree", the mean was 2.94 and the interpretation was good. This means that companies' cashiers deliver all the funds they receive from the customers to the treasury after every shift.

"Written policies and procedures are maintained from all departmental function" was ranked eleventh by the respondents. The respondent mode to this item was "agree", the mean was 2.93 and the interpretation was good. This means that every department follow the policies and procedures of the companies.

"Policies and procedures are reviewed and updated annually" was ranked twelfth by the respondents. The respondent mode to this item was "agree", the mean was 2.93 and the interpretation was good. This means that companies' management and shareholders update and review the police and producers every year (at the general meeting).

"Cash receipt slips are accounted and reconciled on a regular basis" was ranked thirteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.92 and the interpretation was good. This means that companies' accountant reconcile the cash receipts from the customers in daily basis.

"More than one person has access to every screen or software application in the department" was ranked fourteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.91 and the interpretation was good. This means that the

management has also access to every screen in order to check the data entered.

"All requisitions are reviewed by the department administrator to assure reasonableness and appropriate delivery address" was ranked fifteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.89 and the interpretation was good. This means that companies check every requisition if they received the right quantities ordered.

"Cash that has been received and deposited is reconciled monthly" was ranked sixteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.86 and the interpretation was good. This means that companies' accountants make reconciliation with bank statements monthly.

"Policies on the use of petty cash funds are followed" was ranked seventeenth by the respondents. The respondent mode to this item was "agree", the mean was 2.85 and the interpretation was good. This means that companies give limit petty cash to the treasury and follow the policies of the usage of petty cash.

"All petty cash disbursement are required original receipts for reimbursement" was ranked the eighteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.85 and the interpretation was good. This means that companies maintain every petty cash voucher and make reconciliation on monthly basis.

"Maintain a record of checks and cash received" was ranked nineteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.84 and the interpretation was good. This means that companies keep a record of all transaction of cash and checks received.

"Staff vacation and sick leave reports are reviewed at each pay period by the department administrator for reasonableness" was ranked twentieth by the respondents. The respondent mode to this item was "agree", the mean was 2.84 and the interpretation was good. This means that companies have a record of staff vacation and sick leave approved by the management.

"Have a formal strategy" was ranked twenty first by the respondents. The respondent mode to this item was "agree", the mean was 2.82 and the interpretation was good. This means those internal audit departments of companies have a formal strategy which it follows.

"The department's ordering and receiving processes are separated to the greatest extent possible" was ranked twenty second by the respondents. The respondent mode to this item was "agree", the mean was 2.82 and the interpretation was good. This means that companies and different departments for ordering and receiving.

"All purchase requisitions of goods and services are reconciled to the monthly report of transactions and statement of account" was ranked twenty third by the respondents. The respondent mode to this item was "agree", the mean was 2.82 and the interpretation was good. This means that companies make monthly reconcile for all the goods and services have received that month.

"Have an update policy and procedure manual" was ranked twenty fourth by the respondents. The respondent mode to this item was "agree", the mean was 2.80 and the interpretation was good. This means that companies update their policy and procedure manual annually.

"Cash receipts are kept in secure storage until deposited" was ranked twenty fifth by the respondents. The respondent mode to this

item was "agree", the mean was 2.80 and the interpretation was good. This means that companies keep all cash receipt in a safe until deposited to the banks.

"All staff time records are reviewed and authorized by the department administrator" was ranked twenty sixth by the respondents. The respondent mode to this item was "agree", the mean was 2.79 and the interpretation was good. This means that companies' management approve the payroll.

"Competitive bidding policies are followed on all requisitions against standing purchase" was ranked twenty seventh by the respondents. The respondent mode to this item was "agree", the mean was 2.78 and the interpretation was good. This means that companies have policies on competitive bidding and are followed smoothly.

"Cash handling responsibilities are turned among two or more employees when possible" was ranked twenty eighth by the respondents. The respondent mode to this item was "agree", the mean was 2.77 and the interpretation was good. This means that mostly only one employee handles the cash responsibilities.

"Overtime hours reported are verified for reasonableness and proper approval" was ranked twenty ninth by the respondents. The respondent mode to this item was "agree", the mean was 2.77 and the interpretation was good. This means that overtime hours are only given to the employees for reasonableness approval.

"Pay checks are distributed by someone other than the timekeeper" was ranked thirtieth by the respondents. The respondent mode to this item was "agree", the mean was 2.73 and the interpretation was good. This means that the pay checks are distributed by the treasury.

"The work of all staff member is double checked on a random and unannounced basis" was ranked thirty first by the respondents. The respondent mode to this item was "agree", the mean was 2.73 and the interpretation was good. This means that companies checks the work done by the employees randomly.

"Have a mission statement" was ranked thirty second by the respondents. The respondent mode to this item was "disagree", the mean was 2.48 and the interpretation was fair. This means those internal audit departments of the companies do not have a clear mission statement nor follow if they have a mission statement.

"Cash receipts are recorded and used only for the purpose for which they are received" was ranked last or thirty third by the respondents. The respondent mode to this item was "disagree", the mean was 2.44 and the interpretation was fair. This means that companies do not record of every cash receipts and they are not used for the purpose which they are received.

Table 4(A):
Level of Financial Management

Indicator	Mean	Interpretation	Rank
Accounting Information System			
Accounting information system in the company updates the business transactions.	2.92	Good	2
Senior management involves in preparing accounting information	2.86	Good	3
Accounting information system is useful in making decisions.	2.95	Good	1
Prepare its accounting reporting by using accounting applications.	2.48	Fair	4
Mean Average	2.80	Good	
Financial Reporting and Analysis			
Prepare and analyze the financial statements annually.	2.96	Good	1
Always apply computer in financial reporting and analysis.	2.90	Good	2
Prepare regularly the financial statements	2.72	Good	3
Mean Average	2.86	Good	
Cash Management			
Determine the cash shortage and cash surplus.	2.90	Good	1
Invest the cash surplus in bank deposit.	2.84	Good	2
Utilize computers in cash management.	2.81	Good	3
Prepare cash budget annually.	2.79	Good	4
Mean Average	2.84	Good	
Receivable Management			
Review its level of receivable and bad debts quarterly	2.85	Good	1
Sell service in credit.	2.79	Good	2
Use computers in receivable management.	2.79	Good	2
Set up credit policy to the customers.	2.75	Good	3
Mean Average	2.80	Good	

Table 4(B):
Level of Financial Management

Inventory Management			
Prepare inventory budget	3.02	Good	1
Review its inventory levels.	2.79	Good	2
Mean Average	2.91	Good	
Fixed Assets Management			
Review efficiency of using fixed assets after investing.	3.19	Good	1
Evaluate its project before making capital investment decisions.	2.79	Good	2
Mean Average	2.99	Good	
Financial Planning			
Compare between budgeted and actual results.	2.93	Good	1
Prepare financial budgets.	2.75	Good	2
Mean Average	2.84	Good	
Overall Mean	2.86	Good	

Source: Primary Data, 2012

Tables 4(A) and 4(B) reveal that the level of financial management was good because all the mean averages (2.80, 2.86, 2.84, 2.80, 2.91, 2.99 and 2.84) were all interpreted good. In other words, on average, many companies offer internal auditing and have good financial management.

Tables 4(A) and 4(B) consist of seven items (accounting information system, financial reporting and analysis, cash management, receivable management, inventory management, fixed assets management and financial planning) that have twenty one indicators that show the level of financial management arranged according to their ranks and they are as follows:

“Review efficiency of using fixed assets after investing” was ranked first by the respondents. The respondent mode to this item was

"agree", the mean was 3.19 and the interpretation was good. This means that companies review the efficiency of the fixed assets monthly.

"Prepare inventory budget" was ranked second by the respondents. The respondent mode to this item was "agree", the mean was 3.02 and the interpretation was good. This means that companies' management prepare inventory budget on monthly basis.

"Prepare and analyze the financial statements annually" was ranked the third by the respondents. The respondent mode to this item was "agree", the mean was 2.96 and the interpretation was good. This means that accountant prepare and analyze the financial statements annually and also check if the financial statements give fair and true statement.

"Accounting information system in useful in making decisions" was ranked the fourth by the respondents. The respondent mode to this item was "agree", the mean was 2.95 and the interpretation was good. This means those companies' management and shareholders use accounting information system in decision making.

"Compare between budgeted and actual results" was ranked fifth by the respondents. The respondent mode to this item was "agree", the mean was 2.93 and the interpretation was good. This means that management of the companies compare the budgeted and actual results annually.

"Accounting information system in the company updates the business transactions" was ranked sixth by the respondents. The respondent mode to this item was "agree", the mean was 2.92 and the interpretation was good. This means that companies' transactions are updated by accounting information system daily.

"Always apply computer in financial reporting and analysis" was ranked seventh by the respondents. The respondent mode to this item was "agree", the mean was 2.90 and the interpretation was good. This means that companies use accounting package in financial reporting and analysis.

"Determine the cash shortage and cash surplus" was ranked the eighth by the respondents. The respondent mode to this item was "agree", the mean was 2.90 and the interpretation was good. This means that companies' treasury check cash shortage and cash surplus daily.

"Senior management involves in preparing accounting information" was ranked ninth by the respondents. The respondent mode to this item was "agree", the mean was 2.86 and the interpretation was good. This means that companies' management are involved in preparing the accounting information system.

"Review its level of receivable and bad debts quarterly" was ranked tenth by the respondents. The respondent mode to this item was "agree", the mean was 2.85 and the interpretation was good. This means that companies' accountant present quarterly to the management the level of receivable and bad debts.

"Invest the cash surplus in bank deposit" was ranked eleventh by the respondents. The respondent mode to this item was "agree", the mean was 2.84 and the interpretation was good. This means that companies' treasury deposit the cash surplus in the bank.

"Utilize computers in cash management" was ranked twelfth by the respondents. The respondent mode to this item was "agree", the mean was 2.81 and the interpretation was good. This means that companies use computers in cash managing and keep record.

"Prepare cash budget annually" was ranked thirteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.79 and the interpretation was good. This means that companies prepare cash budget annually.

"Sell service in credit" was ranked fourteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.79 and the interpretation was good. This means that companies sell the services in credit to the customers.

"Use computers in receivable management" was ranked fifteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.79 and the interpretation was good. This means that companies use computerized accounting package in maintaining the receivable management.

"Review its inventory levels" was ranked sixteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.79 and the interpretation was good. This means that companies review the level of inventory monthly.

"Evaluate its project before making capital investment decisions" was ranked seventeenth by the respondents. The respondent mode to this item was "agree", the mean was 2.79 and the interpretation was good. This means that companies' shareholder evaluate the projects before allowing taking new shares.

"Set up credit policy to the customers" was ranked the eighteenth by the respondents. The respondent mode to this item was "agree", the mean was 2.75 and the interpretation was good. This means that companies have a policy of a month due to pay the money back for the service for the customer who have taken credit services.

"Prepare financial budgets" was ranked nineteenth by the respondents. The respondent mode to this item was "agree", the mean

was 2.75 and the interpretation was good. This means those companies' management prepares financial budgets monthly.

"Prepare regularly the financial statements" was ranked twentieth by the respondents. The respondent mode to this item was "agree", the mean was 2.72 and the interpretation was good. This means that accountants prepare financial statements monthly and give to the management.

"Prepare its accounting reporting by using accounting applications" was ranked twenty first by the respondents. The respondent mode to this item was "agree", the mean was 2.48 and the interpretation was good. This means that companies use computerized accounting packages for preparing the financial reporting.

Table 5:
Relationship between Internal Auditing and Financial Management

Variables correlated	Computed r- value	P-value	Interpretation of Correlation	Decision on Ho
Internal Auditing Vs Financial Management	0.750	0.000	Significant relationship	Reject

In table 5, the relationship between the two variables (internal auditing and financial management) is statistically significant or big enough since the accompanying p-value is small enough because it is less than 0.05 level of significance and so, the null hypothesis that states that there is no significant relationship between internal auditing and financial management was rejected and the alternative hypothesis that states that there is a significant relationship between internal auditing and financial management accepted. Therefore, it was concluded that there is a significant relationship between internal auditing and financial management.

This means that, the level of internal auditing in the companies, the way the companies are guided by internal auditing does significantly determine the level of financial management. Companies which are properly guided have effective financial management than those which are not properly guided.

Table 6:
Regression Analysis
Effect of Internal Auditing on Financial Management

Variable Regressed	Adjusted r^2	F-value	Sig.	Interpretation	Decision on Ho
Internal Auditing and Financial Management	0.559	154.176	0.000	Significant effect	Rejected

Table 6 shows that internal auditing positively and significantly affects financial management ($F=154.176$, $\text{sig}=0.000$). Also the results showed that internal auditing contributes the variations 56% to the financial management (adjusted $r^2 = 0.559$).

CHAPTER FIVE

FINDINGS, CONCLUSIONS, RECOMMENDATIONS

This chapter reports the overall findings, conclusions and recommendations of the study.

Findings

The questions investigated in this study included the following: (1) What are the profile characteristics of the respondents in terms of gender, age, marital status, level of education, position in the company, number of years in the company and employment status? (2) What is the level of internal auditing? (3) What is the level of financial management? (4) Is there a significant relationship between internal auditing and financial management?

Profile of employees in selected private electricity supply companies in Puntland, Somalia

The findings suggested that; male (61.5%) dominate female (38.5%) among the employees in the selected private electricity supply companies in Puntland; Age, age bracket between 20-25 years old (45.1%), 26-35 years old (27.9%), 36-45 years old (18.0), 46-55 years old (5.7%) and above 55 years old (3.3%); Marital status, single workers (31.1%), married workers (53.3%), divorce workers (4.9%) and widow workers (10.7%); Education level, secondary level (9.8%), diploma (21.3%), degree holders (29.5%), masters (24.6%) and PhD (14.8%); Position level, member of board of directors (41.0%), senior management (9.0%), internal auditor (8.2%), accountant (8.2%), Treasury (8.2%), and cashier (25.4%) ; number of years working, below one year (13.1%), 1 to 2 years (13.1%), 3 to 4 years (17.2%),

5 to 6 years (25.4%) and over 6 years (31.2%) ; employment status, full time working employees (68.0%), and part time working employees (32.0%).

Level of internal auditing in selected private electricity supply companies in Puntland, Somalia

Findings in Tables 3(A), 3(B) and 3(C) show that, internal audit department was found good (mean=2.86), policy and procedures, good with (mean=2.92), cash receipts was good (mean=2.83), petty cash found good with (mean=2.91), purchase requisition, good with (mean=2.83), payroll was good (mean=2.78) and fraud indicators was found good (mean =2.91).

Level of financial management in selected private electricity supply companies in Puntland, Somalia

Results indicated that, accounting information system was good (mean=2.80), financial reporting and analysis that was good with (mean=2.86), cash management was found good (mean=2.84), receivable management was good (mean=2.80), inventory management, good with (mean=2.91), fixed assets management was good (mean=2.99), and financial planning was also found good (mean=2.84).

Significant relationship between levels of internal auditing and financial management

The level of internal auditing is positively and significantly correlated with the level of financial management ($r=0.750$) and (sig value is less than 0.05).

Effect of internal auditing on financial management

The results indicated that internal auditing significantly affects financial management ($F=154.176$, $\text{sig}=0.000$), and it affects 56% on financial management.

CONCLUSION

1. The study was to test the hypothesis as follows:

The null hypothesis that stated that there is no significant relationship between internal auditing and financial management was rejected and therefore, was concluded that there is a significant relationship between internal auditing and financial management and the effect of internal auditing on the financial management was 56% (adjusted $r^2=0.559$).

2. The study was to validate the Agency theory by Jensen and Meckling (1976) that stated that a company consists of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources. The theory was accepted because internal auditing influences the financial management in selected private electricity supply companies.

RECOMMENDATIONS

Based on the findings of the study, the following are suggested:

Management should promote more women in the companies in order to promote gender equality.

Management need to develop effective performance based internal auditing in the companies.

In all, performance based internal auditing departments are good and would lead to the improvement in company's overall financial management, if the above recommendations are considered.

Furthermore, a strong audit committee should be established, training of internal auditors should be done, the capacity of the internal auditors should be increased, even if more are recruited from college graduates, The reports of the internal auditors should be sent to the shareholder board and an audit committee, other than the supervising directors or CEOs, an audit charter should be compiled and approved by an audit committee, the role of internal auditors should be communicated throughout the organization, The internal auditors should adhere to the standards of the generally Accepted Audit Principles (GAAP).

SUGGESTED AREAS FOR FURTHER RESEARCH

The researcher is recommending for further research to be conducted in areas which are: the relationship between external audit and internal audit; financial planning and financial reporting and analysis.

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INTERNET

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(<http://www.auasb.gov.au>)

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Appendix I

Transmittal Letter



**KAMPALA
INTERNATIONAL
UNIVERSITY**

Ggaba Road - Kansanga
P.O. Box 20000, Kampala, Uganda
Tel: +256 - 414 - 266813 / +256 - 772 - 322563
Fax: +256 - 414 - 501 974
E-mail: admin@kiu.ac.ug
Website: www.kiu.ac.ug

**OFFICE OF THE HEAD OF DEPARTMENT, ECONOMICS AND
MANAGEMENT SCIENCES
COLLEGE OF HIGHER DEGREES AND RESEARCH (CHDR)**

Date: 03rd September.2012

**RE: REQUEST OF DEQA ABDULKADIR ISLAN
MBA/34708/113/DF TO CONDUCT RESEARCH IN YOUR
ORGANIZATION**

The above mentioned is a bonafide student of Kampala International University pursuing Masters of Business Administration (Finance and Accounting).

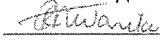
She is currently conducting research entitled " **Internal Auditing and Financial Management in Selected Private Electricity Supply Companies in Puntland, Somalia**".

Your organization has been identified as a valuable source of information pertaining to her research project. The purpose of this letter is to request you to avail her with pertinent information she may need.

Any information shared with her from your organization shall be treated with utmost confidentiality.

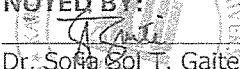
Any assistance rendered to her will be highly appreciated.

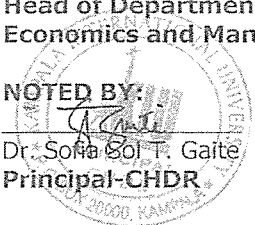
Yours truly,

pp 

Mr. Malinga Ramadhan
Head of Department,
Economics and Management Sciences, (CHDR)

NOTED BY:


Dr. Sofia Sol T. Gaité
Principal-CHDR



Shirkadda Korontada Nugaal



Nugaal Electric Company

DATE: 13/09/2012

Ref: 020/2012

TEL: +252 90 794117/843208

Email: necgaroowe@hotmail.com

To Whom It May Concern

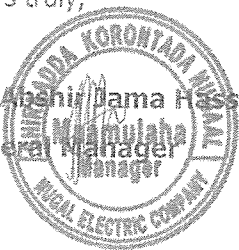
As **Nugal Electricity Company (NEC)** we are delighted to share with you that we have allowed, the information which she has requested from the company in the form of questionnaire under title of **"Internal Auditing and Financial Management in Selected Private Electricity Supply Companies in Puntland, Somalia."**

We have given her this information after she has brought us a request letter from **Kampala International University (KIU)** which was dated on **03rd September 2012.**

We hope success to her and the university as whole.

Yours truly,

Mr. **Abshir Dama Hassan**
General Manager



W.X.K.U

Wakaaladda Xooga Korontada Umadda

Bosaso Puntland State of Somalia

To Whom It May Concern

As **Aneeyo Electricity Company** we are delighted to share with you that we have allowed, the information which she has requested from the company in the form of questionnaire under title of **"Internal Auditing and Financial Management in Selected Private Electricity Supply Companies in Puntland, Somalia."**

We have given her this information after she has brought us a request letter from **Kampala International University (KIU)** which was dated on **03rd September 2012**.

We hope success to her and the university as whole.

Yours truly,

General Manager



Appendix II
Clearance from Ethics Committee

Date _____

Candidate's Data

Name: Deqa Abdulkadir Islan

Reg. #: MBA/34708/113/DF

Course: Master of Business Administration in Finance and Accounting

Title of Study: **Internal Auditing and Financial Management in Selected Private Electricity Supply Companies in Puntland, Somalia.**

Ethical Review Checklist

The study reviewed considered the following:

- ___ Physical Safety of Human Subjects
- ___ Psychological Safety
- ___ Emotional Security
- ___ Privacy
- ___ Written Request for Author of Standardized Instrument
- ___ Coding of Questionnaires/Anonymity/Confidentiality
- ___ Permission to Conduct the Study
- ___ Informed Consent
- ___ Citations/Authors Recognized

Results of Ethical Review

- ___ Approved
- ___ Conditional (to provide the Ethics Committee with corrections)
- ___ Disapproved/ Resubmit Proposal

Ethics Committee (Name and Signature)

Chairperson _____

Members _____

Appendix III

Calculation of Content of Validity Index

CVI= *Number of all relevant questions/ The total number of items*

Section A: $= 25/33 = 0.76$

Section B: $= 17/21 = 0.81$

Therefore, Average of Content Validity Index is:

CVI $= 1.57/2 = 0.79$

Appendix IV

Informed consent for the respondents

Dear Sir/ Madam,

Greetings!

I am a candidate for Master of Business Administration in Finance and Accounting at Kampala International University with a thesis on, **"Internal Auditing and Financial Management in Selected Private Electricity Supply Companies in Puntland, Somalia"**. Pursue to complete this academic requirement; may I request your assistance by being part of this study?

Kindly provide the most appropriate information as indicated in the questionnaire and please do not leave any item unanswered, any data from you shall be for academic purpose only and will be kept utmost confidentially.

May I retrieve the questionnaire within 3 days after you receive them?

Thank you very much in advance

Yours faithfully,

Deqa Abdulkadir Islan

APPENDIX V

QUESTIONNAIRE

QUESTIONNAIRE ON INTERNAL AUDITING AND FINANCIAL MANAGEMENT

Instruction

This questionnaire is designed with a view to gaining insight into your perception as to what forms of internal auditing would contribute the effectiveness of financial management to your company. There are no right and wrong answers and your anonymity is ensured.

Please place an (✓) in the box that most accurately reflects your view.

SECTION A: DEMOGRAPHIC PROFILE

1. Gender

_____ Male
_____ Female

2. Age

_____ 20-25
_____ 26-35
_____ 36-45
_____ 46-55
_____ Above 55

3. Marital Status

_____ Single
_____ Married
_____ Divorced
_____ Widow

4. Level of Education

- ☐ Secondary School
- ☐ Diploma
- ☐ Bachelor
- ☐ Postgraduate
- ☐ PhD

5. Position in the Company

- ☐ Member of Board of Directors
- ☐ Senior Management
- ☐ Internal Auditor
- ☐ Accountant
- ☐ Treasury
- ☐ Cashier

6. Number of Years in the Company

- ☐ Below one year
- ☐ 1-2 years
- ☐ 3-4 years
- ☐ 5-6 years
- ☐ Over 6 years

7. Employment Status

- ☐ Full time position
- ☐ Part time position

APPENDIX VI

Section B: Questionnaire on Level of Internal Auditing

These questions are to indicate the extent which you agree with the following statements about the effectiveness of internal auditing in your company. Tick the right number corresponding with each item.

Respond Mode	Rating	Description	Legend
Strongly Agree	4	Very Good	SA
Agree	3	Good	A
Disagree	2	Fair	D
Strongly Disagree	1	Poor	SD

Internal Audit Department				
1. Have a mission statement.	1	2	3	4
2. Have a formal strategy.	1	2	3	4
3. Have formally recognized objectives.	1	2	3	4
4. Develop communication strategies to effectively communicate audit finding to stakeholders.	1	2	3	4
5. Give a true and fairness statement to stakeholders regarding the accountability they get from the managers and directors.	1	2	3	4
Policies and Procedures				
6. Have an update policy and procedure manual.	1	2	3	4
7. Written Policies and procedures are maintained for all departmental functions.	1	2	3	4
8. Policies and procedures are reviewed and updated annually.	1	2	3	4
9. Every department has the company's chart that clearly defines lines of authority and responsibility.	1	2	3	4
Cash Receipts				
10. Cash receipts are kept in secure storage	1	2	3	4

until deposited.				
11. Deposits are made daily to the bank.	1	2	3	4
12. Cash that has been received and deposited is reconciled monthly.	1	2	3	4
13. Cash receipts are recorded and used only for the purpose for which they were received.	1	2	3	4
14. Cash handling responsibilities are turned among two or more employees when possible.	1	2	3	4
15. Cash receipt slips are accounted and reconciled on a regular basis.	1	2	3	4
16. Maintain a record of checks and cash received.	1	2	3	4
17. Deliver all funds from the cashier' office to the treasury's office daily.	1	2	3	4
Petty Cash				
18. Petty cash funds are kept in secure storage.	1	2	3	4
19. Policies on the use of petty cash funds are followed.	1	2	3	4
20. All petty cash disbursement are required original receipts for reimbursement.	1	2	3	4
21. Surprise cash counts of department petty cash and change funds performed on a regular, random, and unannounced basis.	1	2	3	4
Purchase Requisition				
22. Competitive bidding policies are followed on all requisitions against standing purchase orders.	1	2	3	4
23. All requisitions are reviewed by the department administrator to assure reasonableness and appropriate delivery address.	1	2	3	4
24. The department's ordering and receiving processes are separated to the greatest extent possible.	1	2	3	4

25. All purchase requisitions of goods and services are reconciled to the monthly report of transactions and statement of account.	1	2	3	4
Payroll				
26. All staff time records are reviewed and authorized by the department administrator.	1	2	3	4
27. Overtime hours reported are verified for reasonableness and proper approval.	1	2	3	4
28. Pay checks are distributed by someone other than the timekeeper.	1	2	3	4
29. Staff vacation and sick leave reports are reviewed at each pay period by the department administrator for reasonableness.	1	2	3	4
Fraud Indicators				
30. The work of all staff member is double checked on a random and unannounced basis.	1	2	3	4
31. Duties are separated in all cash handling functions.	1	2	3	4
32. More than one person has access to every screen or software application in the department.	1	2	3	4
33. Missing numbers in sequences of numerically are controlled documents identified and investigated immediately.	1	2	3	4

Source I: Gary Mc Gee and Co. (2003)

Source II: United State Trustee (2005)

11. Invest the cash surplus in bank deposit.	1	2	3	4
Receivable Management				
12. Sell service in credit.	1	2	3	4
13. Set up credit policy to the customers.	1	2	3	4
14. Use computers in receivable management	1	2	3	4
15. Review its level of receivable and bad debts quarterly	1	2	3	4
Inventory Management				
16. Review its inventory levels.	1	2	3	4
17. Prepare inventory budget	1	2	3	4
Fixed Assets Management				
18. Evaluate its project before making capital investment decisions.	1	2	3	4
19. Review efficiency of using fixed assets after investing.	1	2	3	4
Financial Planning				
20. Prepare financial budgets.	1	2	3	4
21. Compare between budgeted and actual results.	1	2	3	4

Source: Ann-Marie Hogan, City Auditor, CIA, CGAP Teresa Barkeley, Audit Manager, and Frank Marietty, Sr.Auditor, CIA CGAP. Presented to City Council on February 19, 2001.

THANK YOU FOR COMPLETING THE QUESTIONN

RESEARCHER'S CURRICULUM VITAE

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May 2009- May 2010 Dominion International College, Diploma in
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Nov-Dec 2005 Project Cycle Management (**PCM**), PSU,
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2002-2003 Advanced English Language Course Ramadan Institute of
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1993 – 1999 UHURU Primary School, Tanzania

Work Experience

July 2008- March 2011 Accountant- Nugal Electricity Company,
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14-24 September 2009 Translator--- Standing Orders of the
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April 2006 -June 2008 Secretary –Nugal Electricity Company,
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