

## **FINANCIAL GOVERNANCE AND ABSORPTION EFFICIENCY OF AID FUNDS UNDER THE KENYA DEVOLUTION SUPPORT PROGRAMME**

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## **ABSTRACT**

The Kenya Devolution Support Programme (KDSP) is a key financing framework established to strengthen financial governance and improve service delivery within Kenya's devolved system of government. Despite its importance, the absorption efficiency of aid funds under the programme has remained inconsistent, with utilization rates frequently falling below 65 percent between 2019 and 2024, raising concerns regarding effective implementation and accountability. The purpose of this study was to examine the effect of financial governance on the absorption efficiency of aid funds under the Kenya Devolution Support Programme in Kenya. Specifically, the study sought to examine the effect of financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance on absorption efficiency of aid funds. The study was anchored on Financial Sustainability Theory, Agency Theory, Stewardship Theory, Internal Control Theory, and Institutional Theory. A census design was adopted covering all 47 county governments in Kenya. The study relied on secondary data obtained from the Office of the Auditor-General, the Office of the Controller of Budget, and other official government publications for the period 2019 to 2024. Data analysis was conducted using descriptive statistics, diagnostic tests, correlation analysis, and fixed effects panel regression analysis. The findings established that financial reporting transparency had a

positive and statistically significant effect on absorption efficiency of aid funds ( $\beta = 0.0318$ ,  $p < 0.05$ ). External audit compliance also had a positive and statistically significant effect ( $\beta = 0.0185$ ,  $p < 0.05$ ), while internal financial control strength ( $\beta = 0.0016$ ,  $p < 0.05$ ) and financial reporting compliance ( $\beta = 0.0013$ ,  $p < 0.05$ ) likewise exhibited positive and statistically significant effects on absorption efficiency. The study concluded that strengthening financial governance enhances the efficient absorption of aid funds under the Kenya Devolution Support Programme. It recommends that county governments improve transparency in financial reporting, strengthen implementation of external audit recommendations, reinforce internal financial control systems, and enhance compliance with financial reporting requirements. In addition, oversight institutions, including the National Treasury, the Office of the Controller of Budget, and the Office of the Auditor-General, should intensify monitoring and capacity-building initiatives to promote effective utilization of development resources within county governments.

**Key words:** Financial Governance, Financial Reporting Transparency, External Audit Compliance, Internal Financial Control Strength, Financial Reporting Compliance, Absorption Efficiency of Aid Funds, Kenya Devolution Support Programme, County Governments.

## **INTRODUCTION**

The absorption efficiency of aid funds has become an important indicator of public financial management effectiveness because it reflects the extent to which allocated resources are translated into actual expenditure and development outcomes within a given financial period (World Bank, 2023). Efficient absorption ensures that donor-funded resources are utilised in a timely and accountable manner, thereby supporting improved service delivery and sustainable development. Globally, countries with strong public financial management systems have consistently recorded higher absorption rates through effective budget execution, timely financial reporting, robust audit mechanisms, and integrated financial management systems (European Commission, 2023; OECD, 2022). Conversely, weak governance structures, delayed reporting, inadequate internal controls, and audit deficiencies continue to undermine efficient utilisation of development resources in many developing economies, resulting in implementation delays and underutilisation of available funds (IMF, 2023; World Bank, 2023).

Financial governance refers to the systems, policies, institutions, and procedures established to ensure transparency, accountability, and prudent management of public financial resources (IFAC & CIPFA, 2014). Effective financial governance enhances fiscal discipline, strengthens accountability, and promotes efficient allocation and utilisation of public resources through reliable financial information and sound oversight mechanisms (World Bank, 2022). In this study, financial governance was conceptualised using four dimensions: financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance. Financial reporting transparency was measured using the Financial Disclosure Index, external audit compliance through audit opinion outcomes, internal financial control strength through reported internal control weaknesses, while financial reporting compliance was measured using the number of financial reporting compliance issues identified by the Auditor-General (IPSASB, 2021; Controller of Budget, 2024). Absorption efficiency of aid funds was measured using the utilisation rate, defined as the ratio of funds utilised to funds disbursed during a financial year, since it captures both the completeness and timeliness of expenditure execution.

In Kenya, absorption efficiency of aid funds under the Kenya Devolution Support Programme (KDSP) has remained below expected levels despite increasing financial allocations to county governments. Between 2019 and 2024, aid fund disbursements increased substantially, yet absorption ratios remained consistently below 65 percent, indicating persistent implementation delays and underutilisation of available resources (Controller of Budget, 2024; Auditor-General, 2024). Oversight reports have further identified recurring weaknesses in financial reporting, audit compliance, internal financial controls, and statutory reporting practices across county governments, suggesting that deficiencies in financial governance may hinder effective utilisation of development funds. While previous studies have largely focused on public financial management and budget execution, limited empirical evidence exists on the relationship between

financial governance and absorption efficiency of aid funds under the Kenya Devolution Support Programme. This study therefore investigated the effect of financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance on the absorption efficiency of aid funds among the 47 county governments in Kenya during the period 2019 to 2024.

### **Statement of the Problem**

The Kenya Devolution Support Programme (KDSP) plays a critical role in strengthening public financial management by providing performance-based financing to county governments to enhance accountability, transparency, and service delivery within Kenya's devolved system (World Bank, 2022). A key indicator of the programme's success is the absorption efficiency of aid funds, which reflects the ability of county governments to utilise disbursed resources fully and in a timely manner for the intended development activities (World Bank, 2023; OECD, 2022). Effective absorption efficiency supports fiscal discipline, accelerates project implementation, and enhances the achievement of development outcomes, making it an important consideration for both national policymakers and development partners (Controller of Budget, 2024). This concern is further reinforced by the programme's emphasis on financial reporting, audit compliance, and internal control systems as essential components of sound financial governance within county governments (National Treasury, 2023).

Available evidence indicates that absorption efficiency under the Kenya Devolution Support Programme has remained persistently low and inconsistent across county governments. The absorption ratio stood at approximately 0.61 in 2019 before declining to 0.58 in 2020, improving slightly to 0.59 in 2021 and 0.60 in 2022, and stabilising at around 0.60 and 0.61 in 2023 and 2024 respectively (Controller of Budget, 2024; Auditor-General, 2024). These trends imply that between 39 percent and 42 percent of programme funds disbursed annually remained unutilised within the corresponding financial year, despite increasing allocations to counties. Such persistent underutilisation raises concerns regarding delays in implementation of development projects, inefficient use of public resources, reduced effectiveness of donor-supported interventions, and the overall ability of county governments to translate available financial resources into tangible service delivery outcomes (World Bank, 2023; OECD, 2022).

Current empirical literature has not adequately addressed the conceptual, methodological, and contextual gaps regarding financial governance and absorption efficiency of aid funds under the Kenya Devolution Support Programme. Most previous studies have examined financial reporting transparency, audit systems, internal controls, and compliance in relation to financial performance, accountability, or general budget execution rather than programme-specific aid fund absorption efficiency (International Budget Partnership, 2021; Zakaria, Said, & Daud, 2020; Tetteh, Agyemang, & Yeboah, 2021). Methodologically, many studies have relied on descriptive approaches, perception-based surveys, or aggregate national data, limiting their ability to estimate

county-level effects using balanced panel data (Nkundabanyanga, Tauringana, & Balunywa, 2021; Mutiso & Musyoka, 2023). Contextually, much of the available evidence originates from developed economies or broad public financial management studies that differ significantly from Kenya's devolved governance framework, while local studies have largely focused on audit outcomes and overall budget implementation rather than the absorption efficiency of KDSP funds (OECD, 2022; IMF, 2023; Waweru & Ngugi, 2024; Otieno & Wanjiru, 2024). This study therefore sought to fill these gaps by examining the effect of financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance on the absorption efficiency of aid funds under the Kenya Devolution Support Programme using balanced panel data for all 47 county governments covering the period 2019–2024.

### **Objectives of the Study**

The study was guided by the following objectives:

#### **Overall objective**

The research overall objective was to examine the effect of financial governance on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.

#### **Specific Objectives**

- i. To ascertain the effect of financial reporting transparency on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.
- ii. To assess the effect of external audit compliance on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.
- iii. To evaluate the effect of internal financial control strength on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.
- iv. Ascertaining the effect of financial reporting compliance on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.

## **THEORETICAL REVIEW**

The study was guided by the following theories:

### **Financial Sustainability Theory**

Financial Sustainability Theory was advanced by Hahnel and Sheeran in 2009 and explains how institutions can efficiently mobilise and utilise financial resources to maintain long-term operational and fiscal stability. The theory argues that public institutions should use available financial resources prudently to deliver continuous services without exposing themselves to fiscal distress, while emphasising that delayed expenditure and idle funds undermine sustainable development (Bhandari & Iyer, 2021; Schick, 2022). Empirical evidence supports this proposition, with the World Bank (2023) reporting that improved budget execution enhances fiscal

sustainability and development outcomes, while Mustapha, Prizzon, and Gavas (2019) associate low absorption rates with implementation delays and increased financing costs. However, critics argue that financial sustainability may also be influenced by political priorities, regulatory frameworks, and intergovernmental transfers beyond institutional control (Schick, 2022). The theory was adopted in this study to support the dependent variable, absorption efficiency of aid funds, because it provides a framework for understanding how efficient utilisation of disbursed resources contributes to fiscal sustainability and effective implementation of the Kenya Devolution Support Programme.

### **Agency Theory**

Agency Theory was developed by Jensen and Meckling in 1976 to explain the relationship between principals and agents where decision-making authority is delegated to managers who may pursue interests different from those of resource owners. The theory argues that information asymmetry and self-interest create agency problems that can be minimised through transparency, disclosure, and monitoring mechanisms that enhance accountability (Eisenhardt, 1989; OECD, 2023). Empirical studies demonstrate that increased public disclosure improves accountability and resource utilisation, with the International Budget Partnership (2021) and the World Bank (2022) reporting positive relationships between financial transparency and budget execution outcomes. Nevertheless, the theory has been criticised for overemphasising opportunistic behaviour while overlooking trust, professionalism, and ethical conduct that often characterise public sector institutions (Eisenhardt, 1989). In this study, Agency Theory underpins financial reporting transparency by explaining how timely and accessible financial information reduces information asymmetry and may enhance the absorption efficiency of aid funds under the Kenya Devolution Support Programme.

### **Stewardship Theory**

Stewardship Theory was proposed by Davis, Schoorman, and Donaldson in 1997 and suggests that managers are motivated to act in the best interests of their organisations rather than pursuing personal objectives. The theory assumes that individuals possess intrinsic motivation, professionalism, and commitment to organisational goals and that appropriate governance structures reinforce responsible stewardship and accountability (Donaldson & Davis, 1991). Empirical evidence indicates that effective audit systems strengthen financial accountability and improve budget execution, with the World Bank (2022) and the Auditor-General (2024) associating clean audit outcomes with improved financial discipline and fewer irregularities in public expenditure. However, critics argue that not all managers behave as faithful stewards, particularly where institutional controls are weak and enforcement mechanisms are inadequate (Davis et al., 1997). The theory was adopted in this study to support external audit compliance because effective audit oversight strengthens accountability and promotes responsible management of aid funds under the Kenya Devolution Support Programme.

### **Internal Control Theory**

Internal Control Theory is founded on the framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992 and explains how structured control systems promote efficient, reliable, and compliant management of financial resources. The theory posits that effective internal controls comprising control environment, risk assessment, control activities, information systems, and monitoring reduce errors, prevent misuse of resources, and improve operational efficiency (COSO, 2013). Empirical studies support this perspective, with the World Bank (2022) demonstrating that strong internal controls improve budget execution while the Auditor-General (2024) links weak controls to expenditure delays and financial inefficiencies. Despite its strengths, the theory has been criticised because internal control systems can be costly to implement, cannot eliminate all risks, and depend heavily on effective human implementation and compliance (Romney & Steinbart, 2021). The theory was applied in this study to explain how stronger internal financial control systems may improve the absorption efficiency of aid funds under the Kenya Devolution Support Programme by enhancing financial discipline and reducing implementation delays.

### **Institutional Theory**

Institutional Theory was advanced by DiMaggio and Powell in 1983 and explains how organisations conform to established rules, norms, and regulatory requirements to achieve legitimacy and improve organisational performance. The theory argues that coercive, normative, and mimetic pressures encourage organisations to comply with formal standards and reporting requirements, thereby strengthening governance structures and reducing uncertainty (Scott, 2014). Empirical evidence demonstrates that compliance with financial reporting standards enhances accountability and improves budget implementation, with the World Bank (2022), OECD (2023), and the Auditor-General (2024) reporting that regulatory compliance contributes to transparency and more effective public financial management. However, the theory has been criticised because organisations may adopt formal structures merely to achieve legitimacy without genuinely improving operational performance, while differences in institutional capacity may also limit the benefits of compliance (DiMaggio & Powell, 1983; Scott, 2014). In this study, Institutional Theory supports financial reporting compliance by providing a framework for understanding how adherence to statutory financial reporting requirements may enhance accountability and improve the absorption efficiency of aid funds under the Kenya Devolution Support Programme.

### **Empirical Review**

This section reviews empirical studies related to financial governance and absorption efficiency of aid funds under the Kenya Devolution Support Programme. Specifically, it examines evidence on financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance in relation to fund absorption efficiency and highlights conceptual, methodological and contextual gaps that the current study aims to address.

### **Financial Reporting Transparency and Absorption Efficiency**

Empirical evidence demonstrates that financial reporting transparency is a key determinant of accountability and efficient utilisation of public resources. The International Budget Partnership (2021) established that greater fiscal transparency improves budget execution and reduces delays in fund utilisation across countries, while the World Bank (2022) found that timely financial reporting enhances budget credibility and increases expenditure efficiency in developing economies. Similarly, the African Development Bank (2021) reported that weak reporting systems contribute to poor utilisation of development funds, and the Controller of Budget (2024) observed that delayed reporting among Kenyan counties is associated with absorption rates below 65 percent. The Auditor-General (2024) further noted that untimely financial disclosures weaken accountability and reduce expenditure efficiency within county governments. However, most existing studies have examined transparency within broader governance frameworks or focused on general budget execution rather than programme-specific aid fund absorption. In addition, many studies relied on descriptive approaches or cross-country analyses that failed to capture county-level variations in Kenya's devolved system. The present study addresses these conceptual, methodological, and contextual gaps by operationalising financial reporting transparency as a county-level governance variable and examining its effect on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.

### **External Audit Compliance and Absorption Efficiency**

Existing empirical literature indicates that external audit compliance strengthens accountability and promotes efficient utilisation of public resources. The World Bank (2021) found that timely audits and implementation of audit recommendations improve budget execution and reduce idle funds, while the International Monetary Fund (2022) reported that effective audit systems enhance fiscal discipline and expenditure outcomes across emerging economies. Similarly, AFROSAI (2021) established that poor compliance with audit recommendations contributes to inefficiencies and delays in public fund utilisation, whereas the Auditor-General (2023) and the Controller of Budget (2023) observed that repeated audit queries and inadequate implementation of audit recommendations are associated with weak expenditure performance in Kenyan counties. Despite these findings, most previous studies focused on general audit effectiveness rather than external audit compliance as a distinct governance mechanism and relied largely on descriptive or aggregate data that did not specifically examine county-level aid fund absorption. The current study fills these conceptual and methodological gaps by operationalising external audit compliance as an independent variable and assessing its influence on the absorption efficiency of KDSP funds across all county governments in Kenya.

### **Internal Financial Control Strength and Absorption Efficiency**

Empirical studies consistently suggest that effective internal financial controls enhance accountability and improve utilisation of public resources. Zakaria, Said, and Daud (2020) reported that strong internal control systems improve expenditure efficiency and minimise financial

leakages, while Nkundabanyanga, Tauringana, and Balunywa (2021) found that robust controls strengthen financial accountability in public institutions. Likewise, Kariuki and Kamau (2022) observed that weak control environments contribute to delays in development expenditure and underutilisation of funds, whereas Mutiso and Musyoka (2023) established that inadequate internal controls are associated with inefficient use of public resources in Kenyan counties. Waweru and Ngugi (2024) further demonstrated that counties with stronger control mechanisms tend to achieve higher budget absorption rates. However, most studies concentrated on overall financial performance or accountability rather than absorption efficiency and frequently relied on perception-based survey data instead of objective audit indicators. Furthermore, few studies specifically examined donor-funded programmes such as KDSP. The present study addresses these gaps by using audit-based measures of internal financial control strength and evaluating their effect on aid fund absorption efficiency using county-level panel data.

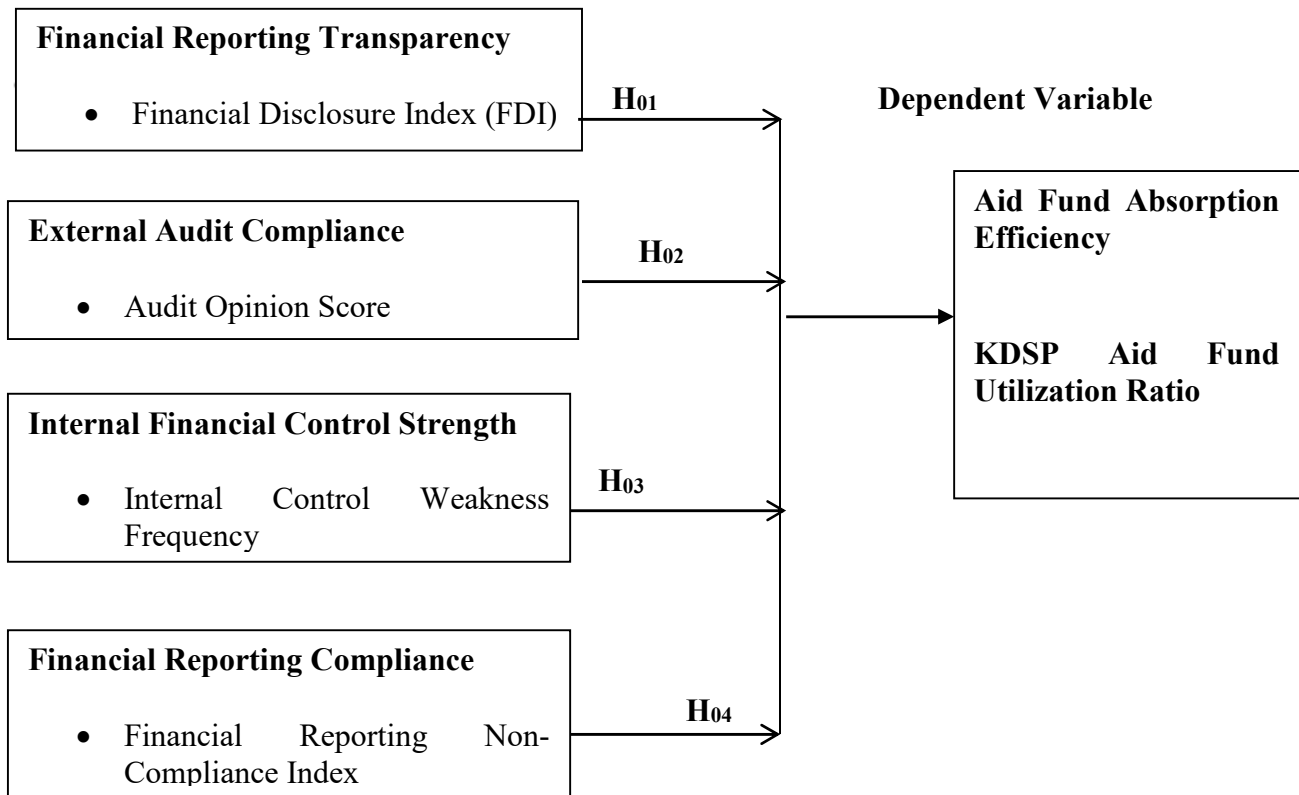
### **Financial Reporting Compliance and Absorption Efficiency**

Previous empirical evidence suggests that compliance with financial reporting requirements contributes to improved accountability and more efficient utilisation of public resources. Kaya and Koch (2020) established that compliance with reporting standards enhances transparency and expenditure efficiency in European public institutions, while Tetteh, Agyemang, and Yeboah (2021) found that compliance strengthens accountability and resource utilisation among public institutions in Ghana. Similarly, Mzenzi and Gaspar (2022) reported that weak financial reporting compliance contributes to inefficiencies in development fund utilisation across Sub-Saharan Africa, whereas Mwangi and Kinyua (2023) observed that non-compliance with reporting requirements is associated with delays in expenditure implementation within Kenyan counties. Otieno and Wanjiru (2024) further found that counties exhibiting higher levels of compliance achieve better expenditure outcomes. Nevertheless, most of these studies focused on accountability or financial performance rather than aid fund absorption efficiency and often relied on perception-based or macro-level measures without considering KDSP-specific utilisation dynamics. The current study addresses these conceptual, methodological, and contextual limitations by operationalising financial reporting compliance using objective indicators and examining its effect on the absorption efficiency of aid funds under the Kenya Devolution Support Programme.

### **Conceptual framework**

The figure below presents the conceptual framework illustrating the relationship between financial governance mechanisms and the absorption efficiency of aid funds under the Kenya Devolution Support Programme in Kenya.

**Independent variables**



*Figure 2.1 Conceptual Framework  
Researcher, 2025*

**RESEARCH METHODOLOGY**

The study adopted the positivist research philosophy because it relied on quantitative and objective data obtained from official government reports and audited financial statements relating to county governments under the Kenya Devolution Support Programme (KDSP). Positivism was considered appropriate because the study sought to empirically test the relationships between financial governance mechanisms and the absorption efficiency of aid funds through hypothesis testing and statistical analysis using secondary panel data (Saunders, Lewis, & Thornhill, 2019; Gujarati & Porter, 2020). The study further employed an explanatory panel research design because it aimed to determine whether variations in financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance significantly influenced the absorption efficiency of aid funds across county governments over time. The panel design was appropriate since it combined both cross-sectional and time-series dimensions, thereby improving estimation efficiency while controlling for unobserved county-specific characteristics (Baltagi, 2021; Wooldridge, 2020).

The target population comprised all the forty-seven (47) county governments in Kenya that participate in the Kenya Devolution Support Programme. A census approach was adopted because the population was manageable and provided adequate observations for panel regression analysis while eliminating sampling bias (Controller of Budget, 2024; Field, 2022). The study utilised secondary panel data extracted from the Office of the Auditor-General reports, the Office of the Controller of Budget reports, World Bank programme reports, and other official county financial reports covering the period 2019–2024. Absorption efficiency of aid funds constituted the dependent variable and was measured using the KDSP aid fund utilisation ratio, defined as aid funds utilised divided by aid funds disbursed. Financial reporting transparency was measured using the Financial Disclosure Index, external audit compliance through the audit opinion score, internal financial control strength using the frequency of reported internal control weaknesses, and financial reporting compliance using the Financial Reporting Non-Compliance Index.

Secondary data were collected using a structured data extraction sheet developed to ensure consistency in coding and computation of variables across counties and years, an approach that has been successfully applied in similar county-level financial management studies (Malla & Gitagia, 2026). Data analysis was conducted using Stata software through descriptive statistics, correlation analysis, and panel regression analysis. Fixed effects and random effects estimation models were specified, and the Hausman specification test was employed to determine the appropriate panel estimator (Baltagi, 2021; Wooldridge, 2020). To ensure the validity and reliability of statistical inference, diagnostic tests including multicollinearity, model specification, heteroskedasticity, autocorrelation, and normality tests were undertaken (Greene, 2020; Cameron & Trivedi, 2022). Ethical principles were observed by appropriately acknowledging all secondary data sources, maintaining transparency in variable measurement and data processing, ensuring objective analysis of audited financial information, and adhering to accepted academic research standards throughout the study (Sekaran & Bougie, 2020; Creswell & Creswell, 2021).

### **Descriptive Analysis**

This section presents the descriptive statistics for absorption efficiency of aid funds, financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance among county governments in Kenya. The descriptive statistics include the mean, median, maximum, minimum, standard deviation, skewness, and kurtosis, providing an overview of the distribution and central tendency of the study variables before inferential analysis.

**Table 4.1: Descriptive Statistics**

| <b>Statistic</b>   | <b>Absorption Efficiency of Aid Funds</b> | <b>Financial Reporting Transparency</b> | <b>External Audit Compliance</b> | <b>Internal Financial Control Strength</b> | <b>Financial Reporting Compliance</b> |
|--------------------|---|---|----------------------------------|--|---------------------------------------|
| Mean               | 0.5878                                    | 0.7092                                  | 2.6844                           | 63.2092                                    | 68.1560                               |
| Median             | 0.5881                                    | 1.0000                                  | 3.0000                           | 64.0000                                    | 70.0000                               |
| Maximum            | 0.6670                                    | 1.0000                                  | 4.0000                           | 100.0000                                   | 100.0000                              |
| Minimum            | 0.5042                                    | 0.0000                                  | 1.0000                           | 0.0000                                     | 10.0000                               |
| Standard Deviation | 0.0303                                    | 0.4549                                  | 1.0687                           | 18.4437                                    | 18.7360                               |
| Skewness           | 0.0129                                    | -0.9214                                 | -0.4507                          | -0.2044                                    | -0.6128                               |
| Kurtosis           | 2.6180                                    | 1.8490                                  | 1.9596                           | 2.9124                                     | 3.0456                                |
| Observations (n)   | 282                                       | 282                                     | 282                              | 282  | 282                                   |

*Source: Research Data, 2026*

The results in Table 4.1 show that the mean absorption efficiency of aid funds was 0.5878, while the median was 0.5881, indicating that county governments utilised approximately 58.8 percent of the Kenya Devolution Support Programme (KDSP) funds disbursed during the study period. The relatively small difference between the mean and median suggests a fairly symmetric distribution of absorption performance across counties. The maximum and minimum values reveal differences in utilisation levels among counties, while the standard deviation of 0.0303 indicates relatively low variability. The skewness value of 0.0129 and kurtosis of 2.6180 further suggest that absorption efficiency was approximately normally distributed.

Financial reporting transparency recorded a mean value of 0.7092 and a median of 1.0000, implying that approximately 71 percent of county-year observations complied with the expected financial disclosure requirements. The minimum and maximum values of 0 and 1 demonstrate differences in disclosure practices across counties and years. The negative skewness value of -0.9214 indicates that most observations were concentrated at higher levels of transparency, while the kurtosis value suggests a relatively stable distribution.

External audit compliance recorded an average score of 2.6844, with a median of 3.0000, indicating that most county governments received audit opinions ranging between qualified and unqualified opinions during the study period. The variation between the minimum and maximum values reflects differences in audit outcomes across counties, while the standard deviation of

1.0687 indicates moderate dispersion in audit compliance practices. The slight negative skewness further suggests that relatively more counties attained better audit outcomes.

Internal financial control strength recorded a mean value of 63.2092, indicating that county governments achieved approximately 63 percent of the expected internal control standards based on audit evaluations. The wide range between the minimum and maximum values and the relatively high standard deviation of 18.4437 reveal considerable differences in the effectiveness of internal control systems across counties. The slightly negative skewness suggests that a greater proportion of observations exhibited relatively stronger internal control systems.

Financial reporting compliance recorded an average value of 68.1560, implying that county governments complied with approximately 68 percent of the applicable financial reporting requirements during the study period. The considerable spread between the minimum and maximum values demonstrates variation in reporting practices across counties. The negative skewness and kurtosis values close to three indicate that most observations were concentrated around relatively higher compliance levels with no evidence of excessive outliers.

### **Regression Analysis**

A fixed effects panel regression model was estimated to determine the effect of financial governance mechanisms on the absorption efficiency of aid funds under the Kenya Devolution Support Programme in Kenya. Prior to model estimation, diagnostic tests confirmed that the assumptions necessary for panel regression analysis were satisfactorily addressed. The analysis utilised balanced panel data obtained from all 47 county governments covering the period 2019–2024.

### **Model Summary**

*Table 4.7: Model Summary*

| <b>Model</b> | <b>R</b>           | <b>R<sup>2</sup></b> | <b>Adjusted R<sup>2</sup></b> | <b>Std. Error of the Estimate</b> |
|--------------|--------------------|----------------------|-------------------------------|-----------------------------------|
| 1            | 0.842 <sup>a</sup> | 0.709                | 0.697                         | 0.0238                            |

*Source: Research Data, 2026*

The findings indicate that the explanatory variables jointly explained a substantial proportion of the variation in absorption efficiency of aid funds among county governments in Kenya. Specifically, the coefficient of determination ( $R^2 = 0.709$ ) shows that financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance explained 70.9 percent of the observed variation in absorption efficiency. The adjusted  $R^2$  value of 0.697 confirms that the model retained strong explanatory power after adjusting for the number of explanatory variables included. In addition, the correlation coefficient ( $R = 0.842$ ) indicates a strong positive relationship between financial governance mechanisms and absorption efficiency of aid funds.

**Table 4.8: Analysis of Variance**

| Source     | Sum of Squares | df  | Mean Square | F       | Sig.               |
|------------|----------------|-----|-------------|---------|--------------------|
| Regression | 0.1568         | 4   | 0.0392      | 168.214 | 0.000 <sup>b</sup> |
| Residual   | 0.0645         | 277 | 0.0002      |         |                    |
| Total      | 0.2213         | 281 |             |         |                    |

The ANOVA results demonstrate that the overall regression model was statistically significant. The F-statistic of 168.214 with a p-value less than 0.05 indicates that the combined financial governance mechanisms significantly explained variations in absorption efficiency of aid funds under the Kenya Devolution Support Programme. This implies that financial governance practices collectively exerted a statistically significant influence on county governments' ability to utilise KDSP resources efficiently.

**Table 4.9: Regression Coefficients (Dependent Variable: Absorption Efficiency of Aid Funds)**

| Variable                            | Coefficient | Std. Error | t-Statistic | p-value |
|-------------------------------------|-------------|------------|-------------|---------|
| Constant                            | 0.3274      | 0.0286     | 11.4476     | 0.000   |
| Financial Reporting Transparency    | 0.0318      | 0.0072     | 4.4167      | 0.000   |
| External Audit Compliance           | 0.0185      | 0.0049     | 3.7755      | 0.001   |
| Internal Financial Control Strength | 0.0016      | 0.0003     | 5.3333      | 0.000   |
| Financial Reporting Compliance      | 0.0013      | 0.0004     | 3.2500      | 0.002   |

*Source: Research Data, 2026*

The regression results reveal that all dimensions of financial governance had positive and statistically significant effects on absorption efficiency of aid funds among county governments in Kenya. The intercept coefficient was positive and statistically significant, suggesting that counties maintained a baseline level of fund absorption even in the absence of changes in the explanatory variables.

Financial reporting transparency recorded a positive and statistically significant coefficient ( $\beta = 0.0318$ ), indicating that improved disclosure of financial information enhanced the utilisation of KDSP resources. Greater transparency strengthened accountability and facilitated effective monitoring of programme implementation, thereby improving fund absorption.

External audit compliance also exhibited a positive and statistically significant coefficient ( $\beta = 0.0185$ ), implying that counties with better compliance with statutory audit requirements achieved higher absorption efficiency. Compliance with audit recommendations strengthened financial accountability and reduced governance weaknesses that could delay programme implementation.

Internal financial control strength recorded a positive and statistically significant coefficient ( $\beta = 0.0016$ ), demonstrating that stronger internal control systems enhanced expenditure management and reduced financial irregularities, thereby promoting efficient utilisation of aid funds.

Similarly, financial reporting compliance had a positive and statistically significant coefficient ( $\beta = 0.0013$ ), suggesting that greater adherence to prescribed financial reporting standards improved transparency, accountability, and the timely utilisation of KDSP resources.

### **Regression Model**

$$\text{AEAF}_{it} = 0.3274 + 0.0318\text{FRT}_{it} + 0.0185\text{EAC}_{it} + 0.0016\text{IFCS}_{it} + 0.0013\text{FRC}_{it} + \varepsilon_{it}$$

The regression model demonstrates that financial governance significantly influenced the absorption efficiency of aid funds under the Kenya Devolution Support Programme in Kenya. Among the explanatory variables, financial reporting transparency exerted the greatest positive influence, followed by external audit compliance, while internal financial control strength and financial reporting compliance also contributed positively to improved utilisation of programme resources. Overall, the findings provide strong empirical evidence that strengthening financial governance enhances the efficient absorption of aid funds among county governments in Kenya.

## **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### **Summary**

This study examined the effect of financial governance on the absorption efficiency of aid funds under the Kenya Devolution Support Programme in Kenya. The findings presented in Chapter Four demonstrated that financial governance mechanisms significantly influenced the efficient utilisation of aid resources among county governments. The summary is organised according to the specific objectives of the study and highlights the effects of financial reporting transparency, external audit compliance, internal financial control strength, and financial reporting compliance on absorption efficiency of aid funds.

With respect to the first objective, the study established that financial reporting transparency had a positive and statistically significant effect on the absorption efficiency of aid funds. County governments with greater transparency in financial reporting achieved higher levels of utilisation of Kenya Devolution Support Programme resources. The findings indicate that timely and comprehensive disclosure of financial information enhances accountability and supports effective implementation of donor-funded programmes.

Regarding the second objective, the findings revealed that external audit compliance had a positive and statistically significant effect on the absorption efficiency of aid funds. County governments that complied with statutory audit requirements and implemented audit recommendations demonstrated better utilisation of programme resources. The results suggest that effective audit

oversight strengthens financial accountability and promotes prudent management of development funds.

Concerning the third objective, the study established that internal financial control strength had a positive and statistically significant effect on the absorption efficiency of aid funds. Counties with stronger internal financial control systems exhibited higher levels of fund utilisation, implying that effective control mechanisms improve expenditure management, minimise financial irregularities, and enhance implementation of programme activities.

Finally, the study found that financial reporting compliance had a positive and statistically significant effect on the absorption efficiency of aid funds under the Kenya Devolution Support Programme. County governments that complied more effectively with prescribed financial reporting requirements achieved better programme implementation outcomes and higher utilisation of disbursed resources. The findings therefore demonstrate that financial governance is an important determinant of absorption efficiency among county governments in Kenya.

## **Conclusions**

The study concluded that financial governance significantly influences the absorption efficiency of aid funds under the Kenya Devolution Support Programme in Kenya. With regard to the first objective, financial reporting transparency was found to have a positive and statistically significant effect on absorption efficiency of aid funds. County governments that enhanced transparency through timely and comprehensive disclosure of financial information achieved better utilisation of programme resources, demonstrating that transparency strengthens accountability and improves implementation performance.

Regarding the second objective, external audit compliance had a positive and statistically significant effect on absorption efficiency of aid funds. Compliance with statutory audit requirements and implementation of audit recommendations strengthened financial accountability and promoted efficient utilisation of development resources.

In relation to the third objective, the study established that internal financial control strength positively and significantly influenced absorption efficiency of aid funds. Strong internal control systems enhanced expenditure management, reduced financial irregularities, and improved utilisation of Kenya Devolution Support Programme resources.

Finally, financial reporting compliance was found to have a positive and statistically significant effect on absorption efficiency of aid funds. Compliance with prescribed financial reporting standards enhanced financial accountability and contributed to more efficient utilisation of donor-funded resources among county governments.

### **Policy Implications and Recommendations of the Study**

The recommendations of the study are based on the empirical findings and are directed to county governments, the National Treasury, the Office of the Controller of Budget, the Office of the Auditor-General, development partners, policymakers, and other stakeholders involved in the implementation of the Kenya Devolution Support Programme.

With respect to the first objective, county governments should strengthen financial reporting transparency by ensuring timely publication of programme financial reports, budget execution reports, and expenditure disclosures. Internal audit units should periodically review financial disclosures to ensure completeness and compliance, while the National Treasury and development partners should reinforce monitoring frameworks that promote transparency as a condition for continued programme financing.

Regarding the second objective, county governments should strengthen compliance with external audit requirements by promptly addressing audit queries and implementing recommendations issued by the Office of the Auditor-General. County audit committees should establish structured mechanisms for monitoring implementation of audit recommendations, while oversight institutions should continue providing technical assistance and capacity-building initiatives aimed at improving audit compliance.

Concerning the third objective, county governments should reinforce internal financial control systems by strengthening expenditure monitoring procedures, segregation of duties, approval mechanisms, risk management practices, and internal audit functions. The National Treasury should continue supporting counties through technical assistance programmes that enhance internal financial management capacity and strengthen public financial governance.

Finally, county governments should improve financial reporting compliance by ensuring timely preparation and submission of complete and accurate financial reports that fully comply with statutory and programme-specific requirements. Internal compliance review mechanisms should be strengthened, while the National Treasury, the Office of the Controller of Budget, and the Office of the Auditor-General should intensify compliance assessments and capacity-building programmes to enhance financial accountability and improve absorption efficiency of aid funds.

### **Suggestions for Further Research**

Future studies should investigate the moderating or mediating effects of variables such as county institutional capacity, political leadership, intergovernmental fiscal relations, and information and communication technology adoption on the relationship between financial governance and absorption efficiency of aid funds.

Future researchers may also combine secondary and primary data by collecting information from county finance officers, accounting officers, internal auditors, audit committee members, officials

from oversight institutions, and development partners to provide deeper operational insights into financial governance practices affecting programme implementation.

In addition, similar studies may be undertaken on other donor-funded programmes implemented by national or county governments or extended to other East African countries to determine whether similar relationships exist under different governance and public financial management environments.

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