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EFFECTS OF INTERNAL CONTROL SYSTEMS ON THE FINANCIAL PERFOMANCE OF SACCOS IN KENYA; CASE STUDY OF SACCOs IN KISII COUNTY

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Abstract

Internal control systems are the most important and challenging issue in the SACCOs in Kenya. Making sure SACCOs manage their internal control systems is essential to streamlining operations and minimizing unnecessary financial costs which in turn affect their growth. Inadequate internal control systems probably the most frequent stumbling block for the growth of SACCOs in Kenya. The study was restricted to the effects of internal control systems on the financial performance of SACCOs in Kisii County, Kenya. SACCOs in Kisii County which was the research study in question found this study important because it offered out ways of improving its operations and strategies in providing the services to its customers. The specific objective of the study was to establish the extent to which risk assessment, accounting control and administrative control contribute to the financial performance of SACCOs. The coefficient of determination proved that the independent variables contributed to 75.7% of the variation in financial performance as explained by adjusted R2 of 0.757 which shows that internal control systems influence the performance of SACCOs.

Keywords: financial performance, internal control systems

Background of the Study

Internal Controls are processes designed and affected by those charged with governance, Management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Increasingly, reliability of financial reporting in accounting context is very important for the investors who use the information for decision management as supported by (Jenning et al., 2008). The reliability of financial reporting is effective to internal control efficiency to ensure that the transactions and bookkeeping are appropriate and properly authorized, valid, correctly recorded, complete, and on time.

Moreover, it is very important that organizations have fairly summarized accounting information data disclosure. However, in general, a quality reporting is affected by internal control mechanism. It is a general belief that properly instituted systems of internal control improve the reporting process and also give rise to reliable reports which enhances the accountability function of management of an entity.

Appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. Performance is the ability to operate efficiently, profitability, survives, grow and react to the environmental opportunities and threats. The study will focus on Control Environment, Internal Audit, and Control activities whereas financial performance will be looked at basically from the three perspectives of Liquidity, Accountability and Reporting.

Organizational performance encompasses accumulated end results of all the organization's Work processes and activities. Performance measures can be financial or non-financial. Both measures are used for competitive firms in the dynamic business environment. Financial measures of organizational performance include; return on assets, return on sales, return on equity, return on investment, return on capital employed and sales growth.

Statement Of The Problem

Internal control systems are the most important and challenging issue in the SACCOs in Kenya. Making sure SACCOs manage their internal control systems is essential to streamlining operations and minimizing unnecessary financial costs which in turn affect their growth. Inadequate internal control systems probably the most frequent stumbling block for the growth of SACCOs in Kenya. Data from ministry of trade and cooperatives indicate that SACCOs revenues in the larger Kisii County has dropped by 15% also, indicates that 32.3% of the SACCOs in Kisii County have closed down in the past five years, most of the SACCOs are under performing probably because of inadequate internal control systems. Internal control systems is an integral part of running SACCOs, organizations fail due to liquidity problems to support their day-to-day activities than because of inadequate management of other resources (Singh and Lakanatan, 2002). It should be noted that SACCOs are presently facing severe shortages of liquidity cash to carry their daily operations. Good internal control systems will ensure there is sufficient cash to finance the business plans and cushion economic down town. SACCOs with sufficient internal control systems can confidently focus on business operations but a firm suffering from inadequate internal control systems must constantly reexamine and modify its plans, exerting enormous energies to obtain and keep additional financing. This study therefore proposes to assess the influence of internal control systems on the financial performance of SACCOs in Kenya with particular interest in Kisii County.

Study's Objectives

The study was guided by the following specific objectives:

i. To establish the extent to which risk assessment control systems influences performance of SACCOs in Kenya.

ii. To find out the extent to which accounting control systems influences the performance of SACCOs.

iii. To find out the extent to which internal administrative control systems influences the performance of SACCOs.

Research Design

The target population which was the totality of the cases comprised of 168 respondents. The sample size was 70.2% of the target population which comprised of 118 respondents. The study employed a descriptive research design. A questionnaire was used for data collection and data was analyzed with both qualitative and quantitative methods. Descriptive statistics involved the use of frequency, means, tables, and percentages. Inferential statistics involved the use of regression analysis to assess the strength and association of the variables in the study.

Sample Size

Since the overall population is heterogeneous, stratified random sampling was used in the study to select the respondents. Yamane (1967) provides a simplified formula to calculate sample sizes. This formula was used to calculate the sample sizes as shown below.

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

Where n is the sample size, N is the population size, and e is the level of precision or margin of error at 5% (standard value of 0.05). When this formula was applied to the above sample, we got;

$$n = \frac{168}{1+168(0.05)^2} = 118$$

Table 1

Type of SACCO	Branch manager	Credit manager	Accountant	Total
Employee based saccos	10	18	28	56
Rural saccos	10	18	28	56
Transport bases saccos	10	18	28	56
Total	30	54	84	168

Regression Analysis

A study was conducted on the relationship between internal controls and financial performance of SACCOs in Kisii county, Kenya. The analysis applied the statistical package for social sciences (SPSS) to compute the measurements of the multiple regressions for the study. The study evaluated the independent variables and the dependent using questionnaires. The findings are provided below:

Model Summary

The model summary shows the summary of the regression analysis as shown in the regression model. Below are the findings in the table 2.

Table 2: Model Summary

Model	R	R Squared	Adjusted R Squared	Std. Error of the Estimate
1	.957(a)	.916	.757	.250

In order, to explain the percentage of variation in the dependent variable financial performance as explained by the independent variables. The researcher used coefficient of determination that was obtained from the model summary in the table 4.8. Coefficient of determination was used to explain whether the model is a good predictor. From the results of the analysis, the findings show that the independent variables (risk assessment, accounting control, administrative control) contributed to 75.7% of the variation in financial performance as explained by adjusted R2 of 0.757% which shows that the model as a good prediction.

Analysis of Variance

The study conducted an Analysis of Variance, in order to test the impact of the relationship between internal controls and financial performance of the SACCOs. The findings were as shown below:

Table 3: ANOVA

Model	sum of squares	Df	Mean square	F	Sig.
Regression	2.117	31	0.4234	4.888	.001(a)
Residual	1.213	87	0.0866		
Total	5.24	118			

The results of the findings above revealed that the level of significance was .001(a) this implies that the regression model is significant in predicting the relationship between internal control and financial performance. By the help of an F-test table, the tabulated value for F (5%, 5, 14) is 2.96 which was less than 4.888 meaning that the model was statistically significant.

Test for Coefficients

This table shows the level of significance on the variables, it also provides the standardized and unstandardized coefficients are shown below:

Table 5 Test for Coefficients

	Unstandardized Coefficients	standardised Coefficients			
Model	B	Std. error	Beta	t	sig.
1 constant	0.989	2.163		5.331	.000
Control systems	.483	.395	.612	1.211	.004
Challenges of implementation internal controls	.101	.2005	.328	-.815	.001
control activities	.213	.1331	.637	1.609	.003
information and communication	-.328	1.001	-.961	.976	.006
Monitoring	.892	0.224	.843	.542	.005

Dependent variable: financial performance

From the above table 5, the researcher sought to establish the extent to which internal control impact on financial performance of SACCOs‟. The following regression equation was obtained:

ROA= 0.989+.483X1+.101X2+.213X3- .338X4+.892X5

From the above regression model holding all the other factors constant, financial performance is measured by the efficiency and effective implementation of internal controls. The results of the multiple regression model shows that there is a positive relationship between internal control and financial performance of the SACCOs. This implies that a single unit increase in any of the independent variables results into a corresponding increase in financial performance of the SACCOs. The regression analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the corresponding probability value obtained and $\alpha=0.05$. If the probability value was less than α, then the predictor variable was significant but from the above analysis. The results above shows that the variables were significant since their corresponding predictor values were below 5% apart from information and communication which had 6% meaning that an inverse relationship existed between internal control and financial performance of the SACCO.

Conclusions

Risk Assessment Control

From the findings of the study, it was concluded that SACCOs that had invested on effective internal control systems had more improved financial performance as compared to those SACCOs that had a weak internal control system. From the findings, it was revealed that those SACCOs that observed integrity, ethical values, risk assessment, control activities, monitoring and information communication technology recorded high financial performance. Most SACCOs that fully invested in strong internal control systems were able to mitigate fraud.

Accounting Control

Based on the study findings, the results indicated that some SACCOs faced challenges in effective implementation of internal control systems due lack of sufficient resources to hire competent staff and to invest in modern technologies for example information communication technology. The findings of the study found that control activities had a significant positive relationship with financial performance indicators.

Administrative Control

Similarly the other variables for instance control environment, risk assessment and information communication technology was also found to have a positive relationship with financial performance of SACCOs in Kenya apart from monitoring that revealed a negative relationship with financial performance of SACCOs. From the findings of the study internal reviews of internal control units of most SACCOs were not conducted periodically, monitoring was not carried out regularly and untimely assigning of audit reports leading to lack of compliance of audit reports if done the SACCOs will achieve good financial performance.

Recommendation

Risk Assessment

The study recommends that both internal and external auditor should be constantly updated and well grounded on international financial reporting standards (IFRS) and principles in order to enhance their knowledge and skills in application of accounting practices and to keep them updated on the contemporary issues.

Kenya SACCOs regulation authority should monitor and supervise SACCOs to ensure that the accountants comply with accounting regulations and requirement as provided by the Institute of Certified Public Accountants to ensure proper implementation and compliance with accounting standards and principles.

Accounting Control

Organizations should develop a mechanism to incorporate relevant feedback from the various stakeholders into their internal control system. SACCOs should develop and organize constant seminars and workshops to train and educate auditors and accountant on matters pertaining proper implementation of accounting policies and procedures to enhance their skills and expertise in their practice as professionals.

Administrative Control

The study further recommends that the governing body, possibly supported by the audit committee, should ensure that the internal control system is periodically monitored and evaluated. The actual assessment can be executed by the organization's management. A staff person who is sufficiently independent from those responsible for the system, such as the internal auditor, could provide additional assurance on the effectiveness and cost efficiency of the internal control system. The SACCOs should transparently report on the structure and performance of their governance, risk management, and internal control system in their various reports to internal and external stakeholders, such as through their periodic accountability reports or on the organization's website.

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