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IMPACT OF INTERNAL CONTROL PROCEDURES AND MONITORING ON FINANCIAL PERFORMANCE OF SACCOS IN KENYA. A CASE OF THARAKA NITHI COUNTY.

Kangogo Kipkosgei Mathew
Researcher, Faculty of Business studies, Chuka University, Kenya

Abstract

The Savings and Credit Cooperative Societies sector is considered both economically and socially important. The sector has continued to mobilize savings and developed demand driven financial products which has encouraged members to save additional resources to finance education from primary to university through affordable loans to the members. However, sectoral report indicates that nearly 5% of Savings and Credit Cooperative Societies collapse every year and registered members withdraw their membership annually. Therefore, there was the need to investigate the real cause of this problem. The main aim of the study was to establish the impact of internal control procedures and monitoring on financial performance of Savings and Credit Cooperative Societies in Kenya. The specific objectives of the study were to establish the impact of internal control procedures and monitoring on financial performance of Savings and Credit Cooperative Societies in Tharaka Nithi County. The study adopted descriptive research design on the target population of 208 members of staff from ten Savings and Credit Cooperative Societies within Tharaka Nithi County. The study employed a non-probabilistic purposive sampling technique to come up with a sample of 69 members of staff. The study used both primary and secondary data. The questionnaires were pre-tested to ensure validity and reliability. The study used secondary data for three years (2013-2015). Multiple regression analysis was used to determine the relationship between dependent and independent variables. A t-test and F-ratio were applied to test hypotheses and overall significance of the regression model at 5% significance level. Findings of the study indicated that both control procedures and monitoring had a positive and significant impact on financial performance of Savings and Credit Cooperative Societies. This implies that both internal procedures and monitoring are major determinants of financial performance of Savings and Credit Cooperative Societies. The study findings would benefit Savings and Credit Cooperative Societies, government and other policy makers in providing policies that are backed with research findings. The study recommends the Savings and Credit Cooperative Societies to put in place effective policies to ensure proper implementation of control procedures and monitoring measures.

Keywords: Control Procedures, Monitoring, Financial Performance, SACCOs.

INTRODUCTION

Background of the Study

Internal control procedures and monitoring are crucial to success and survival of any firm in today's complex and dynamic environment. They keep the organization on the right truck. But in many instances organizations go off the rails thus impacting negatively on the attainment of the set objectives (Committee of Sponsoring Organizations (COSO), 1992/2008). As a result of increased number of business failure and financial scandals, organizations have started to shift their focus to improving effectiveness of their internal control procedures and Monitoring measures. Management is under a lot of pressure to institute effective internal controls and communicate regularly to board of directors and shareholders (Kuhn & Sutton, 2010).

Control procedures are the policies and activities in addition to the control environment, which the management has established to achieve the entity's specific objectives (Amudo & Inanga, 2009). The mix of types of controls implemented by management will depend on the control objectives and the size of the entity. Control activities include a combination of manual controls and automated controls (Millichamp, 1999). Effective communications should occur in a broad sense with information flowing down, across, and up within all the sections of the organization. Maintenance of strong internal control system enables a company to reduce wastage; prevent errors and cases of fraud; improvement in safe custody of organization's assets; it increases reliability and dependability of accounting data through elimination of unnecessary suspicion and maintenance of adequate and accurate accounting records (Amudo & Inanga, 2009).

However, the presence of weak internal control procedures and monitoring have been the main cause of many cases of fraudulent company financial reporting and global corporate accounting scandals in the recent years (COSO, 2008). Globally, an example of accounting scandal was recorded in WorldCom a telecommunication company in USA. As a result of loopholes in their internal control system the company lost $3.8bn. The scandal involved manipulation of reserves to create the accounting equivalent of a slush fund (Treadway Commission, 2008). Locally, report compiled by the SACCO Societies Regulatory Authority, 2015 showed that some SACCOs have been using creative accounting tactics to cover up fraud and non-payment of loans by some members.

In Kenya, the Savings and Credit Cooperative Societies subsector remains a significant player in the provision of financial services to the Kenyan households and small businesses segments. Total deposits for the sector stood at Kshs.241 billion posting an increase of 8.4 % from Kshs. 213 billion in 2012. Loans to members grew by 32 billion to stand at Kshs. 253 billion up from 221 billion in 2012 (SASRA report, 2013). However, despite this growth, out of the 7,400 registered SACCOs equivalent to 42% of all co-operatives, only 3800 are active and 215 have Front Office Service Activities offering basic banking services across the country (SASRA, 2011).

The following specific objectives guided the study:

i. To establish the impact of control procedures on financial performance of SACCOs in Tharaka Nithi County.
ii. To establish the impact of monitoring on financial performance of SACCOs in Tharaka Nithi County.

In order to achieve the above specific objectives, the following null hypotheses guided the study:
H_{01}: Control procedures have no significant impact on financial performance of SACCOs in Tharaka Nithi County.
H_{02}: Monitoring has no significant impact on financial performance of SACCOs in Tharaka Nithi County.

METHODOLOGY

The study adopted a descriptive survey study research design which was aimed at examining the impact of internal control procedures and monitoring on financial performance of SACCOs in Kenya a case of Tharaka Nithi County. Descriptive research portrays an accurate profile of persons, events, or situation (Robson, 2002). A descriptive survey is usually concerned with describing a population with respect to important variables with the major emphasis on establishing the relationship between the variables in question and reporting the way things are (Zikmund et al, 2010). The study was undertaken in Tharaka Nithi County, Kenya. The County had both SACCOs licensed and those not licensed by SASRA. This gave the researcher a chance to study both scenarios in context of their internal control procedures and monitoring measures.

The study adopted purposive sampling technique to select 69 respondents from a population of 208 individuals drawn from ten Savings and Credit Cooperative Societies in the County. This method of sampling was used because it enabled the researcher to select cases from the population that have the required information for the study. According to Palys (2008), the main goal of purposive sampling is to focus on particular characteristics of a population that are of interest, which will best enable a researcher to answer the research questions.

The primary data was collected through the use of structured questionnaires issued to the respondents. The secondary data was obtained from SACCOs' financial statements, SASRA annual reports and journals. The structured questionnaires were administered through a drop and pick later method at an agreed time with the respondents. According to Mugenda and Mugenda (2003) a questionnaire is a series of questions asked to individuals to obtain statistically useful information about a given topic. A five point Likert scale ranging from very great extent to no extent was used in measuring the extent of the responses provided.

A multiple regression model was adopted to check the form of relationship between the dependent and the independent variables. This model was adopted, since it is used when one is interested in predicting a continuous dependent variable from a number of independent variables. Hypotheses were tested using t-test at five percent significance level. The p-value for each t-test was used to make conclusions on whether to fail to accept or fail to reject the null hypotheses. If the p-value for t-test was less than 5% (0.05) then null hypothesis failed to be accepted and the alternate hypothesis failed be rejected. Also if the p-value was greater than 5% (0.05) then null hypothesis failed to be rejected and the alternate hypothesis failed to be accepted. Fischer distribution test called F-test was applied in testing the significance of the overall model at a 5% significance level. The variables in the study were related using a multiple regression model of the form:

$$FP=\beta 0 + \beta 1X1 + \beta 2X2 + \varepsilon$$

Where

FP= Financial performance of SACCOs in Tharaka Nithi County, Kenya

$\beta 0$= Constant

$\beta 1$, $\beta 2$ = Predictor variable coefficients

X1= Control Procedures

X2=Monitoring

ε= Error term

The study performed diagnostic tests on the model to determine whether regression assumptions hold. The assumptions of the model that were tested included Normality, Multicollinearity and Autocorrelation.

RESULTS AND DISCUSSIONS

A total of 69 questionnaires were administered and out of this 66 questionnaires were properly filled and returned by the SACCOs staff members. This represented a successful response rate of 95.65%. Majority of the respondents were from management level cumulatively consisting of 60.6% of the total respondents while the remaining 39.4% were employees. Therefore, majority of the respondents in the study were those directly responsible for or directly involved in the implementation of the Internal Control procedures and monitoring. Therefore, their responses are deemed to reflect what actually takes place in the organization.

The respondents were requested to determine the extent of functionality of internal control procedures and monitoring in their organization in a five point Likert scale. The statements were ranked in terms of their means and standard deviations so as to deduce meaning out of the results. The range was from very great extent to no extent. Great extent was assigned the value

(5) while no extent was assigned the value (1). A standard deviation greater than 1.5 was taken to imply a significant variation in the responses provided by respondents under the study.

Control Procedures

The study sought to determine the extent to which the control procedures of the institution impacts on the financial performance of SACCOs in Kenya. Table 1 below shows the results obtained.

Table 1
Control Procedures

Control Procedures	N	Mean	Std. Dev
Our organization has clear separation of roles	66	3.64	1.283
Every employee's work is checked by others	66	3.17	1.111
There is appropriate supervision by senior staff on the work done by their juniors	66	3.59	.990
Corrective action is always taken to address weaknesses	66	3.36	1.098
It is impossible for a member of staff to have access to all available information without the consent of senior staff	66	4.19	.809
Our security system identifies and safeguards the organizations assets	66	4.10	1.073
Controls are in place to avoid incurring expenditure in excess of allocated funds	66	3.39	1.032
Our SACCO has an internal audit department	66	3.46	1.587
Our internal audit function is sufficiently staffed	66	3.13	1.514
Internal audit staff conduct regular audit activities in our organization	66	3.35	1.739
Internal audit reports address weaknesses in our internal control system	66	3.42	.991
Valid N (list wise)	66		

From the findings on table 1 above, most of the SACCOs had control procedures in place. The results revealed that it was impossible for members of staff to have access to all available information without the consent of senior staff having a mean of 4.19 and a standard deviation 0.809 indicating low variation in the responses. Security system identifying and safeguarding the organizations assets was also highly ranked with a mean of 4.10 and a standard deviation 1.073 indicating low variation in responses. SACCOs having an internal audit department (M=3.47, SD=1.78), internal audit function being sufficiently staffed (M=3.13, SD=1.514) and Internal audit staff conducting regular audit activities in the organization (M=3.35, SD=1.739) received varied responses (S. D>1.5). These results clearly indicate that majority of the SACCOs observed control procedures.

Monitoring

The study sought to determine the extent to which monitoring measures of the institution affected the financial performance of SACCOs in Kenya. Table 2 below shows the results obtained.

Table 2
Monitoring

Monitoring	N	Mean	Std. Dev
There are independent processes, checks and evaluations of control activities on ongoing basis	66	3.83	1.057
Internal reviews of implementation of internal controls in units are conducted periodically	66	3.49	1.120
Monitoring has helped in assessing the quality of performance of the organization over time	66	4.12	.832
Management has assigned responsibilities for the timely review of audit reports and resolution of any non-compliance items noted in those audit reports	66	3.88	.900
Valid N (list wise)	66		

The results on table 2 above revealed that majority of the SACCOs had independent processes, checks and evaluations of control procedures was done on an ongoing basis (M=3.83, SD=1.057), another aspect of monitoring that received high ranking was that monitoring had helped in assessing the quality of performance of the organizations over time with mean of 4.12 and a standard deviation of 0.832 indicating low variation in responses. In general, monitoring as a functionality of internal control system was widely carried out by SACCOs as revealed by

results on table 2 above.

Significance Test for Model Assumption

The linear regression model was tested to ensure that the model is applicable and that the assumptions of ordinary least squares hold. The following tests were carried out:

Test for Normality

The study tested normality of the sample data using descriptive statistics. A normal distribution of data helps in making accurate and reliable conclusions. The mean was used to determine the average of the data and standard deviation was used to measure dispersion from the mean. Skewness goodness of fit test was used to determine the normality of the data. Skewness is used to determine whether the frequency curve of the distribution is not a symmetric bell-shaped curve making it stretched more to one side than the other thus rendering the data not to be normal (Aczel & Sounderpadian, 2002). Data is normal and unbiased when skewness statistic is between the range of ±3 (Aczel & Sounderpadian, 2002).

Table 3
Skewness of Data for the Model

Variable	Skewness	
	Statistic	Std. Error
Financial performance (ROE)	1.154	.687
Control Procedures	1.264	.687
Monitoring	.731	.687

From table 3 above, the value of skewness for the data of both the variables were in the range of ±3, this implied that the data of both the variables was normal and unbiased.

Autocorrelation

The study employed Durbin Watson test to detect presence of autocorrelation. Autocorrelation leads to biasness and inconsistency of parameter estimates. Autocorrelation is present when variances of the error terms are serially interdependent. A Durbin Watson of zero implies presence of positive autocorrelation, while Durbin Watson of 4 implies high negative correlation level. A Durbin Watson of value between 2 and 2.5 implies that there is no autocorrelation. The results of Durbin Watson value is shown on table 4 below.

Table 4
Durbin Watson Value

Model	**Durbin Watson value**	**Status**
Model	2.456	No autocorrelation

From table 4 above, the model's Durbin Watson value was 2.456. Since this value lies between 2 and 2.5, it indicates that there was no autocorrelation in the model.

Multicollinearity Test

Multicollinearity occurs when a combination of independent variables in a regression model are highly but not perfectly correlated (Aczel & Sounderpadian, 2002). Presence of Multicollinearity makes it difficult to isolate the effect of each independent variable on the dependent variable. The greater the multicollinearity between two variables, the less precise is the estimates of individual regression parameters (Aczel & Sounderpadian, 2002). The study detected Multicollinearity using coefficient of determination (R^2). If the coefficient of determination (R^2) is high in excess of 0.9 or very low of less than 0.1, with a significant t – ratios, then Multicollinearity is present (Granger & Hatanaka, 1964). The table 5 below shows coefficient of determination estimate**.**

Table 5

Coefficient of Determination Estimate

Model	Coefficient of determination (R^2)	Status
1	0.880	No Multicollinearity

From table 5 above, coefficient of determination value is between 0.1 and 0.9. This implied that there was no intercorrelation that existed between explanatory variables, hence absence of Multicollinearity.

Model Summary

The model summary shows the summary of the regression analysis as shown in the regression model.

Table 6
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics		Durbin-Watson
					F Change	Sig.F Change	
1	.938[a]	.880	.784	.325	9.161	.016	2.456

a. Predictors: (Constant), Control Procedures, Monitoring.
b. Dependent Variable: ROE

The study used coefficient of determination to explain the variation in the dependent variable financial performance as explained by independent variables. According to research analysis on the table 6 above, the adjusted R^2 is 78.4%. This implies that 78.4% of total variation in the financial performance is explained by Control procedures/Activities and monitoring jointly in the

model, it also signifies existence of a strong correlation between the variables. The remaining 21.6% of the total variability in financial performance is explained by other factors not included in the model.

Analysis of Variance

The study carried out Analysis of Variance, in order to test the impact of the relationship between internal control procedures and monitoring and financial performance of SACCOs in Kenya.

Table 7
Analysis of Variance

Model		Sum of Squares	Mean Square	F	Sig.
1	Regression	3.872	.968	9.161	.016[b]
	Residual	.528	.106		
	Total	4.400			

From table 7 above, the results of analysis of variance indicated that the overall model was significant, that is, the independent variables are good joint explanatory variables for financial performance of SACCOs (F=9.161, P value =0.016<0.05).

Test of Significance of Regression Coefficients

To determine the cause effect relationship between dependent variable and the explanatory variables the regression coefficients were tested at 5% level of significance using t-test. The regression is presented on table 8 below.

Table 8

Regression Equation Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.828	.176		10.383	.000
	Control Procedures	.213	.1331	.637	1.609	.003
	Monitoring	.892	.224	.843	.542	.005

a. Dependent Variable: ROE

The following regression equation was obtained.

ROE= 1.828+.999X1+ .911X2

According to equation obtained the value of financial performance (ROE)=1.828 when Control procedures and monitoring are held constant.
The coefficient for control procedures obtained was 0.213 with a p-value of 0.003 which is less than 0.05 as indicated on table 8 above. This shows that the relationship between Control procedures and financial performance is positive and significant hence the null hypothesis that control procedures have no significant effect on financial performance of SACCOs was rejected as the analysis results revealed that there existed a significant positive relationship between control procedures and financial performance at 5% significance level. The coefficient of 0.213 implies that for every one-unit increase or improvement in control procedures, financial performance increases by 0.213 units. The findings are consistent with those of Muraleetharan (2010) who found positive relationship between control activities and financial performance.

The coefficient for monitoring obtained was 0.892 with a p-value of 0.005 which is less than 0.05 as indicated on table 8 above. This shows that the relationship between monitoring and financial performance is positive and significant hence the null hypothesis that monitoring has no significant effect on financial performance of SACCOs was rejected as the analysis results revealed that there existed a significant positive relationship between monitoring and financial performance at 5% significance level. The coefficient of .892 implies that for every one-unit increase or improvement in monitoring, financial performance increases by 0.892 units. The results were consistent with those of Romar and Moberg (2003) who did a case study to establish what contributed to WorldCom scandal in 2002.

CONCLUSION

Based on the findings of the study, it is concluded that SACCOs that had implemented effective internal control procedures and monitoring measures had more improved financial performance as compared to those SACCOs that had weak internal control procedures and monitoring measures. This has been clearly indicated by high significant relationship between internal control procedures, monitoring and financial performance based on Return on Equity.

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