

**EFFECTS OF INTERNAL CONTROLS ON PERFORMANCE OF NON-  
GOVERNMENTAL ORGANIZATIONS IN NAIROBI CITY COUNTY,  
KENYA**

**By**

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
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## DECLARATION

This project is my original work and has not been presented for the award of degree in any other University.

Signature.......... Date..... 11/05/2021.....

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This Research Project has been submitted for presentation with the endorsement of the university supervisor.

  
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## **DEDICATION**

To my father Hassan Adan, I am grateful for the support you gave me.

## **ACKNOWLEDGEMENT**

To Allah, the support I received was great. I appreciate my supervisor, Dr. Herrick Ondigo for supporting and encouraging me to this end.

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## LIST OF ABBREVIATIONS AND ACRONYMS

<b>EPS</b>	Earnings <u>Per</u> Share
<b>GDP</b>	Gross Domestic Products
<b>ICT</b>	Information Computer and Technology
<b>IFRS</b>	International Financial Reporting Standards
<b>IJCRR</b>	International Journal of Contemporary Research and Review
<b>ISX</b>	Indonesia Stock Exchange
<b>NGO</b>	Non-Governmental Organization
<b>ROA</b>	Return on Assets
<b>ROI</b>	Return on Investment

## ABSTRACT

The interplay between internal controls and performance was explored in this inquiry. The adopted design was descriptive and 1,882 NGOs were targeted. From these, 330 were sampled and covered. Information was sought from first hand sources and processing was done descriptively and inferentially. Relevant diagnostic tests covering normality, multicollinearity and autocorrelation were conducted and appropriately interpreted before running regression analysis. The study established that compliance with accounting standards ( $\beta=.394$ ,  $p<0.05$ ) exerted the greatest positive and significant effect on performance of the NGOs in Nairobi followed by fraud audits ( $\beta=.213$ ,  $p<0.05$ ), separation of duties ( $\beta=.207$ ,  $p<0.05$ ) and lastly management control ( $\beta=.117$ ,  $p<0.05$ ). The study concludes that those internal controls have positive and significant effect on performance of the NGOs. It was recommended that finance managers of the NGOs in Nairobi should ensure there is strict compliance with the accounting standards. The internal auditors of the NGOs in Nairobi should closely work with independent external auditors to carry out fraud audits. The Human Resource managers of the NGOs in Nairobi should ensure there is clear separation of duties as this also contribute towards performance. The internal audits of the NGOs in Kenya should strengthen the effectiveness of the management controls in place so as to enhance performance.

# CHAPTER ONE: INTRODUCTION

## 1.1 Background of the Study

According to Khrawish (2011) the establishment of a system that enhances control of processes within an organization and which enhances the authenticity of financial performance of the organization may be referred as the internal control system of the organization (Ongore, 2011). Performance on the other hand has been defined by Stevenson (2004) as the outcome of activities undertaken in an organization that lead to either positive or negative results. The aspect of internal control in an organization is a vital component in corporate governance of any organization. The fact that internal control systems are essential in enhancing the direction as well as determining the achievement of goals and objectives according to the budget estimates, indicates that enhancing internal controls is paramount for any organization (Krishnan, 2005). Non-governmental organizations (NGOs) are funded by different donors to undertake different projects according to pre-approved budgets. Achievement of these goals in the allocated budget is crucial for each NGO and as such, wastages and lose of crucial resources through fraudulent activities always lead to lack of achievement of these goals at the expected budget estimates. This leads to aggrieved donors who may not want to undertake other projects with such an NGO. It is therefore vital for each NGO to ensure that it implements solid internal control systems that curtails fraudulent dealings, misuse of donor resources and enhances achievement of project goals and objectives at specified budgetary estimates and at the specified time (Oppong et al., 2016).

Enhancing effective control systems in organizations has attracted a number of researchers as well as theorists who have proposed relationships of internal control systems with efficiency as well as performance of these organizations. The exaggerated costs of different activities in a project are discouraged significantly using elaborate internal control systems. However,

implementation of internal controls in any organization is an uphill task that requires dedication, monitoring, and proper leadership and management of employees as well as resources in an organization (Ibrahim, 2017). The different theories that suggest the nature of relationships between internal controls and performance indicate a consistent pattern. The theories therefore build on provisions of earlier theories where the importance of effective internal controls is emphasized in order to enhance positive results in efficiency and effectiveness Mawanda (2008). These theories seek to define a relationship with which enhancing internal control in an organization would impact performance of the organization.

NGOs are significantly different from other profit motivated firms since NGOs are non-stock entities where control and ownership is vested on supporters or the members of these organizations. These organizations are therefore unique and needs unique management control process. The ownership structure of these entities shows managers in NGOs may not find themselves accountable to donors as other managers may feel accountable to owners of their organizations. The effective establishment of internal controls in NGOs may therefore not be a priority area for these managers as it would be for managers in profit-oriented organizations. Similarly, the fact that NGOs are not motivated by profits make it cumbersome to determine performance of these entities. Different projects may have different metrics and different priorities, that makes it difficult to use one single activity as a measure of performance for these entities. The traditional observation of management in NGOs may have little or lack proper financial literacy as they are motivated by implementation of different goals and objectives of donors in various projects. The challenge therefore entails that there is lack of coordinated efforts to ensure compliance with effective internal control systems while at the same time, it becomes cumbersome to measure and objectively determine performance of one NGO from the other (Anthony and Young, 1994).

### **1.1.1 Internal Control Practices**

Internal control practice's purpose is to align with the set standards of internal controls which have been instituted by the central regulating authority. The relevant proxies of internal control include activities of control, information and communication, the need to monitor, assess risks and the control environment in place (Sampson, 1999). Functionality and coordination of each of these proxy are linked with success of the internal control (Oseifuah & Gyekye, 2013).

Environment control is a main aspect of entity management since it reflects the attitude and management policies regarding the importance of internal audit in economic unit (Theofanis, Drogalas & Giovanis, 2011). The main aim of carrying out a assessment of risk is to determine any situations which may pose a legal or financial risk to a firm (Boame, Solace & Issaka, 2014). Hence, the risk level that can easily be accepted should be clearly identified in an entity (Badara & Saidin, 2013).

The activities that fall under control initiatives dictate that the directives issued by management should be observed to the letter. These initiatives are meant to ensure that the actions required to address various risks have been adequately undertaken. Control activities achieve desired goals and objectives (Mwakimasinde, Odhiambo & Byaruhanga, 2014). Organization control is therefore established to ensure that the risk component of the organization has highly been reduced and therefore paved way for the achievement of goals and objectives (Boame, Solace & Issaka, 2014). These may cover bank reconciliations among others (Badara & Saidin, 2013).

### **1.1.2 Organization Performance**

Financial performance may mean the ability of an organization to produce new resources from the use of existing resources of the organization. It also may imply is the ability of an organization to utilize their resources in an effective and efficient manner to enhance the

achievement of goals and objectives (Stoner, 2003). Kagoyire and Shukla (2016) sought to define financial performance where the study settled on the definition that it was the ability of an organization to operate efficiently as it increases its profitability level in order to finance growth of the enterprise. Financial performance may therefore not be assumed to emanate from one activity of the organization, but it may be related to different activities undertaken in the organization (Han, 2014).

Financial performance measurements are essential for accountability and strategic planning. Performance measurement deals with a measure on how well firms are managed in relation to set targets and the generate values to the firm's stakeholders. There exist different ways that organizations can adapt to in order to improve their financial performance, though all these systems adopted should be considered in aggregation (Han, 2014).

### **1.1.3 Internal Control Practices and Financial Performance**

Control is a major task which squarely lay on the shoulders of the firm's owners' or the management. Internal control on NGOs is very crucial since it plays a great role on their performance in general (Uzun, 2011). IFAC (2012) posits that effective internal control has a potential of creating a competitive advantage since a firm with an effective control system is able to take on additional risk. Jensen (2003) systems of internal control and practices comprising of internal audits are aimed at enhancement of reliability of performance in financial perspective by simply increasing accountability among providers of information in a firm. Sanusi et al. (2015) observed that majority of the mosques in Malaysia do leverage IC to meet their stated objectives. Muraleetharan (2011) was keen to link IC and performance. Noted was the fact that IC significantly enhances ability of entity to perform. In fact, the interplay between the two was direct and a significant one.

#### **1.1.4 NGOs in Nairobi County, Kenya**

Vikal (1997) defined non-Governmental organisations as self-governing, not-for-profit organisations that are geared towards improving the quality of life to the disadvantaged. According to the Annual NGO Sector Report of 2018/19, the number of registered NGOs and their status is: Number of registered NGOs is 11,262, Deregistered NGOs is 2,468, Reinstated NGOs is 113, Dissolved NGOs is 14, and Active NGOs is 8,893. Of these, the ones listed in Nairobi County are 1,882 in number.

The NGO council asserts that fraud practices have been on the increase within NGOs thus having a great influence on their financial performance. In addition, Wanjiku (2013) revealed that NGOs record challenges in relation to fraud that majorly emanate from running their activities based on trust as a result of volunteerism. According to Greenlee et al. (2007) most of these organizations are un-willing to tackle the issue of fraud through implementation of these practices. They further assert that with the occurrence of fraud generally giving rise to loss of monies within organizations, among the NGOs, this results to the organizations not having enough funds to execute their mandate due to eroded donor confidence.

#### **1.2 Research Problem**

Many social discipline scholars and auditors believe or have evidence that the weakening or lack thereof of internal controls, corporate governance, and ethics is the cause or correct explanation of low or detrimental financial performance (Nakashima, 2017). Systems of internal controls allow the entity to plan on effective utilization of resources (Sangmi, 2010).

Organizations lose up to 5 % of their revenue each year (ACFE, 2012) resulting to them, especially NGOs, not having enough funds to execute their mandate. Most NGOs still register a low degree in the implementation of the fraud risk management practices in their operations

(Neely, 2011). Even with critical contributions to society, all NGOs are continuously targeted by unscrupulous people and groups, giving rise to scandal and disrepute among these organisations (Hamilton & Slatten, 2013).

Fraud in Kenya has been on the rise and NGOs also form part of the statistics. Greenlee et al. cited a number of aspects that result to NGOs being more vulnerable to fraud that include operating mostly an atmosphere of trust, challenges in evaluating specific revenue streams (including individual cash donations), weak established internal controls, insufficient organizational and financial expertise, and over-reliance on volunteer boards. However, most organizations with better established fraud risk management practices perform better financially (Wanjiku, 2013), hence they can be used to enhance the performance of NGOs. According to Hightower (2013), organizations such as Non-Governmental Organizations (NGOs) can use the internal controls to promote, evaluate and boosts their performance.

Kerine (2015) in her study on factors influencing financial sustainability of NGOs in Nakuru County concluded that staff training ensures continued staff competence. She however fails to address financial performance linking it up to internal controls. Odhiambo (2013) assessed the financial fraud and liquidity and financial performance Muio (2012) did not incorporate the NGOs. Chepkorir (2010) observed that internal control supports firm on a daily basis.

From the reviewed studies, it is therefore clear that there exists a knowledge gap as most of these studies were based on profit making organization hence their findings may not be easy to adopt in NGOs. In addition, the studies done on NGOs mostly targeted organizations outside Nairobi which is the current study' study area.



### **1.3 Research Objective**

The research objective of the study was to assess the effect of internal controls on performance of NGOs in Nairobi County, Kenya.

### **1.4 Value of the Study**

It is with focused intention that this study would be valuable to the body of NGOs as it would offer crucial insights on the importance of inculcating internal controls measures in their functionality and the way it would assist them achieve their ultimate mission and improve on financial performance. The research would also lay a firm foundation on which future related studies can be undertaken. Researchers can refer to this study to acquire credible data, findings, and literature to complement their studies or advance them in relation to how IC and performance are interlinked.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

The focus of this chapter is on the theories that inform the variables. The past empirical inquiries are also reviewed. Relevant gaps are pointed out.

### **2.2 Theoretical Review**

Theoretical review involves the review of the theories by elucidating the meaning of each theory, identifying the proponent of the theory, and identifying the relevance of the theory to the study. The study focuses on three theories namely: theory of internal control, agency theory and positive accounting theory.

#### **2.2.1 Theory of Internal Control**

Lark (1999) advanced this theory and it argues that the board of directors institute internal controls to assure the need which the firm is meeting the stated objectives. Centrally, this theory argues that an organization designs and implements internal controls with the need to ensure that relevant risks have been mitigated. This way, an entity is able to realize the stated objectives. The system of governance in an entity is largely informed by internal controls. This is because it allow the entity to ensure that all inherent risks have been countered (Swanson, Hunson & Ross, 1998).

The corporate failure of large entities requires managers to put in place more stringent rules. It require the entity to work in a best manner to ensure that the existing policies have been strengthened. Strong internal controls help the firm to counter risks and this remains competitive (IFAC, 2011). The theory relevantly supports the need for NGOs to enhance their mechanisms of corporate governance so as to be viable.

### **2.2.2 Agency Theory**

This theory provides an illustration of the link between managers, the board and the shareholders who are the owners of the entity. The specific roles of each of these parties are clearly set out by this theory. The managers have the role of executing the activities in the entity while ensuring wealth of owners is maximized. The owners should ensure the firm is adequately funded while directors play an oversight role (Barlie & Means, 1932).

However, managers may not necessarily engage in actions that meet the stated goals. At times, management of the entity could undertake actions that satisfy their own selfish interests thus creating conflicting concerns with the owners. The board comes in to check the activities of the management and ensure they are suited to meeting the goals of the owners (Coarse, 1937). The theory relevantly explores how best corporate governance through boards can counter conflicts of interest between managers and the owners of the firms.

### **2.2.3 Positive Accounting Theory**

Watts and Zimmerman (1986) proposed this theory and its key focus and explanation is on accounting practices in an entity. The theory provides a prediction of the accounting method that is suitable and relevant to another specific entity. The premise guiding this theory is that the actions at an individual level are governed by selfish interests and the actions partaken by individuals are always opportunistic ones.

Deegan and Unerman (2006) argued that entities will always work out to ensure that relevant mechanisms have been put in place to counter self-interested actions and undertakings in the firm. This is an important step towards aligning the management and the owners. Firms incur some form of monitoring costs to counter this conflict of interests. Thus, the theory relevantly addressed key concerns of conflict of interest that may arise in an entity.

## **2.3 Determinants of Financial Performance of NGOs in Nairobi County, Kenya**

There are various determinants of financial performance of NGOs in Nairobi County, Kenya. Thus, for the purposes of this study, the four variables: Frequency of Undertaking Fraud Audits, Compliance Level with Accounting Policies, Management Control, and Separation of duties shall be analyzed and the relationship that exists be elaborated while taking Corporate Governance and Size of firm as moderating variables.

### **2.3.1 Frequency of undertaking Fraud Audits**

Auditing for fraud is an important step towards sustaining an entity. It seeks to ensure the firm has effectively and prudently utilized the existing resources (Atieno et al. 2015). Fraud audits can be conducted internally as well as externally and these should complement each other. Such audits keep management on toes as any misdeed can easily be exposed and the managers may end up losing their jobs.

### **2.3.2 Compliance Level with Accounting Policies**

Relevance is understood as financial information which can make a difference in the decisions of its users. To make a difference in decisions financial information must have predictive value, confirmatory value, or both (IASplus, 2010). The critics point out that though the declared objective of IASB is to establish standards that are top-notch on the premise of well-designed principles, IFRS are becoming more complex and harder to follow because of the frequent revisions and amendments (Morais, 2019).

To be of great benefit, relevance of financial information is paramount, but also it must also reflect with precision the facts and events which it claims to show-case (Pasekova *et al.* 2019). There exists voluminous research evidence that the quality of accounting information has an impact on how management decides (Healy & Palepu 2001).

### **2.3.3 Management Control**

Adequate controls should be in place in the firm to counter conflicts of interests that arise from the managerial undertakings. The activities undertaken by the management should be objectively analyzed in light of the budgets. Thus, budgetary procedures should be used when evaluating the actions undertaken by the management (Amaratunga, 2001).

Some occurrences like technological advances have impacted on the way firms operate. This has raised the scrutiny of some aspects like budgets in the firm. For an entity to remain competitive, the costs should be kept at bare minimum. Without this, viability of the firm in future may be compromised (Hansen and Mowen, 2005).

### **2.3.4 Separation of Duties**

Countering collusion in the firm that may allow fraud is largely informed by separation of the duties held by the staff (Sarens & De Beelde, 2006). Barra (2010) argued that existence of separation of duties in the firm raises the cost of committing some sort of fraud. This means that staff should weigh between costs and benefits of commitment of the fraudulent deals. Mukhtaruddin et al (2019) observed that sound corporate governance in the entity is characterized by some degree of separation of duties.

### **2.3.5 Size of NGO**

In the study conducted by Oksana and Kamil (2020) shared size has widely been embraced as a control variable. Larger firms are deemed to have adequate resources and thus may theoretically have stronger mechanisms of internal controls. Additionally, the resources available to large firms allow them to invest and enhance their internal controls. This is as opposed to smaller firms that struggle to access adequate funds for running. The logarithm of the assets of the entity will be a gauge of size.

### **2.3.6 Corporate Governance**

Corporate governance is the internal control system within an entity that helps in countering risks while attaining the stated objectives (Fujinuma, 1999). Corporate governance helps in safeguarding the assets of the entity. This way, the wealth of the shareholders can fully be optimized. Sound mechanisms of corporate governance are critical towards success of the entity. These include the board, the management of the entity and the owners. The link between these parties informs viability of the entity at large.

### **2.4 Empirical Studies**

Tuan (2020) explored IC and performance among Vietnamese construction enterprises and a direct link was identified. Palfi and Muresan (2009) focused on Rome with focus on banking sector. The inquiry shared a significant interaction between IC and performance. Musa (2010) placed emphasis on banking of Saudi Arabia. It emerged that security controls have been instituted by banking entities in this country. Computerization had also been embraced. Eke (2018) placed emphasis within hotel sector in Nigeria arguing existence of the link between IC and performance.

Magu (2016) used control environment and control activities to explain the internal control system. On data collection and analysis, emphasis was put on physical control, ICT and segregation of duties. The researcher did not exhaust all the identified aspects of control activities. The sample population was limited to top level managers. The researcher's variables are too wide to be undertaken in a single study paper to come up with a conclusion of positive relationship between IC and financial performance.

Nyakundi et al, (2014) used convenience sampling technique for data collection. This technique is subject to sampling error-bias. A direct link was identified between IC and

performance in financial terms. Similar research by Akimana (2019) was conducted in Nairobi City has the same conclusion on internal controls and financial performance. By using both primary and secondary data, Njoki (2015) demonstrated that the higher the level of application of control environment, the greater the performance of the institutions in Nairobi. It is worthy to note that the period of data was too short to arrive at a conclusive finding. A longer period could be explored to ascertain whether the same findings still hold.

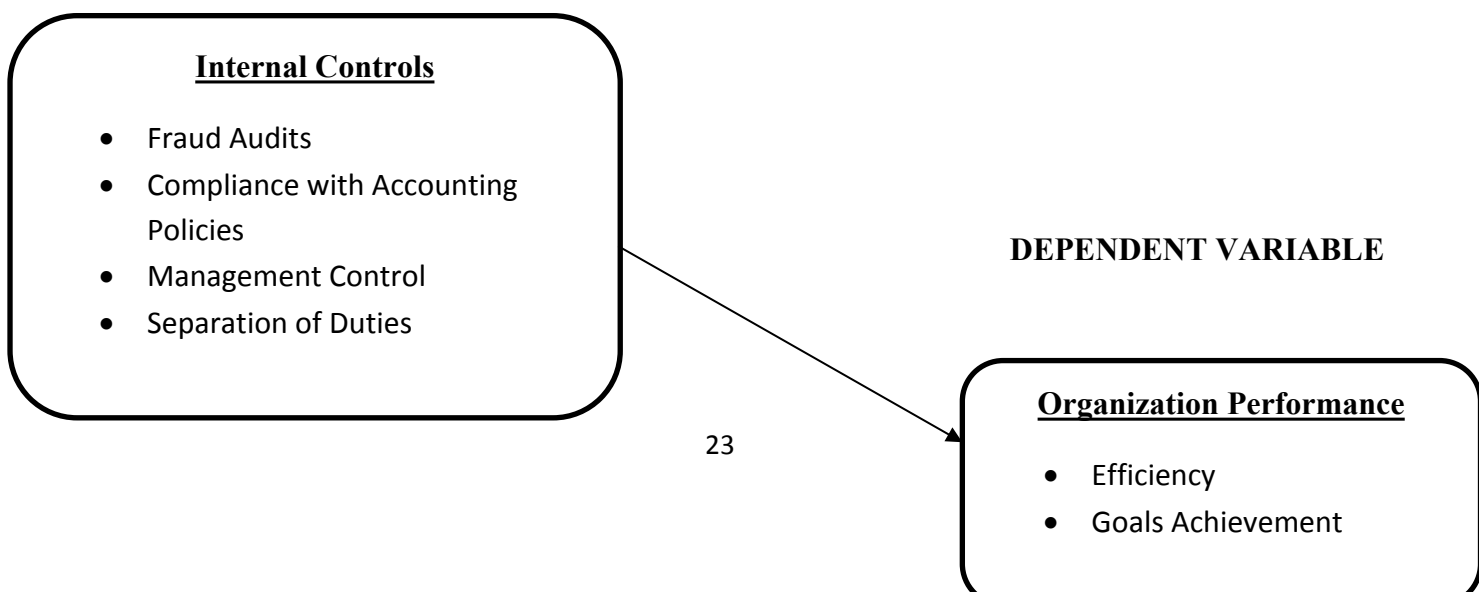
Kinyua (2015) placed emphasis on IC environment and financial performance with focus on listed entities. A direct and significant interplay was registered between financial performance and IC environment. Mawanda (2008) observed that well performing entities are those having relevant IC systems. Ndiwa (2014) covered Kenyan tertiary entities to link IC system and financial performance. A significant link was registered by the inquiry.

## 2.5 Conceptual Framework

Figure 2.1 comprised of concepts that are used to express or enhance the understanding or simulate a certain proposition that is being expressed in the model. Therefore, the conceptual model for this study indicates the interactions and the possible relationships that would interact. The conceptual model that will be used in the study is indicated in the figure below:

**Figure 2.1: Conceptual Framework**

### INDEPENDENT VARIABLES



**Institutional Characteristics**

- Size of the NGO
- Corporate Governance Structure



## CHAPTER THREE: RESEARCH METHODOLOGY

### 3.1 Introduction

The embraced design and targeted participants are discussed in this chapter. The means of gathering information and how the same was processed and processed are also detailed.

### 3.2 Research Design

The embraced design was descriptive. The research design sought to provide a description of the study variables without interfering or seeking to control or affect them to achieve certain goals. The interplay between variables was explored by this inquiry and thus supported by this design.

### 3.3 Population of the Study

According to the Annual NGO Sector Report of 2018/19, the number of registered and active NGOs is 8,893. The NGOs based and licensed to operate in Nairobi County are 1,882 as indicated in table 3.1

**Table 3. 1: Population Distribution of NGOs in Nairobi County**

Constituency	Number of NGOs	Percentage
Westlands	340	18%
Dagoretti	169	9%
Langata	282	15%
Kasarani	376	20%
Embakasi	188	10%
Kamukunji	151	8%
Starehe	376	20%
<b>Total</b>	<b>1,882</b>	<b>100%</b>

Source: NGOs Sector Report, 2019

### 3.4 Sample Design

In gauging the study sample, Yamane (1967) formula with an assumption of 95% confidence level to estimate the sample size was embraced.

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

Where: n = sample size

N = population size

e = the confidence level

$$n = \frac{1882}{1 + 1882(0.05)^2}$$

$$= 329.88 \approx 330 \text{ respondents}$$

**Table 3. 2: Sample Distribution of NGOs**

Constituency	Population	Sample	Percentage
Westlands	340	59	18%
Dagoretti	169	30	9%
Langata	282	50	15%
Kasarani	376	66	20%
Embakasi	188	33	10%
Kamukunji	151	26	8%
Starehe	376	66	20%
<b>Total</b>	<b>1,882</b>	<b>330</b>	<b>100%</b>

Source: NGOs Sector Report, 2019

### 3.5 Data Collection

Firsthand information was obtained by this inquiry supported by questionnaire. The contents covered in the questionnaire underwent structuring to ease the analysis process. The

questionnaire was arranged in several sections covering the study variables. Drop and pick latter technique helped the participants to get the tools so that they give their relevant views.

### **3.6 Data Analysis**

Coding of the questionnaires was undertaken, where descriptive analysis of the variables was also carried out by the use of tables, charts and graphs. SPSS supported the analysis conducted descriptively and inferentially.

#### **3.6.1 Diagnostic Tests**

##### **3.6.1.1 Normality Test**

Normality test indicates whether data forms a bell-shaped distribution format which is called a normal curve. When data is large enough, it tends to take the shape of a normal curve and therefore the data may be used to undertake statistical assumptions. Normality test was undertaken by the use of Shapiro Wilk test. The null hypothesis states that the population from which the data is obtained is normally distributed. The null hypothesis is rejected if the significance (p-value) is below 0.05. Transformation of data is preferred when the null hypothesis is rejected.

##### **3.6.1.2 Multi-Collinearity Test**

This is a test that shows whether the independent variable remain independent, or they influence each other. Regression analysis assumes that independent variables remain independent and therefore do not influence each other. Multi collinearity test is undertaken by the use of Variation inflation Factors (VIF) or tolerance levels to determine whether there exists multi-collinearity between variables or not. There exists a multi-collinearity when the VIF values are above 10. In this case the variable with multicollinearity is dropped from the model.

### 3.6.1.3 Autocorrelations Test

Durbin Watson test was used for testing autocorrelation. A value that is close to 2 indicates that there is less autocorrelation while values closer to either 0 or 4 indicates that there is either positive or negative autocorrelation respectively (Creswell, 2008).

### 3.6.2 Analytical Model

Analytical model refers to the system that is employed in a study to undertake empirical analysis to accomplish the research goals and therefore give feedback on the research questions effectively. The analytical model for this study will take the form:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where Y is the Organization performance determined by the efficiency and goals achievement

$\alpha$  refers to the Y intercept of the linear model

$X_1$  refers to Fraud Audits

$X_2$  refers to Level of Compliance

$X_3$  refers to Management Control

$X_4$  refers to Separation of duties

$X_5$  refers to corporate governance structure

$\beta_1, \beta_2, \beta_3, \beta_4$  and  $\beta_5$  are the coefficient of  $X_1, X_2, X_3, X_4,$  and  $X_5$  respectively while  $\varepsilon$  is constant.

## CHAPTER FOUR: DATA ANALYSIS AND DISCUSSION

### 4.1 Introduction

The analyzed findings based on the data gathered from the field are indicated in this chapter. The specific contents of this chapter include the response rate, the descriptive statistics, diagnostic tests as well as regression results.

### 4.2 Response Rate

From the 330 questionnaires that were administered to respondents, 233 of them were dully filled and returned to the researcher. This was equivalent to a response rate of 70.6% which was good for this inquiry (Babbie, 2010).

### 4.3 Descriptive Statistics

The Likert scale was converted into an interval scale giving the following values as far as interpretation was concerned: 1-1.4 mean highly disagreed, 1.5-2.4 mean disagreed, 2.5-3.4 meant neutral, 3.5-4.4 meant agree and 4.5-5.0 meant strongly agreed. The resultant means and standard deviations of the individual items were used to compute the composite values for each of the specific objective variables of the study as summarized in Table 4.1.

**Table 4. 1: Summary of Descriptive Statistics on the Variables of the Study**

	<b>Mean</b>	<b>Std. Dev</b>
Organization performance	3.71	0.857
Fraud Audits	3.67	0.839
Compliance with Accounting Standards	3.76	1.048
Management Control	3.63	0.794
Separation of Duties	3.68	0.884

**Source: Field Data (2021)**

Table 4.1 shows that on average (M=3.71), respondents highly agreed on the statements provided under organization performance. In other words, it can be inferred that the studied NGOS were doing well as far as their performance was concerned. The results on fraud audit

show that on average (M=3.67), respondents agreed on the associated statements. This probably indicates that fraud audits were conducted among the studied NGOs. The findings on compliance with accounting standards were that on average (M=3.76), respondents highly agreed on the provided statements. This means that the studied NGOs complied with accounting standards, especially during preparation of the financial statements. With regard to management control, the study showed that on average, (M=3.63), respondents agreed on the provided statements. This has an implication that the studied NGOs exercised some degree of management control. With regard to separation of duties, it was shown that on average (M=3.68), majority of the respondents highly agreed on the provided statements. This means that there was separation of roles in the studied NGOs.

#### **4.4 Diagnostic Tests**

These include autocorrelation test, multicollinearity test and normality test as specified in the subsequent sections.

##### **4.4.1 Autocorrelation Test**

Durbin Watson statistic was computed as a measure of the autocorrelation test. The findings were determined and summarized as shown in Table 4.2.

**Table 4.2: Autocorrelation Test**

<b>Model</b>	<b>Durbin-Watson</b>
1	2.043

**Source: Field Data (2021)**

Table 4.2 gives the value of d as 2.043, which happens to be exactly 2 when truncated to a whole number. This finding is echoed by Creswell (2008) who said that Durbin Watson test produces test scores that ranges from 0 to 4. A value that is close to 2 indicates that there is less

autocorrelation while values closer to either 0 or 4 indicates that there is either positive or negative autocorrelation respectively (Creswell, 2008).

#### 4.4.2 Multicollinearity Test

VIF values were computed to estimate the presence of multicollinearity and the findings are as shown in Table 4.3.

**Table 4.3: Multicollinearity Test**

	Collinearity Statistics	
	Tolerance	VIF
Fraud Audits	.842	1.188
Compliance with Accounting Standards	.795	1.258
Management Control	.970	1.031
Separation of Duties	.714	1.400
<b>Mean VIF</b>	<b>.830</b>	<b>1.219</b>

**Source: Field Data (2021)**

Table 4.3 shows the value of the mean VIF as 1.219 with all the values for the respective variables being within the range of 1-10. This is an indication of absence of multicollinearity in the data and thus its suitability in carrying out regression analysis.

#### 4.4.3 Normality Test

Normality test indicates whether data forms a bell-shaped distribution format which is called a normal curve. When data is large enough, it tends to take the shape of a normal curve and therefore the data may be used to undertake statistical assumptions. Normality test is undertaken by the use of Shapiro Wilk test.

**Table 4.4: Shapiro-Wilk test for Normality**

	Shapiro-Wilk		
	Statistic	df	Sig.
Organization performance	.661	36	.556
Fraud Audits	.841	45	.457
Compliance with Accounting Standards	.881	71	.345
Management Control	.640	22	.123
Separation of Duties	.640	24	.234

**Source: Field Data (2021)**

Based on Table 4.4, the p-values of the respective variables were above the threshold ( $p > 0.05$ ).

Thus, the study assumed the presence of normality in the data.

#### 4.5 Regression Results and Testing of Hypotheses

Table 4.5 gives the findings of the regression model summary.

**Table 4.5: Regression Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.785 <sup>a</sup>	.616	.609	1.54458

**Source: Field Data (2021)**

Table 4.5 gives the value of R square as .616, an indication that 61.6% change in organization performance of the studied NGOs is explained by changes in internal controls. Table 4.6 gives the findings of the ANOVA.

**Table 4.6: Analysis of Variance**

	Sum of Squares	df	Mean Square	F	Sig.
Regression	873.137	4	218.284	91.496	.000
Residual	543.945	228	2.386		
<b>Total</b>	<b>1417.082</b>	<b>232</b>			

**Source: Field Data (2021)**

Table 4.6 shows that the regression model was overall significant ( $F=91.496$ ,  $p < 0.05$ ). Table 4.7 gives the beta coefficients and significance.

**Table 4.7: Beta and Significance**



	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	11.094	1.604		6.916	.000
Fraud Audits	.213	.061	.009	3.492	.036
Compliance with Accounting Standards	.394	.021	.783	18.739	.000
Management Control	.117	.037	.018	3.162	.016
Separation of Duties	.207	.054	.006	3.833	.015

**Source: Field Data (2021)**

The results in Table 4.7 show that compliance with accounting standards ( $\beta=.394$ ,  $p<0.05$ ) exerted the greatest direct link with performance of the NGOs in Nairobi followed by fraud audits ( $\beta=.213$ ,  $p<0.05$ ), separation of duties ( $\beta=.207$ ,  $p<0.05$ ) and lastly management control ( $\beta=.117$ ,  $p<0.05$ ). This implies that internal controls have positive and significant effect on performance of the NGOs.

#### **4.6 Discussion**

This study was set out to analyze the effect of internal controls on performance of the NGOs. The four specific elements of internal controls that were analyzed include fraud audits, compliance with accounting standards, management control and separation of duties. From the findings of descriptive statistics, all these indicators had composite means of above 3.5; this means that the studied NGOs had embraced internal controls. The finding is supported by Oseifuah and Gyekye (2013) who observed that internal control practice's purpose is to align with the set standards of internal controls which have been instituted by the central regulating authority. These views are corroborated by Uzun (2011) who suggested that internal control on NGOs is very crucial since it plays a great role on their performance in general and that the systems of internal control play an important role.

It was shown that  $R^2$  was 0.499, this was interpreted that internal controls account for almost half of the variation in performance of the NGOs, In other words, the contribution made by

internal control in improving performance of the NGOs cannot be underestimated. These findings are strongly supported by Shanmugam, Haat and Ali (2012) who indicated that sound internal controls supports firm operations for continuity. IFAC (2012) posits that effective internal control has a potential of creating a competitive advantage since a firm with an effective control system is able to take on additional risk. Jensen (2003) systems of internal control and practices comprising of internal audits are aimed at enhancement of reliability of performance in financial perspective by simply increasing accountability among providers of information in a firm. Muraleetharan (2011) established that a direct and significant interplay between IC and performance.

An analysis of the contribution of the individual components of internal control on performance show that compliance with accounting standards ( $\beta=.394$ ,  $p<0.05$ ) exerted the greatest direct link with performance of the NGOs in Nairobi followed by fraud audits ( $\beta=.213$ ,  $p<0.05$ ), separation of duties ( $\beta=.207$ ,  $p<0.05$ ) and lastly management control ( $\beta=.117$ ,  $p<0.05$ ). This implies that internal controls have positive and significant effect on performance of the NGOs. The importance of complying with accounting standards is reflected in the quality of the financial reports generated by the NGO. This assertion is supported by Biddle et al (2009) who maintained that firms should reports quality information to support decision making ability of the parties.

## **CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Introduction**

The chapter provides a recap of the findings noted from the analysis. The concluding remarks and recommendations are also pointed out. Limitations and areas that need further studies are also discussed.

### **5.2 Summary**

The four specific elements of internal controls that were analyzed include fraud audits, compliance with accounting standards, management control and separation of duties. From the findings of descriptive statistics, all these indicators had an above average value in their composite scores; this means that the studied NGOs had embraced internal controls. In fact, the highly practiced aspect of internal control among the NGOs in Nairobi was compliance with accounting standards followed by separation of duties, fraud audits as well as management control.

The coefficient determination showed that internal controls account for almost half of the variation in performance of the NGOs. In other words, the contribution made by internal control in improving performance of the NGOs cannot be underestimated. An analysis of the contribution of the individual components of internal control on performance show that compliance with accounting standards exerted the greatest positive and significant effect on performance of the NGOs in Nairobi followed by fraud audits, separation of duties and lastly management control. This implies that internal controls have positive and significant effect on performance of the NGOs.

### **5.3 Conclusion**

Internal controls are important mechanisms that foster performance of the firm. A firm with weak internal controls will face concerns about its performance as compared to the firm where

the systems are strong. This observation is strongly rooted in the theory of internal control whose central theme is that managers and the board are responsible for maintenance of stronger internal controls in the entity. Internal controls are a must for all firms whether for profit or nonprofit organization including those operating in the public as well as private sector.

Different components determine the effectiveness of the internal controls as far as performance of the organization is concerned. These include compliance with accounting standards, fraud audits, separation of duties and management control. Complying with accounting standard is important as it enhances the quality of financial reports. Providing quality financial information is an important step towards restoring the confidence of the shareholders in the entity.

Separation of duties makes it hard for employees in a given department to collude and execute fraudulent deals. As such, it checks against fraud in an organization which can adversely affect performance. Management control is another important component of internal control in an organization. The senior management of the NGO has the responsibility of carrying out the day to day activities that are in line with the shareholders. In monitoring and overseeing the operations of the management, shareholders opt to put in a place a board of directors. Management controls aim at reducing possible conflicts between the management and the shareholders as founded in the agency theory.

#### **5.4 Recommendations of the Study**

Based on regression analysis results, finance managers of the NGOs in Nairobi should ensure there is strict compliance with the accounting standards. The finance managers of these NGOs should ensure that all financial reports have quality information that as required by the financial standards. The internal auditors of the NGOs in Nairobi should closely work with independent external auditors to carry out fraud audits. The Human Resource managers of the NGOs in

Nairobi should ensure there is clear separation of duties as this also contribute towards performance. The internal audits of the NGOs in Kenya should strengthen the effectiveness of the management controls in place so as to enhance performance.

The policy makers at the NGO Coordination Board (NCB) should come up with relevant policies requiring the NGOs to strengthen their internal controls. The policy makers of the NGOs in Nairobi should develop sound policies with regard to internal controls so as to enhance performance. The board of directors of the NGOs in Nairobi should enhance their oversight role to enhance the effectiveness and soundness of the internal controls. The shareholders of the NGOs in Nairobi should demand for stronger internal controls for their institutions.

### **5.5 Limitations of the Study**

Only a single county, Nairobi was covered in this study. There are 47 counties in Kenya. The study covered the NGOs operating in Nairobi County. More specifically, 1,882 were targeted and 330 of them were covered. The study was limited to information obtained from first hand sources guided by the questionnaire.

### **5.6 Areas for Further Research**

There are other relevant sector like universities or supermarkets as well as the public sector context in Kenya away from the NGOs that need further investigations. These sectors are currently facing concerns about performance and this could probably be attributed to challenges in internal controls. Future studies should extent the analysis to establish whether internal controls equally exert an effect on financial performance.



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## APPENDICES

### APPENDIX 1: Questionnaire

#### Informed Consent

The respondent agrees that he/she willingly participates in the study without any monetary consideration. The respondent also understands that the data collected will not be used for any other purpose other than for academic purpose. By Ticking on agree below, the respondent agree to provide as truthful data as possible.

I AGREE

I DO NOT AGREE

#### SECTION A: BACKGROUND INFORMATION

1. Kindly indicate the number of years the NGO has been operational?
  - A) Below 2 Years
  - B) 2 -5 Years
  - C) 6-10 Years
  - D) 11-20 years
  - E) Over 20 Years
  
2. Please indicate the number of permanent employees working for the NGO.
  - A) Below 5
  - B) 5 – 20 Employees
  - C) 21 – 50 Employees
  - D) 51 – 100 Employees
  - E) Over 100 Employees
  
3. Kindly indicate the percentage of women in the management/ female directors
  - A) None
  - B) 1%-20%
  - C) 21% - 40%
  - D) 41% - 60%
  - E) Above 60%

## SECTION B: PERFORMANCE OF NGO

Kindly indicate the extent to which you agree or disagree with each of the statement indicating performance of the NGO. Use the scale 1=highly disagree, 2=disagree, 3=neutral, 4=agree and 5=highly agree

No	Statement	1	2	3	4	5
1	The NGO always meets its objectives according to the budget					
2	The NGO is efficient in using resources from donors to attain specific objectives					
3	All projects are always undertaken within the allocated time					
4	Corrective measures are adopted effectively for projects that are not according to budget					
5	The NGO uses its resources efficiently to achieve projects' objectives					

## SECTION C: FRAUD AUDITS

Kindly indicate the extent to which you agree or disagree with each of the statement indicating performance of the NGO. Use the scale 1=highly disagree, 2=disagree, 3=neutral, 4=agree and 5=highly agree

No	Statement	1	2	3	4	5
1	The NGO solicits services of qualified and licensed auditors in undertaking annual audits of projects					
2	All projects with significant budget variance are always investigated/audited					
3	The NGO has a well elaborate and computerized system that detects and prevents fraud					
4	Culprits of fraudulent activities are always heavily punished					
5	Audit reports are seriously handled at the highest management's level					

## SECTION D: COMPLIANCE WITH ACCOUNTING STANDARDS

Kindly indicate the extent to which you agree or disagree with each of the statement indicating performance of the NGO. Use the scale 1=highly disagree, 2=disagree, 3=neutral, 4=agree and 5=highly agree

No	Statement	1	2	3	4	5
1	All people working in the accounting department are qualified and competent to work in the department					
2	The accountants are very observant of all accounting standards including emerging issues on IFRS					
3	Relevant procedures are followed to ensure compliance with accounting standards					
4	Donors' support is pegged on strict adherence to proper accounting of projects					
5	The management always demand for accurate reports from the accounting and finance department					

## SECTION E: MANAGEMENT CONTROL

Kindly indicate the extent to which you agree or disagree with each of the statement indicating performance of the NGO. Use the scale 1=highly disagree, 2=disagree, 3=neutral, 4=agree and 5=highly agree

No	Statement	1	2	3	4	5
1	The management are keen to efficient performance of each department					
2	Management involves all staffs involved in a project in the planning and budgetary allocation of the project					
3	Management is always quick to implement and adopt corrective mechanisms for activities that do not go according to plans					
4	The NGO's management team is well balanced in form of gender representation as well as age structure					
5	The managers undertake effective control of all projects					

## SECTION F: SEPARATION OF DUTIES

Kindly indicate the extent to which you agree or disagree with each of the statement indicating performance of the NGO. Use the scale 1=highly disagree, 2=disagree, 3=neutral, 4=agree and 5=highly agree

No	Statement	1	2	3	4	5
1	The NGO undertakes psychometric tests for all employees to determine their effectiveness in service delivery					
2	Duties in each project are well divided and assigned to individuals according to their qualifications					
3	The management ensures that the best employees are deployed in sensitive projects					
4	The employees allocated duties in project have relevant authority to execute their responsibilities					
5	There are clear rules to prevent personal interests to conflict with objectives of different projects					

- The End-