

**FINANCIAL DECISIONS AND PERFORMANCE OF THE BOARD
OF DIRECTORS IN NON GOVERNMENTAL ORGANISATIONS IN
KISUMU COUNTY**

**By
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**A Project Submitted In Partial Fulfillment of The Requirement For The
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DECLARATION

I Grace Akinyi Chumbe acknowledge that to the best of my knowledge , this research project is my original work and it contains no material previously published or written by another person, except when due reference is made in the text of the project.

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Signature

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DEDICATION

I would like to dedicate this study to my dearest friend Francis Wessel and my parents.
Thank you very much for your support and encouragement while undertaking this study.

ABSTRACT

The general objective of the study was to examine the effect of financial decision on board performance in NGOs in Kisumu County. The study narrowed its undertakings on budgets, investment strategies and financial reports as determinants of financial decisions. Literature review looked into role of the board with regards to financial oversight and safe guarding organization resources. Primary data was collected using a semi-structured questionnaire through survey research cross sectional approach. Data on financial decision and board performance were obtained from a sample of 284 NGOs in Kisumu County. Quantitative approach was employed. Data analysis was done using tables, factor and correlation analysis. The study found that board performance and financial decisions are positively related. The results indicate a positive and statistically significant relationship between the financial decision and board performance .The board members have reduced their participation in investment strategies as few organizations invest funds in interest bearing accounts due to donor designated fund restrictions. The study recommends donors and other well wishers should provide financial support to NGOs that is specifically focusing on strengthening board performance especially on their financial oversight role, promoting accountability and ensuring that NGOs have effective boards who understand the organizational goals and objectives.

ABBREVIATIONS AND ACRONYMS

BOD- Board of Governors

CEO – Chief Operating Officer

NGO –Non Governmental Organization

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Agency theory is a model that explicate why performance or judgment differ when display by member of a group. Specifically, it explains the connection between the parties, called the principal that delegates work to another, called the agent. It clarifies their dissimilarity in performance or judgment by noting that the two parties regularly have different goals and, independent of their respective goals, may have unusual manner toward threat.

The concept of agency theory originated from the work of Adolf Augustus Berle and Gardiner Coit Means, who were discussing the issues of the agent and principle as early as 1932. Berle and Means explored the concepts of agency and their applications toward the development of large corporations and organizations. They saw how the interests of the directors and managers of a given firm differ from those of the owner of the firm, and used the concepts of agency and principal to explain the origins of those conflicts.

Michael C. Jensen and William Meckling shaped the work of Berle and Means in the context of the risk-sharing research popular in the 1960s and '70s to develop agency theory as a formal concept. Jensen and Meckling formed a school of thought arguing that corporations are structured to minimize the costs of getting agents to follow the direction and interests of the principals. Agency theory essentially acknowledges that different parties involved in a given situation with the same given goal will have different motivations, and that these different motivations can manifest in divergent ways. It states

that there will always be partial goal conflict among parties, efficiency is inseparable from effectiveness, and information will always be somewhat asymmetric between principal and agent.

Good governance provide a firm a basis for setting performance measures and creating an enabling environment to facilitate superior performance thus lowers the risk of poor performance. The Non Governmental Organizations (NGOs) in Kenya, which are civil society organizations were established for the public benefit, have their performance measured differently. They are registered under the NGO Coordination Act No. 19 of 1990, these organizations are viewed as voluntary grouping of individuals or organizations, not operated for profit but they are organized. They are run by boards who are chosen by the members.

Literature on the board points out that board composition is an important determinant of its effectiveness and the performance of an organization (Dalton, et al. 1998; King III 2009; Zahra & Pearce 2007). Board composition can be analyzed in terms of, among others, its independence (external versus internal members), the experience and education of board members, gender balance, etc. Because of the nature of NGOs' services, their boards need to have a mixture of members in order for them to share experiences, learn from each other, and contribute effectively to the performance of NGOs.

Kingoro and Bujra (2009), in their study on the contribution of non-state actors to development in Kenya, analyzed governance in NGO's including HIV/AIDS NGO's. Beneficiaries did not have a voice and the spirit of volunteerism is diminished, boards are

rarely held to account and founders wield too much power over boards, founders and volunteers resist diversity and inclusiveness of the governing body. Some have no clear separation of roles between board and management, blurring the governance line, and leading to conflict. They withhold crucial information such as funding timelines from employees or beneficiaries, funds received and how the funds are being utilized.

Recently the government has been scrutinizing the operations of firms, public owned organizations and not for profit organizations. This has come about due to the increasing number of financial mismanagement and ethical misconduct in firms. Owing to these happenings corporate governance is now acknowledged as critical that organizations have to factor in carrying out its activities. Most local NGOs attract donors because of their effective programming and reach. It is the financial management capacity and governance of these many local NGOs that raises obvious concerns for donors.

Recent research findings have revealed that boards do often play an important hands-on role in the failure and turn-around of non profit Organizations (Jill and Chris 2004). Governing boards are responsible for navigating and overseeing the fiscal operations of NGOs while managers are responsible for directing daily activities. Managers utilize the policies adopted by the board to guide their decision making and to supervise both accounting and other fiscal activities. Ultimately, financial decisions are the responsibility of the governing board and interim reports (like budgetary status reports) are needed to keep the board informed about financial, performance, and legal compliance matters.

1.1.1 Financial Decisions

Financial decisions are judgments an organizations makes about its current operations and its sustainability in the future. It determines its continuity and existence in achieving its laid down vision, mission and goals. These are decisions that involve: determining the proper amount of funding required by an organization; selecting projects and capital expenditure analysis; raising funds on the most favorable terms possible; and managing working capital such as inventory , cash, accounts payable and accounts receivable. An organization has a choice to choose a project that can be sustained by the organization when there will be no donor funding or choose a project that is donor dependent. For sustainability an organization would rather opt to implement projects that in the long term would be sustainable without donor funds.

1.1.2 Board of directors performance

Simerly & Mingfang (2000) observed that measuring performance has been a major challenge for scholars and practitioners as well. Performance has been viewed as is a multidimensional construct and thus, no single index may be able to provide a comprehensive understanding of the performance relationship relative to the constructs of interest (Chakravathy, 1986). In this study, performance was operationalized along the board performance indicators as they focus on overseeing the organization, rather than hands-on management, and include: ensure that funds are used to help beneficiaries effectively; the organization has enough fund; the organization has effective senior management; the organization operates within the law and that the board can handle its responsibilities effectively.

1.1.3 Non Governmental Organization and Governance

Kenya is a commonwealth country with a common law system. There are five primary types of non-for-profit organizations (NPOs): Public Benefit Organizations (PBOs), Non Governmental Organizations (NGOs), companies, societies and associations.

Non-governmental organization, or NGO, is a legally constituted organization created by natural or legal persons that operates independently from any government. The term originated from the United Nations (UN), and is normally used to refer to organizations that do not form part of the government and are not conventional for-profit business. In the cases in which NGOs are funded totally or partially by governments, the NGO maintains its non-governmental status by excluding government representatives from membership in the organization. The term is usually applied only to organizations that pursue some wider social aim that has political aspects, but that are not overtly political organizations such as political parties. In many jurisdictions, these types of organization are called "civil society organizations". (Wikipedia 2012)

NGOs exist for a variety of reasons, usually to further the political or social goals of their members or funders. Examples include improving access to social services e.g. education, water, health; environmental protection, justice and human rights including children and gender rights, and improving welfare of various disadvantaged groups. However, there are a huge number of such organizations and their goals cover a broad range of political and philosophical positions (Wikipedia, 2012).

Wyatt (2004) has concluded that, “governance in nonprofits works in much the same way as in the public sector”. An organization is said to exercises good governance when it has

put in place clear and transparent internal system of checks and balances that ensures the public interest is served. Good NGO governance is therefore based on the clear distinction between the management of the organization and the governing body (the Board) on one hand. It is also based on having clear and transparent process for distribution of decision making powers. Wyatt observed that this kind of internal mechanisms helps to bring under control and moderate the control of any one person or group to ensure organization's resources are well managed, and safeguard the NGO's public-service orientation.

1.1.4 Kisumu County

NGO activities are widespread in every corner of Kenya and cover almost every aspect of the economy. There are currently over 4000 registered NGOs (this includes about 400 international NGOs), employing 50,000 people. It was estimated at the end of 2002 that the wider not for profit sector (including NGOs, self-help groups, women and youth groups) encompassed over 220,000 organizations. It is estimated that the annual income of NGOs was \$ 1 billion, approximately 3% Gross Domestic Product (GDP). The government now regards NGOs as true partners in development. (Ngoregnet2013)

Kisumu county covers an area of 2085 sq Km. It has five local authorities; Kisumu County's neighbours are Siaya County to the West Vihiga County to the North, Nandi County to the North East and Kericho County to the East. Its neighbour to the South is Nyamira County and Homa Bay county is to the South West. The county has a shoreline on Lake Victoria, occupying northern, western and a part of the southern shores of the Winam Gulf. (Wikipedia, 02Oct2013) The NGO board was established to oversee

registration, coordination, monitoring and evaluating the NGOs' in Kenya and their role in national development.

Most studies regarding NGOs (Kingoro and Bujra, 2009; Kimambo 2007) have been carried out in governance (Kateeba, 2010; Mutua, 2010). However, this study provides an opportunity to widen our perspective and applying knowledge gained from the previous studies carried out in Nairobi (Kingoro and Bujra, 2009; Mutua, 2010). The reason why I chose to study financial decision and board performance in NGOs was due to Kenya government scrutiny in to shut down two NGOs due to financial mismanagement and deregistration of 1000 NGOs by the NGO Coordination Board. The boards lack pressure from the shareholders to show value created by the organization but there is pressure from the government and NGO Coordination board to know how they manage organization finances or funds.

1.2 Statement of the Problem

Good governance is crucial not only for the sustainable growth of the NGO but also for securing public trust in civil society. Governance to the NGOs means effective and valued social services; accountability to funders, and trust and respect of the community. Boards and board members serve as the institutions of governance for an organization and they provide a framework within which the social and economic life of these organizations is conducted. From the earliest days corporate governance has been a subject of concern especially in non-profit organizations. Having a good and effective NGO Board provides a basis for successful governance (financial oversight), sound financial decision making and sustainability of the organization.

According to a study carried out by Kimambo (2007) in Uganda, he reveals that there is evidence of best governance practices in NGOs such as its role to recruit new board members and evaluation of senior management performance to ensure efficient use of resources. Though he found performance monitoring, reviews of the organizations operations, none availability of the board to carry out fiscal oversight and other activities alarming.

Kateeba (2010) carried out a study in Uganda which indicated that governance is a predictor of quality of financial reports accounting for 49.2% of variation in quality of financial reports. The findings from the study revealed that strong positive correlations exist between leadership, transparency, accounting system and the quality of financial reports of NGO. He recommended that board members who carry out fiscal oversight and financial management decisions should ensure that NGOs have systems that will assure donors transparency and efficient utilization of resources. The findings imply that the quality of financial reports of an NGO can be greatly improved if leadership, transparency and accounting systems are strengthened.

According to a survey carried out by Mutua (2010) in Kenya financial management practices of NGOs partially conforms which the laid down procedures of International Financial Reporting Standards. Inadequate budget forecasts was notably present which results in poor financial planning. The study also revealed inadequate regulatory financial structure in which NGOs operate and key weaknesses in financial management practices of internal control namely: Fiscal policies and financial oversight, analysis of service cost on regular basis, establishment of guidelines to invest idle funds, implementation of audit

recommendations for systems and procedural improvements that covers financial compliance.

The studies mentioned here show that making sound financial management decisions in NGO is crucial for continuity of the organization. The government of Kenya shut down two local non-governmental organizations because of alleged misuse of donor funds (Wachira, 1995). The Boards play very important hands-on role in the failure and or success of Non-governmental organization (Jill and Chris, 2004) since they oversee the running of the organization on behalf of the society. To effectively manage its resources – financial, human and materials – and contribute successfully towards achieving its vision and mission, NGO need to have strong and responsible boards to manage the organization resources. (Kimambo, 2007). The above studies emphases are on role of NGOs board but little is known regarding board financial decisions and their performance. Do the boards' financial decisions affect their performance? This study focuses on the effect of financial decisions on board performance and if there is a relationship between them to what extent.

1.3 Research Objective

The objective of the study was to examine the effect of financial decision making on board of directors' performance in NGOs in Kisumu County.

1.4 Value of the Study

This study will add up to the existing literature about Board members performance in NGO sector in Kisumu in particular about financial management decisions. Furthermore,

the findings would enable NGOs, Government, Donors and general public to contribute towards policy formulation and supporting governance of NGOs in Kisumu and beyond.

According to Willets (2002) many NGOs are having poor organizational structures which facilitate their inefficiency and inability to sustain their financial resources. As Chang (2005) holds, poor organizational management and lack of transparency has largely contributed to bad performance of most NGOs, despite their having rich financial resources. Despite being economic boosters across the world, they have been facing a number of challenges in their funding, efficiency and effectiveness, and accountability. This study would go deeper in determining the apparent challenges faced by these NGOs, and try to offer solutions to such problems (Moore, 2004). The performance and accountability, as well as efficiency of these NGOs have aroused a lot of concern among donors.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter there is a discussion on theory and empirical studies relating to role of board of directors. These are the agency, stewardship, stakeholder and resource dependency theory.

The agency problem is that agents often have ideas to use capital that lies outside the intent (purpose) of the principals. This can apply to a single (financial) or triple (economic, social, environmental) bottom line: principals have a purpose in mind for their resources, and agents aim to accomplish. The problem of agents being responsible to principles is that it compounds the agency costs identified by Jensen & Meckling (1976). A basic assumption is that managers will act opportunistically to further their own interests before shareholders. The agency theory shareholders expect the agents to act and make decisions in the principal's interest. On the contrary, the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000).

Davis et al. (1997) describes the stewardship theory as a relationship in which managers are stewards whose motives are aligned with the objectives of many parties. In their model, the behavior of the steward is collectively or organizationally centered in terms of seeking and sustaining the objectives of the entire organization. They suggest that the role of the steward is to protect and maximize shareholders' and organizational wealth and to avoid or prevent substituting individual self-serving behaviors for organizational behaviors that enhance organizational functioning and effectiveness.

The stakeholder theory takes a broader approach to how managers should articulate management policies and managerial attention among diverse constituencies. It was originally proposed as an alternative theory to the traditional agency theory (Donaldson and Davis, 1989, 1991). The theory posits that managers should pursue the best interests of organizational owners while weighing in the needs of other stakeholders. The term 'stakeholders' often refers to persons, groups, or organizations whose view must be taken into account in the decision making process. This is consistent with Freeman (1984) who defines a stakeholder as "any group or individual who can affect or is affected by the achievement of the organization's objectives."

In addition to monitoring, board members are also required to provide organizations with resources (Hillman & Dalziel 2003). The provision of resources is linked to the resource dependence theory. This theory holds that organizations are interdependent (Pfeffer & Salancik 1978) in that they depend on each other and various actors for their survival as well as for resources. As a result, they need to find different ways of managing this dependence and ensuring they get the resources and information they need. From this perspective, the board is seen as one means of reducing uncertainty by creating influential links (Hillman & Dalziel 2003; Peng 2004). Board members provide organizations with various resources through board members' skills, experience, and expertise. Pfeffer and Salancik (1978) also note that 'when an organization appoints an individual to a board, it expects the individual will come to support the organization, will concern himself with its problems, will invariably present it to others, and will try to aid it'.

Diversity in the composition of boards is important if boards are to effectively provide advice and resources. Board members with different skills and experience and of both genders contribute to effective resource provision and to the beneficial performance of organizations. In summary, the above theories advocate that boards should have a diversity of competent members who are able to effectively monitor top managers and provide organizations with the resources they need. By performing these roles, board members are able to positively influence the financial decisions they make for the organization.

2.2.1 The Board as the Governing Body

The Board has been regarded as the ultimate form of corporate control, charged with the responsibility to monitor and reward chief executives while assuring that corporate activity reflects stakeholder expectations (Judith, 2003). Regardless of the form and type of governance structure of an organization, there should be one governance body that has full responsibility on the financial oversight and decision-making authority. Wyatt (2004) differentiates between the principle governing body from the highest governing body. He gives an example of membership organizations that have Annual General Meeting (AGM) as the highest structure whose decisions and instructions outweigh those of the other parts of the organization. The principle governing body however, has the duty to perform fiscal oversight and accountability functions. Fiscal oversight includes the existence of an independent board of director with a financial expert and documented policies and procedures. Financial management includes the existence and use of a

budget, controls over cash receipts and disbursements, financial reporting, and tax reporting and compliance.

2.2.2 Role of NGO Boards

The roles of the board members are, to set policies and strategies for the NGO, in line with the agreed purposes or goals, principles and scope of the NGO. It also sets operational guidelines, work plans and budgets for the NGO and policy and program support. Many times, it is also called on to make funding decisions. It assists the internal workings of the NGO by setting criteria for membership of, and appointing, review panels and/or support groups. It may also establish a framework for monitoring and periodic independent evaluation of performance and financial accountability of activities supported by the NGO. (Kimambo, 2007)

Hardy defines the role of the board as to plan and make policy decision, make goals and set objectives and to empower the staff to move ahead by having set the course for action. Additionally, the board is to oversee the financial development of the institution and monitor its function (Anonymous, 1995). In another finding, Salmon (2000) pointed out that the two crucial responsibilities of the board is oversight of long term company strategy and the selection, evaluation and compensation of top management. Yet another renowned author in this subject has argued that the role of the board is to have the ability to influence management to change the strategic direction of the company (Lorsch, 2000).

Boards are expected to provide an authoritative overview of how management initiate, negotiate and administer the business of the organization (Bird, 2001). According to a Reference Guide for NGO Boards (2002), boards have to ensure that stewardship frameworks are in place. Stewardship function of the Board includes establishing policies on risk management, financial controls, internal controls, compliance and public reporting; accepting accountability and responsibility to stakeholders of the NGO; being transparent, including communicating to members, stakeholders and the public, and making information available upon request; developing appropriate structures and ensuring the Board understands its role, operates efficiently and effectively, and avoids conflict of interest; and enhancing the reputation of the NGO in the social welfare sector and the community. Boards are not expected to administer programs, or to oversee activities of individuals and units. This is called often being referred to as 'micromanagement'. Boards are expected to deliberate on policy level type of decisions and not manage (in other words – boards are supposed to set limit, parameters and frameworks within which the management will operate in fulfilling their mandates).

In summary, the importance to ensure that the role of the board to oversee organization performance through monitoring and accountability is stressed throughout the literature on NGOs – so much so that the future of the sector has appeared to rest on their ability to convince the public that it is performing and accountable. The board is put to task to ensure sound financial decision making and accountability to ensure proper use of resources in Non Governmental Organization.

2.2.3 Financing decisions in NGO

The board financing decisions in Non Government Organization are influenced by budgets, financial reports and investment strategies.

2.2.3.1 Budgets

Budget, in simple terms, means a document where you specify how much money you are going to spend (in other words, expenditure), especially if the organization has received grants. In some cases, as in businesses, budgets can also include the money that the organization is going to generate or “income.” The latter is important for all NGOs now because managing any organization, including an NGO does not mean just spending – we also need to look at how costs can be covered and how money can be spent efficiently.

Budgeting and cash management are two areas of financial management decisions that are extremely important exercises for not-for-profit organizations. The organization has to pay close attention to whether it has enough cash reserves to continue to provide services to its clientele or community. Cash flow is extremely challenging to predict, because the organization relies on revenue from resource providers that do not expect to receive the service provided. In fact, an increase in demand for a not-for-profit’s services can lead to a management crisis. It is difficult to forecast contribution revenue in a reliable manner from year to year. For that reason, the control of expenses is an area of increased emphasis. Budgeting therefore becomes a critical activity for a not-for-profit.

(Black baud)

2.2.3.2 Financial Reports

NGOs are generally expected to produce financial reports for various interested parties including the Board of Directors, the NGOs appointed auditor and donors. These reports generally include a Balance Sheet and a Statement of Receipts and Disbursements. The Statement of Receipts and Disbursements is the equivalent of a Profit and Loss Statement for companies. The balance sheet provides a picture of the assets, liabilities and capital reserves of an NGO at a given point in time. The Statement of Receipts and Payments shows the amount of money coming into an organization, how this money was paid out and any leftover money for a given period of time (i.e.: three months, one year, etc). These two reports in combination with more frequently generated performance reports can form the basis of financial reporting for NGOs. (Website, Funds for NGOs)

Prudent financial oversight requires that the board looks beyond monthly or annual financial reports to consider how the organization's current financial performance compares with that of previous years and how its financial future appears. If the organization's net assets have been declining over a period of years, or if future funding seems likely to change significantly, the board may need to take steps to achieve or maintain stability of the organization.

2.2.3.3 Investment Strategies for donor fund

Part of an NGO's Board responsibility to donors is to manage their funds well. This normally includes spending the money on agreed upon activities or items in an agreed upon time frame, and acquitting those expenses per the requirements of the donor. In

addition, it is the NGO's responsibility to manage donor funds to guarantee their value over time (especially in situations of high inflation). As donor funds are generally given in lump payments in advance, the NGO must safeguard these funds (i.e. deposit them in the bank) for future use. As well, it is generally expected that those funds should be deposited in interest bearing accounts, so that they will in fact be productive assets while they await expenditure. Some donors make a provision in their reporting so that interest gained can be itemized. (Website, Funds for NGOs)

Whenever possible, an organization should generate enough income to create cash reserves for its future. When an organization has built sufficient reserves to allow for investments, the board is responsible for establishing policies that govern how the funds will be invested and what portion of the returns, if any, can be used for immediate operations or programs. The boards of organizations with sizeable reserves or endowments generally select one or more independent investment managers to handle the organization's investments. In those cases, the board or a committee of the board should monitor the outside investment manager(s) regularly.

2.2.4 Board performance

The challenge for boards is to prevent crises in the organizations they govern. A regular process of evaluating the board's performance can help to identify strengths and weaknesses of its processes and procedures and to provide insights for strengthening orientation to ensure funds availability, effective resource allocation, effective senior management, organization is law abiding and the board awareness of their

responsibilities. The board's first responsibility is to ensure that the organization has clearly established goals; objectives and strategies for achieving them; that they are appropriate in the circumstances; and that they are understood by management to ensure implementation. The other responsibility in which a board can contribute to the performance of an organization is to establish performance indicators with management and to monitor actual results against them. These responsibilities are encapsulated in Garratt (2003)'s overview of how boards and directors should behave through an emphasis on the duties each director must have including duties of care, legitimacy, upholding governance values, trust, loyalty, critical review and independent thought.

Garratt (2003) also points out the elements of a failing board include not only problems of abuse of power and conflicts of interest but also basic laziness and cowardice (2003:117). To avoid the undesirable elements, he introduces the concept of "directorial dashboards" to help boards focus their attention on key business performance indicators (2003:147).

2.3 Empirical Studies

Governance research represents a very dynamic interdisciplinary field of studies that substantially evolved since the seminal publication by Berle and Means (1932). Most of the empirical literature on governance has been rooted in agency theory and is concerned with linking different aspects of corporate governance with firm performance in order to prevent principal-agent conflicts and maximize value for shareholders (principals). The assumption here is that, by managing the principal-agency problem, firms will operate more efficiently and perform better. The central premise of this framework is that managers as agents of shareholders (principals) can engage in self-serving behavior that may be inconsistent with the shareholders' wealth maximization principle.

Research into this area has produced a number of common problems and dilemmas that NGOs experienced. One of the most mentioned common problem was to do with the governance of the organizations and the relations between board members and staff. These stemmed largely from the boards' inability or unwillingness to carry out their responsibilities of governing the organizations. Board members often lacked the time or the expertise to be able to carry out these responsibilities effectively. As a result, senior staffs were often left to make policy decisions with little or no support from board members (Mukasa, 2006). Governance and decision making; the governance picture of many NGOs is quite complex. Most nonprofits are governed by self-perpetuating, largely self-appointing boards of directors. "Though trustees are not elected by society at large, their essential purpose is to hold an organization in trust for the benefit of society, as specified in its papers of incorporation and grants of tax exemption" (Lewis, 2005)

Raymond Elson et al (2007) carried out a research in religious organizations: a study of current practices in the local church. They examined the fiscal oversight and financial management practices in the local church. A questionnaire was developed to collect data for the study. The results showed that faith based organizations have adequate fiscal oversight and financial management controls. However, opportunity existed for improvement. They recommended that personnel should attend non-profit seminar and the organization should communicate policies and procedures to their employees and board members.

Empirical literature on non profit board governance has examined the ways in which adherence to “best practices” has the potential to influence positive organizational outcomes. For example, in their study of 400 nonprofit organizations in Canada, Bradshaw, Murray, and Wolpin (1992) found a positive relationship between the perception of board effectiveness and widely accepted notions of how a nonprofit board of directors should operate. Specifically, they argued that board involvement in the development of the agency’s mission and in strategic planning, together with participation at meetings and in committees, contributed to the perception that the board had a positive impact on organizational performance.

Similarly, Green and Grieinger (1996) examined 16 social service organization boards to assess the degree to which board attention to the duties and responsibilities prescribed in the normative literature related to organizational effectiveness(that is sustaining long-term quality client service).The others found that the boards of directors for effective organizations tended to be engaged in at least seven best practices including policy

formation, strategic planning, program monitoring, financial planning and control, resource procurement, board development, and dispute resolution.

A positive relationship between best practices and desired organizational outcomes can be found in Herman and Tulipana's (1985) study that showed how organizational effectiveness was related to the extent to which board members believed they were properly informed of their roles and responsibilities.

According to Conforth and Edwards (1999), the contribution of board members in the strategic management of nonprofit organization in UK depended and varied according to complex interplay of the system of regulation, sectoral traditions and norms of governance, the way board members are chosen, board members skills and experience, organizational size and status and the way boards are organized and run. These interplay factors determine how board members carry out their two crucial responsibilities, which Salmon (2000) pointed them out as-oversight of long term company strategy and the selection, evaluation and compensation of top management.

From the above studies carried out board involvement in the running of the organization is crucial to ensure objectives of the organization are met as per the strategic plan and proper utilization of resources.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the methodology that was used in this study. It covers the description of the overall research approach, sampling procedures, instrumentation, data collection and data analysis that were used.

3.2 Research Design

The study was carried out through survey research cross sectional approach .According to Shuttlework (2008), cross sectional survey describes the characteristics of that population at one time, but it cannot give any insight as to the causes of population characteristic because it is predictive, cross sectional design. This study design was used since my study was collecting respondents' opinions and thoughts regarding financial decisions and board performance. The respondents were randomly sampled. This increased the validity of the results as bias in choosing the respondents is eliminated.

3.3 Population of the study

In Kisumu County there are 731 NGOs which are recognized by the NGO Co-ordination Board. (Sep 2013) They are not for profit organizations that are donor funded.

3.4 Sample size

Determining sample size is very important in getting accurate results. In this project 284 organizations were be chosen for the study. Yamane (1967:886) provides a simplified formula to calculate sample sizes as below. A 95% confidence level

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

Where:

n is the desired sample size

N is the population size

e is the level of statistical significance test (At 95% confidence level is equivalent to 5% significance level the z statistics is 1.96)

$n=731/ [1+731(0.05)^2]$ gives 258.53 approximately 259 organizations plus 10% refusals will be 284.

3.5 Data Collection

Primary data was collected through quantitative structured questionnaire. The data was on financial decisions and board performance. The data was gathered using a structured questionnaire which was administered to directors or their designate. The financial decisions and board performance were captured using a 5-point Likert-type scale using relevant descriptive statements for each financial decision (budgets, investment strategies and financial reports). Board performance was the same way using indicators of three key measure of performance (funds availability, effective resource management and the organization is law abiding). Questionnaire was also administered through personal interview. Telephone interview was used as a follow up for organizations that the respondents were unavailable during the administration of the questionnaire.

3.6 Data Analysis

Descriptive statistic was used. According to Trochim (2006), it is used to describe the basic features of data in a study. They provide simple summaries about the sample and measures. Factor analysis and correlation analysis were also used to know the relationship between financial decision and board performance.

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter gives the results of the data obtained from informants in selected nongovernmental organizations in Kisumu. One hundred and fifty three NGOs participated in providing information for this study.

4.2 Data Analysis

Data analysis for financial decision involved getting the percentage of frequency scores through descriptive analysis while data analysis for the effect of financial decision on board performance involved factor analysis and correlation analysis at 95% confidence level ($p = 0.05$). The percentages show the ranking of various aspects that describe financial decision in the surveyed organization. Factor analysis and correlation analysis tested the combined effect of financial decision on board performance. A sample of 284 NGOs in Kisumu County were selected and approached to provide data. Out of the 170 administered questionnaires, only 153 were found valid for analysis.

4.3 Results

4.3.1 Financial decisions

To capture financial decisions 12 descriptive statements were used which included statements on budgets, investment strategies and financial reports. The respondents were asked to what extent those statements applied to their organization.

Below is a table with the summary of the findings on financial decisions

| | 1 | 2 | 3 | 4 | 5 |
|--------|-------------|------------|----------|------------|--------------|
| F b1 | | | | 13% (20) | 87% (133) |
| F b2 | | | | 7 % (10) | 93 % (143) |
| F b3 | | | | | 100 % (153) |
| F i4 | | | | | 100 % (153) |
| Fi 5 | 96% (147) | 3% (5) | 1% (1) | | |
| Fi 6 | | | | 59 % (90) | 41 % (63) |
| Ffr7 | | | | | 100 % (153) |
| Ffr 8 | | | | | 100 % (153) |
| Ffr 9 | 79 % (120) | 20 % (31) | 1 % (2) | | |
| Ffr10 | | | | 51 % (78) | 49 % (75) |
| Ffr 11 | | | | 44 % (67) | 56 % (86) |
| Ffr 12 | | | | 29 % (45) | 71 % (108) |

Table 1: Findings on financial decisions

Source field data 2013

Where:

Fb 1 - Board is involved in budget preparation and resource mobilization.

Fb2- The organization operates with an annual operating budget approved by the board.

F b3 - The budget is presented to and approved by the board prior to the start of the financial year.

F i4 - The board participates and is aware of investment decisions of the organization.

Fi 5- Donor funds are deposited in interest bearing accounts.

Fi 6 - Projects implementation is based on value addition and sustainability.

Ffr 7 - Financial statements are prepared in accordance with general accepted accounting standards and reviewed by the board.

Ffr 8 - The board reviews the financial statements yearly in relation to the organization objectives.

Ffr 9 - The organization has incurred penalties in the last two years because of late filing or payment of payroll taxes and returns.

Ffr10 - Financial information and other significant organization activities are discussed with the board on a regular basis.

Ffr 11- Bank reconciliation(s) are prepared for all the organization bank accounts at least monthly.

Ffr 12 - The board conduct compliance audit annually to ensure rules and control; the organization carries out independent financial audit.

4.3.1.1 Budgets: Research findings show that during financial decision making 13% of the 284 organization agreed that the board was involved in budget preparation and

resource while 87 % strongly agreed. 7% ranked agreed that the organization operates within the approved budget while 93% strongly agreed. 100% of the sampled population strongly agreed budget was presented to and approved by the board prior to the start of the financial year.

4.3.1.2 Investment strategies: The findings showed that 100% of the sampled population strongly agreed that the board participated and was aware of investment decisions of the organization. 96% of the sampled population strongly disagreed that they organization did not deposit donor funds in interest bearing accounts; 3% disagreed while 1% was undecided. 59 % agreed while 41% strongly agreed that project implementation was based on value addition and sustainability.

4.3.1.3 Financial reports: Findings shows that 100% of the sampled population strongly agreed that financial statements are prepared in accordance with general accepted accounting standards and reviewed by the board and the board reviewed the financial statements yearly in relation to the organization objectives. 79% strongly disagreed, 20% disagreed and 1% undecided on whether the organization had incurred penalties in the last two years because of late filing or payment of payroll taxes and returns. 59 % agreed while 41 % strongly agreed that financial information and other significant organization activities were discussed with the board on a regular basis. 44% agreed while 56% strongly agreed bank reconciliation(s) were prepared for all the organization bank accounts at least monthly. 29% agreed while 71 % strongly agreed that the board conduct compliance audit annually to ensure rules and control; the organization carries out independent financial audit.

4.3.2 Board Performance

To capture the results of board performance 8 descriptive statements were used which included statements on funds availability, effective resource mobilization and organization was law abiding.

Below is the summary of the findings on board performance;

| | 1 | 2 | 3 | 4 | 5 |
|------------------|---|---|---------|-------------|-------------|
| Bp funds13 | | | | 22 %(33) | 78% (120) |
| Bp funds 14 | | | | 52 %(79) | 48 %(74) |
| Bp resource15 | | | | 72% (110) | 28% (43) |
| Bp resource 16 | | | | 16 %(25) | 84 %(128) |
| Bp resource 17 | | | | 1% (2) | 99 %(151) |
| Bp management 18 | | | 3 %(5) | 95 %(144) | 2 %(4) |
| Bp management 19 | | | | 100 %(153) | |
| Bp management 20 | | | | | 100 %(153) |

Table 2: Findings on board performance

Source field data 2013

Where;

Bp funds13 -Monitor fundraising activities and the amount of income received .

Bp funds 14 -Monitor relationships with donors (e.g. if reports are submitted on time) and monitor the amount of money held in reserves.

Bp resource15- Monitor whether the organization is being accountable to its beneficiaries.

Bp resource 16 - Approves a realistic annual budget .

Bp resource 17 - Regularly monitoring financial reports, including the income and expenditure statement and the balance sheet .

Bp management 18 -Making sure that the management team meets legal requirements.

Bp management 19 -Appoints auditors and overseeing the audit .

Bp management 20 - Approves the audited accounts and annual reports.

4.3.2.1 Funds availability: The findings showed that 22% agreed while 78% strongly agreed that the board monitored fundraising activities and the amount of income received. 52% agreed while 48% strongly agreed that the board monitored relationships with donors and monitored the amount of money held in reserves.

4.3.2.2 Effective resource allocation: The findings showed that 72% agreed while 28% strongly agreed that the board monitored whether the organization is being accountable to its beneficiaries. 16% agreed while 84% strongly agreed that the board regularly monitored financial reports, including the income and expenditure statement and the balance sheet.99% of the sampled population strongly agreed while 1% agreed that the board approved a realistic annual budget.

4.3.2.3 Organization is law abiding: 3 % agreed, 95% agreed and 2% undecided on whether the management was meeting legal requirements. 100% agreed that auditors

were appointed to oversee annual audits. 100% of the sampled population strongly agreed that the board approved audited accounts and annual financial reports.

4.3.3 Financial decision and board performance

Board performance and financial decisions are positively related. Overall, financial decisions are significantly positively related to board performance ($r = 0.9743$, where r is correlation coefficient, p value = 0.0000) at 5% level of significance.

4.4 Discussions

Financial decisions that affect board performance negatively were donor funds were not placed in interest bearing accounts and the organization did not face any penalties.

Budgets were presented to the board for approval and boards reviewing financial statements were perfect influencers of financial decisions and were excluded in the factor and correlation analysis. However all the other factors reviewed in this study affected board performance positively. Board performance was obtained by getting the scores of all the factors that influence board performance (sum of rankings of the descriptive statements which included the board monitored funds received, the board monitored their relationship with the donors, the board monitored whether the organization was accountable to the beneficiaries, the board approved realistic budgets and reviewed financial reports, the board ensured that the management meet legal requirements, the board appointed auditors and they approved the audited accounts). The scores were then categories into five (very poor, poor, fair, good and very good). In general, board performance was good and very good mainly as per the findings in figure 2.

CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The main objective of this study was to examine the effect of financial decision making on board of directors' performance in NGOs in Kisumu County.

5.2 Summary

Board performance and financial decisions are positively related. Budgets were approved by the board and the board was involved in resource mobilization. The boards have reduced their participation in investment strategies as few organizations invest funds in interest bearing accounts due to donor designated fund restrictions. The board reviewed financial statements and reports; the board participated in discussions of financial reports. Organization faced penalties due to late filing of returns to NGO coordination board. The board assisted in fund raising activities and they monitored their relationships with the donors. During Annual General Meetings (AGM) the board was involved in vetting auditors and overseeing their performance. Some of the board members attended AGM because of the allowances given. The boards need to be enlighten to enable them understand their crucial role in financial oversight to improve board performance.

5.3 Conclusion

The study objective was to examine the effect of financial decision on board performance in Kisumu County, Kenya. The study was guided by relevant theories and empirical studies in the areas of financial decision and board performance. Most of the

organizations were funded by individual well wishers, international and Kenyan government. A major concern was donor restricted funding on overheads to support board capacity building on financial management decisions. 100% of the respondents' organizations were registered with NGO Coordination Board meaning oversight of NGOs was attained.

The findings of the study provide evidence that financial decision and board performance are significantly positively related. The results offer partial support to agency theory (Jensen and Meckling, 1976), stakeholder theory (Donaldson and Davis, 1989, 1991), stewardship theory (Davis and Donaldson, 1997) and resource dependence theory (Pfeffer and Salancik, 1978). The main proposition of these theories is that if the board members are able to perform their roles, they will be able to positively influence their financial oversight role and enhance their performance. The board should make financial decisions in the best interest of the beneficiaries.

5.4 Recommendations

In order to strengthen and improve board performance in the NGO sector in Kisumu and ensure effective board member participation in financial decisions, the following recommendations are offered based on the findings of this research.

Donors and other well wishers should provide financial support to NGOs that is specifically focusing on strengthening board performance specifically on their role on financial oversight, promoting accountability and ensuring that NGOs have effective boards who understand the organizational goals and objectives.

Research & academic institutions as well as book publishers should research and document more on the dynamics of board performance in NGO sector broadly and board participation in financial decisions.

5.5 Limitations of the study

Telephone interviews had repeat calls which were inevitable and the respondent did not have enough time to think. Communication with the respondents was difficult since some of the numbers were out of service.

Some of the respondents requested for alternative days to respond to the questionnaires which make the process time consuming. Some of the respondents also requested for funding support on board capacity building in financial management.

5.6 Recommendation for Further Studies

Since the study was carried only on financial decisions and board performance more studies should be carried out to examine the impact of allowance on board performance.

Does one become a board to receive allowance or do they become a board to provide oversight to the organization?

The study should be replicated in the other 47 Counties to know if the findings will be the same since Kenya has over 4000 registered NGOs.

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APPENDIX 1: Questionnaire

A sample of research questionnaire

Section A: Basic NGO Information

1. Name of NGO _____
2. Year Founded _____
3. Is your NGO Registered? Yes _____ No _____
4. Form of Registration, (please tick appropriate)
 - a) Trustee
 - b) Society
 - c) Association
 - d) For Profit Company
 - e) Company Not for Profit
 - f) Other (specify) _____

Section B: Financial decisions

Please indicate to what extent you agree or disagree to the below statements. Rate on scale: 1= strongly disagree 2= disagree 3= Undecided 4= Agree 5= strongly agree

| | | | | | |
|----------------|--------------------------|-----------------|------------------|--------------|-----------------------|
| <i>Budgets</i> | <i>Strongly disagree</i> | <i>Disagree</i> | <i>Undecided</i> | <i>Agree</i> | <i>Strongly agree</i> |
|----------------|--------------------------|-----------------|------------------|--------------|-----------------------|

| | | | | | |
|---|--------------------------|-----------------|------------------|--------------|-----------------------|
| 5. Board is involved in budget preparation and resource mobilization.(fund raising) | | | | | |
| 6. The organization operates with an annual operating budget approved by the board. | | | | | |
| 7. The budget is presented to and approved by the board prior to the start of the financial year. | | | | | |
| <i>Investment strategies</i> | <i>Strongly disagree</i> | <i>Disagree</i> | <i>Undecided</i> | <i>Agree</i> | <i>Strongly agree</i> |
| 8. The board participates and is aware of investment decisions of the organization. | | | | | |
| 9. Donor funds are deposited in interest bearing accounts. | | | | | |
| 10. Projects implementation is based on value addition and sustainability. | | | | | |

| <i>Financial reports</i> | <i>Strongly disagree</i> | <i>Disagree</i> | <i>Undecided</i> | <i>Agree</i> | <i>Strongly agree</i> |
|---|--------------------------|-----------------|------------------|--------------|-----------------------|
| 11. Financial statements are prepared in accordance with general accepted accounting standards and reviewed by the board. | | | | | |
| 12. The board reviews the financial statements yearly in relation to the organization objectives. | | | | | |
| 13. The organization has incurred penalties in the last two years because of late filing or payment of payroll taxes and returns. | | | | | |
| 14. Financial information and other significant organization activities are discussed with | | | | | |

| | | | | | |
|--|--|--|--|--|--|
| the board on a regular basis. (quarterly or half yearly) | | | | | |
| 15. Bank reconciliation(s) are prepared for all the organization bank accounts at least monthly. | | | | | |
| 16. The board conduct compliance audit annually to ensure rules and control. | | | | | |
| 17. The organization carries out independent financial audit. | | | | | |

Section C: Board performance

Please indicate to what extent you agree or disagree to the below statements. Rate on scale: 1= strongly disagree 2= disagree 3= Undecided 4= Agree 5= strongly agree

| | | | | | |
|------------------------------|--------------------------|-----------------|------------------|--------------|-----------------------|
| | <i>Strongly disagree</i> | <i>Disagree</i> | <i>Undecided</i> | <i>Agree</i> | <i>Strongly agree</i> |
| <i>i. Funds availability</i> | | | | | |

| | | | | | |
|--|--------------------------|-----------------|------------------|--------------|-----------------------|
| 18. Monitor fundraising activities and the amount of income received. | | | | | |
| 19. Monitor relationships with donors (e.g. if reports are submitted on time) and monitor the amount of money held in reserves | | | | | |
| <i>ii. Effective resource allocation</i> | <i>Strongly disagree</i> | <i>Disagree</i> | <i>Undecided</i> | <i>Agree</i> | <i>Strongly agree</i> |
| 20. Monitor whether the organization is being accountable to its beneficiaries (e.g. presenting financial reports to them). | | | | | |
| 21. Approving a realistic annual budget. | | | | | |
| 22. Regularly monitoring financial reports, including the income and expenditure statement and | | | | | |

| | | | | | |
|---|--------------------------|-----------------|------------------|--------------|-----------------------|
| the balance sheet. | | | | | |
| <i>iii. Organization is law abiding</i> | <i>Strongly disagree</i> | <i>Disagree</i> | <i>Undecided</i> | <i>Agree</i> | <i>Strongly agree</i> |
| 23. Making sure that the management team meets legal requirements (e.g. paying taxes, filing annual reports). | | | | | |
| 24. Appointing auditors and overseeing the audit. | | | | | |
| 25. Approving the audited accounts and annual reports. | | | | | |

Thank you for your time