AN INVESTIGATION OF THE RELATIONSHIP BETWEEN THE INTERNAL CONTROLS AND FINANCIAL PERFORMANCE OF ALEXANDER FORBES FINANCIAL SERVICES OF (EA) LIMITED

BY

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D61/70610/2008

A MANAGEMENT RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION (MBA), SCHOOL OF BUSINESS, UNIVERSITY OF NAIROBI

NOVEMBER 2011

DECLARATION

This research project is my original work and has not been presented to any university for any award or anywhere else for academic purposes.

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This project has been submitted for examination purposes with my approval as University Supervisor.

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ACKNOWLEDGEMENT

I take this opportunity to give thanks to the Almighty God for seeing me through the completion of this project.

The work of carrying out this investigation needed adequate preparation and therefore called for collective responsibility of many personalities. The production of this research document has been made possible by invaluable support of many people. While it is not possible to name all of them, recognition has been given to a few.

My sincere gratitude goes to my project supervisor Dr. Josiah O. Aduda for his invaluable guidance and support throughout the project. He not only guided me well, but also showed very keen interest in the project work, and ensured that I was on the right track throughout. I am greatly indebted to my supervisor for his advice and unlimited patience in reading through my drafts and suggesting workable alternatives, my profound appreciation to you.

The entire staff of Alexander Forbes Financial Services of (EA) Limited cannot pass without my special acknowledgement for taking time off their busy schedule to provide me with all the information I needed in the course of the research and moral support. Without their immense cooperation I would not have reached this far.

My family will forever be in my heart for their support in every way. I would also wish to thank my darling husband for his continued love, support, encouragement and understanding when I was not there for them during the project period; I wouldn't have made it this far without him.

I would also wish to extend my sincere gratitude to all the MBA students, staff, lecturers and the entire University of Nairobi fraternity for changing me from what I was to what I am.

Thank you all. May the Almighty God bless you abundantly.

DEDICATION

To my husband Richard and my daughters Carolyn and Sharon for the love and support they have shown throughout this project and entire course.

ABSTRACT

The study being descriptive in nature used primary and secondary data from the following sources that is questionnaire and published financial statements of the company. Prior to secondary data analysis, primary data was analyzed using descriptive statistics to establish the impacts of internal controls on the company's operational efficiencies and financial performance. Internal Control System is a vital in the every organization to achieve their management objectives. The study focuses in AFFS's. The study examined whether there is a relationship between the internal controls system and the financial performance. In this study internal control is measured by control environment, risk assessment, control activities information and communication and monitoring and the financial performance are measured by profit, efficiency and liquidity respectively. To test this hypothesis data were collected through questionnaire from the employees of AFFS's. Regression analysis was used to measure the variables. The study finds that internal control and financial performance are statistically significant in determining financial performance.

The study concluded that, the AFFS's external auditors report their findings directly to the board or to a board committee while the board reviews the qualifications and the independence of the company's external auditors. Policies and procedures are periodically reviewed by the board to ensure that appropriate internal controls have been established. In addition, all company personnel in the areas of control understand their roles, accountability for their activities, approves the company's systems of internal controls. The study recommends that, for any company, the external auditors report their findings directly to the board or to a board committee; the board should review the qualifications and the independence of the company's external auditors. Policies and procedures should be periodically reviewed by the board to ensure that appropriate internal controls have been established.

LIST OF ABBREVIATION

AFFS - Alexander Forbes Financial Service (EA) Limited

ANOVA - Variance of Analysis

CEO - Chief Executive Officer

COSO - Committee of Sponsoring Organizations

ICs - Internal Controls System

IFRS -International Financial Reporting Standards

ILOC - Internal Locus of Control

KRA -Kenya Revenue Authority

RBA - Retirement Benefit Authority

ROA - Return on Assets

SEC - Securities and Exchange Commission

SPSS - Statistical Package for Social Sciences

UK - United Kingdom

USA - United States of America

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Internal control is a process affected by an organization board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of effectiveness and efficiency of operation, reliability of financial reporting and compliance with the applicable laws and regulations (COSO, 1992).

When companies suddenly collapse, the often-resounding question is, "what went wrong?" A breakdown in the internal control system is the usual cause. Internal control is a process that guides an organization towards achieving its objectives. These objectives include operational efficiency and effectiveness, reliability of financial reporting, and compliance with relevant laws and regulations (COSO, 1992). Absence of these variables often results in organizational failure. The findings of the Treadway Commission Report of 1987 in the United States of America (USA) confirmed absence of, or weak, internal controls as the primary cause of many cases of fraudulent company financial reporting (Nahon, 2009).

Over the past decade, organizations have invested heavily in improving the quality of their internal control systems. They have made the investment for a number of reasons, notably: (1) good internal control is good business — it helps organizations ensure that operating, financial and compliance objectives are met, and (2) many organizations are required to report on the quality of internal control over financial reporting, compelling them to develop specific support for their certifications and assertions. (COSO's 2006 Guidance)

Internal control is designed to assist organizations in achieving their objectives. The five components of COSO's Internal Control which will be evaluated and compared with the financial performance are as follows: Control environment - an environment or culture where control is recognized and emphasized, Risk Assessment - the establishment of policies and procedures for risk assessment, Control Activities - the recognition that all activities require some measure of control, Accounting, Information and Communication Systems - the institution of accounting, information and communication systems and Self-Assessment or Monitoring - the establishment of policies and procedures for self-assessment and monitoring.

1.1.1 Internal Controls

While the specific definition of internal control differs across the various models, a number of concepts are very similar across these models. In particular, the models emphasize that internal control is not only policies and procedures to help an organization accomplish its objectives but also a process or system affected by people. In these models, people are perceived to be central to adequate internal control (Masiga 2008).

These models also stress the concept of reasonable assurance as it relates to internal control. Internal control systems cannot guarantee that an organization will meet its objectives. Instead, internal control can only be expected to provide reasonable assurance that a company's objectives will be met. The effectiveness of internal controls depends on the competency and dependability of the organization's people. Limitations of internal control include faulty human judgment, misunderstanding of instructions, errors, management override of controls, and collusion. Further, because of cost-benefit considerations, not all possible controls were implemented. Because of these inherent limitations, internal controls cannot guarantee that an organization will meet its objectives (COSO, 2006).

1.1.2 Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is used as a general measure of firm's overall financial health over a given period, and can be used to compare similar firms across the industry or to compare industries or sectors in aggregation. There are many different ways to measure financial performance but all measures should be taken into aggregation. Line items such as revenue from operations, operating income or cashflow from operations can be used, as well as total unit sales. Furthermore, the analyst or investors may wish to look deeper into financial statements and seek out margin growth rate or any declining debt (White head and Gup, 1985).

Performance is the outcome of all of the organization's operations and strategies (Wheelen and Hunger, 2002). Measuring financial performance accurately is critical for accounting purposes and remain a central concern for most organizations. Performance measurement systems provide the foundation to develop strategic plans, assess an organization's completion of objectives, and remunerate managers (Lttner and Larcker, 1998). Although assessment of performance in the marketing literature is still very important, it is also complicated (Pont and Shaw, 2003). While consensual measurement of performance promotes scholarly investigations and clarify managerial decisions, marketers have not been able to find clear, current and reliable measures of performance on which marketing merit could be judged.

1.1.3 Relationship between the Internal Controls and Financial performance

This study examines the relationship between internal controls and financial performance of Alexander Forbes Financial Service of (EA) Limited (AFFS). Unlike business organizations where shareholders are the major class of stakeholders and profitability is the primary objective, AFFS serve the society through delivering services and conducting research, and have a diffuse group of stakeholders. Thus, efficiency rather than profitability becomes an important measure of performance. In addition, relying on a focused class of stakeholders (e.g., shareholders) to monitor performance becomes less feasible because companies do not have alienable residual interest (Sunder, 1997). As a consequence, internal controls are no less important for companies than for business organizations.

1.1.4 Alexander Forbes Financial Service (EA) Limited (AFFS), Kenya

Alexander Forbes Financial Services (EA) Limited as an Administrator, registered with the Retirement Benefit Authority (RBA) performs the roles of carrying out daily administration of the affairs of the scheme in accordance with the provision of the Act, scheme trust deed and rules and its amendments, any other relevant legislation in force and all other legal documents related to the scheme; liaise with the trustees, the Retirement Benefit Authority (RBA), the Kenya Revenue Authority (KRA) Department for the time being responsible for collecting domestic taxes and the scheme service providers in the course of administration of the scheme; Offer advisory and training services to the trustees, members and the Sponsor on their rights and obligations in the scheme; Avail the required data of the scheme to the service providers to enable preparation of statutory returns to the Authority; Submit or cause to be submitted required statutory returns to the Authority; Compute and pay benefits to the members and their beneficiaries directly as provided for in the law and the scheme rules; Prepare the scheme budgets, cash flows and liquidity requirements as may from time to time be required;

Where required, offer secretarial services to the Board of Trustees by organizing meetings, issuing notices for the same and taking minutes during the meetings (AFFS hand book).

1.2 Problem Statement

During the past two decades, many organizations and specifically service sectors have faced dramatic changes in their business environment. Deregulation and change of requirements by the government combined with extensive competition in domestic markets has resulted in a situation where most companies are now competing in a highly competitive global market. At the same time, there has been a significant reduction in product life cycles arising from technological innovations and the need to meet increasingly discriminating customer demands. To compete successfully in today highly competitive global environment, companies have made customers satisfaction an overriding priority hence have adopted new management approaches changed their systems and the issue of the Benefit Administrator Companies applying for the continuation of the business of offering services to the retirement benefit schemes on a yearly basis.

The changes have significant influence on internal control system. Little attention is given to develop internal control systems, which can accurately measure costs and profitability of individual services. The Benefit Administrator Companies faces drastic changes every year after the budget. In 2010/2011 budget led by the honorable deputy prime minister Uhuru Kenyatta reduced the payment of withdrawal benefit process from 60 days to 30 days thus call for more efficiency in the in administration of the retirement benefits Legal Notice No. 87 of 2010 budget.

A good number of people and institutions have suffered big losses because of poor control system in companies and their money getting lost through fraud and misuse of assets that are used to generate revenue. Inadequate controls have also led to corruption and collusion of management and external auditors leading to an organization not achieving its set objectives. Technological changes has also brought with it challenges in controls systems and this has necessitated the development of new ways of controlling organizations.

This therefore represented a deliberate attempt by the author to immerse him in the important problems found in the swampland of internal control practice. The author intends to know how AFFS have succeeded in its maximization of profit. Some of the studies conducted in Kenya are evaluated of the internal controls of Ethiopian Airlines Branch office in Nairobi (Mohammed, 1983) and a case study of internal controls of Nyayo Bus Service Corporations in Nairobi (Esmailjee, 1993). Chira, (2009) researched on the analysis of internal controls systems in financial institution. The findings were that though various internal controls systems do exist in the banking industry more weight had been given to operational controls compared to other types of controls. There has been no research done on the internal control systems in administration of Retirement Benefits. Its recommend that this study should be understood as investigations of these theoretical interests especially in the interest of the study motive and companies impact on the financial performance. Since the case study is on the AFFS, the outcome cannot be generalized to the whole industry.

1.3 Research Objectives

The research objective is to establish the relationship between the internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited.

1.4 Significance of the Study

The results of the study may be useful to;

The management of AFFS, Nairobi, who are interested to come up with various ways in which to improve their efficiency and effectiveness through the use of proper internal control system in all their operations.

The regulator of the Retirement Benefits Schemes that is Retirement Benefits Authority (RBA) in Strong internal controls aids safeguarding the assets of the retirement benefits and in preparation of accurate financial statements, which are understandable to the trustees and complies with the RBA ACT.

Industry sector by gaining competitive advantage by improving their operations and quality of service to their clients better than their competitors.

The scholars and researchers who might have an interest in developing the findings further or taking other related field or empowerment and as a source of reference. The student and academics will use this study as a basis for evaluation of the internal controls on the Retirement Benefits Administrators in Kenya and their effects on financial performance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The relationship between formal internal control and an organization financial performance is a controversial problematic and unresolved issue. The chapter gives the definitions of internal controls, internal control over financial reporting, organization financial performance, financial ratio to be used to determine the relationship between the internal control and financial performance, the empirical study and the conclusion of the study.

2.2 Internal Controls

The Committee of Sponsoring Organizations (COSO) of the Tread way Commission defines internal controls as "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial information, and compliance with the applicable laws and regulations" (COSO, 1992). Though it is important for both business and not-for-profit organizations to establish internal controls to improve operating efficiency, issues pertaining to internal controls had not been extensively studied until after the passage of the Sarbanes-Oxley Act. Per Section 302 and Section 404 of the Sarbanes-Oxley Act, Securities and Exchange Commission (SEC) in the U.S. mandated the enterprises to disclose information on internal controls (SEC 2002, 2004), whereby researchers used publicly available data to empirically examine the determinants of internal control weakness (Krishnan 2005; Ashbaugh-Skaife et al. 2007; Doyle et al. 2007a), and the association between internal controls and the financial performance (Doyle et al. 2007b).

2.3 Theories on Internal Control

2.3.1 Control Theory

Control theory and experience suggests that a person who abuses a system of controls is more likely to act alone than to collude with another. According to Rotter (1966), internal locus of control (ILOC) versus external locus of control conceptualizes how individuals see their own actions affecting events that surround their lives. Individuals with ILOC tend to believe that events are the results of their own actions (Rotter, 1966), while individuals with external locus of control tend to attribute events to external environmental factors, such as powerful others or chance (Levenson, 1973).

If we put the concept of ILOC in the context of an entrepreneur running their business in a competitive environment, we can imagine that an entrepreneur with a strong ILOC would believe that they can make things happen, and that the success or failure of their business is the result of their own actions. In contrast, an entrepreneur with an external locus of control might consider that the external environment is the main reason for their business success or failure.

2.3.2 Agency Theory

The study by Berle and Means (1932) on modern corporations gave rise to managerial models proposed by Williamson (1964) and the problems of discretionary managerial behaviour considered in this research led to the first contributions from the field of economics to agency theory. The contributions to agency theory from Jensen and Meckling (1992), which can also be considered classic contributions to organisational theory, will serve as fundamental references to develop this section. The way they describe the causes of the agency problem and procedures for controlling agency in organizations is an important contribution that can be explained satisfactorily in terms of relations and contents. In this case contents act as the basic explanatory variable.

According to Fama and Jensen (1983a, b) there are three factors whose nature (or content) explain the problem of agency. The first factor is technology and its characteristic scale of production. The second factor explaining the problem of agency is that agents are not perfect agents (Jensen, 1998).Finally, the third factor explaining the problem of agency, by substantially reinforcing the other two factors and extending the problem to the entire organization, is the specific knowledge distributed among the agents (Jensen and Meckling, 1992). Because agency theory is considered to be very appropriate for conceptualizing control and monitoring situations (Daily *et al.*, 2003), we therefore deem it to be the most relevant for this research work. Furthermore, the model we developed serves as a formal control mechanism which facilitates the monitoring of a critical aspect of the banking industry.

2.3.3 Value Theory

According to Catton (1956) an individual's preferential behavior shows certain regularities and this pattern can be attributed to some standard or code, which persists through time. Values provide a basis by which people can order their intensities of desiring various desiderata (something desirable). Based on available choices, people make preferences grounded in their values. In an organizational context, knowledge of such preferences of individuals provides a context for managerial decision-making. Keeney (1992) argues that values are guiding principles to evaluate the desirability of a particular consequence. "Values are what we care about and they should be the driving force for our decision making (Keeney, 1992)".

Value is not a property of an object but is a quality of relationship (Catton, 1956,). A person's desire for something under a given situation depends on "selective perception" of that person. Selective perception directs valuation by substituting final goals with other intermediary goals i.e. a goal may be pursued in order to attain some higher ultimate goals. Thus the nature of the major goals accepted by individuals together with notions of ways in which these goals might be affected by future events, are the determinants of values of people. Value Theory provides a theoretical platform to affirm that values are important for decision making and incorporating values in developing decision objectives helps individuals accept the results of such decisions.

2.4 Internal Control over Financial Reporting

AFFS has integrated risk management and internal control into its business processes. As defined in the COSO framework, internal control includes components such as a control environment, risk assessment, control activities, Accounting, Information and Communication Systems and monitoring (COSO, 1992). The internal controls components are discussed as follows:

2.4.1 Control environment

The core of any business is its people- their individual attributes, including integrity, ethical values and competence- and the environment in which they operate. They are the engine that drives the entity and the foundation on which everything rests.

The Company's internal control structure is based on the division of labor between the Board of Directors and its Committees and CEO. The company has implemented a management system that is based on: Steering documents, such as policies, directives and a code of business ethics, and a strong corporate culture, the company's organization and mode of operations, with well-defined roles and responsibilities and delegations of authority and several well-defined group-wide processes for planning, operations and support.

The most essential parts of the control environment relative to financial reporting are included in steering documents and processes for accounting and financial reporting. These steering documents are updated regularly to include, among other things, changes to retirement benefits laws, International Financial Reporting Standards and listing requirements, such as IFRS. The processes include specific controls to be performed to ensure high quality reports. Each reporting legal entity, market unit and business unit has a financial controller function supporting the entity management with execution of controls related to transactions and reporting. A financial controller function is also established on group level, reporting to the CFO.

In an attempt to define a client's control environment from auditors perception , (Haskins, 1987) identified 48 client control attributes and their perceived levels of importance in adequately describing a client's control environment, thus serving to define more clearly audit concepts in addition, clients contextual variables were found not to be frequently associated with the attributes important rating (except size and management structure) thus highlighting the generalisability across a variety of clients. Audit firms, specialization and audit rank were found to be significant mediating contextual variables and that seniors had the largest share of the evaluation of internal control attributes responsibility.

2.4.2 Risk Assessment

Risks of material misstatements in financial reporting may occur in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure. Other risks related to financial reporting include fraud, loss or embezzlement of assets and undue favorable treatment of counterparties at the expense of the Company. Policies and directives regarding accounting and financial performance cover areas of particular significance to support correct, complete and timely accounting, reporting and disclosure. Identified types of risks are mitigated through well defined business processes with integrated risk management activities and segregation of duties and appropriate delegation of authority. This requires specific approval of material transactions and ensures adequate asset management.

2.4.3 Control activities

Control activities are all of the policies and procedures that have been instituted by the company to direct the staff in carrying out the directives of both board and management. All of these activities help the board and management control risks that could adversely affect the company's operations and results. The policies that direct these control activities should also provide that the company personnel who are responsible for these control activities do not evaluate their own work in these areas. Control activities are engaged in at various levels within the company's organizational structure can include, *inter alia,* the following:

Operational Performance Control activities in this area include the review of risk in the actual financial performance compared against the budgeted forecasts. Any significant variances are then analyzed to determine whether any specific company activity should be revised.

Information Processing, Control activities in this area include the verification of the accuracy and completeness of company transactions to determine whether they had been properly authorized. Control activities in the information area are broadly measured through two approaches - general controls and application controls. General controls are oversight over data center operations, including mainframes and servers, and system software procurement, maintenance and access. Application controls are the oversight for the programs that the company utilizes to process and monitor transactions.

Physical Controls - Control activities in this area generally refer to the physical security of the company's assets, including all company records.

Segregation of Duties, Control activities in this area refer to the assignment of the various duties involved in a transaction, or any company activity, to different persons. This approach is intended to prevent a company employee from being in a position to effect and conceal an irregular or illegal activity in the course of that person's normal duties.

2.4.4 Accounting Information and communication

The Company's information and communication channels support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned. Regular updates and briefing documents regarding changes in accounting policies, reporting and disclosure requirements are also supplied.

Subsidiaries and operating units prepare regular financial and management reports to internal steering groups and Company management. These include analysis and comments on financial performance and risks. The Board of Directors receives financial reports monthly. The Audit

Committee of the Board has established a whistle blower procedure for reporting violations in accounting, internal controls and auditing matters.

2.4.5 Monitoring

The Company's process for financial reporting is reviewed annually by the management. This forms a basis for evaluating the internal management system and internal steering documents to ensure that they cover all significant areas related to financial reporting. The shared service center management continuously monitors the accounting quality through a set of performance indicators. Compliance with policies and directives is monitored through annual self-assessments and representation letters from heads and controllers in all subsidiaries as well as in business units and market units. The Company's financial performance is also reviewed at each Board meeting. The committees of the Board fulfill important monitoring functions regarding remuneration, borrowing, investments, customer finance, cash management, financial reporting and internal control. The Audit Committee and the Board of Directors review all interim and annual financial reports before they are released to the market. The Company's internal audit function, which reports to the. Audit Committee, performs independent audits. The Audit Committee also receives regular reports from the external auditor. The Audit Committee follows up on any actions taken to improve or modify controls.

2.5 Organization Financial Performance

Financial performance is measured in terms of results (Rue and Byars, 1992). The term performance generally carries with it an understanding of a degree of achievement of an operation or a set of connected. These operations, in so far an organization's goals and objectives are concerned. These operations may have been formally put in place by the organization to evaluate and monitor the organization's capability to successfully meet its goals, and assess its employees and stakeholders responsiveness to what has been learned, though the adoption of efficient structure, system, and capital investments. Performance is key between the knowledge flow and the workflow (Sita, 2003).

Financial performance is essential to the survival of firms in the competitive and uncertain environment. Management is eager to learn how the effort of service quality improvement is related to an organization's performance (Sousa and Voss, 2002). Financial performance ultimately reflects whether or not service quality is realized in a firm. Financial performance is conceptualized as an extent to which a firm increases sales, profit, and return on equity. These are indicators of financial performance and manifest the well being of a firm collectively.

Objectives of Key Performance Indicators (KPIs) need to be put in place to monitor processes, and develop measures and criteria to evaluate organizational financial performance and change, and to report any noted deviation from the organizational expectations. Through this then causes of failure may be addressed, and success enhanced within an organization. Like most other industries, construction industry performance is largely dependent on the demands and requirement of its clients. Critical Success Factors (CSFs), indicate those areas of corporate performance that are vital to the success accomplishment of an organization's mission (Armstrong, 2002). Performance indicators in this industry are determined by the range along the line of CSFs similar to those identified by (Pearce and Robinson, 1997).

Profitability (Donnelly et al, 1992) – which is the firm's ability to maintain a reasonable Rate of Investment (ROI) within the industry.

Price competitive- which infers overall cost leadership; ability to establish a position that has significant cost advantage over all its competitors in the industry. This is established through the number of competitive tender bids awarded on contracts to implement projects, vigorous pursuit of cost reduction from experience, spelt out in method statement submitted during tender bidding. The key driver of sector investment in infrastructure construction and design is donor funding therefore there is stiff competition for award of such contracts (Yamo, 2006).

Calibre of personnal (Donnelly et al, 1992) – relevant key persons, both local and expatriates, and their academic and professional qualifications, skills talents, inclinations and their level of experience comprise what is broadly seen as work performance and worker attitude, and manager Performance and Responsibility, - which enhances competitive advantage.

Information Technology – access to relevant hardware and software to maximize output, and minimize input, lead times associated with project(s) locations (remoteness and geographical dispersion). The ability of the system to be used as primary integrated communication tool also enhances competitive advantages; and finally, *Social Responsibility*, indicating an appropriate response to societal needs and expectations.

2.6 The Empirical Studies

A study conducted in Kenya resulted that Nyayo Bus Service Corporation was required to adhere to Government financial regulations and procedures as provided for in the Constitution of Kenya under section 48, 99 to 105, the Exchequer and the Audit Act (Cap 412) and the paymaster – General's Act and Regulations (Cap 413). In 1992 the Kenya Parliament passed the Nyayo Bus Corporation Act. Since then, there has been a gradual shift from Government Accounting System to the convention commercial accounting system (Esmailjee A.E.K, 1993).

In spite of the continuous effort by the Nyayo Bus Service Corporations' managements in moving towards the conventional commercial accounting systems, the corporations' accounting systems until now is predominantly the Kenya Government accounting system. Thus the study showed that a discussion of the Kenya Government financial procedures relating to state corporations is important in facilitating the understanding of the Nyayo Bus Service Corporations accounting systems and internal accounting controls. (Esmailjee A.E.K, 1993).

Mohammed (1983) evaluated the internal controls Ethiopian Airlines Branch office in Nairobi, concluded that lack of segregation of accounting and custodian functions was the greatest weakness of the branch office. He argued that there is need to centralize cash receipts, establish an audit unit, separate accounting unit from sales section, separate duties of purchase activities and establish a perpetual inventory system for the tickets. He further emphasized that the existence of controls is very crucial, especially under today's conditions with severe competition which placed premium on reliable customer services, on the conservation of cash, on realization of capital assets and manpower, and on the reduction of cost.

The concept of internal controls has received considerable attention from researcher for a long time. Research in this area can be traced away back to (Cook and Kapran, 1968) and may further back in time. They have tended to focus on aspects of controls that relates to performance reporting, organization structure, behavior and external auditors' work [(Burns & Waterhouse (1975), Hayes (1977), Piper (1980) Mohamed (1983), Esmailjee (1993), Cook (1968), Dew & Gee (1972), Flamhelz 1982, Haskins (1987) and Schineider and Wilner (1990)]. The techniques used in these studies varied from research to research; however, the common ones employed statistical techniques such as correlation, regression and factor analysis.

Past studies have indicated that internal controls results in financial performance [(Burt, 1978), East lack & Mc Donald, (1970), Guynes (1969); and Leotiades & Tezel, (1980)], measured in terms of generally accepted financial measures for example, sales, net income, return on sales. Subsequent studies [(Armstrong, (1986); Greenley, (1986); Mintzberg, (1990); Shrader, Taylor, & Balton, (1984)] have studied internal controls superior performance relationship. In a related study involving multiple retailers, (Piper, 1980) found that the task complexity financial control system structure and organizational structure measured on the dimension of centralization and decentralization are related to each other. Piper had generated a hypothesis that the primary determinant of financial control system is task complexity, but their effect is via an intervening variable - the organization structure. By conducting a case study of 4 companies

which were evaluated on the basis of number of stores, range of products, product characteristics, number of years in existence, store controls manager evaluation, company financial performance among others. He concluded that high task complexity is linked to a low level of financial controls system structure and a decentralization structure while low task complexity is linked to a high level of financial controls and a decentralized structure. Research conducted on effectiveness of the frequency of performance reporting and control. (Cook, 1968) studied the effectiveness of control reports with the objective of ranking on scale the attitude of 134 managers in 59 USA companies towards the control report they received. Cook's findings obtained via mail questionnaire revealed that the attitude of managers toward control reports was a function of the frequency with which the reports were provided. The participating managers face the highest rating to daily control reports and gave the lowest ratings to annual reports (Cook, 1968).

Khandwalla (1972) carried out a research on the relationship between the degree of competition, the grester would be the need to control costs and evaluate whether actual performance met expected performance. He surveyed 92 companies using cardinal ranking and divided the variables into four independent variables; price competition, marketing competition, product quality and variety competition. The independent variable was usage controls. His findings indicated that product competition had the highest correlation with control usage.

In many companies in the United Kingdom (UK), as in the USA, the familiar cry "everything here is viewed in terms of the bottom line!" can be heard. In this sort of corporate environment, financial indicators remain the fundamental management tool and could be said to reflect the capital market's obsession with profitability as almost the sole indicator of corporate performance. Opponents of this approach suggest that it encourages management to take a number of actions, which focus on the short term at the expense of investing for the long term. It results in such action as cutting back on R & D revenue expenditure in an effort to minimize the impact on the costs side of the current year's P & L, or calling for information on profits at too frequent intervals so as to be sure that targets are being met, both of which actions might actually jeopardize the company's overall performance rather than improve it (Morch et al, 1988).

2.7 Measures of Performance

One of the measures of performance is the simulated welfare due to the redistribution of wealth from the shareholders. We consider how social private firms sets its prices to maximize profits but also more efficient in producing its output (Pont and Shaw, 2003).

Another measure of performance is cost-benefit analysis. This is relating cost to benefits that are measurable in monetary terms. The cost benefit of the government provided goods or services should be compared with the costs and benefits of having the private sector provide the same goods and services. In such cases, we may use cost-effectiveness (one variable) and/or weighed cost-effectiveness (several variables) to measure performance (Goh, 2003).

Other measures of performance include surging stock prices, increase in foreign exchange reserves, improved services while prices drop and elimination of previous government subsidies (Matto and Sauve, 2003).

2.8 Financial Performance Measurement

Whether the company is in the manufacturing or the service sector, in choosing an appropriate range of performance measures it will be necessary however to balance them, to make sure that one dimension or set of dimensions of performance is not stressed to the detriment of others. The mix chosen will in almost every instance be different. While most companies will tend to organize their accounting systems using common accounting principles, they will differ widely in the choice, or potential choice, of performance indicators. Authors from differing management disciplines tend to categorize the various performance indicators that are available as follows:- competitive advantage, flexibility, financial performance, resource utilization, quality of service and innovation.

As with any method of analyzed designed to measure financial performance, there are limitations and imperfections associated with the use of financial ratios, particularly the use of very few ratios in isolation (Goh, 2003). Hence this research endeavors to bring together several performance measures, financial ratios, linear programming techniques and investigate the interplay between them rather than focusing on any individual measure in isolation.

There are many different ways to measure financial performance, but all measures should be taken in aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. One has to look deeper into financial statements and seek out margin growth rates or any declining debt. This study therefore used both profitability and liquidity to measure financial performance. Liquidity financial performance measures a firm's ability to meet its cash obligations. Profitability performance measures, compares profit level to sales revenue, assets, and equity to determine the operating efficiency of a business. To test this hypothesis data were collected through questionnaire from the employees of AFFS's. The regression analysis is carried out to find out the significant of internal controls factors. The study finds that internal control and financial performance are statistically significant in determining the financial performance

2.9 Financial Ratios in Measuring the Company Financial Performance

Performance measures here would include liquidity, profitability and activity analysis ratios. (Pandey, 2000) describes ratio analysis as a powerful tool of financial analysis. Ratios measures how well a firm has performed and it collapses data / figures into a few concise ratios. A ratio is defined as the indicated quotient of two mathematical expressions and as a relationship between two or more numbers.

Financial analysis can be trend analysis or comparison with others. The analyst present ratios with past and expected future ratios of the same companies. Such are then arrayed in spread sheet over a period of years. It is possible to study the composition of changes and determine whether there has been an improvement or deterioration in the financial condition and performance over the firm overtime.

Ratios of one firm can also be compared with similar ratios of firms in the same industry or with average industry ratios. Such a comparison gives insight into the relative financial condition and performance of the firm. Ratios generally hold no meaning unless they are benchmarked against something else, like past performance or another company. Thus, the ratios of firms in different industries, which face different risks, capital requirements and competition, are usually hard to compare. In this study the financial statements for four years were used as a benchmark. Some of the different types of ratios that can be calculated from data in the financial statements and used to evaluate a business include Liquidity Analysis Ratios, Profitability Analysis Ratios and Activity Analysis Ratios. The ratio which was used is the profitability ratios which included the Return on Assets (ROA) and profit margin.

Buijink and Jegers (1986) studied the financial ratios distribution from year to year from 1977 to 1981 for 11 ratios in Belgium firms. Refined industry classification brought less extreme deviation from normality. They pointed the need of studying the temporal persistence of cross-sectional financial distributions and suggested a symmetry index measuring it.

Jebet, (2001) used two financial ratios. Activity ratios were used to evaluate firm's efficiency in managing and utilizing its assets, profitability ratios to measure operating efficiency of firms related in NSE for the period between 1995 and 1999. Her results were not conclusive due to complexities she observed in corporate governance.

Muthungi, (2003) used financial ratio analysis to evaluate financial performance of commercial bank in Kenya by comparing between local and foreign banks in the period from 1996 to 2001. His results were that foreign banks financial performance over weighed the local bank.

Ogoye, (2002), used ROA, ROE and Robins Q Ratio to measure firms performance while examining the effects of Executive compensation on firm performance. He concludes that sales in the major determinant of executive compensation.

Korir (2006) used Variance of Analysis (ANOVA) to measure the impact of performance contracting in state corporations. He concludes that the parent ministry was responsible for setting the Board of Director while head public services was responsible for setting responsibilities and commitments of the Government.

2.10 Conclusion

The CEO duality and firm performance relating CEO duality more especially to firm performance, researchers however find mixed evidence. Daily & Dalton (1992) find no relationship between the CEO duality performances in entrepreneurial firms. Brickley et.al (1997) show that CEO duality is not associated with inferior performance. On this study internal controls are not the only measures of financial performance. Other players like the regulators the government, the competence of the staff among many affects the performance of the company.

Internal control can be expected to provide only reasonable assurance, not absolute assurance, to an entity's management and board. No internal control structure by itself can improve performance, however detailed and comprehensive, can guarantee efficient administration and complete and accurate records or be foolproof against fraud, especially when those involved hold positions of authority or trust (Mahmud, 2008).

The available literature shows that, internal control systems cannot guarantee that an organization will meet its objectives due to changes affecting the retirement benefits every year.

Instead, internal control can only be expected to provide reasonable assurance that a company's objectives will be met. The effectiveness of internal controls depends on the competency and dependability of the organization's people. Limitations of internal control include faulty human judgment, misunderstanding of instructions, errors, management override of controls, and collusion. Further, because of cost-benefit considerations, not all possible controls will be implemented. Because of these inherent limitations, internal controls cannot guarantee that an organization will meet its objectives (COSO, 2006).

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Introduction

This chapter is concerned with various steps that will facilitate execution of the study to satisfy the study objectives. These included: research design, data collection method, evaluation of data collection method, data analysis, data reliability and validity.

3.2 Research Design

The research design was a case study. The case study is used to establish whether there is a relationship between the internal control and financial performance. Young (1960) observed that a case study is very powerful form of qualitative analysis that involves a careful and complete observation of social unit. He defined a case study as an examination of a specific phenomenon. According to Cooper and Schindler (2003), the case study places more emphasis on full contextual analysis of fewer conditions or events thus enabling intensive study of social unit.

3.3 Data Collection

The study used primary and secondary data from the following sources that is questionnaire and Published financial statements of the company. The study relied heavily on secondary data from published financial statements of the company. The data collection entailed the examination of the financial statements of the company for the period of 2004-2009.

In assessing the impact of internal control on the company's operation and performance, this paper used both primary and secondary data collection. The respondents were the employees of

AFFS and were selected from different managerial level and departments to answer the questions on components of internal controls.

Primary data collection was collected to establish internal control efficiency and performance by the company on the components of internal controls. This was done using an open and closed-ended questionnaire. The questionnaire was administered on a drop and pick-up later' basis to the company's head of departments. In some cases, personal interviews were conducted to get an in-depth understanding in the subject matter. A letter of introduction was given to each respondent prior to research questionnaire.

To proxy firm financial performance, Return on Investment and Profit (Net profit before Exchange differences and tax) was used to proxy profitability. The study used each measure of profitability independently in the analysis.

The six years period (2004-2009) was considered to derive conclusive results. The year 2004 was taken as a base year to allow time series comparative analysis. Year 2009 was chosen as the end year as it provided the latest complete data and also allowed comparative analysis two years after.

3.4 Data Analysis

Prior to secondary data analysis, primary data was analyzed using descriptive statistics to establish the impacts of internal controls on the company's operational efficiencies and financial performance. Data was analyzed on the basis of descriptive statistics and performance comparison done across time between the years 2004-2009. Performance was classified in terms of profitability. Statistical Package for Social Sciences (SPSS) version 17 was used as an aid to analysis. SPSS was preferred because of its ability to cover a wide range of most statistical and graphical data analysis and is systematic. In order to determine the relationship between the internal controls and financial performance a linear multiple regressions was used. The regression equation ($Y = \beta_0 + \beta_i X_i + \beta_{ii} X_{ii} + \beta_{iii} X_{iii} + \beta_{iv} X_{iv} + \beta_v X_v + e$)

Whereby Y = Financial Performance

$\beta 0$ = Constant

X_i = Control Environment

X_{ii} = Risk Assessment

X_{iii} = Control Activities

X_{iv} = Accounting Information and Communication

X_v = Monitoring

e = Error Term

The ROI variables are in percentage while profitability was measured in Kenya Shilling. The variables were converted into quantity using Likert Scale of 0 to 1.

3.5 Data Reliability and Validity

The researcher carried out a pilot study to pretest the validity and reliability of data collected using the questionnaire. According to Berg and Gall (1989) validity is the degree by which the sample of test items represents the content of test is designed to measure. Content validity which was employed by this study is a measure of the degree to which data collected using a particular instrument represents a specific domain or content of a particular concept. Mugenda and Mugenda (1999) contend that the usual procedure in assessing the content validity of measure is to use a professional or expert in a particular field.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents data analysis, findings and presentation. The main research objective was to establish the relationship between the internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited. Information was presented in form of tables and interpretation done through frequencies and percentages.

4.2 Data Presentation

Table 4.1: Control Environment

Control Environment	Frequency			Percent		
	Yes	No	Total	Yes	No	Total
Policies and procedures are periodically reviewed by the board to ensure that appropriate internal controls have been established	31	5	36	86.1	13.9	100.0
There is a monitoring system in the Companies to determine compliance with internal controls and are instances of noncompliance reported to the board	29	7	36	80.6	19.4	100.0
The board does take appropriate follow-up	29	7	36	80.6	19.4	100.0

action in instances of noncompliance that are reported to it						
Companies management allow access to all retirement benefits records to the board of trustees or trustees representatives	30	6	36	83.3	16.7	100.0
Board decisions are made collectively and not controlled by a dominant individual or group	29	7	36	80.6	19.4	100.0
The board receives appropriate and current information from the company's accounting, information and communication systems to make informed and timely decisions	30	6	36	83.3	16.7	100.0
The board receives sufficient information about the company's internal risk assessment process	26	10	36	72.2	27.8	100.0
The board reviews the qualifications and the independence of the company's internal auditors	27	9	36	75.0	25.0	100.0
The board reviews the qualifications and the independence of the company's external auditors	32	4	36	88.9	11.1	100.0
The company's internal auditors report their findings directly to the board or to a board committee	28	8	36	77.8	22.2	100.0

The company's external auditors report their findings directly to the board or to a board committee	35	1	36	97.2	2.8	100.0
The company's internal auditors periodically assess the adequacy of the company's internal control systems	29	7	36	80.6	19.4	100.0
The company's external auditors periodically assess the adequacy of the company's internal control systems	31	5	36	86.1	13.9	100.0
Internal control policies are communicated to all of the company's employees	25	11	36	69.4	30.6	100.0
Staff conduct policies are communicated to all of the company's employees	29	7	36	80.6	19.4	100.0
Policies on staff ethics or codes of conduct exist	30	6	36	83.3	16.7	100.0
Audit procedures or other control systems exist to test on a periodic basis for staff compliance with ethics policies or codes of conduct	21	15	36	58.3	41.7	100.0

On control environment, AFFS's external auditors report their findings directly to the board or to a board committee (97.2%), the board review the qualifications and the independence of the company's external auditors (88.9%), policies and procedures are periodically reviewed by the board to ensure that appropriate internal controls have been established (86.1%). In addition, the

company's external auditors periodically assess the adequacy of the company's internal control systems (86.1%) and its management allow access to all retirement benefits records to the board of trustees or trustees representatives
(83.3%).

At AFFS, the board receives appropriate and current information from the company's accounting, information and communication systems to make informed and timely decisions (83.3%) and policies on staff ethics or codes of conduct exist (83.3%). At the same time, there is a monitoring system in the Companies to determine compliance with internal controls and are instances of noncompliance reported to the board (80.6%). Respondents claimed that, the board does take appropriate follow-up action in instances of noncompliance that are reported to it (80.6%). The study also revealed that, the board decisions are made collectively and not controlled by a dominant individual or group (80.6%), the company's internal auditors periodically assess the adequacy of the company's internal control systems (80.6%) and the staff conduct policies are communicated to all of the company's employees (80.6%).

4.3 Risk Assessment

Table 4.2: Risk Assessment

	Frequency			Percent		
Risk Assessment	**Yes**	**No**	**Total**	**Yes**	**No**	**Total**
The board and management appropriately evaluate risks when the company is planning and approving new products or activities	32	4	36	88.9	11.1	100.0

The board and management appropriately discuss and plan for control systems when the company is planning and approving new products or activities	33	3	36	91.7	8.3	100.0
Internal audit staff, or other internal control staff, is involved in discussions about appropriate controls when the company is developing new products and activities	24	12	36	66.7	33.3	100.0
The company's board and management involve internal audit staff, and other internal control staff, in the risk assessment process	28	8	36	77.8	22.2	100.0
The company's board and management consider and appropriately address technology issues in the risk assessment process	30	6	36	83.3	16.7	100.0
There are sufficient personnel who are competent and knowledgeable to manage current and proposed company activities in all areas	29	7	36	80.6	19.4	100.0
The staff members have been provided with adequate resources to manage these company activities	24	12	36	66.7	33.3	100.0
There are sufficient personnel who are	28	8	36	77.8	22.2	100.0

competent and knowledgeable to manage the company's risk management activities						
The staff members have been provided with adequate resources to manage these company risk management activities	26	10	36	72.2	27.8	100.0

Concerning the risks assessment at AFFS, the board and management appropriately discuss and plan for control systems when the company is planning and approving new products or activities (91.7%) and the board and management appropriately evaluate risks when the company is planning and approving new products or activities (88.9%). The company's board and management consider and appropriately address technology issues in the risk assessment process (83.3%).

The study also revealed that, there are sufficient personnel who are competent and knowledgeable to manage current and proposed company activities in all areas (80.6%), the company's board and management involve internal audit staff, and other internal control staff, in the risk assessment process (77.8%) and there are sufficient personnel who are competent and knowledgeable to manage the company's risk management activities (77.8%). In addition, the staff members have been provided with adequate resources to manage these company risk management activities (72.2%), Internal audit staff, or other internal control staff, are involved in discussions about appropriate controls when the company is developing new products and activities (66.7%). The staff members have been provided with adequate resources to manage these company activities (66.7%).

4.4 Control Activities

Table 4.3: Control Activities

Control Activities	Frequency			Percent		
	Yes	No	Total	Yes	No	Total
Policies and procedures exist to provide that decisions are made with appropriate approvals	29	7	36	80.6	19.4	100.0
Processes exist to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process	29	7	36	80.6	19.4	100.0
Processes exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items	30	6	36	83.3	16.7	100.0
The decision-making authorities for all risk taking areas are separate from the reconciliation activities for those areas	23	13	36	63.9	36.1	100.0
Policies and procedures exist to provide that all exceptions to policy are minimal and are reported to	25	11	36	69.4	30.6	100.0

management in each instance of exception						
The personal leave policy for all company staff provides that each employee has an absence for two consecutive weeks at least once annually	28	8	36	77.8	22.2	100.0
There are provisions in the personnel policies of the company to provide for periodic rotation of staff duties	16	20	36	44.4	55.6	100.0
There are dual controls over company assets and separation of duties provided for in the company's organizational structure	19	17	36	52.8	47.2	100.0

The researcher also analyzed the control activities at AFFS. The study revealed that, processes exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items (83.3%), as well as policies and procedures to provide decisions that are made with appropriate approvals (80.6%). At the same time, processes exist to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process (80.6%).

The personal leave policy for all the company staff provides that each employee has an absence for two consecutive weeks at least once annually (77.8%). Majority of respondents also insisted that, policies and procedures exist to provide that all exceptions to policy are minimal and are reported to management in each instance of exception (69.4%) and the decision-making authorities for all risk taking areas are separate from the reconciliation activities for those areas (63.9%). There are also dual controls over company assets and separation of duties provided for in the company's organizational structure (52.8%). Few respondents, however, indicated the presence of provisions in the personnel policies of the company to provide for periodic rotation of staff duties (44.4%).

4.5 Accounting, Information and Communication Systems

Table 4.4: Accounting, Information and Communication Systems

Accounting, Information and Communication Systems	Frequency			Percent		
	Yes	No	Total	Yes	No	Total
The company's accounting systems properly manage and report company transactions in accordance with the proper accounting standards	30	6	36	83.3	16.7	100.0
There are appropriate and sufficient reports produced by the company for the proper management and control of the company	31	5	36	86.1	13.9	100.0
The company's accounting, information and communication systems are able to identify whether all risk taking activities within the company are within the company's policy	26	10	36	72.2	27.8	100.0

guidelines						
All company personnel in the areas of control understand their roles	26	10	36	72.2	27.8	100.0
All company personnel in the areas of control understand how their activities relate to others	24	12	36	66.7	33.3	100.0
All company personnel in the areas of control understand their accountability for their activities	26	10	36	72.2	27.8	100.0

The researcher was also interested in knowing the accounting, information and communication systems at AFFS. There are appropriate and sufficient reports produced by the company for the proper management and control of the company (86.1%), The Company's accounting systems properly manage and report company transactions in accordance with the proper accounting standards (83.3%). The company's accounting, information and communication systems are able to identify whether all risk taking activities within the company are within the company's policy guidelines according to majority of respondents (72.2%). Respondents also said that, all company personnel in the areas of control understand their roles (72.2%) and their accountability for their activities (72.2%) as well as how their activities relate to others (66.7%).

4.6 Self-Assessment or Monitoring

Table 4.5: Self-Assessment or Monitoring

Self-Assessment or Monitoring	Frequency			Percent		
	Yes	No	Total	Yes	No	Total
The board review management's actions in dealing with control weaknesses and verify that the actions taken by company management are appropriate and adequate	25	11	36	69.4	30.6	100.0
There is sufficient detail in audit reports, or other control assessment reports, for the company's board and management to understand the situation as regards internal controls	32	4	36	88.9	11.1	100.0
Audit reports, or other control assessment reports, are timely enough .so that the company's board and management are able to take appropriate action	32	4	36	88.9	11.1	100.0
The board, or a board committee, approves the appointment of the company's internal audit personnel	30	6	36	83.3	16.7	100.0
The board, or a board committee, approves the scope of all internal activities that review	29	7	36	80.6	19.4	100.0

internal controls						
The board, or a board committee, reviews the results of all internal and external audits	32	4	36	88.9	11.1	100.0
The board, or a board committee, approves the company's systems of internal controls	33	3	36	91.7	8.3	100.0

Concerning the self-assessment or monitoring at AFFS, majority of respondents stated that, the board, or a board committee, approves the company's systems of internal controls (91.7%), there is sufficient detail in audit reports, or other control assessment reports, for the company's board and management to understand the situation as regards internal controls (88.9%) and audit reports, or other control assessment reports, are timely enough so that the company's board and management are able to take appropriate action (88.9%). They also revealed that, the board, or a board committee, review the results of all internal and external audits (88.9%), approve the appointment of the company's internal audit personnel (83.3%), approve the scope of all internal activities that review internal controls (80.6%) as well as reviewing management's actions in dealing with control weaknesses and verify that the actions taken by company management are appropriate and adequate (69.4%).

4.7 Relationship between the internal controls and financial performance

Given the control environment, the risk assessment, the control activities, information and communication and the monitoring system at AFFS, the analytical model relating the dependent variable with independent variables can be formulated as follows:

Table 4.6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.877[a]	.783	.129	.3099

Source: Research, 2011

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variables or the percentage of variation in the dependent variable (effectiveness of internal controls and financial performance in Alexander Forbes Financial Services of (EA) Limited.) that is explained by all the five independent variables (control environment, risk assessment, control activities, information and communication and monitoring.).

The five independent variables that were studied, explain only 78.3% of the effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited as represented by the R^2. This therefore means that other factors not studied in this research contribute 21.7% of the effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited. Therefore, further research should be conducted to investigate the other factors (21.7%) that affect effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited.

Table 4.7: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.559	5	2.901	52.3333	.0089
	Residual	196.889	96	2.109		
	Total	209.448	101			

The significance value is .0089 which is less that 0.05 thus the model is statistically significant in predicting control environment, risk assessment, control activities, information and communication and monitoring. The F critical at 5% level of significance was 3.23. Since F calculated is greater than the F critical (value = 52.333), this shows that the overall model was significant.

Table 4.8: Coefficient of determination

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.333	1.033		0.787	0.260
	Control Environment	1.5634	0.123	0.159	1.091	0.002
	Risk Assessment	0.788	0.139	0.085	0.687	0.004
	Control Activities	0.564	0.099	0.135	0.97	0.014
	Information and Communication	0.389	0.079	0.540	0.349	0.033
	Monitoring	0.287	0.074	0.103	0.299	0.003

Source: Research, 2011

The researcher conducted a multiple regression analysis so as to determine the relationship between effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited and the five variables. As per the SPSS generated table 4.11, the equation ($\mathbf{Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \beta_5X_5} + \varepsilon$) becomes:

$Y = 1.5634X_1 + 0.788X_2 + 0.564X_3 + 0.389X_4 + 0.287 X_5 + 2.333$

Where Y is the dependent variable (Financial performance of Alexander Forbes Financial Services of (EA) Limited.), X_1 is the control environment variable, X_2 is risk assessment variable, X_3 is control activities, X_4 is information and communication and X_5 is monitoring.

According to the regression equation established, taking all factors into account (control environment, risk assessment, control activities, information and communication and monitoring.) constant at zero, effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited will be 2.333. The data findings analyzed also show that taking all other independent variables at zero, a unit increase in control environment will lead to a 0.671 increase in effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited; a unit increase in risk assessment will lead to a 0.338 increase in effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited, a unit increase in control activities will lead to a 0.242 increase in effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited, a unit increase in information and communication will lead to a 0.167 increase in effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited and a unit increase in information and communication will lead to a 0.123 increase in effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited. This infers that control activities contribute more to the effectiveness of internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited followed by the risk assessment.

At 5% level of significance and 95% level of confidence, control environment had a 0.002 level of significance; monitoring had a 0.003 level of significance, risk assessment showed a 0.004 level of significant, control activities showed a 0.014 level of significant, information and communication had a 0.033 level of significant, hence the most significant factor is control environment.

4.8 Summary and Interpretation of the Findings

The study revealed that AFFS's external auditors report their findings directly to the board or to a board committee, the board review the qualifications and the independence of the company's external auditors, policies and procedures are periodically reviewed by the board to ensure that appropriate internal controls have been established. In addition, the company's external auditors periodically assess the adequacy of the company's internal control systems and its management allows access to all retirement benefits records to the board of trustees or trustees representatives.

At AFFS, the board receives appropriate and current information from the company's accounting, information and communication systems to make informed and timely decisions and policies on staff ethics or codes of conduct exist. At the same time, there is a monitoring system in the Companies to determine compliance with internal controls and are instances of noncompliance reported to the board. It was found that the board does take appropriate follow-up action in instances of noncompliance that are reported to it. The study also revealed that, the board decisions are made collectively and not controlled by a dominant individual or group, the company's internal auditors periodically assess the adequacy of the company's internal control systems and the staff conduct policies are communicated to all of the company's employees.

On risk assessment, it was clear that the board and management appropriately discuss and plan for control systems when the company is planning and approving new products or activities and the board and management appropriately evaluate risks when the company is planning and approving new products or activities. The company's board and management consider and appropriately address technology issues in the risk assessment process. The study also revealed that, there are sufficient personnel who are competent and knowledgeable to manage current and proposed company activities in all areas, the company's board and management involve internal audit staff, and other internal control staff, in the risk assessment process and there are sufficient personnel who are competent and knowledgeable to manage the company's risk management activities. In addition, the staff members have been provided with adequate resources to manage these company risk management activities, Internal audit staff, or other internal control staff, are involved in discussions about appropriate controls when the company is developing new products and activities. The staff members have been provided with adequate resources to manage these company activities.

On accounting, information and communication systems at AFFS, the study found that processes exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items, as well as policies and procedures to provide decisions that are made with appropriate approvals. At the same time, processes exist to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process.

The personal leave policy for all the company staff provides that each employee has an absence for two consecutive weeks at least once annually. The study also revealed that, policies and procedures exist to provide that all exceptions to policy are minimal and are reported to management in each instance of exception and the decision-making authorities for all risk taking areas are separate from the reconciliation activities for those areas. There are also dual controls over company assets and separation of duties provided for in the company's organizational structure.

On the self-assessment or monitoring at AFFS, the study found that, there are appropriate and sufficient reports produced by the company for the proper management and control of the company, the company's accounting systems properly manage and report company transactions in accordance with the proper accounting standards. The company's accounting, information and communication systems are able to identify whether all risk taking activities within the company are within the company's policy guidelines according to majority of respondents. The study also established that, all company personnel in the areas of control understand their roles and their accountability for their activities as well as how their activities relate to others.

On self assessment or monitoring, the study found that the board, or a board committee, approves the company's systems of internal controls, there is sufficient detail in audit reports, or other control assessment reports, for the company's board and management to understand the situation as regards internal controls and audit reports, or other control assessment reports, are timely enough so that the company's board and management are able to take appropriate action. The study also revealed that, the board, or a board committee, review the results of all internal and external audits, approve the appointment of the company's internal audit personnel, approve the scope of all internal activities that review internal controls as well as reviewing management's actions in dealing with control weaknesses and verify that the actions taken by company management are appropriate and adequate.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

While the specific definition of internal control differs across the various models, a number of concepts are very similar across these models. Internal control systems cannot guarantee that an organization will meet its objectives. Unlike business organizations where shareholders are the major class of stakeholders and profitability is the primary objective, AFFS serve the society through delivering services and conducting research, and have a diffuse group of stakeholders. A good number of people and institutions have suffered big losses because of poor control system in companies and their money getting lost through fraud and misuse of assets that are used to generate revenue. The objective of this study is to establish the relationship between the internal controls and financial performance of Alexander Forbes Financial Services of (EA) Limited.

The research design was a case study that relied heavily on secondary data from published financial statements of the company. Data was analyzed on the basis of descriptive statistics. From the study, AFFS's external auditors report their findings directly to the board or to a board committee, the board review the qualifications and the independence of the company's external auditors, policies and procedures are periodically reviewed by the board to ensure that appropriate internal controls have been established.

Concerning the risks assessment at AFFS, the board and management appropriately discuss and plan for control systems when the company is planning and approving new products or activities and the board and management appropriately evaluate risks when the company is planning and approving new products or activities. The study revealed that, processes exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items as well as policies and procedures to provide decisions that are made with appropriate approvals. At the same time, processes exist to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process. There are appropriate and sufficient reports produced by the company for the proper management and control of the company.

5.2 Conclusions

The AFFS's external auditors report their findings directly to the board or to a board committee while the board reviews the qualifications and the independence of the company's external auditors. Policies and procedures are periodically reviewed by the board to ensure that appropriate internal controls have been established. At the same time, the company's external auditors periodically assess the adequacy of the company's internal control systems; the management allow access to all retirement benefits records to the board of trustees or trustees representatives. The board receives appropriate and current information from the company's accounting, information and communication systems to make informed and timely decisions while policies on staff ethics or codes of conduct exist.

In addition, there is a monitoring system in the Companies to determine compliance with internal controls and are instances of noncompliance reported to the board. The board does take appropriate follow-up action in instances of noncompliance that are reported to it and their decision are made collectively and not controlled by a dominant individual or group. The company's internal auditors periodically assess the adequacy of the company's internal control systems. Moreover, the board and management appropriately discuss and plan for control systems when the company is planning and approving new products or activities, evaluate risks and consider appropriately addressing technology issues in the risk assessment process.

There are sufficient personnel who are competent and knowledgeable to manage current and proposed company activities in all areas, processes exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items, policies and procedures exist to provide that decisions are made with appropriate approvals, processes exist to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process. The personal leave policy for all company staff provides that each employee has an absence for two consecutive weeks at least once annually. In addition, There are appropriate and sufficient reports produced by the company for the proper management and control of the company.

The company's accounting systems properly manage and report company transactions in accordance with the proper accounting standards. The company's accounting, information and communication systems are able to identify whether all risk taking activities within the company are within the company's policy guidelines.

All company personnel in the areas of control understand their roles, accountability for their activities, approves the company's systems of internal controls. There is sufficient detail in audit reports, or other control assessment reports, for the company's board and management to understand the situation as regards internal controls.

The audit reports, or other control assessment reports, are timely enough so that the company's board and management are able to take appropriate action. The board, or a board committee, also review the results of all internal and external audits approve the appointment of the company's internal audit personnel and approve the scope of all internal activities that review internal controls.

5.3 Policy Recommendations

For any company, the external auditors report their findings directly to the board or to a board committee. The board should review the qualifications and the independence of the company's external auditors.

Policies and procedures should be periodically reviewed by the board to ensure that appropriate internal controls have been established. The company's external auditors periodically assess the adequacy of the company's internal control systems.

Companies management allow access to all retirement benefits records to the board of trustees or trustees representatives. The board should receive appropriate and current information from the company's accounting, information and communication systems to make informed and timely decisions.

Processes should exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items. Policies and procedures should also exist to provide that decisions are made with appropriate approvals. Also to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process.

The personal leave policy for all company staff should be put in place to provide that each employee has an absence for two consecutive weeks at least once annually. There should be appropriate and sufficient reports produced by the company for the proper management and control of the company.

5.4 Limitations of the Study

A limitation for the purpose of this research was regarded as a factor that was present and contributed to the researcher getting either inadequate information or responses or if otherwise the response given would have been totally different from what the researcher expected.

The main limitations of this study were: Some respondents refused to fill in the questionnaires. Most of the respondents were busy throughout and had to continuously be reminded and even persuaded to provide the required information.

Further some respondents decided to withhold information which they considered sensitive and classified. This reduced the probability of reaching a more conclusive study. However, conclusions were made with this response rate.

The small size of the sample could have limited confidence in the results and this might limit generalizations to other situations. Time- Due to official duties time was a major concern.

5.5 Suggestion for Further Studies

Further studies should be done to on the factors affecting effective internal controls among financial institutions. This is because internal control is at the core of these firms. Further studies should be done on the challenges faced by financial institutions in their internal control.

The study also recommends that further studies should be done to establish the relationship between the internal controls and financial performance of other financial institutions other than the Alexander Forbes Financial Services of (EA) Limited since each firm has a different strategic approach and environment.

The study also recommends that further studies should be done on the relationship between the internal controls and financial performance of cooperative societies such as SACCOs since their internal control is different from that of the financial institutions.

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APPENDICES

Appendix I: Letter of Introduction

Lucy M. Mwangi

School of Business Studies

University of Nairobi

P.O. Box 30197

Nairobi

Dear Respondent,

RE: REQUEST FOR RESEARCH DATA

I am a postgraduate student at the University of Nairobi, School of Business. In partial fulfillment of the requirements for the award of Master of Business Administration (MBA) course, I am required to conduct a case study on the relationship between Internal Controls and Financial Performance of the Alexander Forbes Financial Services (EA) Limited.

The questionnaire consists of 6 pages and thus should not take more than 20 minutes to fill. Please note there is no right or wrong answer, so feel free to give the answer you think is correct. Strict confidentiality will be maintained and all the information collected through this questionnaire will remain confidential. The information you provide will not be used for any other purpose apart from its intended academic use.

I thank you in advance for your co-operation.

Yours faithfully

Lucy Mwangi

MBA Student - UON

Despondent Name:

Position held in the Company:

Mobile number:

Appendix II: Questionnaire

A Study on the Relationship between Internal Control and Financial Performance of the Alexander Forbes Financial Services (EA) Limited.

The Questionnaires - for use by Internal Company Staff and by Company Supervision Staff

1. Control Environment - Questionnaire

Are policies and procedures periodically reviewed by the board to ensure that appropriate Internal Controls have been established? **Yes** ☐ **N o** ☐

Is there a monitoring system in the Companies to determine compliance with internal controls and are instances of noncompliance reported to the board? **Yes** ☐ **N o** ☐

Does the board take appropriate follow-up action in instances of noncompliance that are reported to it? **Yes** ☐ **N o** ☐

Does Companies management allow access to all retirement benefits records to the board of trustees or trustees' representatives? **Yes** ☐ **N o** ☐

Are boards decisions made collectively and not controlled by a dominant individual or group? **Yes** ☐ **N o** ☐

Does the board receive appropriate and current information from the company's accounting, information and communication systems to make informed and timely decisions? **Yes** ☐ **N o** ☐

Does the board receive sufficient information about the company's internal risk assessment process? **Yes** ☐ **N o** ☐

Does the board review the qualifications and the independence of the company's internal auditors? **Yes** ☐ **N o** ☐

Does the board review the qualifications and the independence of the company's external auditors? **Yes** ☐ **N o** ☐

Do the company's internal auditors report their findings directly to the board or to a board committee? **Yes** ☐ **N o** ☐

Do the company's external auditors report their findings directly to the board or to a board committee? **Yes** ☐ **N o** ☐

Do the company's internal auditors periodically assess the adequacy of the company's internal control systems? **Yes** ☐ **N o** ☐

Do the company's external auditors periodically assess the adequacy of the company's internal control systems? **Yes** ☐ **N o** ☐

Are internal control policies communicated to all of the company's employees? **Yes** ☐ **N o** ☐

Are staff conduct policies communicated to all of the company's employees? **Yes** ☐ **N o** ☐

Do policies on staff ethics or codes of conduct exist? **Yes** ☐ **N o** ☐

Do audit procedures or other control systems exist to test on a periodic basis for staff compliance with ethics policies or codes of conduct? **Yes** ☐ **N o** ☐

2. Risk Assessment -Questionnaire

Do the board and management appropriately evaluate risks when the company is planning and approving new products or activities? **Yes** ☐ **N o** ☐

Do the board and management appropriately discuss and plan for control systems when the company is planning and approving new products or activities? **Yes** ☐ **N o** ☐

Is internal audit staff, or other internal control staff, involved in discussions about appropriate controls when the company is developing new products and activities?

Yes ☐ **N o** ☐

Do the company's board and management involve internal audit staff, and other internal control staff, in the risk assessment process? **Yes** ☐ **N o** ☐

Do the company's board and management consider and appropriately address technology issues in the risk assessment process? **Yes** ☐ **N o** ☐

Are there sufficient personnel who are competent and knowledgeable to manage current and proposed company activities in all areas? **Yes** ☐ **N o** ☐

Have these staff members been provided with adequate resources to manage these company activities? **Yes** ☐ **N o** ☐

Are there sufficient personnel who are competent and knowledgeable to manage the company's risk management activities? **Yes** ☐ **N o** ☐

Have these staff members been provided with adequate resources to manage these company risk management activities? **Yes** ☐ **N o** ☐

3. Control Activities -Questionnaire

Do policies and procedures exist to provide that decisions are made with appropriate approvals? **Yes** ☐ **No** ☐

Do processes exist to provide independent verification of a sufficient sample of transactions to ensure integrity of the decision making process? **Yes** ☐ **No** ☐

Do processes exist to provide that there is ongoing and independent reconciliation of all company balances, both asset and liability and on- and off balance sheet items? **Yes** ☐ **No** ☐

Are the decision-making authorities for all risk taking areas separate from the reconciliation activities for those areas? **Yes** ☐ **No** ☐

Do policies and procedures exist to provide that all exceptions to policy are minimal and are reported to management in each instance of exception? **Yes** ☐ **No** ☐

Does the personal leave policy for all company staff provides that each employee has an absence for two consecutive weeks at least once annually? **Yes** ☐ **No** ☐

Are there provisions in the personnel policies of the company to provide for periodic rotation of staff duties? **Yes** ☐ **No** ☐

Are dual controls over company assets and separation of duties provided for in the company's organizational structure? **Yes** ☐ **No** ☐

4. Accounting, Information and Communication Systems -Questionnaire

Do the company's accounting systems properly manage and report company transactions in accordance with the proper accounting standards? **Yes** ☐ **N o** ☐

Are appropriate and sufficient reports produced by the company for the proper management and control of the company? **Yes** ☐ **N o** ☐

Are the company's accounting, information and communication systems able to identify whether all risk taking activities within the company are within the company's policy guidelines? **Yes** ☐ **N o** ☐

Do all company personnel in the areas of control understand their roles? **Yes** ☐ **N o** ☐

Do all company personnel in the areas of control understand how their activities relate to others? **Yes** ☐ **N o** ☐

Do all company personnel in the areas of control understand their accountability for their activities? **Yes** ☐ **N o** ☐