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**EMPLOYEE PERCEPTIONS ON THE RELATIONSHIP BETWEEN
INTERNAL CONTROLS AND FIRM PERFORMANCE IN KENYA**



OBUOGO ELIZABETH AKINYI

**Submitted in partial fulfillment of the requirements for the Degree of Master of
Business Administration at Strathmore University**

Strathmore University Business School

Strathmore University

Nairobi, Kenya

April 2018

Declaration

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due references is made on the thesis itself.

Obuogo Elizabeth Akinyi - MBA/83023/14

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30th November 2017

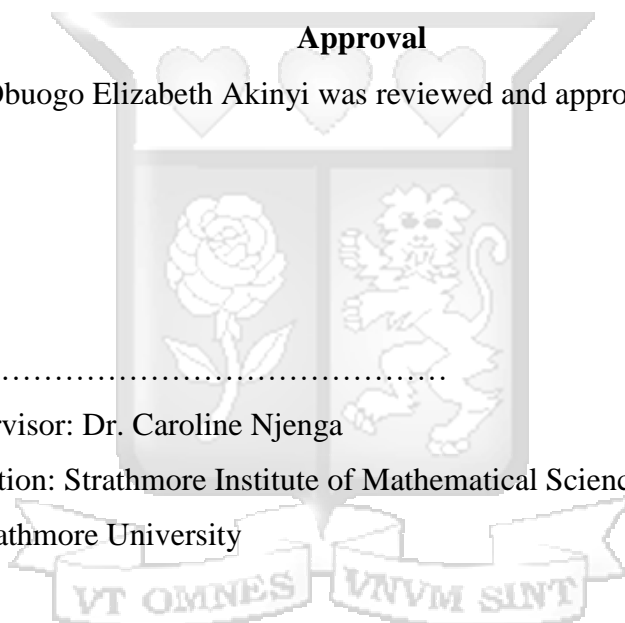
Approval

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ABSTRACT

Internal control is a fundamental component of good corporate governance. It ensures efficiency, effectiveness, reliability and compliance matters are adhered to. The problem stated in this study is that with increased financial scandals in some quoted organizations, financial performance is declining and hence it is worth investigating the role of staff perception on the relationship between internal controls and firm performance plays. The target population of the study was finance staff in selected companies quoted at the Nairobi Securities Exchange. The study sample comprised of 120 respondents drawn from a population of 63 listed public companies. Specifically, the sample was drawn from agriculture, finance, energy, service and manufacturing sectors, all selected using purposive sampling. The study adopted multi-stage sampling technique design to establish employee perceptions on the relationship between internal control and performance in public organizations in Kenya. The study used primary data that was collected using a questionnaire. Data collected was coded and entered into Statistical Package for Social Sciences which aided in organizing and summarizing the data using descriptive statistics, inferential statistics and Pearson's correlation coefficient. The data collected was presented by use of percentages, frequency distributions, tables and graphs. The study findings revealed that, control activities such as checks and balances, separation roles, corrective action, budget allocations and access to key information were considered important by staff and all impacted on firm performance. Further, controls and responsibilities were understood, and there was smooth flow of information, while risk identification was considered as very important. Although the general employee perception of internal controls relationship to company performance was considered high, there were outliers. Agriculture employees' perceptions was generally average while the Finance sector though considered more error prone with a higher magnitude, was considered a high-performance sector. The study finally recommends that organizations should enforce compliance with internal control measures in order to enhance investor confidence and ensure improved performance.



TABLE OF CONTENTS

| | Page |
|--|------|
| Declaration | ii |
| ABSTRACT..... | iii |
| TABLE OF CONTENTS..... | iv |
| LIST OF TABLES..... | viii |
| ABBREVIATIONS AND ACRONYMS..... | ix |
| ACKNOWLEDGEMENT..... | x |
| DEDICATION..... | xi |
| CHAPTER ONE: INTRODUCTION TO THE STUDY..... | 1 |
| 1.1 Introduction..... | 1 |
| 1.2 Background information..... | 1 |
| 1.2.1 The Concept of Internal Controls..... | 1 |
| 1.2.2 Employee Perception and Firm Performance..... | 2 |
| 1.3 Problem Statement..... | 3 |
| 1.4 Objectives of the Study..... | 4 |
| 1.4.1 Main objective of the study..... | 4 |
| 1.4.2 Specific Objectives of the study..... | 4 |
| 1.5 Research Questions..... | 4 |
| 1.6 Scope of the study..... | 5 |
| 1.7 Significance of the study..... | 5 |
| 1.8 Organization of the Study..... | 6 |
| CHAPTER TWO: LITERATURE REVIEW..... | 7 |
| 2.1 Introduction..... | 7 |
| 2.2 Anchoring Theories..... | 7 |
| 2.2.1 Institutional Theory..... | 7 |
| 2.2.2 Attribution Theory..... | 8 |
| 2.3 Types of Internal Controls..... | 10 |
| 2.4 The Role of Internal Controls..... | 11 |
| 2.5 Empirical Review of Literature..... | 12 |
| 2.5.1 Operational Efficiency and Firm Performance..... | 12 |

| | |
|--|-----------|
| 2.5.2 Reporting Reliability and Firm performance | 13 |
| 2.5.3 Compliance of Financial Operations and Firm Performance | 15 |
| 2.5.4 Financial Performance | 16 |
| 2.6 The Research Gap | 19 |
| 2.7 Summary | 19 |
| 2.8 Conceptual Framework | 20 |
| CHAPTER THREE: RESEARCH METHODOLOGY | 23 |
| 3.1 Introduction..... | 23 |
| 3.2 Research design | 23 |
| 3.3 Population and Sampling | 23 |
| 3.3.1 Target Population..... | 23 |
| 3.3.2 Sample Size and Sampling..... | 23 |
| 3.4 Data collection methods..... | 25 |
| 3.4.1 Instrumentation | 25 |
| 3.5 Analysis of data..... | 25 |
| 3.6 Research Validity and Reliability | 27 |
| 3.6.1 Validity | 27 |
| 3.6.2 Reliability..... | 27 |
| 3.6.3 Objectivity..... | 28 |
| 3.7 Ethical Considerations | 28 |
| CHAPTER FOUR: DATA ANALYSIS AND RESULTS..... | 29 |
| 4.1 Introduction | 29 |
| 4.2 Response Rate | 29 |
| 4.3 Demographic Information | 30 |
| 4.3.1 Gender | 30 |
| 4.3.2 Age..... | 30 |
| 4.3.3 Level of Education..... | 31 |
| 4.3.4 Industry or Sector of Organization | 31 |
| 4.3.5 Working Duration..... | 32 |
| 4.3.6 Level of Management..... | 33 |
| 4.4 Control Activities | 34 |
| 4.4.1 Extent the Organizations Practiced the Control Activities..... | 34 |

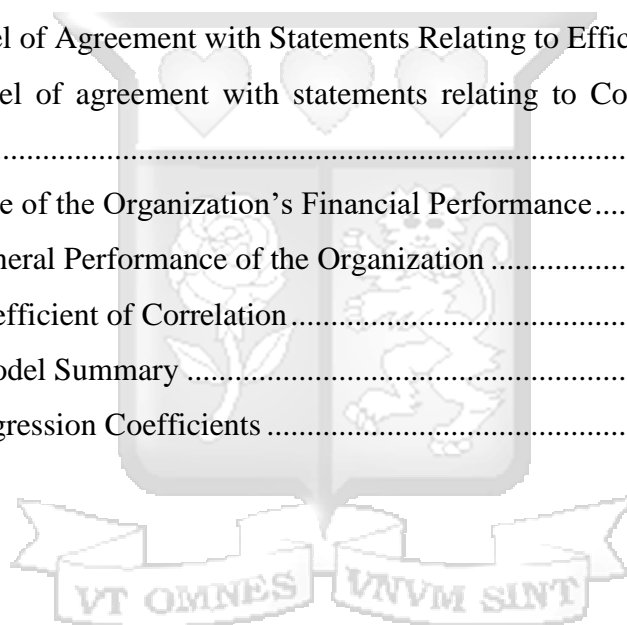
| | | |
|---|--|-----------|
| 4.5 | Reporting Reliability | 35 |
| 4.5.1 | Cases of Errors Reported in a Year | 35 |
| 4.5.2 | Total Magnitude of the Errors Reported..... | 36 |
| 4.5.3 | Level of Agreement with Statements Relating to Reporting Reliability...38 | |
| 4.6 | Operational Efficiency | 39 |
| 4.6.1 | Cases of Operation Inefficiencies | 39 |
| 4.6.2 | Level of Agreement with Statements Relating to Efficiency of Operations 40 | |
| 4.7 | Compliance of Financial Operations | 42 |
| 4.7.1 | Rating of Compliance Record | 42 |
| 4.7.2 | Level of agreement with statements relating to Compliance of Financial Operations | 43 |
| 4.8 | Financial Performance..... | 44 |
| 4.8.1 | Rate of the Organization's Performance | 44 |
| 4.8.2 | General Performance of the Organization | 45 |
| 4.9 | Inferential Analysis | 46 |
| 4.9.1 | Coefficient of Correlation..... | 46 |
| 4.9.2 | Regression Analysis | 47 |
| 4.9.3 | Regression Coefficient | 48 |
| CHAPTER FIVE: DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS | | 50 |
| 5.1 | Introduction..... | 50 |
| 5.2 | Discussions | 50 |
| 5.3 | Internal Control Operations and Activities | 50 |
| 5.4 | Reporting Reliability and Firm Performance..... | 51 |
| 5.5 | Operational Efficiency and Firm Performance | 51 |
| 5.6 | Compliance of Financial Operations and Firm Performance | 52 |
| 5.7 | Employee Perception on Internal controls and Firm Performance..... | 53 |
| 5.8 | Conclusions..... | 54 |
| 5.9 | Recommendations..... | 55 |
| 5.10 | Areas for Further Research | 56 |
| REFERENCES | | 57 |

APPENDIX 1: LETTER OF INTRODUCTION63
APPENDIX 2: RESEARCH QUESTIONNAIRE.....64
APPENDIX 3: FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE
.....69



LIST OF TABLES

| | Page |
|--|------|
| Table 3.1 Sample Size..... | 24 |
| Table 3.2: Data analysis procedures by research question and proposal..... | 26 |
| Table 4.1 Response Rate..... | 29 |
| Table 4.2 Respondents' Age..... | 31 |
| Table 4.3 Highest Level of Education..... | 31 |
| Table 4.4 Industry or Sector of Organization..... | 32 |
| Table 4.5 Extent the Organizations Practiced the Control Activities..... | 35 |
| Table 4.6 Cases of Errors Reported in a Year..... | 35 |
| Table 4.7 Level of Agreement with Statements Relating to Reporting Reliability..... | 39 |
| Table 4.8 Level of Agreement with Statements Relating to Efficiency of Operations..... | 41 |
| Table 4.9 Level of agreement with statements relating to Compliance of Financial Operations..... | 44 |
| Table 4.10 Rate of the Organization's Financial Performance..... | 45 |
| Table 4.11 General Performance of the Organization..... | 45 |
| Table 4.12 Coefficient of Correlation..... | 47 |
| Table 4.13 Model Summary..... | 48 |
| Table 4.14 Regression Coefficients..... | 49 |



ABBREVIATIONS AND ACRONYMS

| | |
|--------------|--|
| ADB | - Africa Development Bank |
| COSO | - The Committee of Sponsoring Organizations of the Treadway Commission |
| CPA | - Certified Public Accountant |
| NSE | - Nairobi Securities Exchange |
| PMMCC | - Pearson Product Moment Correlation Coefficient |
| ROA | - Return on Asset |
| ROE | - Return on Equity |
| ROI | - Return on Investment |
| SPSS | - Statistical Package for Social Sciences |



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The Completion of this research project would not have been possible without the support of my supervisor, Dr. Caroline Njenga. Her contribution is sincerely appreciated and acknowledged.

To my family especially my husband, for their support and understanding throughout my studies, I thank you.

Most of all, to Jehova almighty, for this accomplishment, without whose mercies, this would not have been possible.



DEDICATION

This research project is dedicated to my late father John Okumu Auma for being my champion. You believed in me, and today, I stand proud because of the qualities of hard work and discipline you instilled in me.



CHAPTER ONE: INTRODUCTION TO THE STUDY

1.1 Introduction

The chapter focuses on the background to the study in which the concept of internal controls and employees' perception is put into perspective. It also clearly brings out the general perception that; institution with strong internal controls will always lead to improved firm performance; however, how is this general perception affected by employee perception on the internal controls? The chapter handles the purpose of the study which is to determine employee perception on the relationship between internal controls and the firm performance of quoted companies in Nairobi Securities Exchange (NSE). The chapter also brings into focus the scope of the study as covering finance department employees in companies quoted in NSE.

1.2 Background information

1.2.1 The Concept of Internal Controls

Internal control is defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework (2013) as a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. An organization needs internal controls to provide greater assurance that they will achieve their operating, financial reporting, and compliance objectives; in other words, to help the organization succeed in its mission (COSO, 2013). Internal control is a fundamental component of good corporate governance. Good corporate governance means that the board must identify and manage all risks for a company, in terms of risk management, internal control systems in finance, operations, compliance and other areas, i.e. all the activities of the company.

Internal control ensures effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations to which the company is subject. The success or failure of these three aspects depends on the employees who are directly tasked with the day to day running of the organization. The employees' perception is thus important because the daily operations of the organization determines the overall success of the organization. They therefore play

a very important part in ensuring the effectiveness and efficiency of the operations. They are also directly involved in the preparation of financial reports and are tasked with ensuring the reliability of the financial reporting. During this process they are supposed to do so while ensuring that they comply with the laws and regulations that the company is subject to. According to Mawanda (2008), a sound internal control system helps the firm to prevent frauds, errors and minimize wastage. The completeness and accuracy of accounting records, timely preparation of financial information, can only be achieved if a proper internal controls system is in place.

Internal controls systems including internal audits are intended primarily to enhance the reliability of financial reporting, either directly or indirectly by increasing accountability among information providers in an organization (Jensen, 2013). Internal controls therefore have a much broader purpose in the organization. Internal controls provide an independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better profitability (Beeler *et al.*, 2009). This is because in the presence of internal controls, fraud is greatly minimized. According to Ondieki (2013), fraud is a major enemy of profitability. Control measures are structured in place to avert, detect and eliminate fraudulent occurrence thereby creating an atmosphere for profitability. Effective Internal control system support profitability and growth of an organization by protecting the general assets and resources thereby averting cases of loss. Strong internal control system helps to prevent, minimize, transfer or eliminate risks, which may affect a profitable operation (Mugo, 2013).

1.2.2 Employee Perception and Firm Performance

Firm performance can be measured by financial performance of an organization. Financial performance is a measure of company's policies and operations in monetary terms. It is a general measure of a firm's overall financial health over a given period of time and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to measure firm performance. This may be reflected in the firm's return on investment, return on assets, value addition, among others and is a subjective measure of how a firm can use assets to generate revenues (Mishkin, 2014).

Positive financial performance in a firm can be achieved by eradicating waste in benefits, services, processes and systems. The critical success factor for a firm is the degree to which it fulfils its set objectives and mission in terms of being efficient, effective and economical. The information obtained from a sound internal control system as reflected from financial statements will provide a report on a firm's financial performance and position that is useful to a wide range of users for assessing the stewardship and making economic decisions (Davies, 2012).

While different measurement methods have been prescribed for measuring firm performance, employees of an organization will perceive the firm to be performing well if together with financial results, rules, policies and procedures are followed, and there is no bias or favoritism in handling employee matters, and decisions such as promotion are based on merit. Since rules policies and procedures do not operate in isolation, but are designed and managed by employees, it is important to look at the role of employee perception of internal controls on firm performance.

1.3 Problem Statement

Globally, financial scandals have been witnessed triggering reaction for tighter regulation and enhanced standards for accounting and corporate governance (World Bank, 2014). In Kenya, quoted companies have continued to register declining financial performance. Examples include Kenya Airways which reported a Ksh.10 billion loss in 2017; Mumias Sugar Company, a loss of Ksh.6.8 billion in 2017 and Uchumi Supermarkets, a loss of Ksh.2 billion in 2017.

Most public companies have functional internal audit departments charged with responsibility of providing management with re-assurance that internal control systems are adequate (Institute of Internal Audit, 2009). There is however, continued poor financial performance, budgets are not followed, rules and regulations not adhered to and massive unaccounted-for funds therefore putting these companies at risk of financial inadequacy, employee dissatisfaction and poor financial performance (Mikes & Kaplan, 2014).

Muio (2012) studied the impact of internal controls on the financial performance of private hospitals in Nairobi and established a strong relationship. Kakucha (2009) evaluated the level of effectiveness of internal controls of public companies

operating in Nairobi and established deficiencies in the systems of internal controls that vary from one enterprise to another. Several other studies have been carried out on internal controls globally, regionally and locally on the effect of internal controls systems on profitability. Globally studies by Abu-Musa (2004), Wittayapoom & Limsuwan (2012), and Regionally, Kakucha (2009) and Nyakundi & Nyamita (2014), all establish that there exists a relationship between effective internal controls and financial performance. These studies show a clear gap in literature, since most especially in Kenya focused on specific firms as opposed to firms quoted at the NSE. Further, the studies did not consider role of employee perception on internal controls and firm performance. This study therefore sought to fill this gap by examining employee perceptions on the relationship between internal control and firm performance in selected public organizations in Kenya.

1.4 Objectives of the Study

1.4.1 Main objective of the study

The main objective of this study was to establish employees' perception on the relationship between internal controls and firm performance for selected public organizations in Kenya.

1.4.2 Specific Objectives of the study

- i. To establish employees' perception on the relationship between operational efficiency and firm performance in selected public organizations.
- ii. To establish employees' perception on the relationship between the reporting reliability and firm performance in selected public organizations.
- iii. To establish employees' perception on the relationship between the compliance of financial operations and firm performance in selected public organizations.

1.5 Research Questions

- i. What is the employees' perception on the relationship between operational efficiency and firm performance in selected public organizations?
- ii. What is the employees' perception on the relationship between the reporting reliability and firm performance in selected public organizations?

- iii. What is the employees' perception on the relationship between the compliance of financial operations and firm performance in selected public organizations?

1.6 Scope of the study

The study focuses on determining the relationship between employee perception on internal controls and firm performance of companies quoted at the NSE. Firm performance focused on staff perception of company revenues, profitability and strength of the balance sheet. The study targeted employees of selected companies listed at the NSE. Specifically, the study was conducted amongst employees of firms located within Nairobi County. The study covered employees from 15 companies (see Appendix3) evenly selected across manufacturing, agriculture, finance, energy and service sectors, all quoted at the NSE as this was considered adequate sample for the population of the study which were finance employees of 63 listed companies.

1.7 Significance of the study

In the aftermath of corporate scandals and the global financial crisis, corporate governance has received significant attention from regulators and the public. Regulatory responses have focused on increasing disclosure requirements relating to corporate governance and this has, in turn, driven increased awareness and demand for internal assurance on corporate governance processes, including internal control and risk management. Thornton (2014) observes that in recent years, stakeholder's expectations from internal audit functions have changed significantly. The focus has now moved from a compliance and financial control function to facilitating organizations to proactively identify, assess and control risks. Thus, employees as part of the stakeholders of the organization have become important players in the governance system of the organization. This justifies the need to conduct the present study seeking to establish employees' perception on the relationship between internal controls and firm performance for selected public organizations. This is especially important because previous studies have focused on the contribution of internal control systems on financial performance of organizations, but none has focused on employee perception.

The study is of significance to the policy makers in public organizations in enforcing internal controls in their respective organizations. The findings of this research are also useful to financial management practice in organizations in Kenya. The study also enables organizations to understand the relevance of effective internal control operation in promoting better financial management. This study is helpful in complementing and advancing the discipline of financial management with specific reference to internal controls concepts, practices and rationale. It is instrumental in promoting, particularly, prudent audit and other elements of internal control. The study further advances the principles and practices of specific internal control components as contextualized to public sector organizations in Kenya. The study is also of literary significance, adding more information to previous studies in this area. The management of the selected firms, different stakeholders of interest such as Government who will be ensured of increased tax collection, and consumers who are interested in timely delivery of services in the right amount, right quality, at the right time and at competitive pricing also benefit from this study, as it tests the effectiveness of their error and fraud control initiatives. Most important is the recognition of importance of the employee perception on compliance given that they are actually the major factor of production.

1.8 Organization of the Study

The study comprised of five chapters. Chapter one presents the background of the study, statement of the problem, objectives of the study, research questions, and significance of the study, scope and the structure of the study. Chapter two is a review of the supporting theories and empirical studies which have been done on the study objectives. The chapter went ahead to give a conceptual framework for the study. Chapter three focused on the research methodology that was employed in evaluating employee perception on the relationship between internal controls and firm performance in companies quoted in NSE. This entailed the research design, target population and sample, data collection and data analysis procedures used in the study. Chapter four covers data analysis and presentation while chapter five is the conclusion and recommendations of the study.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter discussed the literature that had been established about employee perception on internal controls and their influence on organizational financial performance. The chapter as well looked at the theoretical framework used as a basis for linking employee perception on the relationship between internal control and firm financial performance. The chapter is thus structured into theoretical, conceptual and empirical review.

2.2 Anchoring Theories

2.2.1 Institutional Theory

Institutions are social structures that have attained a high degree of resilience. They are composed of cultural-cognitive, normative, and regulative elements that, together with associated activities and resources, provide stability and meaning to social life. Institutions are transmitted by various types of carriers, including symbolic systems, relational systems, routines and artefacts (Christopher, Sarens & Leung, 2009). Institutions operate at various levels of jurisdiction, from the world system to localized interpersonal relationships. Institutions connote stability but are subject to change processes, both incremental and discontinuous. Institutional and neo-institutional theory suggests that adoption of organizational practices and environmental alignment is an institutional process subject to the effect of three pressures or forces – coercive, mimetic and normative.

This theory further suggests that these forces can encourage organizations to adopt similar strategic actions thereby leading to organizational homogeneity (Adebanjo, Ojadi, Laosirihongthong & Tickle, 2013). The interests of shareholders have been strengthened over time, especially through efforts by the government and professional bodies. More specifically, there has been increased pressure on management to ensure that an organization is governed efficiently, effectively and economically for the benefit of shareholders. Much of this pressure has been a result of social expectations in response to recent corporate scandals (Christopher, Sarens

& Leung, 2009). This study draws on institutional theory, which essentially points that organizational management and control structures tend to conform to social expectations. The theory therefore advances argument for enhanced corporate governance in management of organizations resources.

Internal controls form the backbone of Governance issues in organizations. While it is management who set up internal controls and oversee their implementation, the theory encourages strengthening of control systems and involvement of stakeholders in ensuring that they are followed in conformity with social expectations. The aspect of management involvement, puts in focus employee perception, because positive employee perception of internal controls within a system enhances performance. The theory therefore strengthens the main objective of the study in looking at employee perception on internal controls and firm performance. On compliance with financial operations, employees as major participants in organizations act in accordance with the formal rules, such as written laws, regulations and standards set out in institutions by devising strategies to ensure compliance. Their perception of the laid down rules and regulations therefore is paramount in ensuring compliance. Ensuring compliance with existing rules and regulations enables employees to come up with reliable financial reports.

2.2.2 Attribution Theory

Attribution theory is a social psychology theory that explores how people interpret events and behaviors and how they ascribe causes to the events and behaviors. According to Martinko *et al.*, (2011), studies using attribution theory examine the use of information in the social environment to explain events and behaviors. Grenier *et al.*, (2012) asserts that when evaluators believe comparable persons would have acted differently in a given circumstance, they (evaluators) tend to attribute responsibility for an outcome to the person. On the other hand, when evaluators believe comparable persons would have acted similarly, the evaluators tend to attribute responsibility for the outcome to the situation. According to Wilks and Zimbelman (2014), the first case refers to internal or dispositional attributions while the second one refers to external or situational attributions.

Earlier literature shows that people are inclined to attribute others' behavior to dispositional tendencies and to attribute their own behavior to situational

circumstances (Wilks and Zimbelman, 2014; Martinko *et al.*, 2011). Often, this is when the observed behavior is negative. Consequently, evaluators are expected to infer the failure to detect internal control on revenue generation as a dispositional tendency on the auditor's part which concludes that auditors are negligent. Bonner *et al.*, (2008) found that auditors are more likely to be sued when they fail to detect common misappropriations that would result to decreased revenues, and the evaluators believe that the fraud could have been detected by other auditors. The auditor's accountability for detecting fraud is extended by Grenier *et al.* (2012) study which predicted that auditors are more likely to be held accountable by evaluators when the auditors fail to detect fraud after they had identified the fraud occurrence as a fraud risk. The result of Grenier *et al.*, (2012) study shows an increase in auditors' liability when an audit fails, after the auditors had identified the perpetrated fraud as a fraud risk and performed procedures to investigate the identified fraud risk. The findings support Grenier *et al.*, (2012) prediction.

Attribution theory thus advocates for auditors to report on the effectiveness of firms' internal control. Auditors are therefore expected to gain a better understanding of the internal controls in place, assess the design and implementation of the internal controls, and test the operating effectiveness of the internal controls. This is deemed necessary for the auditors' reliance and possibly scaling back of other substantive audit procedures for the required revenue generation. According to Bonner *et al.*, (2008), evaluators can use the audit processes as a basis to determine negligence if auditors fail to detect internal control related fraud that may occur. The attribution theory suggests that when fraud occurs, identified parties should be held accountable and auditors, being the "public watch dogs" are most likely to be held accountable if evaluators determine substandard audit services were provided (Grenier *et al.*, 2012).

Since the attribution theory place the burden of fraud reporting to the relevant employees within the institutions, their perception towards the reliability of the financial reporting is paramount. Further, as stated above, attribution theory explores how people interpret events and behaviors and how they ascribe causes to the events and behaviors. Therefore, how employees perceive the operational efficiency and effectiveness as well as the compliance of financial operations is important in linking the two to organizational performance.

2.3 Types of Internal Controls

Internal Controls are processes designed and effected by those charged with governance and management to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Mwindi, 2008). Internal controls are divided into financial internal controls and non-financial (administrative) internal controls. Financial internal control pertains to financial activities and may be exemplified by controls over company's cash receipts and payments financing operations and company's management of receipts and payments. Non-financial internal controls on the other hand deals with activities that are indirectly financial in nature i.e. controls over company's personnel section and its operations, fixed assets controls and even controls over laid down procedures (Reid & Ashelby, 2012). Governance through Board of Directors and Balance of power within organizations by having various departmental roles also fall into non-financial controls category.

There are three major classifications of internal controls; preventive, detective, and corrective. Preventive controls predict potential problems before they occur, make adjustments, and prevent an error, omission or malicious act from occurring; for example, many financial systems have built in controls preventing duplication of data, hence the system will not allow processing of the same document more than once and issue alerts and warnings. The detective controls are used to detect and report the occurrence of an omission, an error or a malicious act. Internal Audit procedures and processes play detective roles. Internal auditors go through organization systems, analyze organization statistics and financial results and often interrogate employees in order to achieve their goals. Finally, the corrective controls help in ensuring that the impact of a threat is minimized, identify the cause of a problem as well as the correct errors arising from the problem. Example of corrective control is termination of employment where employee is found culpable. Corrective controls correct problems discovered by detective controls and modify the processing system to minimize future occurrence of the problem (Singleton et al., 2016).

2.4 The Role of Internal Controls

Tunji (2013) and Dhillon (2011) argue that internal controls encompass a set of rules, policies, and procedures an organization implements to provide reasonable assurance that: (a) its financial reports are reliable, (b) its operations are effective and efficient, and (c) its activities comply with applicable laws and regulations. The Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013) framework looks at internal control as a process, affected 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 reporting, compliance with applicable laws and regulations. A sound internal control system helps an organization to prevent frauds, errors and minimize wastage. Custody of assets is strengthened; it provides assurance to the management on the dependability of accounting data, eliminates unnecessary suspicion and helps in maintenance of adequate and reliable accounting records (Amudo & Inanga, 2009).

One of the major objectives of internal controls pertains to ensuring effectiveness and efficiency of the entity operations. This includes financial performance and safeguarding assets against loss or misuse. If this objective is attained then the entity will be able to improve in its financial performance and attain financial success (Trkman, 2010).

Organizations are constantly and extensively working to improve their internal control systems so as to increase revenue inflow, survive in the rapidly changing economic and competitive environments, and adapt to the shifting customer demands and priorities (Kantzios & Chondraki, 2006). Internal control consists of five interrelated components which are derived from the way management runs a business and are integrated with the management process: control environment; risk assessment; control activities; information and communication; and monitoring (Ratcliffe & Landes, 2009). According to Rittenberg *et al.*, (2015), under the current operations of organizations in general, the importance of internal control can be divided into six major categories; detecting error and fraudulence, decreasing illegal

conduct, improving the competence of the business entity, improving the quality of data, helping to create the business infrastructure, and decreasing auditors' fee.

2.5 Empirical Review of Literature

2.5.1 Operational Efficiency and Firm Performance

Several studies have been conducted on the importance of operational efficiency towards financial performance. Michino (2011) carried out a survey of the impact of internal control on operational efficiency of non-governmental organizations (NGOs) in Nairobi using a sample of fifty (50) NGOs. Data was collected using a questionnaire consisting both open and closed ended questions. The study established that that internal controls in the NGOs based in Nairobi were determined largely by the organization structure such that it is the top management that decides on how the resources received from donors and other financiers are to be allocated and distributed to the beneficiaries. Further, cash management was ranked second internal control factor affecting NGOs operational efficiency. As such, NGOs with good cash management were found to be in a position to attract many sources of funds for their operations and as such, this called for proper use of resources at their disposal. Also, NGOs with well-structured organizational structures had well-structured policies and procedures on how activities were run. The findings also showed that much higher operational efficiency was registered in big well-known NGOs which lead to controlled internal controls by the funding partners. The study concluded that internal control impacts operational efficiency.

In a study on internal control function of the Kenya Polytechnic University College, Wainaina (2011) shows that as a substitute of its presence on the scene of operations, management must rely on internal control techniques to implement its decisions and to regulate the activities for which she would ultimately be responsible for. It is in this light that use of effective Internal Control Systems (ICS's) is deemed crucial in the management of business resources. As a result, the management of any organization designs internal control procedures to allocate, control and ensure efficient utilization of resources, in order to achieve the overall corporate goals.

If internal aspects of a firm are primarily responsible for its financial performance variation, organizations are expected to make changes based on finest operational

practices to their structural and infrastructural elements in order to attain selected performance goals (Swink, Narasimhan & Kim, 2005). The operating efficiency of a business in relation to the efficient utilization of the assets is reflected in net profit margin. Although a high return margin reflects better performance, a lower margin does not automatically indicate a lower rate of return on assets turnover. The overall operating efficiency of a firm therefore can be assessed on the basis of a combination of both. Firms are on performance curves based on the resources they use, however, fresh manufacturing know-hows, including management-related ones, might place firms on new performance curves (Pisano, 1996).

Extant literature has highlighted that operations efficiency is closely associated with the environmental or financial performance of firms. Dhillon (2011), calculated using Karl Pearson's coefficient correlation tool and examined that there was an insignificant positive correlation between operational efficiency and overall profitability in Gill *et al.*, (2014). In this study, he concluded that operational efficiency negatively affects future performance of Indian manufacturing firms. His findings showed that an increase in the cash conversion cycle, operating risk, and operating expenses which represented operational efficiency negatively impacted the future performance of the firms. This study hopes to establish the relationship between operational efficiency and firm performance of firms listed at the NSE.

2.5.2 Reporting Reliability and Firm performance

Holt and DeZoort (2009) did a study that sought to establish the effects of internal audit reporting on corporate governance and performance of the organizational functions. The study established that since internal auditors are expected to check all the organizational controls and report on them, objectivity in the reporting should not be compromised. The reports should not be based on hearsay, subjective judgment or witch-hunting. Reports that are not objective would raise disputes and discontent among the organizational members which would affect the performance of the organization as a whole. The reports of the internal audit department should be factual and authenticate which would increase the chance of action being taken by top management in regard to the report.

Stewart and Subramaniam (2010) studied the effect of internal audit objectivity and independence and the effects these can have on the organization. They observed that

objectivity in the audit function is critical in all the functions including in reporting. Having reports with verifiable and supporting documents is important in ensuring that the credibility of internal audit is not compromised. This ensures that the internal audit function provides reports that are not questioned by any organizational unit and thus effectively playing its role of advisory. On the other hand, reports that are filled with innuendo, allegations and bias may brew discontent and chaos in the organization which may adversely affect the overall organizational performance (Holder-Webb & Sharma, 2010).

The comprehensiveness of the internal audit reports was found by Whittington & Pany (2010) to positively influence the financial performance of an organization through its effect on adherence to ethics, regulations and corporate governance. Completeness in reporting enables the various departments in the organization to effectively have operations that add value to the organization and thus influence the organizations' accountability, use of resources and performance.

Comprehensive reports and assurances that the internal audit department provides to the management of the organization are expected to assure management and provide them with confidence that the internal controls and operational processes in the organization are sound and effective (Arena and Azzone, 2007). For an audit report to comprehensively and completely provide insight to management about the internal controls in operation, it has to reasonably cover all areas of operations and be reasonably complete. Internal audit reporting involves disclosing facts about the organization to the management so that management can take corrective action. The nature of these facts could be financial, operational, regulatory or operational. If the report does not cover all the areas comprehensively, the report will not be very useful to management which could be detrimental to the organization's financial performance (Clikeman, 2003). Incomplete internal audit reports could lead to loss of resources, reduced creditability of the audit department on the eyes of all other departments and occurrences that can lead to loss.

Hutchinson and Zain (2009) studied internal audit quality and the prospects of the firm growth and financial performance. The study established that, the function of the internal audit function is to investigate and assess the internal operations of the company and compile a comprehensive report that would inform management of

how effective the internal controls of the company are. The report should be in a format that is prescribed by the organization and meet completeness standards as per the organization's guidelines. A comprehensive report is important to educate management on what is happening internally in the organization and thus work on improving the company so that it can achieve its objectives (Hutchinson & Zain, 2009). Further, the report should adequately offer insights on the risks that face the organization and how well the organization adheres to regulations. This helps in ensuring that the company will be in a better position to manage its risks comprehensively.

Holt (2012) observed that internal audit reports should be timely compiled and circulated to all respective units after completion of the audit. Delay in reporting may worsen an already bad situation or make an opportunity that could have been taken pass. If there is any expected delay in internal audit reporting, this should be communicated to the relevant authorities and the effect of this delay assessed. Delaying of audit reports may have a negative effect on operations and activities in the organization which may in turn adversely affect the firm's financial performance.

2.5.3 Compliance of Financial Operations and Firm Performance

Companies are required to include a statement of compliance/noncompliance of the Code in their Annual Report. It follows as Fasterling (2012) asserted, that company performance is enhanced when regulations and guidelines have been adhered to. Investors, regulators and other stakeholders clearly consider compliance to be important. It is generally accepted that the purpose of regulations is not to increase the value of a firm but to enhance investors' confidence. Consequently, pressure from the regulatory authorities will encourage firms to comply with voluntary codes of best practice. Mustapha & Che, (2011) suggest that regulatory compliance act in a complementary manner to resolve the agency problem. Regulations reduce management dominance in the firm by increasing the influence of external parties such as auditors and shareholders. Conversely, deregulation increases the influence of management (Kole & Lehn, 2011).

Financial statements form the basis on which economic and financial agents, as well as authorities take their decisions. Hence, non-compliance with the Accounting Standards and rules affect market perception, financial ratios and reports that

supervisors use for assessing the condition of individual firms. The Accounting profession, through the issuance of standards, provides direction and guidance on how firms could achieve the goal of proper record keeping, transparency, uniformity, comparability and enhancing public confidence in financial reporting. Thus, failure on the part of the firm to apply the requirements of accounting standards result in inconsistencies, lack of accountability, transparency, and distortions in financial reports, which in turn results in poor financial reporting practices and dissemination of accounting information that is of less value to any particular group of users. This is because the preparation and presentation of financial statements lacks objectivity, reliability, credibility and comparability, and thus, results in fraudulent business practices, which subsequently lead to business failure, and become devastating on the national economy (Brown, 2011). However, despite the importance and endless benefits that accrue to an economy through effective compliance with accounting standards, there have been only few studies conducted in the area. This study is therefore an endeavor to fill this gap.

Shiyanbola *et al.*, (2015) studied the impacts of compliance with financial reporting standards on organizational performance. The sample comprised 96 companies in Nigeria. The findings of the study showed that Nigerian companies comply with accounting standards reasonably well. The level of compliance was, however, less than the international benchmark of 91%, and there were variations in the depth of disclosure by the studied companies. The study also found that compliance with accounting standards had a significant positive impact on the performance of the companies. There was no significant relationship between companies' sizes and compliance with accounting standards.

2.5.4 Financial Performance

Dixon (2009) stated that appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. Reid and Ashelby (2012) contends that performance is measured by either subjective or objective criteria, arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms.

In order to survive and succeed in a competitive market, firms must focus on maximizing profit or they will eventually be driven out of business (Dutta & Radner, 2011). Jovanovic (2012) supports this claim by saying that only efficient firms stay in the market, and that less productive firms will eventually exit many markets. Performance measures provide a mechanism for the organization to manage its financial and non-financial performance. Accountability is increased and enhanced, ensuring that projects support the organizational strategy and that better services and greater satisfaction are provided to a customer.

Whittington and Kurt (2011) found out that objective performance measures include indicators such as profit growth, revenue growth and return on capital employed. Financial consultants Stern, Stewart and Company created Market Value Added (MVA), a measure of the excess value a company has provided to its shareholders over the total amount of their investments (Kumar & Sharma, 2011). This ranking is based on some traditional aspects of financial performance including: total returns, sales growth, profit growth, net margin, and return on equity.

Dwivedi *et al.*, (2011) argues that other financial measures should include value of long-term investment, financial soundness, and use of corporate assets. Kumar & Sharma (2011) discussed accounting-based performance using three indicators: return on assets, return on equity, and return on sales. Each measure is calculated by dividing net income by total assets, total common equity, and total net sales, respectively. The study assessed firm performance using the following indicators as used by the various scholars discussed in previous studies; turnover, return on equity and return on assets.

2.5.5 The Link between Employee Perception, Internal Controls and Performance

Internal control systems including internal audits are intended primarily to enhance the reliability of financial statements, either directly or indirectly by increasing accountability among information providers in an organization (Jensen, 2013). Internal controls therefore have a much broader purpose such that the organization level of control problems associated with lower revenues, which explore links between disclosure of material weakness and fraud. Internal controls provide an

independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better revenue generation (Beeler et al., 2009).

Fadzil et al., (2015) asserted that effective internal controls unequivocally correlate with organizational success in meeting its revenue target level. Effective internal control for revenue generation involves; regular review of the reliability and integrity of financial and operating information, a review of the controls employed to safeguard assets, an assessment of employees' compliance with management policies, procedures and applicable laws and regulations, an evaluation of the efficiency and effectiveness with which management achieves its organizational objectives (Ittner et al., 2013).

According to CPA Australia (2011) each internal control procedure is designed to fulfil at least one of the following eight criteria: Completeness: that all records and transactions are included in the reports of business. Accuracy: the right amounts are recorded in the correct accounts. Authorization: the correct levels of authorization are in place to cover such issues as approval, payments, data entry and computer access. Validity: that the invoice is for work performed or products received, and the business has incurred the liability properly. Existence of assets and liabilities: Has a purchase been recorded for goods or services that have not yet been received? Do all assets on the books exist? Is there correct documentation to support the item? Handling errors; that errors in the system have been identified and corrected. Segregation of duties; to ensure certain functions are kept separate. For example, the person taking cash receipts does not also do the banking. Presentation and disclosure: timely preparation of financial reports in conformity with generally accepted accounting principles. All internal controls, whether administrative or accounting, are linked to a financial consequence. For example, keeping records for long service leave entitlements is an administrative control but it does ultimately have a financial consequence. If the leave days records are overstated, the organization loses money by lost time of leave days paid when employee exits the organization.

The reinforcement of staff perception on the importance of internal controls as related to organization performance is critical. In organizations where rules, procedures, processes and regulations are followed, staff will be motivated and will strive to follow the same. Following rules, processes, procedures and regulations

enhance staff and company performance by increasing efficiency, reducing wastage and enhance productivity. Staff perception results from a sense of job security of a well-run company leading to better firm performance.

2.6 The Research Gap

From the literature reviews it has been found out that realization of positive financial performance depends on whether firms have effective Internal Controls systems. Non-compliance to the internal controls is one of the major hindrances to the attainment of strong firm performance. Whereas a lot has been done on control environment and control activities and internal audit there is little done about employee perception of internal controls in relation to firm Performance. Hence there is need to establish the relationship between employee perception of internal controls and financial performance of companies listed at NSE.

There is a notable lack of research in developed as well as developing nations regarding the direct association of employee perception on internal controls and firm performance. More specifically, among these few studies is the one conducted by Al-Matari *et al.*, (2012) who investigated the association between the board characteristics and performance of Kuwaiti firms. They called for future researchers to examine the relation between internal controls and firm performance, both directly and indirectly. The current study thus aimed to establish employee perception on the relationship between internal controls and firm performance of companies listed in NSE.

2.7 Summary

Several studies have been conducted on internal controls. Case studies on internal controls in Belgium illustrate the importance of the control environment when studying internal auditing practices. Sarens and De Beelde (2013) found that certain control environment characteristics like tone-at-the-top, level of risk and control awareness, extent to which responsibilities related to risk management and internal controls are clearly defined and communicated are significantly related to the role of the internal audit function and fraud detection within an organization.

Using the analytical approach and focusing on control activities and monitoring, Barra (2010) investigated the effect of penalties and other internal controls on employees' propensity to be fraudulent. Data was collected from both managerial and non-managerial employees. The results showed that the presence of the control activities, separation of duties, increases the cost of committing fraud. Thus, the benefit from committing fraud has to outweigh the cost in an environment of segregated duties for an employee to commit fraud. Further, it was established that segregation of duties is a least-cost fraud deterrent for non-managerial employees, but for managerial employees, maximum penalties are the least-cost fraud disincentives. The results suggest the effectiveness of preventive controls (control activities) such as segregation of duties is dependent on detective controls (monitoring).

Amudo and Inanga (2013) carried out an evaluation of Internal Control Systems on the Regional Member Countries of the African Development Bank Group focusing on Uganda in East Africa. The study established that some control components of effective internal control systems are lacking in these projects which renders the current control structures ineffective. The study recommended an improvement of the existing internal control systems in the projects.

Jones (2014) compared internal controls, accountability and corporate governance in Medieval and modern Britain. He used a modern referential framework (control environment, risk assessment, information and communication, monitoring and control activities) as a lens to investigate medieval internal controls used in the twelfth century royal exchequer and other medieval institutions. He demonstrated that most of the internal controls found today were present in medieval England. Stewardship and personal accountability were found to be the core elements of medieval internal control. The recent recognition of the need for the enhanced personal accountability of individuals is reminiscent of medieval thinking.

2.8 Conceptual Framework

The conceptual framework of the study is adopted from the COSO framework of internal control. It is based on employee perception on the relationship between internal controls and firm performance. Internal controls (the independent variable)

consists of policies and procedures, formulated and enforced by a management with a view to achieving efficiency in operations, safeguard of assets, and compliance to internal and external laws, reliable financial records overall resulting in the achievement of firm performance (dependent variable).

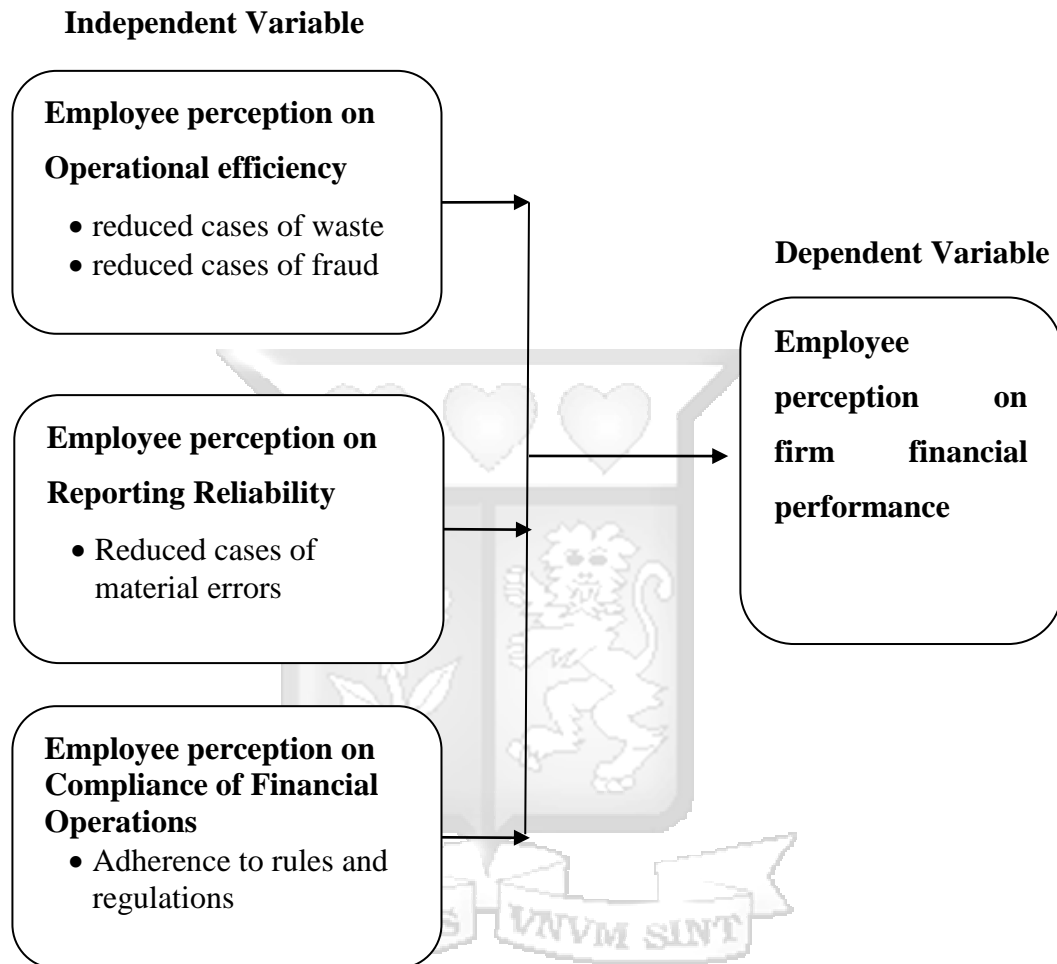


Figure 2.1 Conceptual Model (Source: Author, 2018)

In this study, perceived firm performance was measured by establishing employee perception on revenues, profitability and the strength of the balance sheet or resource utilization.

Revenue analysis can be used to evaluate a company's performance. Analysis of revenue trends is important in establishing any underlying causes for revenue fluctuation. A further comparison of revenue trends with industry averages is useful in establishing the link to the entire industry. Performance of firms around the world

is first evaluated by investors using the measure of profitability. Ratios such as ROA, ROE and many other profitability ratios are applied to asset profitability. The strength of the balance sheet is measured by the debt to equity ratio and gauges the company financial leverage. The higher the debt to equity ratio the weaker the balance sheet.



CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research design, data collection methods, data collection instruments and overall approach to data analysis. Justification for the methodologies is also provided as appropriate.

3.2 Research design

The study used a descriptive survey design of a cross section type. Cross sectional survey design is appropriate because perception of employees is best collected at one point in time. According to Mugenda and Mugenda, (2009) descriptive research is a scientific method of investigation which involves collection and analyzing of both quantitative and qualitative data. Mugenda and Mugenda, (2009) state that the descriptive survey design is a method, which enables the researcher to summarize and organize data in an effective and meaningful way. According to Cooper and Schindler (2008), a descriptive study is concerned with finding out the what, where and how of a phenomenon. This study therefore was able to generalize the findings to all the organizations in the sectors targeted.

3.3 Population and Sampling

3.3.1 Target Population

The study targeted finance employees from 15 out of 63 public organizations quoted at NSE. The unit of analysis was the staff of the selected organizations. The accessible population was the all finance staff from 15 organizations in the five sectors chosen for the study namely agriculture, finance, energy, manufacturing and service. The study was conducted across all various categories of staff according to age, gender, experience and qualification.

3.3.2 Sample Size and Sampling

The study used multi-stage sampling technique to come up with a representative sample. At the first stage, the study employed Stratified random sampling technique to group the organizations from the five different sectors. Stratified random sampling

is unbiased sampling method of grouping heterogeneous population into homogenous subsets then selecting within the individual subset to ensure representativeness. The goal of stratified random sampling is to achieve the desired representation from various sub-groups in the population. From each strata, a purposive sample of 3 organizations was selected which was 24% of the total number of organizations in the NSE which is 63 as shown in appendix 3. This was representative enough as Kothari (2004) states that a representative sample is one which is at least 10% of the population. Purposive sampling is the technique where the researcher consciously decides the sample members. It is mainly used to arrive at 'typical' and relevant members only. Only organizations representing typical entities in the five sectors were selected to participate. It was preferred for this study because of its ability to ensure availability of data, relevance of information policies as well as appropriate use of research time. Subsequently a simple random sample of 8 finance staff of different caliber and personal attributes was selected from each organization. Simple random sample gives each subject in the study population an equal and an independent chance of being selected to participate in the study (Ghauri & Gronhaug, 2010). In that way the technique reduces systematic errors in the data collection process. All this helped come up with a total sample of 120 respondents as shown below.

Table 3.1 Sample Size

| Sectors | Organizations | Sample from each | |
|---------------|---------------|-------------------|--------------|
| | | Staff interviewed | Total Sample |
| Manufacturing | 3 | 8 | 24 |
| Agriculture | 3 | 8 | 24 |
| Finance | 3 | 8 | 24 |
| Energy | 3 | 8 | 24 |
| Service | 3 | 8 | 24 |
| Total | 15 | 40 | 120 |

3.4 Data collection methods

3.4.1 Instrumentation

The study used questionnaires as means for collecting data. This choice was based on the nature of the data to be collected and the study objectives. Primary data was collected using the questionnaire as seen on appendix 2; Likert response scales were used in majority of the questions on the Questionnaire as well as a few closed ended questions. Likert scales questions are easy for respondents as such responses from such scales are likely to be more reliable (Balzan & Baldacchino, 2007; Lam & Kolic, 2008). The questionnaire was administered face to face to ensure a quick capture of the “status quo”.

3.5 Analysis of data

After the data had been collected, it was coded. Descriptive statistics such as means, standard deviations, coefficient of variation and appropriate summaries and illustrations were used to present the data in ways that captured the emerging trends and relationships.

In order to establish the relationships implied in the hypotheses, Pearson Product Moment Correlation Coefficient was computed to enable rejection or non-rejection of the hypotheses. This facilitated generalization of the sample data as representation of the target population.

The following inferential statistics was adopted.

Table 3.2: Data analysis procedures by research question and proposal

| Research Questions | Independent Variables | Dependent Variables | Data Analysis Procedure, statistics |
|---|--|---|--|
| What is the employees' perception on the relationship between operational efficiency and firm performance in selected public organizations? | Employee perception on efficiency of operations <ul style="list-style-type: none"> • Cases of wastage • Cases of fraud | Employee perception on firm financial performance <ul style="list-style-type: none"> • Revenue | Pearson Product Moment Correlation Coefficient |
| What is the employees' perception on the relationship between the reporting reliability and firm performance in selected public organizations? | Employee perception on number of errors and misrepresentation <ul style="list-style-type: none"> • Cases of material errors | <ul style="list-style-type: none"> • Profitability • Balance sheet strength | Pearson Product Moment Correlation Coefficient |
| What is the employees' perception on the relationship between the compliance of financial operations and firm performance in selected public organizations? | Employee perception on compliance <ul style="list-style-type: none"> • Adherence to rules and regulations | | Pearson Product Moment Correlation Coefficient |

The analysis sought to establish whether internal audit function may be used to affect control risk factors.

The following regression equation was used: -

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon$$

Where;

Y= Firm performance;

β_0 = constant term;

$\beta_1 - \beta_3$ = Beta coefficients (intercepts for independent variables);

X_1 = Efficiency of operations;

X_2 = Reporting reliability;

X_3 = Compliance of financial operations;

And ε = Error term.

3.6 Research Validity and Reliability

3.6.1 Validity

According to Mugenda and Mugenda (2009) validity is the accuracy and meaningfulness of inferences, based on the research results. One of the main reasons for conducting the pilot study was to ascertain the validity of the questionnaire. The study used both face and content validity to ascertain the validity of the questionnaires. Content validity draws an inference from test scores to a large domain of items similar to those on the test. Content validity is concerned with sample-population representativeness. Gillham (2008) stated that the knowledge and skills covered by the test items should be representative to the larger domain of knowledge and skills.

3.6.2 Reliability

Pilot testing enabled the researcher to receive important feedback on how questions were to be recorded or structured. According to Bridget and Cathy (2005) the questionnaire should be pre-tested before it is ready for the field, it is therefore very important for the researcher to pretest research instruments to enhance clarity of the instruments to be used and ensuring accurate information and for correcting deficiencies revealed during pre-testing exercise (Mugenda & Mugenda 2009). The researcher pretested the questionnaire on a pilot group of ten colleagues in finance

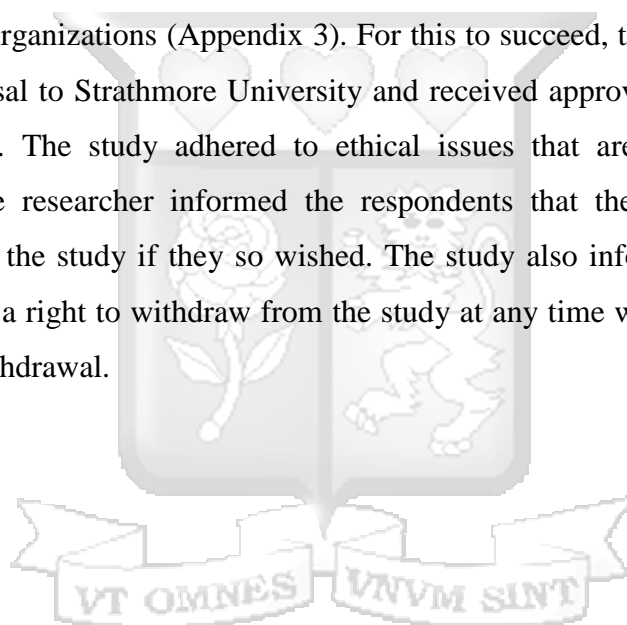
department. The ten colleagues were selected for ease of access and managing the process and they were not involved in final list of respondents. The results obtained from the pilot study assisted the researcher in revising the questionnaire to make sure that it had covered the objectives of the study.

3.6.3 Objectivity

In this study individual opinions were not allowed to interfere with objectivity. This was done by using mainly Likert scale type of questions and minimizing open ended questions.

3.7 Ethical Considerations

The researcher sought approval to perform the study from Strathmore University and the targeted organizations (Appendix 3). For this to succeed, the researcher provided a final proposal to Strathmore University and received approval letter to take to the organizations. The study adhered to ethical issues that are the baseline of any research. The researcher informed the respondents that they had a right not to participate in the study if they so wished. The study also informed the respondents that they had a right to withdraw from the study at any time without giving a reason as to their withdrawal.



CHAPTER FOUR: DATA ANALYSIS AND RESULTS

4.1 Introduction

This chapter discusses the interpretation and presentation of the findings. The purpose of the study was to establish the relationship between internal control and firm performance for selected public organizations in Kenya. The researcher made use of frequency tables and figures to present data. Findings were intended on answering the study's research questions. Data collected was collated and reports were produced in form of tables and figures and qualitative analysis done.

4.2 Response Rate

The study targeted a sample of 120 respondents' who were employees in finance departments of the targeted 15 organizations from 5 different sectors. Out of 120 questionnaires issued out, only 80 respondents completed the questionnaires contributing to 67% response rate. This is a good response rate for data analysis as Mugenda and Mugenda (2009) pointed that for generalization, a response rate of 50% is adequate for analysis and reporting, 60% is good and a response rate of 70% and over is excellent.

Of the 40 non-respondents, 60% came from three organizations in one from Agriculture, and the others from Banking and Energy sectors, they indicated that they were not granted authority to respond to the questionnaire. These companies could have been reluctant with sharing information because of sensitivity and competition within the sector. The rest of non-respondents who made up 13% of the total sample appear not to have been interested in responding for personal reasons.

Table 4.1 Response Rate

| Response | Frequency | Percentage (%) |
|----------------------------|------------------|-----------------------|
| Completed questionnaires | 80 | 67 |
| Uncompleted questionnaires | 40 | 33 |
| Total | 120 | 100 |

4.3 Demographic Information

4.3.1 Gender

According to the findings as presented in figure 4.1, most (54%) of the respondents were male while 46% were female. There was, therefore, an almost equal distribution of respondents by gender.

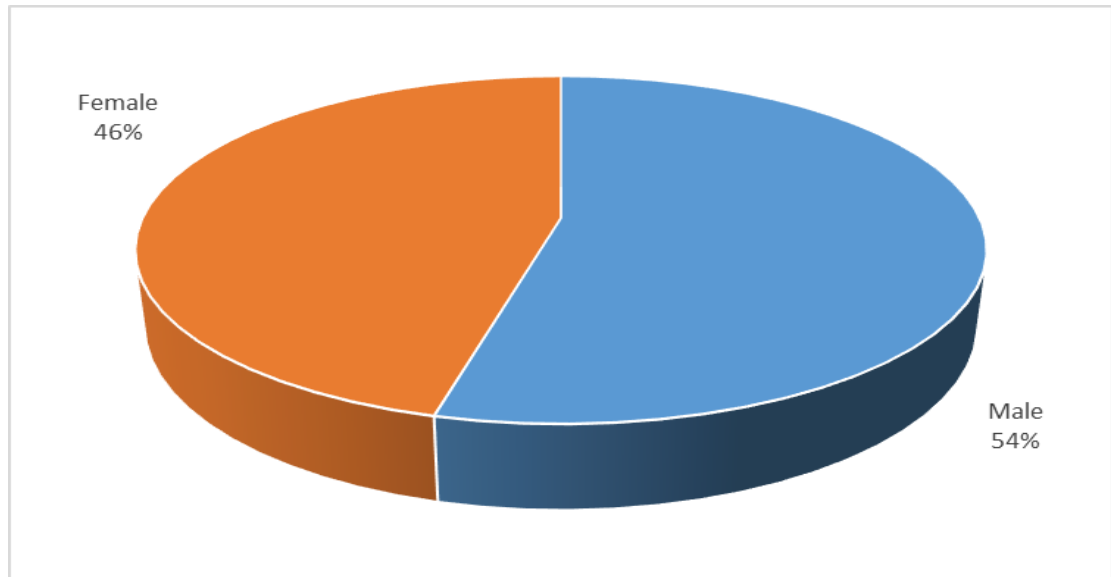


Figure 4.1 Respondents' Gender

4.3.2 Age

The findings were as shown in table 4.2. From the findings, majority (52.5%) of the respondents were aged between 31 and 40 years, 25% were aged between 21 and 30 years, 12.5% were aged between 41 and 50 years, 6% aged between 51 and 60 years, while 4% were aged under 20 years. This means that the largest age group of respondents fell between age 31 and 40 (52.5%), however all respondents were adults while a total of 10% were either below 20 years or above 51 years, which represent people either entering or leaving the working age group.

Table 4.2 Respondents' Age

| Age | Frequency | Percent |
|----------------|------------------|----------------|
| under 20 | 3 | 4.0 |
| 21 to 30 years | 20 | 25.0 |
| 31 to 40 years | 42 | 52.5 |
| 41 to 50 years | 10 | 12.5 |
| 51 to 60 years | 5 | 6.0 |
| Total | 80 | 100.0 |

4.3.3 Level of Education

According to the findings as illustrated in table 4.3 most (50%) of the respondents had a Bachelors' degree as their highest level of education, 28.8% had Masters' degree, 12.5% had Diploma, 5% had Certificate, while 3.8% had secondary school certificate as their highest level of education. This therefore means that most of the finance staff were highly qualified and hence can give reliable information.

Table 4.3 Highest Level of Education

| Level of Education | Frequency | Percent |
|------------------------------|------------------|----------------|
| Secondary school Certificate | 3 | 3.8 |
| Certificate | 4 | 5.0 |
| Diploma | 10 | 12.5 |
| Bachelors' degree | 40 | 50.0 |
| Masters' degree | 23 | 28.8 |
| Total | 80 | 100.0 |

4.3.4 Industry or Sector of Organization

According to the findings as illustrated in table 4.4 below, 27.5% of the respondents were in the agricultural sector, 21% were from the energy sector, 20% from the finance industry while 17.5% and 14% were from the manufacturing and service sectors respectively, notwithstanding, that the questionnaires were given on equal weighting. This means that the study sought information from the targeted

population and data collected was well spread among the targeted sectors. However, employees from Agriculture sector were more willing to respond than other sectors. This could therefore mean that organizations from the agriculture sector had instituted strong internal control measures and were therefore willing to report about them.

Table 4.4 Industry or Sector of Organization

| Industry | Frequency | Percent |
|-----------------|------------------|----------------|
| Agriculture | 22 | 27.5 |
| Finance | 16 | 20.0 |
| Energy | 17 | 21.0 |
| Manufacturing | 14 | 17.5 |
| Service | 11 | 14.0 |
| Total | 80 | 100.0 |

4.3.5 Working Duration

According to the findings as shown in figure 4.2 most (46%) of the respondents had worked in their organizations for between 11 and 20 years, 41% had worked for between 0 and 10 years, 10% had worked for between 21 and 30 years and 3% for between 31 and 40 years. This illustrates that the respondents had worked in the respective organizations for at least 11 years and were therefore adequately well experienced within their organizations to give the information sought by the study.

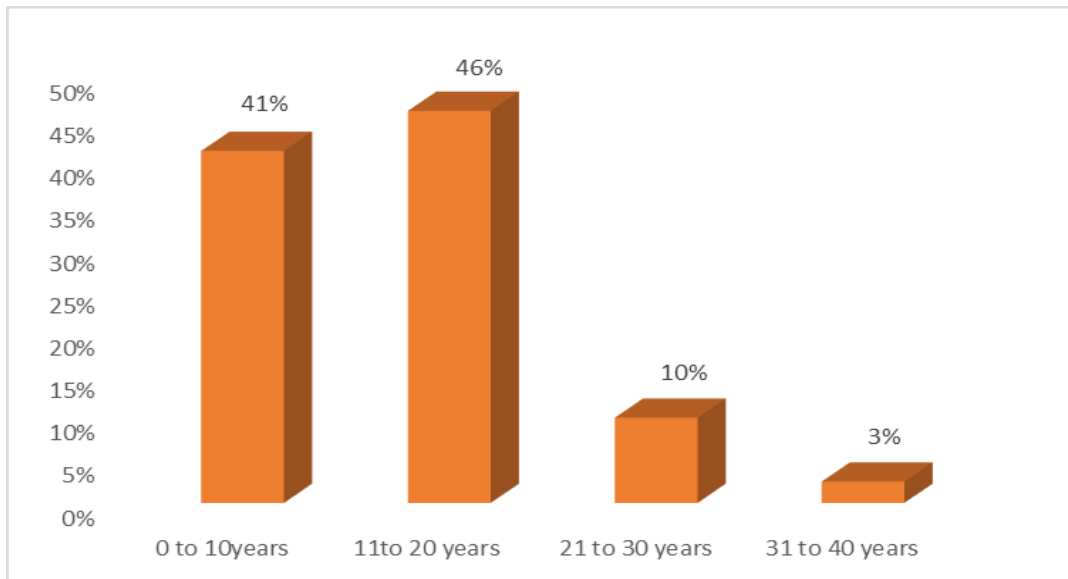


Figure 4.2 Working Duration

4.3.6 Level of Management

From the findings as presented in figure 4.3 below, 46% of the respondents were working in the operational level of management, 41% were working in the middle level management while 13% were working in the senior level management. This shows that the respondents were well balanced between management and operational staff and hence providing a good range of data from different caliber of staff.

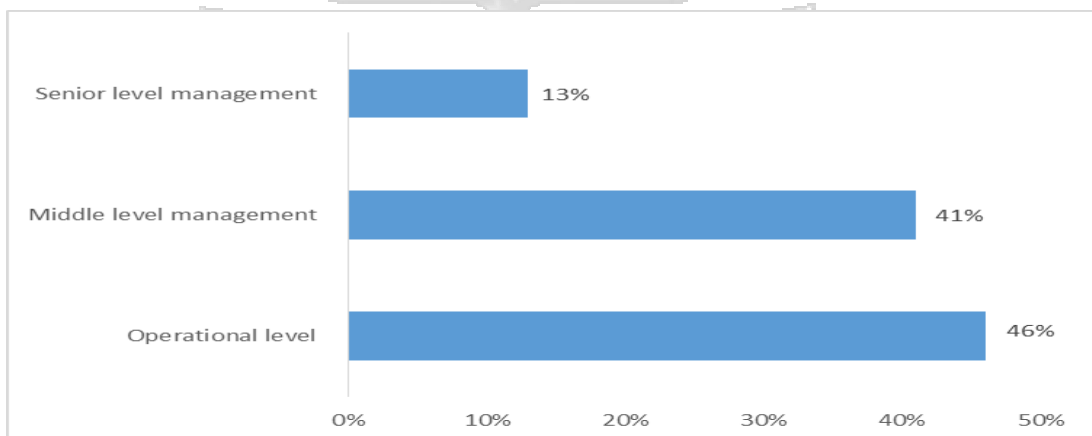


Figure 4.3 Level of Management

4.4 Control Activities

4.4.1 Extent the Organizations Practiced the Control Activities

From the findings as illustrated in table 4.5, most of the respondents indicated that the organizations had clear separation of roles as shown by a mean score of 4.28. Corrective action was taken to address weaknesses as evidenced by a mean score of 4.05, and that staff are trained to implement the accounting and financial management system as shown by a mean score of 3.90. In addition, the respondents stated that their organizations had a well-developed chart of Accounts as shown by a mean score of 3.84, their security system identified, and safeguarded organizations' assets as shown by a mean score of 3.83 and that it was impossible for one staff to have access to all value information without the consent of senior staff as illustrated by a mean score of 3.79. Similarly, the respondents stated that objectives established by management were realistic as shown by a mean score of 3.76. Departments had budget reviews where actual expenditure was compared with budgeted expenditure and explanations for the variances given as evidenced by a mean score of 3.75. And that every employee's work checked on the other as shown by a mean score of 3.74. The respondents also stated that all personnel understood and adhered to the company code of conduct as shown by a mean score of 3.70 and that controls were in place to exclude incurring expenditure in excess allocated funds as evidenced by a mean score of 3.69.



Table 4.5 Extent the Organizations Practiced the Control Activities

| Practices | Mean | Std. Dev |
|--|-------------|-----------------|
| Our organization has clear separation of roles | 4.28 | 0.729 |
| Every employee's work checks on the other | 3.74 | 0.611 |
| Corrective action is taken to address weaknesses | 4.05 | 0.870 |
| Staff are trained to implement accounting systems | 3.90 | 0.704 |
| One staff cannot have unauthorized access to all information | 3.79 | 0.724 |
| Our organization has a well-developed chart of Accounts | 3.84 | 0.961 |
| Controls in place barring expenditure in excess allocated budget | 3.69 | 0.756 |
| Budget reviews for variance explanations are carried out often | 3.75 | 0.834 |
| Our security system identifies and safeguard organization assets | 3.83 | 0.725 |
| Objectives established by management are realistic | 3.76 | 0.875 |
| All personnel understand and adhere to the company code of conduct | 3.70 | 0.892 |

4.5 Reporting Reliability

4.5.1 Cases of Errors Reported in a Year

The researcher was also inquisitive to establish the number of cases of errors that were reported in a year over the past three years in the organizations. The findings were as illustrated in Table 4.6.

Table 4.6 Cases of Errors Reported in a Year

| Cases | Frequency | Percent |
|--------------------|------------------|----------------|
| 3 cases and below | 25 | 31.3 |
| 4 to 6 cases | 38 | 47.5 |
| 7 to 9 cases | 5 | 6.3 |
| 10 cases and above | 12 | 15.0 |
| Total | 80 | 100.0 |

According to the findings 47.5% of the respondents indicated that there were 4 to 6 cases of errors that were reported in a year over the past three years in the organizations. 31.3% indicated that there were 3 cases and below while 15% indicated that there were 10 cases and above and 6.3% indicated that there were 7 to

9 cases. This implies that there were several cases of errors reported per year for the previous three years.

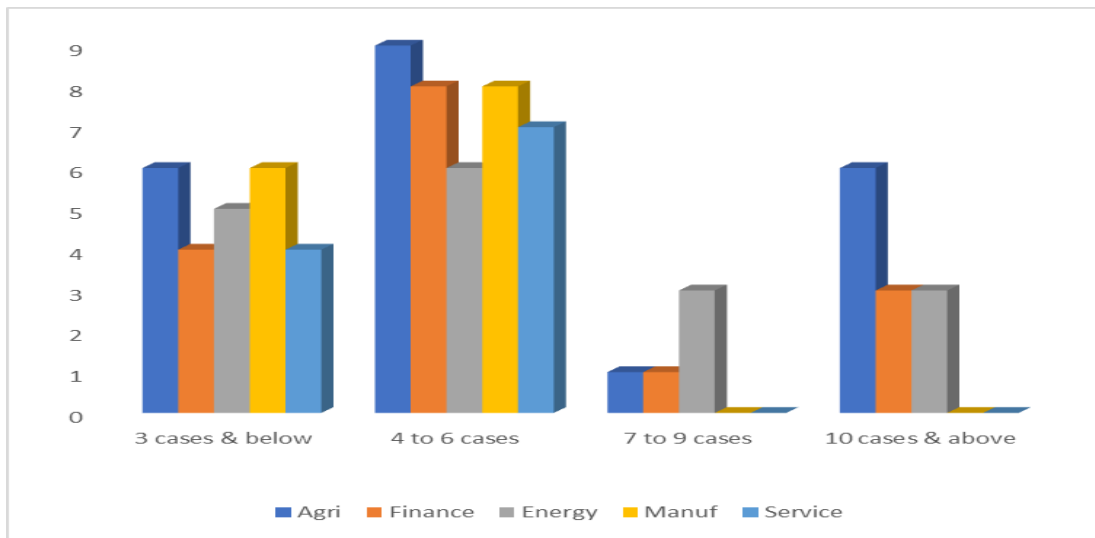


Figure 4.4 Cases of Errors Reported by Sector

Figure 4.4 above shows the distribution of cases of errors recorded within the 5 targeted sectors. Cases of up to 6 errors recorded were well distributed amongst the 5 sectors. Employees from the Energy sector recorded the highest (60%) number of errors within the 7 to 9 cases category. Of the 12 cases of errors reported in the 10 and above category, 50% were found in Agriculture sector. Errors represent non-compliance and inefficiencies hence these results imply that employees of Agriculture, Energy and Finance sectors felt that their companies were more prone to cases errors.

4.5.2 Total Magnitude of the Errors Reported

According to the findings presented in figure 4.5, most (54%) of the respondents indicated that the total magnitude of the errors reported during the previous three years was less than 35% of turnover, and 43% indicated that the total magnitude was 35% to 65% of turnover while 3% indicated that the total magnitude was over 65% of turnover. This implies that the total magnitude of the errors reported during the previous three years was less than 35% of turnover.

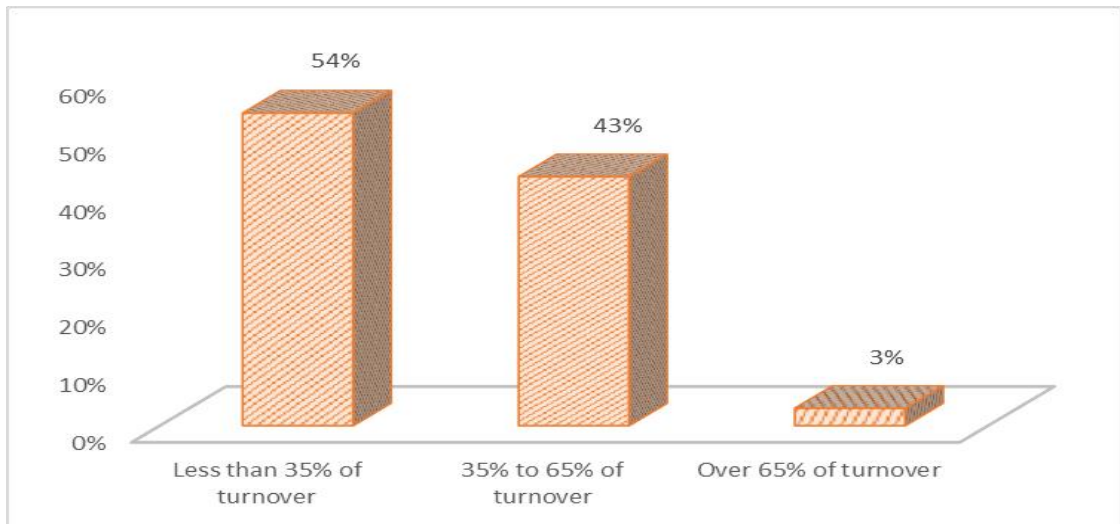


Figure 4.5 Total Magnitude of the Errors Reported

From figure 4.6 below, it appears that employees from Agriculture sector perceived errors within their organizations to be of a lesser magnitude (less than 35% group). Employees of Finance sector on the other hand, mainly perceived the magnitude of their errors to be between 35% and 65% of the turnover.

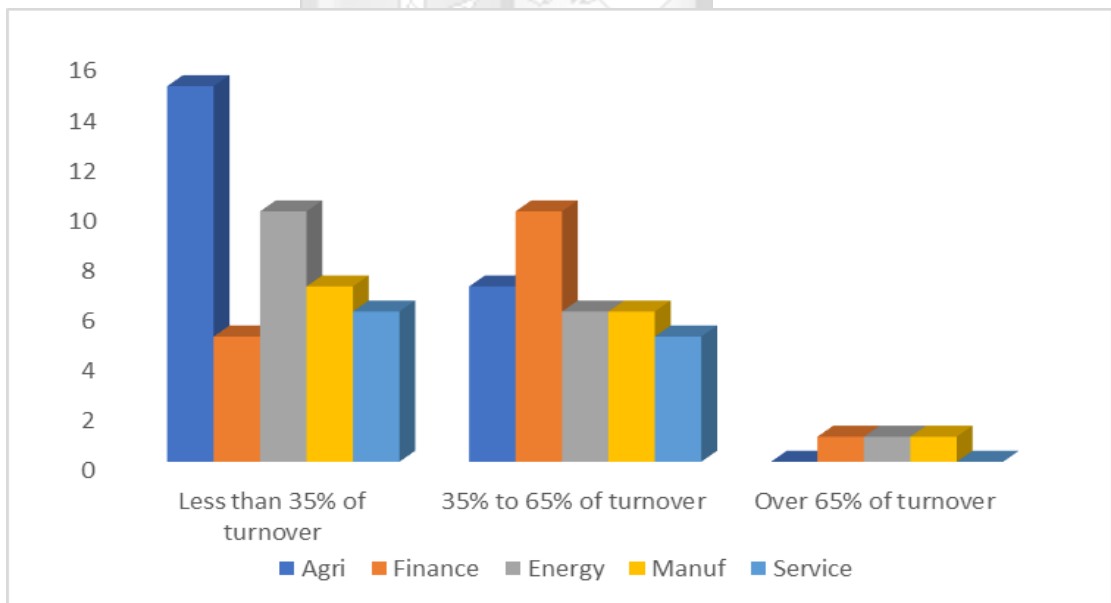


Figure 4.6 Magnitude of the Errors reported by Sector

4.5.3 Level of Agreement with Statements Relating to Reporting Reliability

This was in relation to the objective of employees' perception on the relationship between operational efficiency and firm performance. The respondents were requested to indicate their level of agreement to the statements below using a scale of 1 to 5, where 1 represented strongly disagree, 2- disagree, 3- moderate agree, 4- Agree, 5- Strongly agree. The researcher took the mean of all the responses in each statement. In instances where the mean was less than 4 but more than 3.5 this was taken to represent agreement with the statements. According to the findings as illustrated in table 4.7, most of the respondents agreed that all employees understood the concept and importance of internal controls including the division of responsibility as shown by a mean score of 4.04. There was a smooth flow of information from personnel to internal audit as evidenced by a mean score of 4.03 and that reliability of information was related to company information systems as illustrated by a mean score of 4.01. In addition, the respondents agreed that company's information system was accessible by internal audit staff as evidenced by a mean score of 3.93, that information flow in various departments was considered reliable as shown by a mean score of 3.90 and that communication helped to evaluate how well guidelines and policies of the organization were working and implemented as shown by a mean score of 3.80. The respondents also agreed that the reporting system on organizational structures spelt out all the responsibilities of each section/unit in the organization and that information flowing from personnel to internal audit was reliable as evidenced by mean scores of 3.76. They also agreed that management had identified individuals who were responsible for coordinating the various activities within the entities.

Table 4.7 Level of Agreement with Statements Relating to Reporting Reliability

| Statements | Mean | Std. Dev |
|--|-------------|-----------------|
| Individuals responsible for coordinating various activities identified | 3.54 | 0.871 |
| Importance of internal controls is well understood | 4.04 | 0.683 |
| Guidelines and policies of the org are implemented and working | 3.80 | 0.770 |
| Reporting system on org structures spells out all the responsibilities | 3.76 | 0.815 |
| Smooth flow of information from personnel to internal audit | 4.03 | 0.763 |
| Information flowing from personnel to internal audit is reliable | 3.76 | 0.799 |
| Company's information system is accessible by internal audit staff | 3.93 | 0.925 |
| Information flow various departments is considered reliable | 3.90 | 0.894 |
| Reliability of info is related to org information systems | 4.01 | 0.864 |

4.6 Operational Efficiency

4.6.1 Cases of Operation Inefficiencies

From the findings as shown in figure 4.7, majority (59%) of the respondents indicated that there were 4 to 6 cases of operational inefficiencies discovered over the previous three years. 25% of respondents indicated that there were 3 cases and below. 11% of respondents indicated that there were 10 cases and above, while 5% indicated that there were 7 to 9 cases. This implies that there were several cases of operational inefficiencies discovered in the organizations in a year over the previous three years.

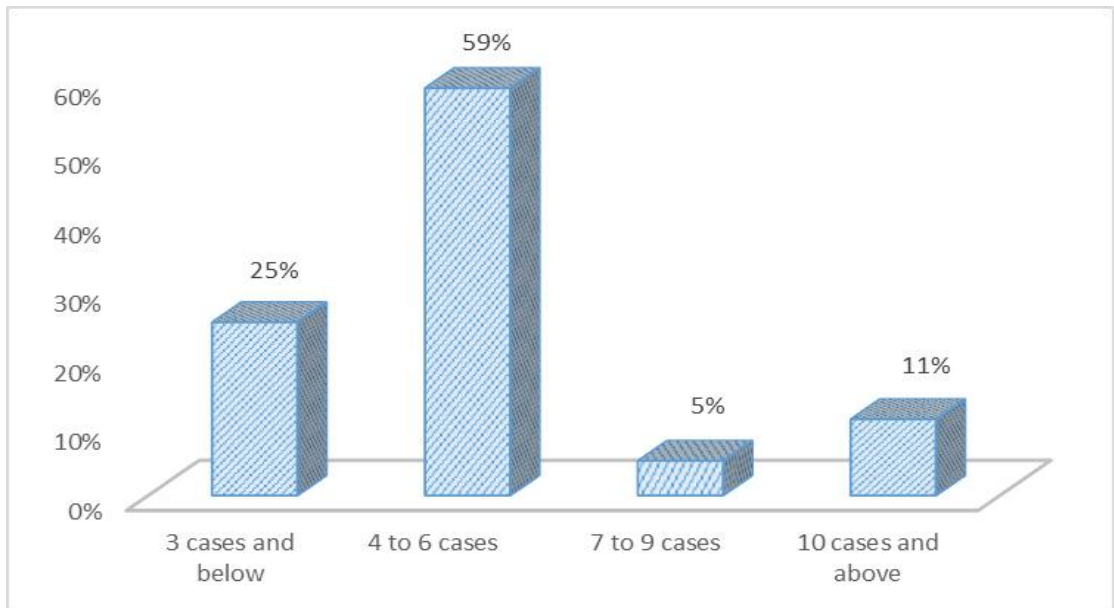


Figure 4.7 Cases of Operation Inefficiencies

From figure 4.8 below, of the 59% respondents who felt that cases of operation efficiencies were between 4 and 6 cases, a majority of them came from the Agricultural sector.

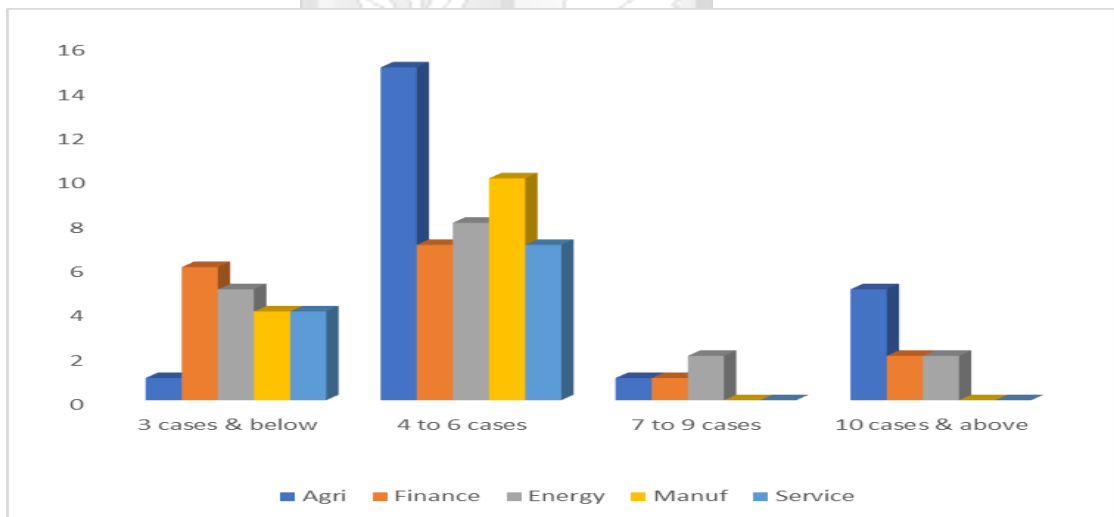


Figure 4.8 Cases of Operation Inefficiencies by Sector

4.6.2 Level of Agreement with Statements Relating to Efficiency of Operations

This was in relation to the objective of employees' perception on the relationship between efficiency of operations and firm performance. The respondents were

requested to indicate their level of agreement to the statements below using a scale of 1 to 5, where 1 represented strongly disagree, 2- disagree, 3- moderate agree, 4- Agree, 5- Strongly agree. The researcher took the mean of all the responses in each statement. In instances where the mean was less than 4 but more than 3.5 this was taken to represent agreement with the statements. According to the findings as presented in table 4.8, most of the respondents agreed that risk identification under special circumstances was possible as shown by a mean score of 4.20. Internal audit was consulted when legitimacy of a transaction process was in question as shown by a mean score of 4.06. That frequency of internal audit procedures was proportional to perceived risk in each department as evidenced by a mean score of 4.04. Also, internal audit personnel were qualified to effectively resolve issues arising during the auditing process as shown by a mean score of 4.00.

Table 4.8 Level of Agreement with Statements Relating to Efficiency of Operations

| Statements | Mean | Std. Dev |
|--|-------------|-----------------|
| Audit objectives are linked to and support company's strategies | 3.69 | 0.628 |
| Risk identification under special circumstances is possible | 4.20 | 0.644 |
| Previous internal audit work is revisited to evaluate its effectiveness | 3.99 | 0.626 |
| Single employee unable to process transactions from beg to the end | 3.95 | 0.810 |
| There exists an integrated procedure for evaluating risks | 3.89 | 0.711 |
| Frequency of Int audit procedures is proportional to perceived risk | 4.04 | 0.683 |
| Establish internal control systems to detect illegal activities | 3.89 | 0.693 |
| Internal audit consulted when legitimacy of transaction is in question | 4.06 | 0.663 |
| Internal audit personnel qualified to effectively resolve issues arising | 4.00 | 0.675 |
| Internal auditing job descriptions cover the internal auditing function | 3.95 | 0.761 |

Additionally, the respondents agreed that previous internal audit work was revisited to evaluate its effectiveness as shown by a mean score of 3.99, a single employee was able to process transactions from beginning to the end and that internal auditing job descriptions cover the internal auditing function well as evidenced by mean scores of 3.95 respectively. Similarly, the respondents agreed that there existed

integrated procedures for evaluating risks, that established internal control systems was able to detect illegal activities within the company and that audit objectives were linked to and supported company's strategies as evidenced by mean scores of 3.89 and 3.69 respectively.

4.7 Compliance of Financial Operations

4.7.1 Rating of Compliance Record

According to the findings presented in figure 4.9, 14% of the respondents indicated that compliance record was very good. Majority (62%) of the respondents indicated that the organizations' compliance record was good, while 20% indicated that the record was fair, and 4% indicated that the record was poor. This implies that the organizations' compliance record was good.

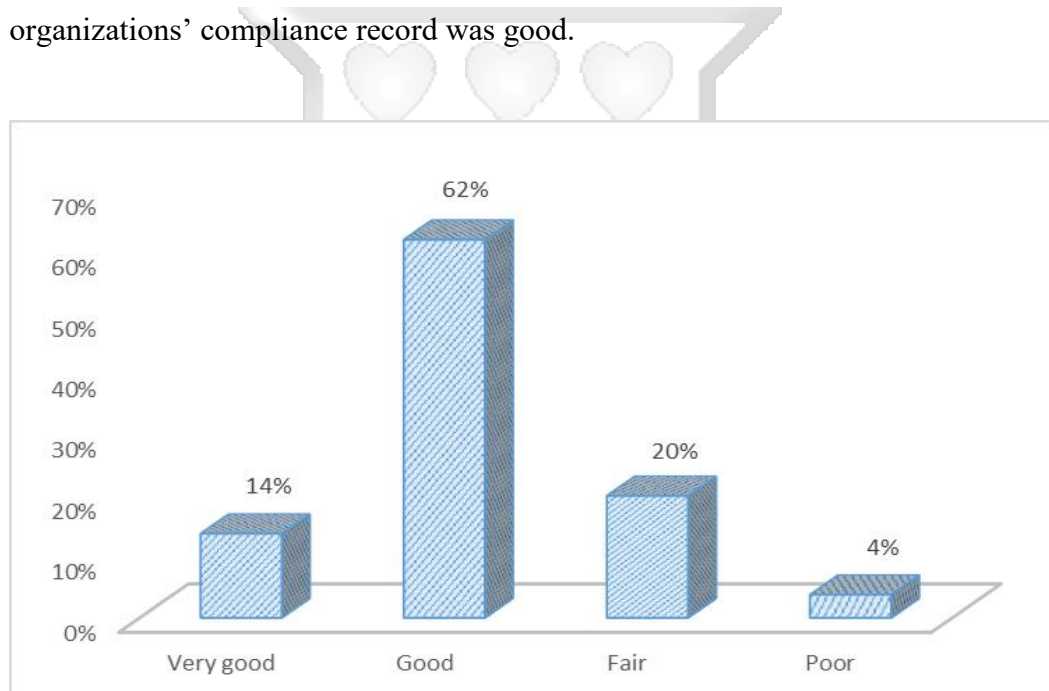


Figure 4.9 Rating of Compliance Record

Figure 4.10 below represents the rating of compliance by sector. Amongst those employees who perceived their organizations as very good with compliance record was the Banking sector followed by manufacturing sector. Out of the 62% who rated compliance as good, 36% came from the Agricultural sector followed by employees of the Energy sector (24%). The 20% who rated compliance as fair were fairly

distributed amongst all the five sectors. Finance and Energy sectors did not have any employees who perceived those organizations had poor compliance records.

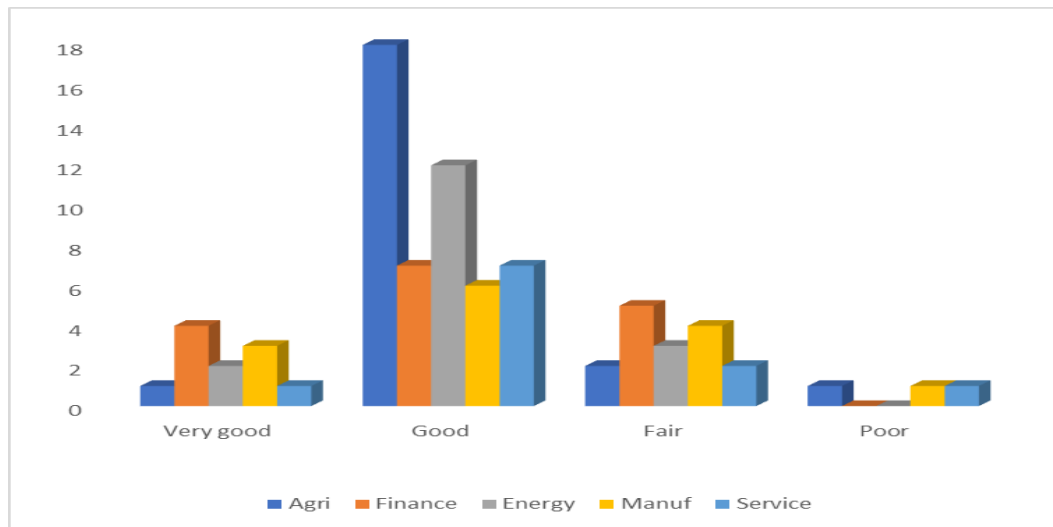


Figure 4.10 Rating of Compliance Record by Sector

4.7.2 Level of agreement with statements relating to Compliance of Financial Operations

This was in relation to the objective of employees' perception on the relationship between compliance of financial operations and firm performance. The respondents were requested to indicate their level of agreement to the statements below using a scale of 1 to 5, where 1 represented strongly disagree, 2- disagree, 3- moderate agree, 4- Agree, 5- Strongly agree. The researcher took the mean of all the responses in each statement. In instances where the mean was less than 4 but more than 3.5 this was taken to represent agreement with the statements. Table 4.9 shows the findings as far as level of the respondents' agreement with statements relating to compliance of financial operations. According to the findings, most of the respondents agreed that auditors in the organizations evaluated compliance programs with the aim of ensuring that the organizations were meeting regulatory requirements as evidenced by a mean score of 4.28. They also agreed that audit processes were in accordance with company formal policies and procedures and that auditing was done in the organizations to identify audit and reporting requirements specified in the audit requirement that were supplementary to the generally accepted standards and

performance procedures as shown by mean scores of 4.15 and 4.11 respectively. Further the respondents agreed that critical plan operations were tested to compare the organizations' actual operation to the governing plan documents and that internal audit followed set standards by audit committee as evidenced by mean scores of 3.96 respectively. Similarly, the respondents agreed that compliance was an act by the auditors, aimed at obtaining evidence that the organizations had operated within set control system as shown by a mean score of 3.94. The respondents also agreed that the organizations had complied in all material respects with the applicable compliance requirements as evidenced by a mean score of 3.94.

Table 4.9 Level of agreement with statements relating to Compliance of Financial Operations

| Statements | Mean | Std. Dev |
|---|-------------|-----------------|
| Compliance, evidence that the org has acted within set systems | 3.94 | 0.460 |
| Auditors, ensuring that the org is meeting regulatory requirement | 4.28 | 0.573 |
| Comparing the org actual operation to the governing plan documents | 3.96 | 0.683 |
| Internal audit follows set standards by audit committee | 3.96 | 0.665 |
| The org has complied with all the applicable compliance requirements | 3.94 | 0.643 |
| Auditing is done in the org to identify audit and reporting requirement | 4.11 | 0.711 |
| Audit processes in accordance with formal policies and procedures | 4.15 | 0.576 |

4.8 Financial Performance

4.8.1 Rate of the Organization's Performance

According to the findings as illustrated in table 4.10, most of the respondents rated the performance of the organization with respect to revenue as good as shown by a mean score of 4.13 and also rated the performance with respect to balance sheet strength and profitability as good as evidenced by mean scores of 4.06 and 4.01 respectively. This implies that the performance of the organizations on revenue, balance sheet strength and profitability was good.

Table 4.10 Rate of the Organization's Financial Performance

| Financial Aspects | Mean | Std. Deviation |
|--------------------------|-------------|-----------------------|
| Revenue | 4.13 | 0.582 |
| Profitability | 4.01 | 0.562 |
| Balance sheet strength | 4.06 | 0.581 |

4.8.2 General Performance of the Organization

The findings as shown in Table 4.11 below, show that 21.2% of the respondents indicated that the performance was excellent, majority (66.3%) indicated that the performance of the organizations was good while 12.5% indicated that the performance of the organizations was average. This depicts that the performance of the organizations was perceived to be good.

Table 4.11 General Performance of the Organization

| Rating | Frequency | Percent |
|---------------|------------------|----------------|
| Average | 10 | 12.5 |
| Good | 53 | 66.3 |
| Excellent | 17 | 21.2 |
| Total | 80 | 100.0 |

Figure 4.11 below represents the perception of employees towards organization performance. It shows that organization performance mainly perceived as good. The Agriculture employees mainly perceived their organization performance as average and good while employees of Finance, Energy and Services sectors perceived the performance of their organizations as mainly good and excellent. The perception of manufacturing employees was fairly spread across the three categories with a higher tendency towards good performance.

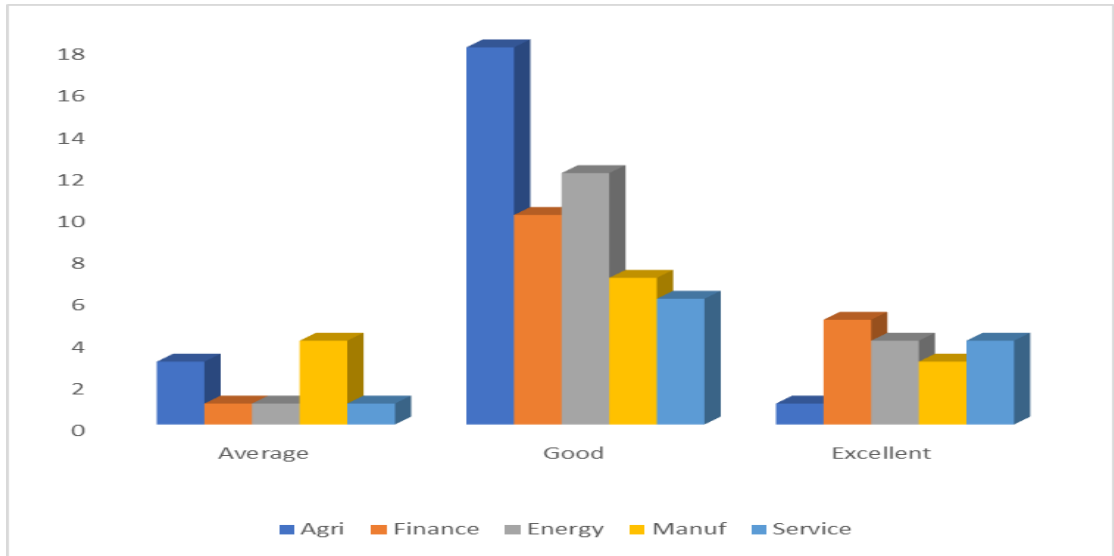


Figure 4.11 General Performance of the Organization by Sector

4.9 Inferential Analysis

4.9.1 Coefficient of Correlation

To compute the correlation (strength) between the study variables and their findings the researcher used the Pearson's coefficient of correlation (R). From the study findings, there was a strong positive correlation between firm performance (dependent variable) and reporting reliability, operational efficiency and compliance of financial operations (independent variables) as shown by Pearson Correlation r values more than 0.5. As shown in table 4.12, it was clear that there was a positive correlation between firm performance and reporting reliability as shown by a correlation figure of 0.523. It was also clear that there was a positive correlation between firm performance and operational efficiency with a correlation figure of 0.614 and finally, that there was also a positive correlation between firm performance and compliance of financial operations with a correlation value of 0.7460.

There was no multi co-linearity problem.

Table 4.12 Coefficient of Correlation

| | | Firm Performance | Reporting Reliability | Operational Efficiency | Compliance of Financial Operations |
|---|-----------------|-----------------------------|----------------------------------|-----------------------------------|---|
| Firm Performance | Coefficient | 1 | | | |
| | Sig. (2-tailed) | | | | |
| Reporting Reliability | Coefficient | .523 | 1 | | |
| | Sig. (2-tailed) | .0032 | | | |
| Operational efficiency | Coefficient | .6140 | .3421 | 1 | |
| | Sig. (2-tailed) | .0021 | .0014 | | |
| Compliance of Financial operations | Coefficient | .7460 | .1240 | .0621 | 1 |
| | Sig. (2-tailed) | .0043 | .0120 | .0043 | |

4.9.2 Regression Analysis

Further the researcher conducted a simple regression analysis so as to determine the influence of internal control activities on firm performance of selected public organizations in Kenya.

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 (firm performance) that is explained by all the three independent variables (reporting reliability, operational efficiency and compliance of financial operations).

The three independent variables that were studied, explain only 83.4 percent of the firm performance of the selected public organizations as represented by the adjusted

R². This therefore means that other factors not studied in this research contribute 16.6 percent of the firm performance of selected public organizations. Therefore, further research should be conducted to investigate the other factors (16.6 percent) that influence the firm performance of selected public organizations.

Table 4.13 Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------|----------|-------------------|----------------------------|
| 1 | 0.913 | 0.834 | 0.751 | 0.4538 |

4.9.3 Regression Coefficient

Simple regression analysis was conducted to determine the relationship between firm performance of selected public organizations and the three independent variables. As per the SPSS generated table 4.14, the equation

($Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \epsilon$) becomes:

$$Y = 1.308 + 0.558X_1 + 0.731X_2 + 0.785X_3$$

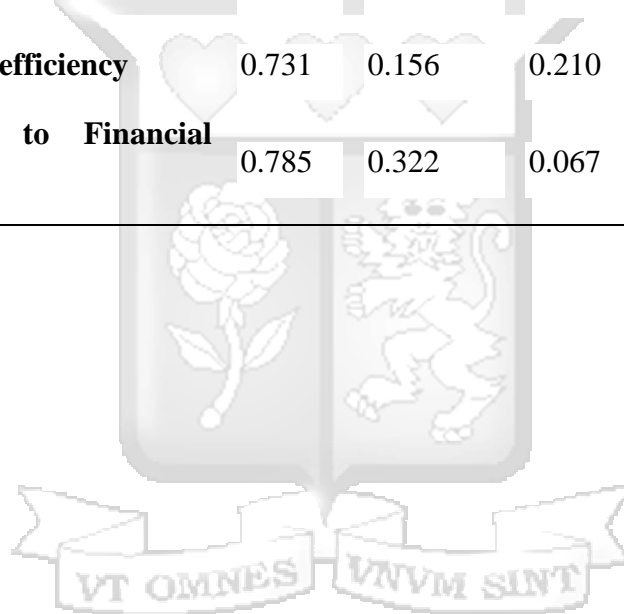
The regression equation above has established that taking all factors into account (reporting reliability, operational efficiency and compliance of financial operations) constant at zero, firm performance of selected public organizations will be 1.308. The findings presented also shows that taking all other independent variables at zero, a unit increase in reporting reliability will lead to a 0.558 increase of firm performance of the selected public organizations; a unit increase in operational efficiency will lead to a 0.731 increase of firm performance of the selected public organizations; and a unit increase in compliance of financial operations will lead to a 0.785 increase in firm performance of the selected public organizations. This means that compliance of financial operations contributes most to firm performance of public organizations followed by operational efficiency while reporting reliability contributed the least to firm performance of selected public organizations.

At 5% level of significance and 95% level of confidence, reporting reliability had a 0.0285 level of significance; operational efficiency showed a 0.0276 level of significance; and compliance of financial operations showed a 0.0202 level of significance hence the most significant factor. This implies that all the three

independent variables (reporting reliability, operational efficiency and compliance of financial operations) significantly affected the dependent variable (firm performance).

Table 4.14 Regression Coefficients

| Model | Unstandardized Coefficients | | Standardized Coefficients | | |
|---|-----------------------------|------------|---------------------------|-------|-------|
| | B | Std. Error | Beta | T | Sig. |
| (Constant) | 1.308 | 1.342 | | 1.623 | 0.357 |
| Reporting Reliability | 0.558 | 0.310 | 0.172 | 4.342 | .0285 |
| Operational efficiency | 0.731 | 0.156 | 0.210 | 3.532 | .0276 |
| Compliance to Financial operations | 0.785 | 0.322 | 0.067 | 3.542 | .0202 |



CHAPTER FIVE: DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of the data findings on the influence of employee perception on the relationship between internal controls and firm performance of selected public organizations in Kenya. The conclusions and recommendations are drawn there to. The chapter is structured into summary of findings, conclusions, recommendations and area for further research.

5.2 Discussions

The objectives of this study were to establish employees' perception on the relationship between internal controls and firm performance for selected public organizations in Kenya; to establish the relationship between operational efficiency and firm performance; relationship between the reporting reliability and firm performance and relationship between the compliance of financial operations and firm performance in selected public organizations in Kenya.

5.3 Internal Control Operations and Activities

On the control activities practiced by the organizations, the study established that the organizations had clear separation of roles. Corrective action was taken to address weaknesses, and that staff are trained to implement the accounting and financial management systems. In addition, the organizations had a well-developed chart of accounts and their security system identified and safeguarded the organizations' assets. The study also found that it was impossible for one staff to have access to all value information without the consent of senior staff; that objectives established by management were realistic; that departments had budget reviews where actual expenditure was compared with budgeted expenditure and explanations for the variances given and that every employee's work checked on the other. All personnel understood and adhered to the company code of conduct and controls were in place to exclude incurring expenditure in excess allocated funds.

5.4 Reporting Reliability and Firm Performance

On reporting reliability, the study established that all employees understood the concept and importance of internal controls including the division of responsibility, that there was a smooth flow of information from personnel to internal audit and that reliability of information was considered to be related to company information systems. This is in line with Holt and DeZoort (2009) who indicated that since internal auditors are expected to check all the organizational controls and report on them, objectivity in the reporting should not be compromised. This is because reports that are not objective would raise disputes and discontent among the organizational members which would affect the performance of the organization as a whole.

In addition, the study found that; company's information system was accessible by internal audit staff; that information flow in various departments was considered reliable and that communication helped to evaluate how well guidelines and policies of the organization were working and implemented. This is in line with Stewart and Subramaniam (2010) who stipulated that having reports with verifiable and supporting documents is important in ensuring that the credibility of internal audit is not compromised. This ensures that the internal audit function provides reports that are not questioned by any organizational unit and thus effectively playing its role of advisory. The study also established that the reporting system on organizational structures spelt out all the responsibilities of each section/unit in the organization and that information flowing from personnel to internal audit was reliable. The study further established that management had identified individuals who were responsible for coordinating the various activities within the entities. The study further established that there was a positive correlation between firm performance and reporting reliability. This therefore means that the findings confirm strong staff perception on relationship between reporting reliability and firm performance in selected public organizations in Kenya.

5.5 Operational Efficiency and Firm Performance

On operational efficiency, the study established that risk identification under special circumstances was possible in the organizations and that internal audit was consulted when legitimacy of a transaction process was in question. This complies with

Wainaina (2011) who shows that as a substitute of its presence on the scene of operations, management must rely on internal control techniques to implement its decisions and to regulate the activities for which she would ultimately be responsible for. Further the study found out that frequency of internal audit procedures was proportional to perceived risk in each department and that internal audit personnel were qualified to effectively resolve issues arising during the auditing process. In addition, the study established that previous internal audit work was revisited in order to evaluate its effectiveness; that a single employee was able to process transactions from beginning to the end and that internal auditing job descriptions covered the internal auditing function well. This conforms to Swink *et al.*, (2005) that if internal aspects of a firm are primarily responsible for its financial performance variation, organizations are expected to make changes based on finest operational practices to their structural and infrastructural elements in order to attain selected performance goals. Similarly, the study found out that there existed integrated procedures for evaluating risks; that established internal control systems was able to detect illegal activities within the companies and that audit objectives were linked to and supported company's strategies. Further the study found out that there was a positive correlation between firm performance and operational efficiency.

5.6 Compliance of Financial Operations and Firm Performance

On compliance of financial operations, the study found out that the organizations' compliance record was good. This finding concurs with Cadbury report of 1992 that recommended that listed companies should comply with the Code of Best Practice. This further follows Fasterling (2012) who asserted, that company performance is enhanced when regulations and guidelines have been adhered to mainly because potential investors and regulators consider compliance to be very vital. In addition, the study established that, auditors in the organizations evaluated compliance programs with the aim of ensuring that the organizations were meeting regulatory requirements. This is in line with the findings of Fasterling (2012) that pressure from the regulatory authorities will encourage firms to comply with voluntary codes of best practice.

The study also established that audit processes were in accordance with company formal policies and procedures and that auditing was done in the organizations to identify audit and reporting requirements specified in the audit requirement that were supplementary to the general accepted standards and performance procedures. Further the study found out that critical plan operations were tested to compare the organizations' actual operation to the governing plan documents and that internal audit followed set standards by audit committee. This agrees to Kole and Lehn, (2011) assertion that the Accounting profession, through the issuance of standards, provides direction and guidance on how firms could achieve the goal of proper record keeping, transparency, uniformity, comparability and enhancing public confidence in financial reporting. This is because failure on the part of the firm to apply the requirements of accounting standards result in inconsistencies, lack of accountability, transparency, and distortions in financial reports, which in turn results in poor financial reporting practices and dissemination of accounting information that is of less value to any particular group of users.

Similarly, the study established that compliance was an act by the auditors, aimed at obtaining evidence that the organizations had operated within set control system and that the organizations had complied in all material respects with the applicable compliance requirements. The study also established that a positive correlation existed between firm performance and compliance of financial operations.

5.7 Employee Perception on Internal controls and Firm Performance

The study found that there was a strong positive correlation between employee perception on internal controls and firm performance. Firm performance is influenced by control measures in place within an organization. Employee perception on rules procedure and regulations influence the way they think and perform. It forms the organization culture 'the way things are done around here'. Important processes like performance appraisals and budget variance are control measures that put in place check and balances in the system and impact directly on employee perception. Properly conducted performance appraisal assure employees that they will be rewarded based on merit, this justifies their resolve to maintain strong performance that include application of control measures. Further, monitoring

budgets through budget variance reporting, a tool used by employees in authority keeps employees in check on spends. A positive correlation is therefore expected between employees' perception on internal controls and firm performance.

Employee perception plays an important role in ensuring that internal controls systems are effective. Internal controls on the other hand directly affect firm performance.

5.8 Conclusions

Based on the findings, the study concluded that there was a general strong employees' perception that there was a relationship between internal controls and firm performance. This was brought out by the fact that there were well laid out internal control systems which were well understood by organization staff. Staff roles were well laid out and trained to implement accounting and financial management systems. It was also concluded from the study that organization security system was well identified and safeguarded the organizations' assets. Authorization levels and limits were well adhered to and effective, budget controls were in place and objectives established by management were realistic.

On reporting reliability, the study concluded that reliable reporting directly impacted on firm performance. It was noted that all employees understood the concept of division of responsibility and reliability of information was related to company information systems. The study also found that company's reporting system on organizational structures spelt out clear responsibilities of each section in the organization and identified individuals who were responsible for coordinating the various activities within the entities.

The study further concluded that operational efficiency impacted on firm performance and audit objectives were linked to and supported company's strategies. Most staff perceived internal control systems within the organizations were able to detect illegal activities and felt that risk identification procedures and time allocated to perceived risky areas was adequate.

On compliance, the study concluded that the organizations' compliance record was good designed to ensure that the organizations were meeting regulatory requirements. Strict adherence to rules and regulations meant abiding by general

accepted standards and performance procedures. The impact on firm performance therefore is great as all companies' critical plan operations are tested and compared to the organizations' actual operation to the governing plan documents and internal audit followed set standards set by audit committee.

5.9 Recommendations

Based on the findings, the study recommends that the management of different organizations should come up with policies to guide internal controls in allocating, controlling and ensuring efficient utilization of resources, to achieve the overall corporate goals. The organizations should make internal changes based on best operational practices to attain selected performance goals.

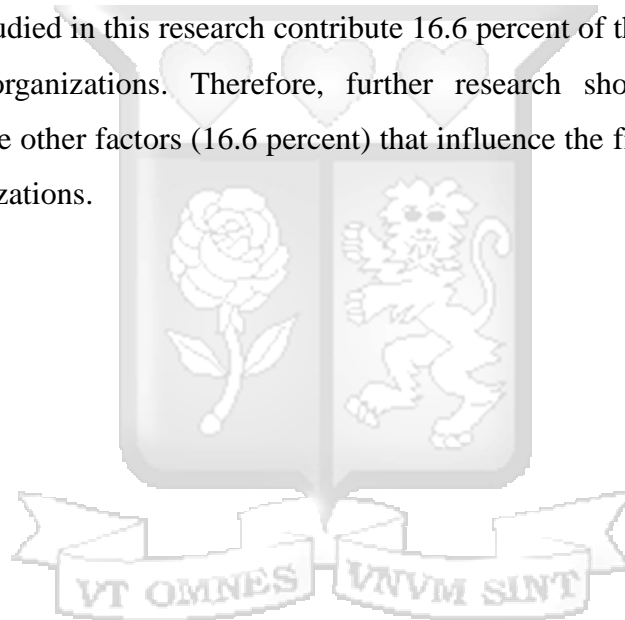
The study further recommends that the reports of the internal audit department should be factual and authenticate as this would increase the chance of appropriate action being taken by senior management. The organizations should also ensure completeness in reporting which will enable the various departments in the organizations to effectively have operations that add value to the organizations and thus influence the organizations' accountability, use of resources and performance. The organizations should continue complying with the Code of Best Practice in order to enhance investor confidence. The organizations should therefore not allow pressure from the regulatory authorities to compel them to comply with voluntary codes of best practice.

This study contributes to the body of knowledge both in methodology, theory and practice. In order to derive more valuable and broader conclusions, the methodology adopted in this research involved administering questionnaires across a wider range of quoted companies in various sectors, in order to increase the generalizability of the results. As lack of strong internal control system leads to poor performance among quoted companies, this research is of scholarly interest as it has further uncovered factors that lead to enhanced internal control systems. This is likewise true for the testing of a possible relation between internal control systems and firm performance. In the context of aspiring to bring out supplemental factors that enhance internal control systems, this study recommends that future studies should

examine the effect of corporate governance and moderating effect of government policy on firm performance.

5.10 Areas for Further Research

The study suggests that further research should be done on the influence of internal controls on firm performance of selected public organizations in Kenya. In carrying out the further research the study suggests that the study area be widened to cover other organizations from other counties and other public institutions for comparison purposes and to allow for generalization of findings. From the study findings it was clear that the three independent variables that were studied, explained only 83.4% of the firm performance of the public organizations. This therefore means that other factors not studied in this research contribute 16.6 percent of the firm performance of the public organizations. Therefore, further research should be conducted to investigate the other factors (16.6 percent) that influence the firm performance of the public organizations.



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APPENDIX 1: LETTER OF INTRODUCTION

Dear Respondent,

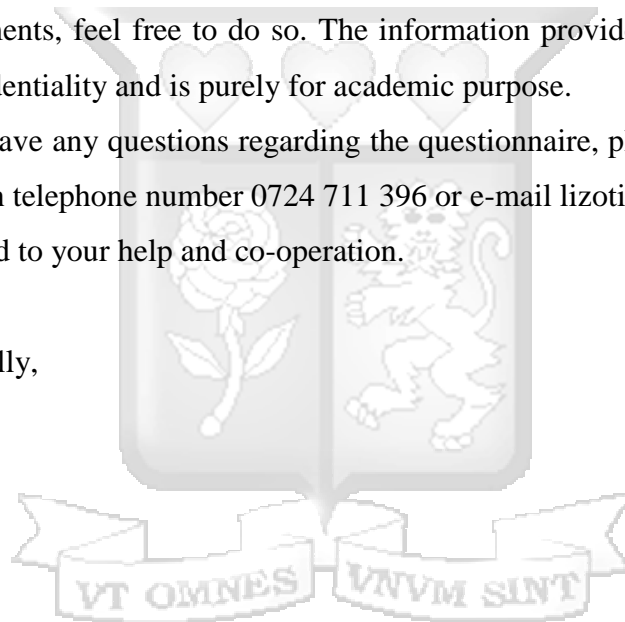
I am an MBA student at Strathmore Business School, Strathmore University. I am currently undertaking my research titled “Employee Perceptions on the relationship between internal controls and Firm Performance in Kenya”. The attached questionnaire is for gathering data, which will be useful in the research project.

Your responses are important in enabling me to obtain a full understanding of this subject matter. The decision however to take part is entirely voluntary. I therefore request you to kindly answer the questions in the spaces provided. If you wish to add further comments, feel free to do so. The information provided will be treated with utmost confidentiality and is purely for academic purpose.

Should you have any questions regarding the questionnaire, please do not hesitate to contact me on telephone number 0724 711 396 or e-mail lizotiob@gmail.com.

I look forward to your help and co-operation.

Yours faithfully,



| | | | | | | |
|----|---|--|--|--|--|--|
| 4 | Staff are trained to implement the accounting systems and processes | | | | | |
| 5 | It is impossible for one staff to have access to all valuable information without the consent of senior staff | | | | | |
| 6 | Our organization has a well-developed Chart of Accounts | | | | | |
| 7 | Controls are in place to exclude incurring expenditure in excess allocated funds | | | | | |
| 8 | Departments have budget reviews where actual expenditure is compared with budgeted expenditure and explanations for the variances given | | | | | |
| 9 | Our security system identifies and safeguard organizational Assets | | | | | |
| 10 | Objectives established by Management are realistic | | | | | |
| 11 | All personnel understand and adhere to company codes of conduct | | | | | |

Part C: Reporting Reliability

8. On average how many cases of errors were reported in a year over the past three years?

- 3 cases and below 4 to 6 cases
 7 to 9 cases 10 cases and above

9. What has been the total magnitude of the errors reported during the last three years?

- Less than 35% of turnover 35% to 65% of turnover
 Over 65% of turnover

10. Kindly indicate your level of agreement with the following statements relating to reporting reliability (1- Strongly disagree, 2- disagree, 3- moderate agree, 4- Agree, 5- Strongly agree).

| | | | | | | |
|--|--|----------|----------|----------|----------|----------|
| | | 1 | 2 | 3 | 4 | 5 |
|--|--|----------|----------|----------|----------|----------|

| | | | | | | |
|---|--|--|--|--|--|--|
| 1 | Management has identified individuals who are responsible for coordinating the various activities within the entity | | | | | |
| 2 | All employees understand the concept and importance of internal controls including the division of responsibility | | | | | |
| 3 | Communication helps to evaluate how well guidelines and policies of the organization are working and being implemented | | | | | |
| 4 | The reporting system on organizational structures spells out all the responsibilities of each section/unit in the organization | | | | | |
| 5 | There is a smooth flow of information from personnel to internal audit | | | | | |
| 6 | Information flowing from personnel to internal audit is reliable | | | | | |
| 7 | Company's information system is accessible by internal audit staff | | | | | |
| 8 | Information from various departments is considered reliable | | | | | |
| 9 | Reliability of information is considered to be related to company information systems | | | | | |

Part D: Operational Efficiency

11. On average how many cases of operation inefficiencies were discovered in a year over the past three years?

3 cases and below []

4 to 6 cases []

7 to 9 cases []

10 cases and above []

12. Kindly indicate your level of agreement with the following statements relating to efficiency of operations (1- Strongly disagree, 2- disagree, 3- moderate agree, 4- Agree, 5- Strongly agree).

| | | 1 | 2 | 3 | 4 | 5 |
|----|--|---|---|---|---|---|
| 1 | Audit objectives are clearly linked to and support Company's strategies | | | | | |
| 2 | Risk identification under special circumstances is possible | | | | | |
| 3 | Previous internal audit work is revisited in order to evaluate its effectiveness | | | | | |
| 4 | A single employee is able to process transactions from beginning to the end | | | | | |
| 5 | There exists an integrated procedure for evaluating risks | | | | | |
| 6 | Frequency of internal audit procedures is proportional to perceived risk in each department | | | | | |
| 7 | Established internal control systems is able to detect illegal activities within the company | | | | | |
| 8 | Internal audit is consulted when legitimacy of a transaction process is in question | | | | | |
| 9 | Internal audit personnel are qualified to effectively resolve issues arising during the auditing process | | | | | |
| 10 | Internal audit job descriptions cover the internal auditing function well | | | | | |

Part E: Compliance of Financial Operations

13. How do you rate compliance record (adherence to rules & regulations?)

Very good [] Good [] Fair []
 Poor [] very poor []

14. Kindly indicate your level of agreement with the following statements relating to compliance of financial operations (1- Strongly disagree, 2- disagree, 3- moderate agree, 4- Agree, 5- Strongly agree).

| | | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|---|
| 1 | Compliance is an act by the auditor, aimed at obtaining | | | | | |

| | | | | | | |
|---|--|--|--|--|--|--|
| | evidence that the organization has operated within set control systems | | | | | |
| 2 | Auditors in the organization evaluates compliance programs with the aim of ensuring that the organization is meeting regulatory requirements | | | | | |
| 3 | Critical plan operations are tested to compare the organization's actual operation to the terms of the governing plan documents. | | | | | |
| 4 | Internal audit follows set standards by audit committee | | | | | |
| 5 | The organization has complied in all material respects with the applicable compliance requirements | | | | | |
| 6 | Auditing is done in the organization to identify audit and reporting requirements specified in the audit requirement that are supplementary to the generally accepted standards and perform procedures to address those requirements | | | | | |
| 7 | Audit processes are in accordance with company formal policies and procedures | | | | | |

Part F: Financial Performance

15. How would you rate the performance of your organization in the following perspectives?

| | Very poor | Poor | Average | Good | Excellent |
|------------------------|-----------|------|---------|------|-----------|
| Revenue | | | | | |
| Profitability | | | | | |
| Balance sheet strength | | | | | |

16. In general, how would you rate the performance of the organization using the following scale?

Poor [] Average []
 Good [] Excellent []

APPENDIX 3: FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE

(Sampled Companies in Blue)

AGRICULTURAL

1. Eaagads Ltd
2. Kapchorua Tea Co. Ltd
3. [Kakuzi](#)
4. [Limuru Tea Co. Ltd](#)
5. Rea Vipingo Plantations Ltd
6. [Sasini Ltd](#)
7. Williamson Tea Kenya Ltd

AUTOMOBILES AND ACCESSORIES

8. Car and General (K) Ltd
9. Sameer Africa Ltd
10. Marshalls (E.A.) Ltd

BANKING

11. [Barclays Bank Ltd](#)
12. CFC Stanbic Holdings Ltd
13. I&M Holdings Ltd
14. Diamond Trust Bank Kenya Ltd
15. Housing Finance Co Ltd
16. [Kenya Commercial Bank Ltd](#)
17. National Bank of Kenya Ltd
18. NIC Bank Ltd
19. Standard Chartered Bank Ltd
20. [Equity Bank Ltd](#)
21. The Co-operative Bank of Kenya Ltd

COMMERCIAL AND SERVICES

22. Express Ltd
23. Kenya Airways Ltd
24. Nation Media Group

- 25. Standard Group Ltd
- 26. TPS Eastern Africa (Serena) Ltd
- 27. Scangroup Ltd
- 28. Uchumi Supermarket Ltd
- 29. Hutchings Biemer Ltd
- 30. Longhorn Kenya Ltd

CONSTRUCTION AND ALLIED

- 31. Athi River Mining
- 32. Bamburi Cement Ltd
- 33. Crown Berger Ltd
- 34. E.A.Cables Ltd
- 35. E.A.Portland Cement Ltd

ENERGY AND PETROLEUM

- 36. KenolKobil Ltd
- 37. Total Kenya Ltd
- 38. KenGen Ltd
- 39. Kenya Power & Lighting Co Ltd
- 40. Umeme Ltd

INSURANCE

- 41. Jubilee Holdings Ltd
- 42. Pan Africa Insurance Holdings Ltd
- 43. Kenya Re-Insurance Corporation Ltd
- 44. Liberty Kenya Holdings Ltd
- 45. British-American Investments Company (Kenya) Ltd
- 46. CIC Insurance Group Ltd

INVESTMENT

- 47. Olympia Capital Holdings ltd
- 48. Centum Investment Co Ltd
- 49. Trans-Century Ltd

MANUFACTURING AND ALLIED

- 50. B.O.C Kenya Ltd
- 51. British American Tobacco Kenya Ltd

- 52. Carbacid Investments Ltd
- 53. East African Breweries Ltd
- 54. Mumias Sugar Co. Ltd
- 55. Unga Group Ltd
- 56. Eveready East Africa Ltd
- 57. Kenya Orchards Ltd
- 58. A.Baumann CO Ltd

TELECOMMUNICATION AND TECHNOLOGY

- 59. Safaricom Ltd

GROWTH ENTERPRISE MARKET SEGMENT

- 60. Home Afrika Ltd
- 61. Flame Tree Group Holdings Ltd
- 62. Kurwitu Ventures
- 63. Atlas Development and Support Services

Date: Dec 2015

Source: Nairobi Securities Exchange

