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EVALUATION OF RISK CONTROL ON FINANCIAL PERFORMANCE OF STATE CORPORATIONS IN KENYA

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Abstract

The use of effective internal control systems (ICS) is deemed crucial in the management of business resources. Internal control systems have been so significant to public organization especially in the aspect of assurance of the reliability and accuracy of the financial reports. For performing the internal audit function, the management may set up a separable internal audit department or it may engage professional accountants to perform internal audit. The study used descriptive research with a target population comprised of the 187 public organizations in Kenya. Simple random sampling method was used to sample 56 per cent respondents in the selected corporations. The study used a questionnaire to collect data from the respondents and secondary data was collected from published material, annual reports, and published data. Data collected was analyzed by the use of descriptive statistics which includes percentages, means, standard deviations and frequencies. To quantify the strength of the relationship between the variables, the researcher conducted a regression analysis and found that risk controlaffect the financial performance of state corporations to a great extent. In addition, identification of operational issues and internal processes affect the financial performance of state corporations to moderate extentswhile risk control contributes immensely to the financial performance of the state corporations in Kenya. The study recommends that the management of state corporations and other public institutions should develop a risk control mechanisms and incorporate relevant feedback from the various stakeholders into their internal control system.

***Keywords*: Evaluation, Risk, Control, Financial Performance**

INTRODUCTION

Internal control systems have drawn considerable attention in the Kenyan context. According to Wainaina (2011), in a study on Internal control function of The Kenya Polytechnic University College, the study shows that as a substitute of its appearance on the scene of operations, management must rely on internal control techniques to implement its decisions and to regulate its activities for which it is ultimately responsible for. The use of effective internal control systems (ICS) is therefore deemed crucial in the management of business resources. According to a study by Nyakundi, Nyamita and Tinega (2014) on the impact of internal control systems on financial performance of small and medium scale business enterprises in Kisumu City, the study revealed that, there has been disagreement as to why there is a decreasing business survival trend among Small and Medium scale Enterprises regardless of government's assurance to accessibility of funds. Economic Survey 2009 statistics show a remarkable growth of small and medium scale Enterprises in Kenya over the last ten years; constituting about 96 per cent of all business enterprises in the country; yet 90% of the business start-ups do not function past their third anniversary. Using a descriptive method, the sample was selected from the study population through stratified and simple random sampling techniques. The study established that a substantial transformation in financial performance is related to internal controls systems.

A study by Hassan (2014), explored the challenges effecting internal control systems in Non-Governmental Organizations (NGO) in Kenya. The study used Faith-Based Organizations (FBO) in Coast Region as a case study site. From a desk search method, the study recognized that FBOs in coast region commonly relies on traditional and informal control structures to meet their welfare agendas. Formal internal control systems as practiced in the corporate world have not fully been applied in the FBOs control systems. However, management controls that incorporate internal controls and traditional welfare goals are thought as a suitable beginning point in the move regarding running in a more modest NGO sector and FBOs are not an exception.

Statement of the problem

Upholding effective internal control systems in organizations has been insistently and vastly emphasized, owing to its potential effect on financial performance (Crawford, 2011). The internal controls are applied to ensure that there are conducted procedures in the institutions and that risk is under control. According to Posthuma (2013) internal control systems have been so significant to public organization especially in the aspect of assurance of the reliability and accuracy of the financial reports. Similarly, according to Verdina (2011) internal control systems are used by public organizations as a basis for establishing a solid control framework for these entities, and by the controllers of the public sector as a means for assessing the internal control system. Despite the importance of internal control systems, it is not very clear on how risk control affect financial performance of state corporations. According to Muraleetharan, 2013, in a study on control activities and performance of organizations, a positive relationship between control activities and performance was recognized.

Research objective

To evaluate the influence of risk control on the financial performance of state corporations in Kenya

LITERATURE REVIEW

Reliability Theory

Reliability theory offered by Gavrilov & Gavrilova (2001) mainly defines the likelihood of a system affecting its anticipated purpose during a period. It was initially an instrument used to aid the nineteenth century maritime insurance and life insurance companies in calculating lucrative rates to bill their customers (Gavrilov & Gavrilova, 2001). In accordance to the reliability theory, an internal control system contains of elements that are interconnected and for each element, there requires to be a distinct degree of success. Therefore, the quality of an element is contingent on whether the element is successful or not successful. The dependability of an element is described as the possibility of the element being established in the 'success' state. Moreover, the dependability of the whole internal control system is a dual amalgamation with two possible values, success and failure. This study considered the part of the reliability theory which communicates the internal control system element reliabilities.

The controllability of reliability theory to the assessment and purpose of internal control systems are present in the professional literature but no practices have been stated that outline upon the much power of the theory of level of reliability (Kinney, 2000). The two possible potential users of the reliability theory are the external auditor and organization business managers. Kinney (2000) states that; throughout the external audit, proof is acquired to support an expert opinion. Internal control systems have a key resolve of valuation and control of threats; that an important error was not deterred or taken to be on a timely base by the system leaving losses. Insubstantial, internal control systems end up in more fundamental work and for this reason higher price. In harmony with to Gavrilov and Gavrilova (2001), the discovery of the "feebleness" of any internal control system is predominantly opinion-giving. Upon the invention of the process and system reliability estimates, comparison with facts from the organizations past performances or other firms may offer a firmer starting point for Judgment of the effect of an internal control system on the firm's income risk and therefore make ready for a more coherent allocation of the auditor's time and effort.

Messier and Austen (2000) state that one of the principal advantages of reliability theory is its close relationship to the auditor's needs concerning understanding the internal control system and control risk valuation. According to Stratton (2007), the value of management objective practices for the assessment of internal control systems have been enlarged by management recent expansions have enlarged the value to management. Consequently, firm managers are required to guarantee the precision of these systems. Stratton (2007) also enhances that the process of assessment of the internal control system by both management and external auditors is judgmental in nature. However, the limited efforts at forming internal control systems have not been affected by firms due to the lack of practicality, difficulty of forming behavioral systems, lack of cost effectiveness, and lack of understanding by practitioners.

Empirical review

The institutions' risk control support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned and that information doesn't land to the wrong hands.

Yang (2012) indicated that internal checks operate as part of the normal processing of transactions. Their purpose is to minimize errors and frauds and to detect them in a timely manner where they take place (Piper, 2008). An essential characteristic of the persons preparing internal verification procedures is independence from the individual originally responsible for preparing the data. For performing the internal audit function, the management may set up a separable internal audit department or it may engage professional accountants to perform internal audit, identify areas that are prone to risk and develop risk assessment tools. On the basis of internal auditor's examinations, he can report to the management on the relevant aspects giving his observations and suggestions (Chaney & Philipich, 2008).

This system is vital for entity to obtain and exchange the information in order to conduct, manage and govern its operation while the control activities are effected (Frazer, 2011). Information systems are also vital to guide in organization procedure process (Wardiwiyono, 2012). For instance, studies by Hanim *et al.* (2005) found that the better information and communication, the enhanced the performance of audit work which is the person in charge with audit work must identify, analyze, evaluate and record sufficient information to achieve desired objectives. For cooperative organizations, sufficient risk controls are required in order to obtain and transmit important cooperative information for decision making to the intended recipients, customer service and business operations (Weber, 2009).

Research Methodology

This research design adopted descriptive research chosen because the study aimed at collecting information from respondents. The target respondents were drawn from the public organizations in Kenya. The target population comprised of the 187 public organizations in Kenya. Simple random sampling method was used to sample 56 per cent respondents in the selected corporations. The study used a questionnaire to collect data from the respondents and secondary data was collected from published material, annual reports, and published data. Data collected was analyzed by the use of descriptive statistics which includes percentages, means, standard deviations and frequencies.

Data Analysis, Presentation, and Interpretation

The response rate achieved for the questionnaire was 86.0%. This response rate was a representative and conforms to Mugenda and Mugenda (2012) stipulation that a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent.

The study sought to establish the extent to which risk control relate to the financial performance of the state corporations in Kenya. From the study, 45.7% of the responses indicated that risk control influenced financial performance of their organizations to a great extent, 32.6% of them indicated to a moderate extent, 17.4% of the respondents to a very great extent, while 4.3% of the respondents to a little extent. These results imply that risk control contributes immensely to the financial performance of the state corporations in Kenya.

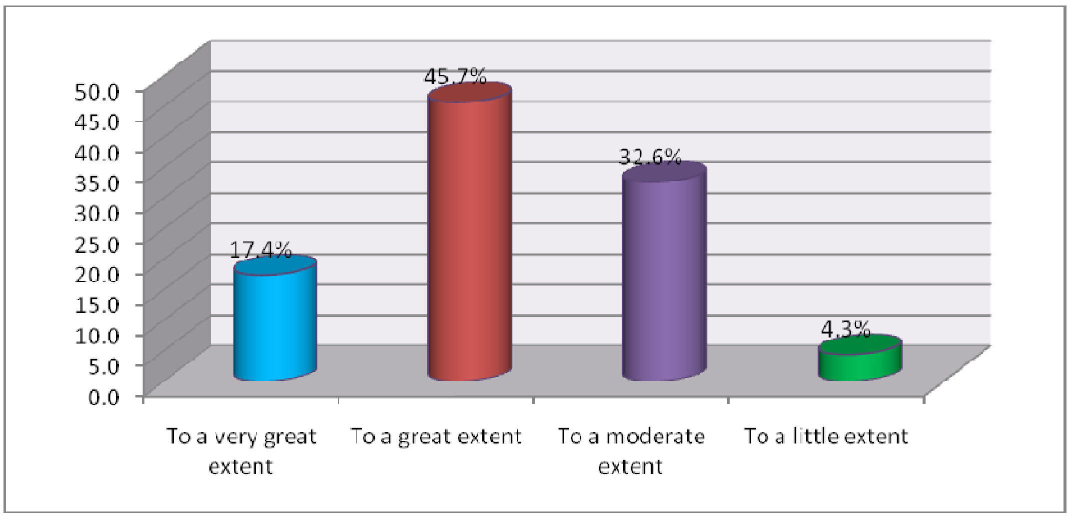

Figure 1: Risk control on financial performance

The study further sought to ascertain the extent to which various aspects of risk control influenced financial performance of state corporations in Kenya. A scale of 1 to 5 was provided where 1= no extent, 2= little extent, 3= moderate, 4= large extent and 5 is to a very large extent.

Table 1: Aspects of Risk Control

Aspects of risk control	Not all	Little Extent	Moderate Extent	Great Extent	Very great Extent	Mean	Std dev
Information and communication	0	3.2	45.8	45.8	5.2	3.5313	0.6481
Internal processes	0	10.4	44.8	33.3	11.5	3.4583	0.8325

Identification of operational issues	0.0	17.6	26.9	47.2	8.3	3.4630	0.8799

From the study, majority of the respondents indicated that information and communication influenced financial performance of their organizations to a great extent as shown by a mean score of 3.5313 while identification of operational issues and internal processes to moderate extents as shown by mean scores of 3.4630 and 3.4583 respectively. Information and communication, internal processes and identification of operational issues determines effectiveness of the organizations to identify, capture, process and report relevant and reliable information in a timely manner so that they can carry out their responsibilities effectively.

The study also sought to establish the extent to which the respondents agreed with various statements regarding the risk control. The results of this section are analyzed in line with a scale of 1 to 5 where 1 is strongly disagree, 2 is disagree, 3 is neutral, 4 is agree and 5 is strongly agree.

Table 2: Statement on Risk Control

Statements on risk controls	**Strongly Disagree**	**Disagree**	**Uncertain**	**Agree**	**Strongly agree**	**Mean**	**Std dev**
The corporations' information and communication channels support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned.	3.7	13.0	27.8	50.0	5.6	3.4110	0.1925
Information is the vehicle by which control policies, procedures are introduced and reinforced	0	3.1	49.0	43.8	4.2	3.4940	0.6323
Communication enable employees to become aware of management's commitment to internal controls	0	27.1	6.8	41.4	22.6	3.5320	1.1772

Reliable and relevant information from both internal and external sources is communicated to everyone in the organization	0	3.1	44.8	45.8	6.3	3.5530	0.6628
Risk controls are implemented thoughtfully, conscientiously and consistently for them to be useful	0	3.1	44.8	45.8	6.3	3.5530	0.6628

Based on the results as tabulated in Table 2 most of the respondents concurred that reliable and relevant information from both internal and external sources is communicated to everyone in the corporations as shown by a mean score of 3.5530, risk controls are implemented thoughtfully, conscientiously and consistently for them to be useful as shown by a mean score of 3.5530 and communication enable employees to become aware of management's commitment to internal controls as shown by a mean score of 3.5320. On the other hand, there was impartiality with that information is the vehicle by which control policies, procedures are introduced and reinforced as shown by a mean score of 3.4940 and the corporations' information and communication channels support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned as shown by a mean score of 3.4110. These results imply that communication and information-systems enable people in the organization to carry out their responsibilities, information is the vehicle by which control policies, procedures are introduced and reinforced and information be communicated throughout the corporations to permit personnel to carry out their responsibilities.

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

From the results, risk control affects the financial performance of the state corporations to a great extent. The study found that information and communication affect the financial performance of state corporations to a great extent. In addition, identification of operational issues and internal processes affect the financial performance of state corporations to moderate extents. There was agreement on that reliable and relevant information from both internal and external sources is communicated to everyone in the corporations, risk controls are implemented thoughtfully, conscientiously, and consistently for them to be useful and communication enable employees to become aware of management's commitment to internal controls. However, there was neutrality on that information is the vehicle by which control policies, procedures are introduced and reinforced and the corporations' information and communication channels support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned.

The study concludes that risk control contributes immensely to the financial performance of the state corporations in Kenya. This implies that information and communication, internal processes and identification of operational issues determines effectiveness of the corporations to identify, capture, process and report relevant and reliable information in a timely manner so that they can carry out their responsibilities effectively. The study revealed that communication and information-systems enable people in the organization to carry out their responsibilities, information is the vehicle by which control policies, procedures are introduced and reinforced and information be communicated throughout the corporations to permit personnel to carry out their responsibilities.

The study recommends that the management of state corporations and other public institutions should develop information and communication mechanisms to incorporate relevant feedback from the various stakeholders into their internal control system. A key issue of concern involves that authorities should develop and plan for constant seminars and workshops to train and educate auditors, accountants, and heads of departments on matters concerning current trends of control measures as well as proper application of accounting policies and procedures.

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