

**THE EFFECT OF INTERNAL CONTROLS ON FINANCIAL PERFORMANCE
OF PUBLIC UNIVERSITIES IN KENYA**

BY

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE
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DECLARATION

This is to declare that this research project is my original work that has not been presented to any other University or Institution of Higher Learning for examination.

Signed 

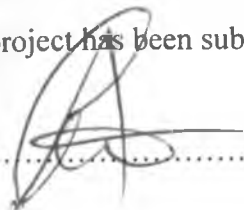
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SUPERVISOR'S DECLARATION

This research project has been submitted with my approval as the University Supervisor.

Signed 

Date 17/11/2011

ANGELA M. KITHINJI

DEDICATION

This study is dedicated to my mum Leah Waithira Nganga and dad, late George Nganga Wamunyu for instilling in me the importance of education, my loving family, dear wife Margaret and loving children Juliet, Josephine and Edwin for their support and sincere understanding during the period of my study.

ACKNOWLEDGEMENT

I thank the Almighty God for His guidance and providence which enabled me to undertake this project that was too involving in terms of time and resources.

I wish to express my sincere appreciation to my family for their understanding and support during the project. Further appreciation goes to the entire staffs of the public universities who I consulted during the study.

Lastly, I would also like to express my sincere thanks to the supervisor Angela M Kithinji for having agreed to supervise this research paper and patience in reading the drafts and occasionally guiding me, without which the research would not have been a reality.

ABSTRACT

Given the effect of internal controls on the financial performance of public universities in Kenya among many other developing countries, it is essential that these proper controls be put in place. The purpose of the study was to establish the effect of internal control on financial performance of public universities in Kenya.

The study used descriptive research design. The target population was all public universities in Kenya. A convenient sample was selected from staff working at all public universities with offices in Nairobi. The studies mainly focused on the heads of finance departments of the respective institutions, since they were the ones conversant with the internal control systems and their effects on financial performance of respective institutions. The data collection instrument was a questionnaire. The questionnaires were delivered to the selected respondents by visiting them in their places of work during which observations were done. Quantitative data collected was analyzed by descriptive statistics using SPSS and presented through percentages, means, standard deviations and frequencies. Content analysis was used on data that is qualitative nature or aspect of the data collected from the open ended questions.

The study concludes that assignment of authority was commensurate with responsibility to a great extent, assessment of risk associated with company-wide objectives was carried out to a great extent, mandatory authorization and approval of transaction by relevant officers was mandatory, periodic reports were made to top management of the institution to a great extent, presence of an effective internal audit facilitated monitoring of efficiency of operations, the institution faced challenges in its internal control systems. The study recommends that integrity and ethical values be held with high esteem, assessment of risk associated with company-wide objectives be carried out regularly so that the management can know whether or not the company objectives will be met, mandatory authorization and approval of transaction by relevant officers be made mandatory, periodic reports be made to top management of the institution. This is to ensure that errors are corrected in time. The study further recommends the institutions to put in place effective internal audit as it facilitates monitoring of efficiency of operations and the company's process for financial reporting be reviewed annually by the management.

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LIST OF ABBREVIATIONS /ACCRONYMS

AFFS	-	Annual reports and financial statements
CFO	-	Chief finance Officer
COSO	-	Committee of Sponsoring Organizations
CSFs	-	Critical success factors
KPIs	-	Key Performance Indicators
CEO	-	Chief Executive Officer
IFRS	-	International Financial Reporting Standards
GoK	-	Government of Kenya
SEC	-	Securities and Exchange Commission
ILOC	-	Internal Locus Of Control

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Internal control is a process effected by an organization board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of effectiveness and efficiency of operation, reliability of financial reporting and compliance with the applicable laws and regulations (Agrwal and Knoeber, 1996). When companies suddenly collapse, the often-resounding question is, “what went wrong?” A breakdown in the internal control system is the usual cause. Internal control is a process that guides an organization towards achieving its objectives. These objectives include operational efficiency and effectiveness, reliability of financial reporting, and compliance with relevant laws and regulations (AFFS 2010). Absence of these variables often results in organizational failure. The findings of the Treadway Commission Report of 2007 in the United States of America (USA) confirmed absence of, or weak, internal controls as the primary cause of many cases of fraudulent company financial reporting (Nahon, 2009).

Over the past decade, organizations have invested heavily in improving the quality of their internal control systems. They have made the investment for a number of reasons, notably: (1) good internal control is good business — it helps organizations ensure that operating, financial and compliance objectives are met, and (2) many organizations are required to report on the quality of internal control over financial reporting, compelling them to develop specific support for their certifications and assertions. (AFFS 2010). Internal control is designed to assist organizations in achieving their objectives. The five components of AFFS Internal Control which will be evaluated and compared with the financial performance are as follows: Control environment - an environment or culture where control is recognized and emphasized, Risk Assessment - the establishment of policies and procedures for risk assessment, Control Activities - the recognition that all activities require some measure of control, Accounting, Information and Communication Systems - the institution of accounting, information and communication systems

and Self-Assessment or Monitoring - the establishment of policies and procedures for self-assessment and monitoring.

1.1.1 Internal Controls

While the specific definition of internal control differs across the various models, a number of concepts are very similar across these models. In particular, the models emphasize that internal control is not only policies and procedures to help an organization accomplish its objectives but also a process or system affected by people. In these models, people are perceived to be central to adequate internal control (Rotter, (2006). These models also stress the concept of reasonable assurance as it relates to internal control. Internal control systems cannot guarantee that an organization will meet its objectives. Instead, internal control can only be expected to provide reasonable assurance that a company's objectives will be met. The effectiveness of internal controls depends on the competency and dependability of the organization's people. Limitations of internal control include faulty human judgment, misunderstanding of instructions, errors, management override of controls, and collusion. Further, because of cost-benefit considerations, not all possible controls were implemented. Because of these inherent limitations, internal controls cannot guarantee that an organization will meet its objectives (COSO, 2006).

The Committee of Sponsoring Organizations (COSO) of the Tread way Commission defines internal controls as “a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial information, and compliance with the applicable laws and regulations” (COSO, 1992). Though it is important for both business and not-for-profit organizations to establish internal controls to improve operating efficiency, issues pertaining to internal controls had not been extensively studied until after the passage of the Sarbanes-Oxley Act. Per Section 302 and Section 404 of the Sarbanes-Oxley Act, Securities and Exchange Commission (SEC) in the U.S. mandated the enterprises to disclose information on internal controls (SEC 2002, 2004), whereby researchers used publicly available data to empirically examine the determinants of internal control weakness (Khandwalla, (2002), and the association between internal controls and the financial performance (Grady, (1957).

Internal control is a multifaceted concept and has been defined in various ways in the management control literature. Mautz and White (1976) provide one of the narrower definitions of internal control. They view internal control as a part of the overall management control system comprising the measure taken by an organization to avoid errors and irregularities while operations are in progress. A broader definition is provided by Grady (1957) who views internal control as the plan of organization and the coordinated procedures used within an entity to Safeguard its assets from loss by fraud or errors, Check the accuracy and reliability of accounting data which management uses in decision making and Promote operational efficiency and encourage adherence to adopted policies in those areas in which the accounting and financial departments have direct or indirect responsibility. According to COSO (1992) internal control consists of all the measures and practices taken by an organization to mitigate exposure to risk and to provide management and other stakeholders with reasonable assurance that, everything is functioning as it should; and any deviations from desired operations are detected and corrected in a timely manner (COSO, 1992)

Gudpa and Arora (2002) identify two types of internal controls: accounting controls and administrative controls. They define accounting controls as those related to accounting system while the administrative control is defined as internal control other than the accounting controls. The system of internal control comprises of those elements of an organization (including its resources, systems, processes, culture and structure) that support people in the achievement of the organization's objectives. They facilitate the effective and efficient operation of companies, by enabling them to respond appropriately to significant risks. This includes safeguarding assets from loss and fraud, and ensuring that liabilities are identified and managed. Furthermore, they help to ensure the quality of internal and external reporting. Finally, internal controls help to ensure compliance with appropriate laws, regulations and intended policies (COSO Framework, 1992). Internal control is not solely a procedure or policy that is performed at a certain point in time. Rather, it is a continually operating, integrated system at all levels within an organization. It is the role of management to implement board policies on risk and internal control. In fulfilling its responsibility, management should identify and evaluate the risks faced by the company for consideration by the board, and it should design, operate and monitor a suitable system of internal control which implements the policies adopted by the board.

An internal control system consists of five interrelated components: Control environments, Risk assessment, Control activities, Information and communication and Monitoring (COSO, 1992). It is generally felt that all five components must be present for an internal control system to be considered effective. The control environment defines the tone of an organization and the way it operates. It concerns the establishment of an atmosphere in which people can conduct their activities and carry out their control responsibilities effectively. The higher-level administrators are responsible for establishing the appropriate control environment. Risk assessment is the process used by an organization to decide how it will deal with the risks that pose a threat to achieving its objectives. It entails the identification and prioritization of objectives, the identification of risk and assessment of their likelihood and impact. Control activities are policies and procedures implemented by an organization to ensure the management's directives are carried out. These activities permeate the entire organization, at all levels and in all functions. These activities are often grouped into the three categories of objectives to which they relate, namely, operations, financial reporting, and compliance.

1.1.2 Financial Performance

Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is used as a general measure of firm's overall financial health over a given period, and can be used to compare similar firms across the industry or to compare industries or sectors in aggregation. There are many different ways to measure financial performance but all measures should be taken into aggregation. Line items such as revenue from operations, operating income or cash flow from operations can be used, as well as total unit sales. Furthermore, the analyst or investors may wish to look deeper into financial statements and seek out margin growth rate or any declining debt (Jensen, (2001).

Performance is the outcome of all of the organization's operations and strategies (Jensen, (2001). Measuring financial performance accurately is critical for accounting purposes and remains a central concern for most organizations. Performance measurement systems provide the foundation to develop strategic plans, assess an organization's completion of objectives, and remunerate managers (Jensen and Meckling, (2006). Although assessment of performance in the marketing literature is still very important, it is also complicated (Pont and Shaw, 2003). While

consensual measurement of performance promotes scholarly investigations and clarify managerial decisions, marketers have not been able to find clear, current and reliable measures of performance on which marketing merit could be judged.

1.1.3 Internal Controls and Financial performance

This study examines the effect of internal controls on financial performance of public universities with special reference to university of Nairobi. Unlike business organizations where shareholders are the major class of stakeholders and profitability is the primary objective, public universities serve the society through delivering services and conducting research, and have a diffuse group of stakeholders. Thus, efficiency rather than profitability becomes an important measure of performance. In addition, relying on a focused class of stakeholders (e.g., shareholders) to monitor performance becomes less feasible because companies do not have alienable residual interest (Jensen and Meckling, (2006). As a consequence, internal controls are no less important for companies than for business organizations.

1.1.4 Public Universities in Kenya

A university is an institution of higher education and research, which grants academic degrees at all levels (Bachelor, Master and Doctorate), in a variety of subjects as guided by the university statutes. A university provides both tertiary and quaternary education. In Kenya, public universities are created under the Act of Parliament to carry out research using their variety of qualified staff in different disciplines. The primary purpose of research, outreach and extension constitute the basis on which research goals are set and measures by which fulfilment of these goals are established (Onsongo, 2007).

The privatization of parastatals and liberalization of the Kenya economy in the 1990s changed the competitive environment in which the service industries operated. This contributed to service industries repositioning themselves for the challenge and development of both strategic and performance objectives (Slack, 2007). Public universities, as other government institution and parastatals operate within such an environment and are therefore environment dependent. As a result of the liberation, turbulence in the economy and new government, policies, public universities have been undergoing changes to survive and compete effectively. There are seven Public Universities in Kenya namely: Jomo Kenyatta University of Agriculture and Technology,

Kenyatta University, University of Nairobi, Moi University, Maseno University, Egerton University and Masinde Muliro University (GoK, 2009).

In almost all African countries, public universities receive financial assistance from the government. The result is that the level of higher education facilities in Kenya has for long depended on the soundness of the national economic performance. From the 1980s, most African countries experienced financial constraints due to poor economic performance and rapid population growth, added to the need to provide other basic services like primary education, food and shelter. University education therefore, has faced severe competition from other sector for limited government funds. In recent years, government and international donors have challenged universities in Africa to justify their existence and their claims to the massive funds allocated to them (Abagi, 1999).

Initial performance of these institutions was encouraging however, with the implementation of economic reforms, discontinuation of price controls and liberalisation in the early 1990s performance of some of the state corporations spiralled downwards. In an effort to address these challenges resulting from poor and declining performance, the government undertook a number of initiatives such as staff rationalization program in state corporations civil service and statutory bodies, rationalisation of functions and structures of ministries, development of strategic plans and performance improvement program (GoK, 2005). In an effort to have a lasting and sustainable change in the way services are offered and manage performance in the public sector, the government introduced PC in the public sector, as a strategy for improving service delivery to Kenyans (GoK, 2005).

1.2 Problem Statement

During the past two decades, many organizations and specifically service sectors have faced dramatic changes in their business environment. Deregulation and change of requirements by the government combined with extensive competition in domestic markets has resulted in a situation where most companies are now competing in a highly competitive global market. At the same time, there has been a significant reduction in product life cycles arising from technological innovations and the need to meet increasingly discriminating customer demands. To compete

successfully in today highly competitive global environment, companies have made customer satisfaction an overriding priority hence have adopted new management approaches changed their systems and the issue of the Benefit Administrator Companies applying for the continuation of the business of offering services to the retirement benefit schemes on a yearly basis.

The changes have significant influence on internal control system. Little attention is therefore given to develop internal control systems, which can accurately measure costs and profitability of individual services. Due to privatization, deregulation of government-controlled companies resulted to intensive competition and expanding product range created the need for service organizations to focus on costs management and develop control systems that would enable them to understand their cost base and determine their sources of profitability for their products, customers and markets. A good number of people and institutions have suffered big losses because of poor control system in companies and their money getting lost through fraud and misuse of assets that are used to generate revenue. Inadequate controls have also led to corruption and collusion of management and external auditors leading to an organization not achieving its set objectives. With a proper internal control practices the author identifies efficiency and effectiveness that in turn makes it possible for the organization to achieve its objectives (Berle and Means, 2002).

Locally, some of the studies have been conducted in Kenya are evaluated of the internal controls of Ethiopian Airlines Branch office in Nairobi (Mohammed, 2003) and a case study of internal controls of Nyayo Bus Service Corporations in Nairobi (Esmailjee, 1993). Chira,(2009) researched on the analysis of internal controls systems in financial institution. The findings were that though various internal controls systems do exist in the banking industry more weight had been given to operational controls compared to other types of controls. There has been no research done on effects of internal control on performance of public universities. This study will therefore seek to answer the question what are the effects of internal control on financial performance of public universities in Kenya?

1.3 Research Objective

To establish the effect of internal control on financial performance of public universities in Kenya.

1.4 Significance of the Study

The results of the study would be useful to;

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

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

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

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

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

2.2 Theoretical orientation

The study by Berle and Means, (2002) on modern corporations gave rise to managerial models proposed by Williamson (2004) and the problems of discretionary managerial behaviour considered in this research led to the first contributions from the field of economics to agency theory. The contributions to agency theory from Jensen and Meckling (1992), which can also be considered classic contributions to organisational theory, will serve as fundamental references to develop this section. The way they describe the causes of the agency problem and procedures for controlling agency in organisations is an important contribution that can be explained satisfactorily in terms of relations and contents.

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

Control theory and experience suggests that a person who abuses a system of controls is more likely to act alone than to collude with another. According to Rotter (2006), internal locus of control (ILOC) versus external locus of control conceptualizes how individuals see their own actions affecting events that surround their lives. Individuals with ILOC tend to believe that events are the results of their own actions (Rotter, 2006), while individuals with external locus of control tend to attribute events to external environmental factors, such as powerful others or chance (Levenson, 2003).

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

According to Catton (2006) an individual's preferential behavior shows certain regularities and this pattern can be attributed to some standard or code, which persists through time. Values provide a basis by which people can order their intensities of desiring various desiderata (something desirable). Based on available choices, people make preferences grounded in their values. In an organizational context, knowledge of such preferences of individuals provides a context for managerial decision-making. Keeney (1992) argues that values are guiding principles to evaluate the desirability of a particular consequence. "Values are what we care about and they should be the driving force for our decision making (Keeney, 1992)".

Value is not a property of an object but is a quality of relationship (Catton, 2006,). A person's desire for something under a given situation depends on "selective perception" of that person. Selective perception directs valuation by substituting final goals with other intermediary goals i.e. a goal may be pursued in order to attain some higher ultimate goals. Thus the nature of the major goals accepted by individuals together with notions of ways in which these goals might be affected by future events, are the determinants of values of people. Value Theory provides a theoretical platform to affirm that values are important for decision making and incorporating values in developing decision objectives helps individuals accept the results of such decisions.

2.3 Internal control systems

Internal control is a multifaceted concept and has been defined in various ways in the management control literature. Mautz and White (1976) provide one of the narrower definitions of internal control. They view internal control as a part of the overall management control system comprising the measure taken by an organization to avoid errors and irregularities while operations are in progress. A broader definition is provided by Grady (1957) who views internal control as the plan of organization and the coordinated procedures used within an entity to: Safeguard its assets from loss by fraud or errors; Check the accuracy and reliability of accounting data which management uses in decision making; and Promote operational efficiency and encourage adherence to adopted policies in those areas in which the accounting and financial departments have direct or indirect responsibility. Recently, the diverse definitions of internal control were reviewed and the major elements synthesized by the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 1992). The COSO (1992) definition has since emerged as the most frequently cited in the internal control literature in the U.S and the English-Speaking countries. As a result, it is adopted in this study.

According to COSO (1992) internal control consists of all the measures and practices taken by an organization to mitigate exposure to risk and to provide management and other stakeholders with reasonable assurance that: Everything is functioning as it should; and any deviations from desire operations are detected and corrected in a timely manner (COSO, 1992) Gudpa and Arora (2002) identify two types of internal controls: accounting controls and administrative controls. They define accounting controls as those related to accounting system while the administrative control is defined as internal control other than the accounting controls.

The system of internal control comprises of those elements of an organization (including its resources, systems, processes, culture and structure) that support people in the achievement of the organization's objectives. They facilitate the effective and efficient operation of companies, by enabling them to respond appropriately to significant risks.

This includes safeguarding assets from loss and fraud, and ensuring that liabilities are identified and managed. Furthermore, they help to ensure the quality of internal and external reporting. Finally, internal controls help to ensure compliance with appropriate laws, regulations and intended policies (COSO Framework, 1992).

Internal control is not solely a procedure or policy that is performed at a certain point in time. Rather, it is a continually operating, integrated system at all levels within an organization. It is the role of management to implement board policies on risk and internal control. In fulfilling its responsibility, management should identify and evaluate the risks faced by the company for consideration by the board, and it should design, operate and monitor a suitable system of internal control which implements the policies adopted by the board.

2.3.1 Components of Internal Control System

An internal control system consists of five interrelated components:

Control environment

According to Caplan, (1968), it is generally felt that all five components must be present for an internal control system to be considered effective. The control environment defines the tone of an organization and the way it operates. It concerns the establishment of an atmosphere in which people can conduct their activities and carry out their control responsibilities effectively. The higher-level administrators are responsible for establishing the appropriate control environment.

Risk assessment

Chaney and Philipich (2002) assert that risk assessment is the process used by an organization to decide how it will deal with the risks that pose a threat to achieving its objectives. It entails the identification and prioritization of objectives, the identification of risk and assessment of their likelihood and impact.

Control activities

Control activities are policies and procedures implemented by an organization to ensure the management's directives are carried out. These activities permeate the entire organization, at all levels and in all functions. These activities are often grouped into the three categories of objectives to which they relate, namely, operations, financial reporting, and compliance. (Caplan, (1968)

Information and communication

Information and communication refer to the systems put in place by an organization to identify, capture, process and report relevant and reliable information in a timely manner so that people

can carry out their responsibilities effectively. These systems deal with both internally and externally generated data and flows both vertically and horizontally in the organization. (Goh (2003).

Monitoring (COSO, 1992)

Monitoring is the process of assessing the quality of a system's performance over time. It is important given the complex and dynamic environments faced by most organizations. Monitoring seek to ensure that systems are performing as intended. This is accomplished through ongoing monitoring activities, periodic evaluations or a combination of the two. (Chaney and Philipich (2002)

2.4 Internal Control over Financial Reporting and accounting system

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

2.4.1 Control environment

The core of any business is its people- their individual attributes, including integrity, ethical values and competence- and the environment in which they operate. They are the engine that drives the entity and the foundation on which everything rests. The Company's internal control structure is based on the division of labor between the Board of Directors and its Committees and CEO. The company should implement a management system that is based on: Steering documents, such as policies, directives and a code of business ethics, and a strong corporate culture, the company's organization and mode of operations, with well-defined roles and responsibilities and delegations of authority and several well-defined group-wide processes for planning, operations and support. (Goh,2003).

The most essential parts of the control environment relative to financial reporting are included in steering documents and processes for accounting and financial reporting. (Chaney and Philipich, 2002). These steering documents are updated regularly to include, among other things, changes to retirement benefits laws, International Financial Reporting Standards and listing requirements,

such as IFRS. The processes include specific controls to be performed to ensure high quality reports. Each reporting legal entity, market unit and business unit should have a financial controller function supporting the entity management with execution of controls related to transactions and reporting. A financial controller function should also be established on group level, reporting to the CFO.

2.4.2 Risk Assessment

Risks of material misstatements in financial reporting may occur in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure. (Chaney and Philipich (2002)). Other risks related to financial reporting include fraud, loss or embezzlement of assets and undue favorable treatment of counterparties at the expense of the Company. Policies and directives regarding accounting and financial performance cover areas of particular significance to support correct, complete and timely accounting, reporting and disclosure. Identified types of risks are mitigated through well defined business processes with integrated risk management activities and segregation of duties and appropriate delegation of authority. This requires specific approval of material transactions and ensures adequate asset management.

2.4.3 Control activities

Control activities are all of the policies and procedures that have been instituted by the institution to direct the staff in carrying out the directives of both board and management (Dew and Gee (1972)) All of these activities help the board and management control risks that could adversely affect the organization's operations and results. The policies that direct these control activities should also provide that the organization's personnel who are responsible for these control activities do not evaluate their own work in these areas. Control activities engaged in at various levels within the organization's organizational structure can include, *inter alia*, the following:

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

Application controls are the oversight for the programs that the organization utilizes to process and monitor transactions. (Caplan, (1968)

2.4.4 Information and communication.

The organization's information and communication channels support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned. Regular updates and briefing documents regarding changes in accounting policies, reporting and disclosure requirements are also supplied (Goh (2003).

Subsidiaries and operating units prepare regular financial and management reports to internal steering groups and institution's management. These include analysis and comments on financial performance and risks. The university's top management receives financial reports monthly. The Audit Committee has established a whistle blower procedure for reporting violations in accounting, internal controls and auditing matters.

2.4.5 Monitoring

The organization's process for financial reporting is reviewed annually by the management. This forms a basis for evaluating the internal management system and internal steering documents to ensure that they cover all significant areas related to financial reporting. The shared service center management continuously monitors the accounting quality through a set of performance indicators. Compliance with policies and directives is monitored through annual self-assessments and representation letters from heads and controllers in all subsidiaries as well as in business units and market units. The organization's financial performance is also reviewed at each management meeting. There are various committees that fulfill important monitoring functions regarding remuneration, borrowing, investments, customer finance, cash management, financial reporting and internal control. The Audit Committee and the top management review all interim and annual financial reports before they are released. The university's internal audit function, which reports to the Audit Committee, performs independent audits. The Audit Committee also receives regular reports from the external auditor. The Audit Committee follows up on any actions taken to improve or modify controls. (Fama and Jensen (2003).

2.4.6 Challenges Facing Internal Control Systems

A problem representation for a task can be defined as a template in which people organize their informational cues in their working memory that are being processed when making a decision within a task context (Winograd et al, 2000). The problem representation influences the retrieval of knowledge, how current information is evaluated, and ultimately guides the judgments involving the task variables. Essentially, a problem representation can be viewed as a cognitive structure that develops during the decision making process. This developmental process will differ, depending on the knowledge retrieved from memory, the informational cues that are acquired, and the subsequent judgments that are made during the decision making process.

Chira (2009) investigated the nature of problem representations created by auditors in a planning task. She noted that a problem representation first develops when an auditor maps the information about a current task into an existing knowledge structure that has been retrieved from memory (Higgs, 2009). At this point, the developmental process is heavily influenced by any additional information that is either provided to (e.g., through a decision aid) or requested by (e.g., from the client) an auditor during the decision making process. Moreover, depending on how the structure develops, there are likely to be differences in subsequent information acquisition behavior and judgments made by an auditor within the task context. Perhaps not surprisingly, the nature and the quality of an auditor's problem representation for a task have been linked to audit judgment and recall performance.

The relationship between the nature and quality of an auditor's problem representation and auditor judgments has been addressed within an internal control context. According to Simmons (2007) the quality of the representation created by an auditor for the client's internal control system, including the strengths and weaknesses of the system, may impact the auditor's evaluation of that system. There is also evidence that the choice of internal control documentation format impacts information acquisition behavior. That is, the quantity and type (e.g., procedural, organizational) of internal control information auditors acquire may differ depending on the documentation format. Consequently, the format used to document internal control information can impact auditors' decision outcomes.

2.5 Organization Financial Performance

Financial performance is measured in terms of results (Salim (2003)). The term performance generally carries with it an understanding of a degree of achievement of an operation or a set of connected operations, in so far as an organization's goals and objectives are concerned. These operations may have been formally put in place by the organization to evaluate and monitor the organization's capability to successfully meet its goals, and assess its employees and stakeholders responsiveness to what has been learned, through the adoption of efficient structure, system, and capital investments. Performance is key between the knowledge flow and the workflow (Schneider and Wilner (1990)).

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

2.6 The Empirical Studies

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

In spite of the continuous effort by the Nyayo Bus Service Corporations' managements in moving towards the conventional commercial accounting systems, the corporations' accounting systems until now is predominantly the Kenya Government accounting system. Thus the study

showed that a discussion of the Kenya Government financial procedures relating to state corporations is important in facilitating the understanding of the Nyayo Bus Service Corporations accounting systems and internal accounting controls. (Esmailjee A.E.K, 1993).

Mohammed (2003) evaluated the internal controls Ethiopian Airlines Branch office in Nairobi, concluded that lack of segregation of accounting and custodian functions was the greatest weakness of the branch office. He argued that there is need to centralize cash receipts, establish an audit unit, separate accounting unit from sales section, separate duties of purchase activities and establish a perpetual inventory system for the tickets. He further emphasized that the existence of controls is very crucial, especially under today's conditions with severe competition which placed premium on reliable customer services, on the conservation of cash, on realization of capital assets and manpower, and on the reduction of cost.

The concept of internal controls has received considerable attention from researcher for a long time. Research in this area can be traced way back to (Cook and Kapran, 2008) and may be found further back in time. They have tended to focus on aspects of controls that relates to performance reporting, organization structure, behavior and external auditors' work [(Burns & Waterhouse (2005), Hayes (2007), Piper (2000) Mohamed (2003), Esmailjee (1993), Cook (2008), Dew & Gee (2002), Flamhelz 2002, Haskins (2007) and Schineider and Wilner (1990)]. The techniques used in these studies varied from research to research; however, the common ones employed statistical techniques such as correlation, regression and factor analysis.

Past studies have indicated that internal controls results in financial performance [(Burt, 2008), East lack & Mc Donald, (2000), Guynes (2009); and Leotiades & Tezel, (2000)], measured in terms of generally accepted financial measures for example, sales, net income, return on sales. Subsequent studies [(Armstrong, (2006); Greenley, (2006); Mintzberg, (1990); Shrader, Taylor, & Balton, (2004)] have studied internal controls superior performance relationship. In a related study involving multiple retailers, (Piper, 2000) found that the task complexity financial control system structure and organizational structure measured on the dimension of centralization and decentralization are related to each other. Piper had generated a hypothesis that the primary determinant of financial control system is task complexity, but their effect is via an intervening variable - the organization structure. By conducting a case study of 4 companies

which were evaluated on the basis of number of stores, range of products, product characteristics, number of years in existence, store controls manager evaluation, company financial performance among others. He concluded that high task complexity is linked to a low level of financial controls system structure and a decentralization structure while low task complexity is linked to a high level of financial controls and a decentralized structure. Research conducted on effectiveness of the frequency of performance reporting and control. (Cook, 2008) studied the effectiveness of control reports with the objective of ranking on scale the attitude of 134 managers in 59 USA companies towards the control report they received. Cook's findings obtained via mail questionnaire revealed that the attitude of managers toward control reports was a function of the frequency with which the reports were provided. The participating managers face the highest rating to daily control reports and gave the lowest ratings to annual reports (Cook, 2008).

2.7 Measures of Performance

Another measure of performance is the on the simulated welfare due to the redistribution of wealth from the shareholders. We consider how social private firms sets its prices to maximize profits but also more efficient in producing its output (Bradbury, 1992). Another measure of performance is cost-benefit analysis. This is relating cost to benefits that are measurable in monetary terms. The cost benefit of the government provided goods or services should be compared with the costs and benefits of having the private sector provide the same goods and services. In such cases, we may use cost-effectiveness (one variable) and/or weighed cost-effectiveness (several variables) to measure performance (Belli, 2001)

2.8 Financial Performance Measurement

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

competitive advantage, flexibility, financial performance, resource utilization, quality of service and innovation.

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

2.9 Financial Ratios in measuring the institutions Financial Performance

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

To evaluate the financial conditions and performance of a firm, the financial analyst needs certain yardsticks. The yardstick frequently used is a ratio, or index relating to two pieces of financial data to each other. This gives a better understanding of the financial condition and performance of a firm than would be obtained from the financial data alone. Financial analysis can be trend analysis or comparison with others. The analyst will present ratios with past and expected future ratios of the same companies. Such are then arrayed in spread sheet over a period of years. It is possible to study the composition of changes and determine whether there has been an improvement or deterioration in the financial condition and performance of the firm overtime.

Ratios of one firm can also be compared with similar ratios of firms in the same industry or with average industry ratios. Such a comparison gives insight into the relative financial condition and performance of the firm. Ratios generally hold no meaning unless they are benchmarked against something else, like past performance or another company. Thus, the ratios of firms in different industries, which face different risks, capital requirements and competition, are usually hard to compare. In this study the financial statements for four years will be used as a benchmark. Some of the different types of ratios that can be calculated from data in the financial statements and

used to evaluate a business include Liquidity Analysis Ratios, Profitability Analysis Ratios and Activity Analysis Ratios. The ratio to be used is the profitability ratios which will include the Return on Assets (ROA) and profit margin.

Buijink W. and Jegers M. (2006) studied the financial ratios distribution from year to year from 2001 to 2005 for 11 ratios in Belgium firms. Refined industry classification brought less extreme deviation from normality. They pointed the need of studying the temporal persistence of cross-sectional financial distributions and suggested a symmetry index measuring it. Jebet, (2001) used two financial ratios. Activity ratios were used to evaluate firm's efficiency in managing and utilizing its assets, profitability ratios to measure operating efficiency of firms quoted in NSE for the period between 1995 and 1999. Her results were not conclusive due to complexities she observed in corporate governance.

2.10 Conclusion

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

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

CHAPTER THREE

RESEARCH METHODOLOGY

3.1. Introduction

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

3.2 Research Design

This study used a descriptive survey. A descriptive study attempted to describe or define a subject, often by creating a profile of a group of problems, people, or events, through the collection of data and tabulation of the frequencies on research variables or their interaction as indicated by Cooper and Schindler (2003). Descriptive research is more rigid than an exploratory research and seeks to describe uses of a product, determine the proportion of the population that uses a product, or predict future demand for a product.

3.3 Target Population

Target population in statistics is the specific population about which information is desired. According to Ngechu (2004), a population is a well defined or set of people, services, elements, events, group of things or households that are being investigated. This definition ensures that population of interest is homogeneous. Population studies are more representative because everyone has equal chance to be included in the final sample that is drawn according to Mugenda and Mugenda (1999).

The target population of this study was all public universities in Kenya. There were seven public universities in Kenya, namely: University of Nairobi, Kenyatta University, Jomo Kenyatta university college of Agriculture and Technology, Egerton University, Moi University, Maseno University and Masinde Mulilo University (GOK, 2009).

3.4 The test sample

A convenient sample was selected from staff working at all public universities with offices in Nairobi. The studies mainly focused on the heads of finance departments of the respective institutions, since they were the ones conversant with the internal control systems and their effects on financial performance of respective institutions.

3.5 Data Collection

The study used primary and secondary data from questionnaires and published financial statements of the company. The study relied heavily on secondary data from published financial statements of the institutions. The data collection entailed the examination of the latest audited financial statements of the institutions. In assessing the impact of internal control on the institutions performance, this paper used both primary and secondary data collection. The respondents were all public universities with offices in Nairobi and were selected from different managerial levels and departments to answer the questions on components of internal controls.

Primary data collection was collected to establish internal control efficiency and performance by the institutions on the components of internal controls. This was done using an open -ended interview guide. The interview guide was administered on one on one basis to the institutions head of departments. Personal interviews were conducted to get an in-depth understanding in the subject matter. A letter of introduction was given to each respondent prior to research interview guide. To proxy institutions financial performance, Return on Investment and Profit (Net profit before Exchange differences and tax) was used to proxy profitability. The study used each measure of profitability independently in the analysis.

3.6 Data Analysis

Prior to secondary data analysis, primary data was analyzed using descriptive statistics to establish the impacts of internal controls on the institutions financial performance. Data was analyzed on the basis of descriptive statistics. Performance was classified in terms of profitability. Statistical Package for Social Sciences (SPSS) version 17 was used as an aid to analysis. SPSS was preferred because of its ability to cover a wide range of most statistical and graphical data analysis and is systematic.

3.7 Data Reliability and Validity

The research carried out a pilot study to pretest the validity and reliability of data collected using the interview guides. According to Berg and Gall (2009) validity is the degree by which the sample of test items represents the content of test is designed to measure. Content validity which was employed by this study is a measure of the degree to which data collected using a particular instrument represents a specific domain or content of a particular concept. Mugenda and Mugenda (1999) contend that the usual procedure in assessing the content validity of measure is to use a professional or expert in a particular field.

CHAPTER FOUR

DATA ANALYSIS AND INTERPRETATION

4.1 Introduction

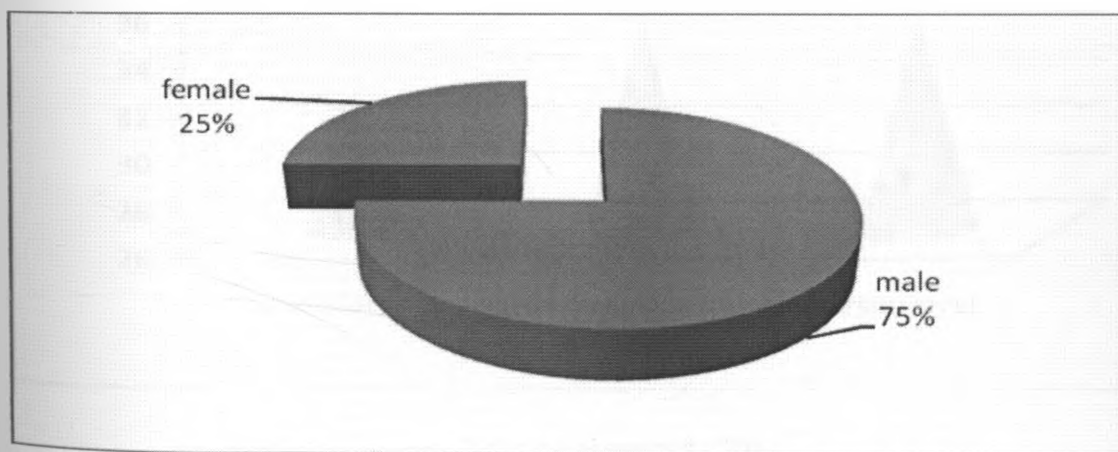
This chapter presents analysis and findings of the study as set out in the research methodology. The study findings are presented on to establish the effect of internal control on financial performance of public universities in Kenya. The data was gathered exclusively from the questionnaire as the research instrument. The questionnaire was designed in line with the objectives of the study.

4.1.1 Response rate

The study targeted 7 respondents in collecting data with regard to the effect of internal control on financial performance of public universities. From the study, 5 out of the 7 sample respondents filled-in and returned the questionnaires making a response rate of 71%. This reasonable response rate was made a reality after the researcher made personal calls and visits to remind the respondent to fill-in and return the questionnaires.

4.2 Demographic Information

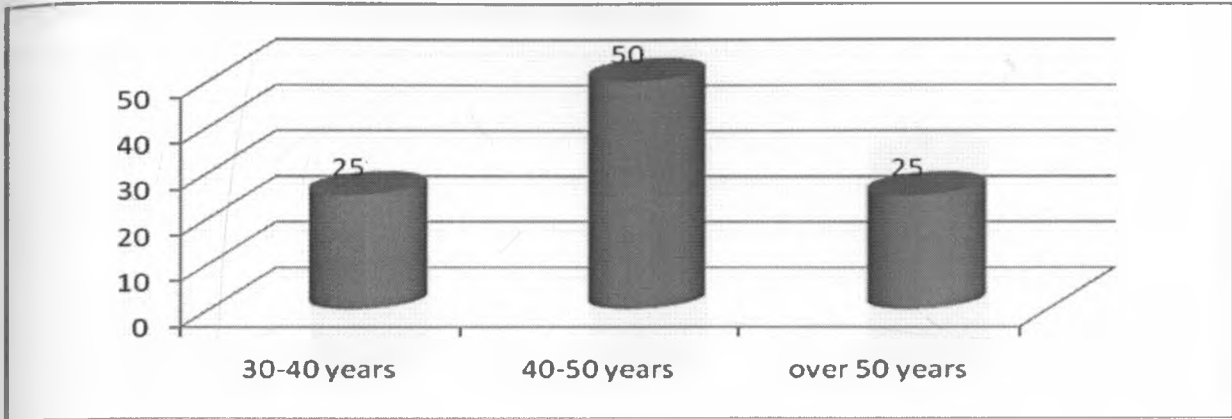
Figure 4. 1: Gender of respondents



Source: Research, 2011

The study sought to find out the gender of the respondents. From the findings, 75% of the respondents were male while 25% of the respondents were female.

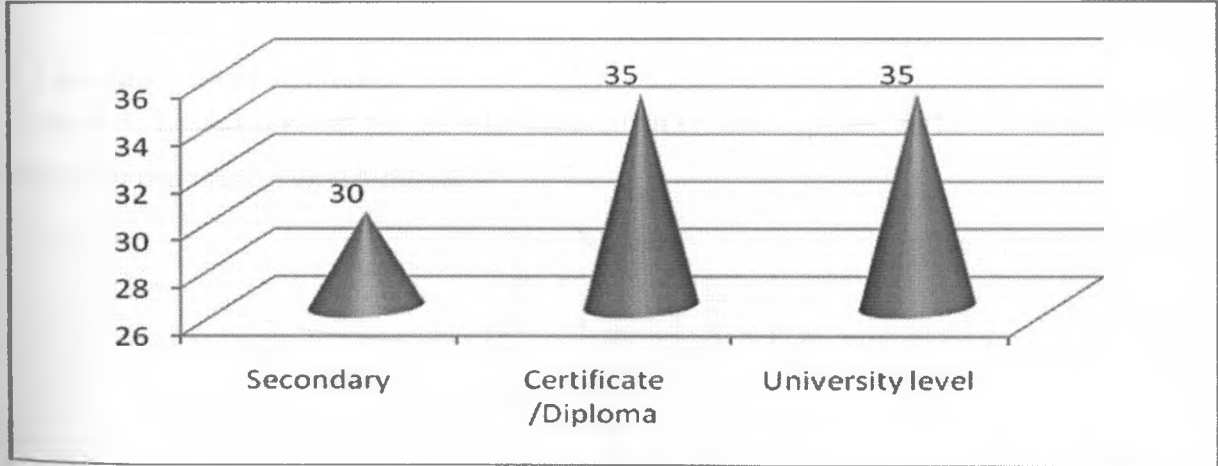
Figure 4. 2: Age of respondents



Source: Research, 2011

The study sought to find out the age of the respondents. From the findings, 50% of the respondents were 40-50 years, 25% of the respondents were above 50 years, 25% of the respondents were 30-40 years,

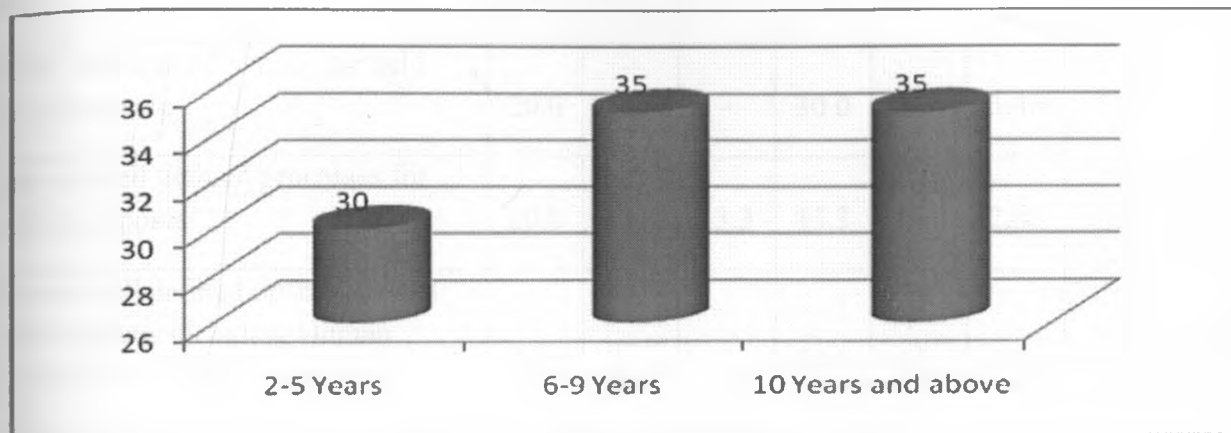
Figure 4. 3: Highest level of education



Source: Research, 2011

The study sought to find out the highest level of education reached by the respondents. From the findings, 35% of the respondents were certificate or diploma holders, 35% of the respondents had university education and 30% of the respondents had reached secondary school.

Figure 4. 4: Working experience of the respondents



Source: Research, 2011

The study sought to find out the working experience of the respondents. From the findings, 26.7% of the respondents had worked in the institutions for 2-5 years, 35.3% of the respondents had worked in the institutions for 6-10 years while 38% of the respondents had worked in the institutions for 10 years and above.

4.3 Internal Control Systems

Table 4. 1: Extent that aspects of internal control systems applied in the institutions with regard to the control environment

ITEM	Very Great Extent	Great Extent	Moderate Extent	Little Extent	No Extent	Mean	Stdev
The institutions' Organizational Policies are Committed to Competence	33.3	13.3	6.7	40.0	6.7	3.27	0.1
Directives are centrally issued and a strong code of business ethics is	6.7	13.3	23.3	16.7	40.0	2.30	0.2

followed in the institution							
The institution practices a Strong corporate culture	0	43.3	0	26.7	30.0	2.57	0.3
Assignment of Authority is commensurate with Responsibility	63.3	6.7	6.7	13.3	10.0	4.00	0.1
Integrity and Ethical Values are held with high esteem	20.0	43.3	-	30.0	6.7	3.40	0.2
There are well defined processes for planning purposes	20.0	13.3	13.3	13.3	40.0	2.60	0.4
There are well defined operations and support systems including Human Resource Policies and Procedures	13.3	30.0	13.3	23.3	20.0	2.93	0.2
The internal control structure is based on the division of labor between the university council its Committees and departmental heads.	36.7	20.0	0	30.0	13.3	3.37	0.3
The most essential parts of the control environment relative to financial reporting are included in steering documents and processes for accounting and financial reporting.	20.0	16.7	10.0	33.3	20.0	2.83	0.1
Steering documents are updated regularly to include, among other things, changes to retirement benefits laws, International Financial Reporting Standards and listing requirements, such as IFRS	33.3	13.3	0	23.3	30.0	2.97	0.2
Steering documents are updated regularly to include specific controls to be performed to ensure high quality reports	6.7	46.7	20.0	6.7	20.0	3.13	0.4

Source: Research, 2011

The study sought to find out the extent that aspects of internal control systems applied in the institution with regard to the control environment. From the findings, assignment of authority was commensurate with responsibility to a great extent as shown by a mean of 4.0, integrity and ethical values were held with high esteem to a moderate extent as shown by a mean of 3.40, the internal control structure was based on the division of labor between the university council its committees and departmental heads to a moderate extent as shown by a mean of 3.37, steering documents were updated regularly to include specific controls to be performed to ensure high quality reports to a moderate extent as shown by a mean of 3.13, steering documents were updated regularly to include, among other things, changes to retirement benefits laws, International Financial Reporting Standards and listing requirements, such as IFRS to a moderate extent as shown by a mean of 2.97, there were well defined operations and support systems including Human Resource Policies and Procedures to a moderate extent as shown by a mean of 2.93, the most essential parts of the control environment relative to financial reporting were included in steering documents and processes for accounting and financial reporting to a moderate extent as shown by a mean of 2.83 and there were well defined processes for planning purposes to a moderate extent as shown by a mean of 2.60.

4.4 Risk Assessment

Table 4. 2: Extent that aspects of internal control systems applied in the institutions with regard to risk assessment

	Very Great Extent	Great Extent	Moderate Extent	Little Extent	No Extent	Mean	Stdev
The institution practice adequate controls in custody and disposal of Assets including cash	26.7	40.0	13.3	6.7	13.3	3.60	0.2
Risk Identification and Analysis is regularly carried out	33.3	3.3	20.0	33.3	10.0	3.17	0.3
Due care is taken in Management of Change	13.3	26.7	3.3	30.0	26.7	2.70	0.1

Assessment of Risk associated with Process-level Objectives are carried regularly	26.7	23.3	13.3	0	36.7	3.03	0.2
Assessment of Risk associated with Company-wide Objectives are carried out	30.0	46.7	10.0	13.3	0	3.93	0.4
Risks of material misstatements in financial reporting may occur in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure.	33.3	30.0	0	16.7	20.0	3.40	0.3
Risks related to financial reporting include fraud, loss or embezzlement of assets and undue favorable treatment of counterparties at the expense of the Company	23.3	13.3	6.7	40.0	16.7	2.87	0.1
Risks are mitigated through well defined business processes with integrated risk management activities and segregation of duties and appropriate delegation of authority to influence performance	36.7	10.0	0	20.0	33.3	2.97	0.2

Source: Research, 2011

The study sought to find out the extent that aspects of internal control systems applied in the institution with regard to risk assessment. From the findings, assessment of risk associated with company-wide objectives was carried out to a great extent as shown by a mean of 3.93, the institution practiced adequate controls in custody and disposal of assets including cash to a great extent as shown by a mean of 3.60 and risks of material misstatements in financial reporting occurred in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure to a moderate extent as shown by a mean of 3.40, risk identification and analysis was regularly carried out to a moderate extent as shown by a mean of 3.17, assessment of risk associated with process-level objectives were carried regularly to a moderate extent as

shown by a mean of 3.03, risks were mitigated through well defined business processes with integrated risk management activities and segregation of duties and appropriate delegation of authority to influence performance to a moderate extent as shown by a mean of 2.97, risks related to financial reporting included fraud, loss or embezzlement of assets and undue favorable treatment of counterparties at the expense of the company to a moderate extent as shown by a mean of 2.87 and due care was taken in management of change to a moderate extent as shown by a mean of 2.70.

4.5 Control Activities

Table 4. 3: Extent that aspects of internal control systems applied in the institutions with regard to the control activities

ITEM	very great extent	great extent	moderate extent	little extent	No extent	mean	stdev
Control activities are all of the policies and procedures that have been instituted by the company to direct the staff in carrying out the directives of both board and management that influence performance.	13.3	23.3	10.0	36.7	16.7	2.80	0.3
Control activities are engaged in at various levels within the company's organizational structure and include information processing, and activities such as verification of the accuracy and completeness of company transactions to determine whether they had been properly authorized.	13.3	6.7	30.0	20.0	30.0	2.53	0.3
There is Proper documentation of transactions	23.3	20.0	0	20.0	36.7	2.73	0.1
Confirmation of arithmetic accuracy is a common practice	20.0	13.3	20.0	26.7	20.0	2.87	0.2

Presence of an effective internal audit enhances performance.	16.7	43.3	0	33.3	6.7	3.30	0.4
Mandatory authorization and approval of transaction by relevant officers is mandatory	43.3	13.3	10.0	13.3	20.0	3.47	0.3
Work of a junior officer is checked by a senior officer before further processing	13.3	26.7	6.7	36.7	16.7	2.83	0.1
General controls are oversight over data center operations, including mainframes and servers, and system software procurement, maintenance and access.	6.7	23.3	16.7	10.0	43.3	2.40	0.2

Source: Research, 2011

The study sought to find out the extent that aspects of internal control systems applied in the institution with regard to the control activities. From the findings, mandatory authorization and approval of transaction by relevant officers was mandatory to a moderate extent as shown by a mean of 3.47, presence of an effective internal audit enhanced performance to a moderate extent as shown by a mean of 3.30 and confirmation of arithmetic accuracy was a common practice to a moderate extent as shown by a mean of 2.87, work of a junior officer was checked by a senior officer before further processing to a moderate extent as shown by a mean of 2.83, control activities were all of the policies and procedures that had been instituted by the company to direct the staff in carrying out the directives of both board and management that influenced performance to a moderate extent as shown by a mean of 2.80, there was proper documentation of transactions to a moderate extent as shown by a mean of 2.73, control activities were engaged in at various levels within the company's organizational structure and included information processing, and activities such as verification of the accuracy and completeness of company transactions to determine whether they had been properly authorized to a moderate extent as shown by a mean of 2.53 and general controls were over sighted over data center operations, including mainframes and servers, and system software procurement, maintenance and access to a little extent as shown by a mean of 2.4.

4.6 Information and Communication

Table 4. 4: Extent that aspects of internal control systems applied in the institutions with regard to reporting and communication

ITEM	very great extent	great extent	moderate extent	little extent	No extent	mean	stdev
Periodic reports are made to top management of the institution	66.7	6.7	0	20.0	6.7	4.07	0.4
Quality of Information is ensured at all levels	13.3	40.0	0	33.3	13.3	3.07	0.6
Effective Communication is practiced across all levels	30.0	20.0	0	36.7	13.3	3.17	0.1
The Company's information and communication channels have built-in systems to support internal control .	6.7	23.3	6.7	30.0	33.3	2.40	0.1
The Company's information and communication channels support complete, correct and timely financial reporting through internal process, instructions and policies accessible to all the employees concerned	36.7	20.0	10.0	16.7	16.7	3.43	0.2
Communication facilitates regular updates and briefing of documents regarding changes in accounting policies, reporting and disclosure requirements to influence performance in the long run.	36.7	10.0	13.3	20.0	20.0	3.23	0.3

Source: Research, 2011

The study sought to find out the extent that aspects of internal control systems applied in the institutions with regard to reporting and communication. From the findings, periodic reports were made to top management of the institutions to a great extent as shown by a mean of

4.07, the Company's information and communication channels supported complete, correct and timely financial reporting by making all relevant internal process instructions and policies were accessible to all the employees concerned to a moderate extent as shown by a mean of 3.43 and communication facilitated regular updates and briefing of documents regarding changes in accounting policies, reporting and disclosure requirements which influenced performance in the long run to a moderate extent as shown by a mean of 3.23, effective communication was practiced across all levels to a moderate extent as shown by a mean of 3.17, quality of information was ensured at all levels to a moderate extent as shown by a mean of 3.07 and the company's information and communication channels supported complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned to a little extent as shown by a mean of 2.40.

4.7 Monitoring

Table 4. 5: Extent that aspects of internal control systems applied in the institutions with regard to monitoring

ITEM	Very great extent	Great extent	Moderate extent	Little extent	No extent	Mean	Stdev
Presence of an effective internal audit facilitates monitoring of efficiency of operations.	43.3	16.7	23.3	10.0	6.7	3.80	0.4
Presence of-going Monitoring of internal controls	6.7	40.0	0	36.7	16.7	2.83	0.6
There is Separate Evaluations of the strength of various internal control procedures	30.0	13.3	0	20.0	36.7	2.80	0.1
Deficiencies in control activities are reported and addressed effectively.	13.3	23.3	13.3	23.3	26.7	2.73	0.1
The Company's process for financial reporting is reviewed annually by the management. This forms a basis for	33.3	10.0	20.0	16.7	20.0	3.20	0.2

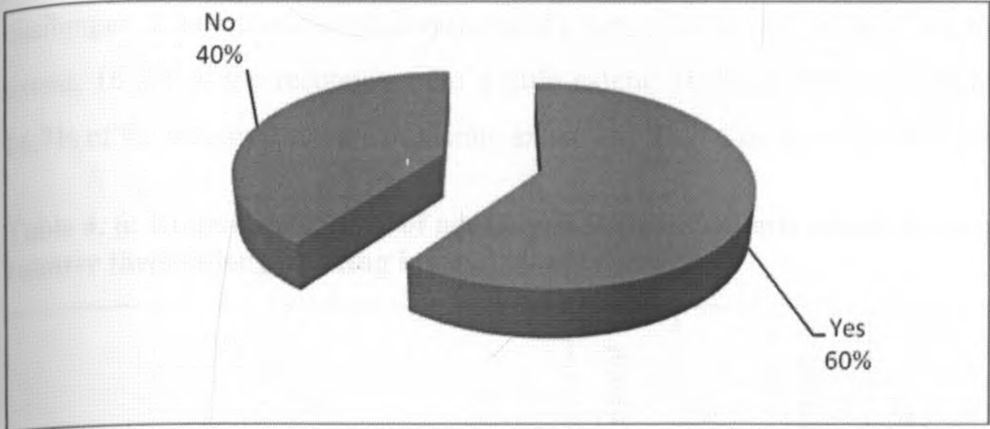
evaluating the internal management system and internal steering documents to ensure that they cover all significant areas related to financial reporting							
The shared service center management continuously monitors the accounting quality through a set of performance indicators.	20.0	16.7	0	50.0	13.3	2.80	0.3
The committees of the Board fulfill important monitoring functions regarding remuneration, borrowing, investments, customer finance, cash management, financial reporting and internal control.	10.0	30.0	3.3	16.7	40.0	2.53	0.2

Source: Research, 2011

The study sought to find out the extent that aspects of internal control systems applied in the institutions with regard to the control activities. From the findings, presence of an effective internal audit facilitated monitoring of efficiency of operations to a great extent as shown by a mean of 3.80, the company's process for financial reporting was reviewed annually by the management. This formed a basis for evaluating the internal management system and internal steering documents to ensure that they covered all significant areas related to financial reporting to a moderate extent as shown by a mean of 3.20 and presence of-going monitoring of internal controls to a moderate extent as shown by a mean of 2.83, there were separate evaluations of the strength of various internal control procedures to a moderate extent as shown by a mean of 2.80, the shared service center management continuously monitored the accounting quality through a set of performance indicators a moderate extent as shown by a mean of 2.80, deficiencies in control activities were reported and addressed effectively a moderate extent as shown by a mean of 2.73, the committees of the board fulfilled important monitoring functions regarding remuneration, borrowing, investments, customer finance, cash management, financial reporting and internal control a moderate extent as shown by a mean of 2.53.

4.8 Challenges Facing Internal Control Systems

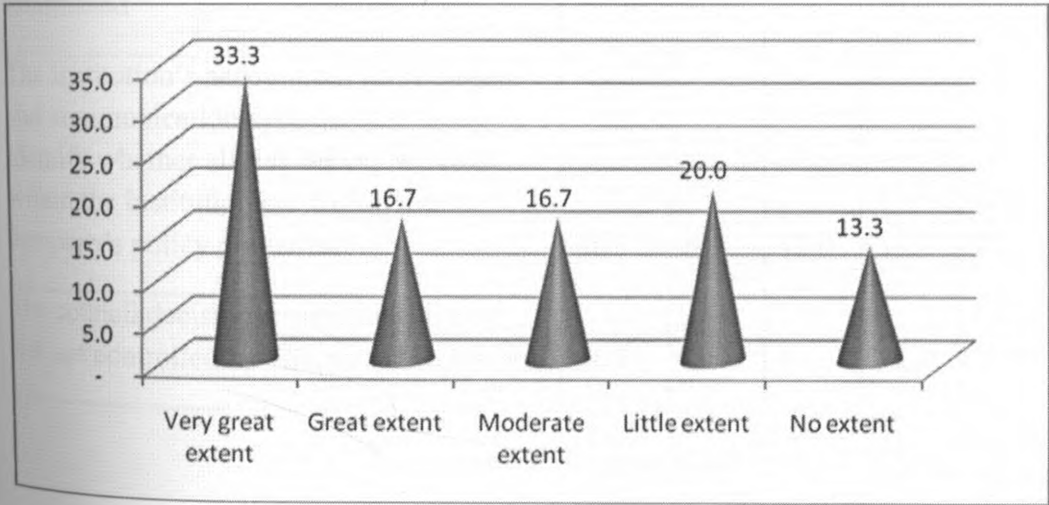
Figure 4. 5: Whether the institutions faced challenges in its internal control systems



Source: Research, 2011

The study sought to find out whether the institutions faced challenges in its internal control systems. From the findings, 60% of the respondents indicated that the institutions faced challenges in its internal control systems while 40% of the respondents indicated that the institutions did not face challenges in its internal control system.

Figure 4. 6: Extent that institutions faced challenges in its internal control systems



Source: Research, 2011

The study sought to find out extent that the institutions faced challenges in its internal control systems. From the findings, 33.3% of the respondents indicated that the institutions faced challenges in its internal control systems to a very great extent, 20% of the respondents to a little extent, 16.7% of the respondents to a little extent, 16.7% of the respondents to a great extent, 16.7% of the respondents to a moderate extent and 13.3% of the respondents to no extent.

Table 4. 6: Respondents level of agreement with statements about the steps taken to counter the challenges facing internal control systems

	Very great extent	Great extent	Moderate extent	Little extent	No extent	Mean	Stdev
Policies and procedures exist to provide that decisions are made with appropriate approvals	23.3	16.7	16.7	30.0	13.3	3.1	0.20
Policies and procedures periodically reviewed by the management to ensure that appropriate internal controls have been established	13.3	30.0	3.3	20.0	33.3	2.7	0.40
The institution's accounting, information and communication systems able to identify whether all risk taking activities within the institution are within the company's policy guidelines	26.7	6.7	10.0	33.3	23.3	2.8	0.30
The council decisions made collectively and not controlled by different stakeholders	46.7	6.7	0	33.3	13.3	3.4	0.42

Source: Research, 2011

The study sought to find out the extent that aspects of internal control systems applied in the institution with regard to the control activities. From the findings, the council decisions were made collectively and not controlled by different stakeholders to a moderate extent as shown by a mean of 3.4, policies and procedures existed to provide that decisions were made with

appropriate approvals to a moderate extent as shown by a mean of 3.1 and the institution's accounting, information and communication systems were able to identify whether all risk taking activities within the institution were within the company's policy guidelines to a moderate extent as shown by a mean of 2.8 and policies and procedures were periodically reviewed by the management to ensure that appropriate internal controls had been established to a moderate extent as shown by a mean of 2.7.

CHAPTER FIVE

SUMMARY OF THE FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The chapter provides the summary of the findings from chapter four, and it also gives the conclusions and recommendations of the study based on the objectives of the study. The objectives of this study were to establish the effect of internal control on financial performance of public universities in Kenya.

5.2 Summary of the Findings

The study aimed at establishing the effect of internal control on financial performance of public universities in Kenya.

5.2.1 Internal Control Systems

The research found that assignment of authority was commensurate with responsibility to a great extent as shown by a mean of 4.0, integrity and ethical values were held with high esteem to a moderate extent as shown by a mean of 3.40 and the internal control structure was based on the division of labor between the university council its committees and departmental heads to a moderate extent as shown by a mean of 3.37

5.2.2 Risk Assessment

The research further found that assessment of risk associated with company-wide objectives was carried out to a great extent as shown by a mean of 3.93, the institutions practiced adequate controls in custody and disposal of assets including cash to a great extent as shown by a mean of 3.60 and risks of material misstatements in financial reporting occurred in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure to a moderate extent as shown by a mean of 3.40

5.2.3 Control Activities

The study further found out that mandatory authorization and approval of transaction by relevant officers was mandatory to a moderate extent as shown by a mean of 3.47, presence of an effective internal audit enhanced performance to a moderate extent as shown by a mean of 3.30 and confirmation of arithmetic accuracy was a common practice to a moderate extent as shown by a mean of 2.87

5.2.4 Information and Communication

The study further found that periodic reports were made to top management of the institutions to a great extent as shown by a mean of 4.07, the Company's information and communication channels supported complete, correct and timely financial reporting by making all relevant internal process instructions and policies were accessible to all the employees concerned to a moderate extent as shown by a mean of 3.43 and communication facilitated regular updates and briefing of documents regarding changes in accounting policies, reporting and disclosure requirements which influenced performance in the long run.

5.2.5 Monitoring

The study further found that presence of an effective internal audit facilitated monitoring of efficiency of operations to a great extent as shown by a mean of 3.80 and the company's process for financial reporting was reviewed annually by the management. This formed a basis for evaluating the internal management system and internal steering documents to ensure that they covered all significant areas related to financial reporting to a moderate extent as shown by a mean of 3.20

5.2.6 Challenges Facing Internal Control Systems

The study found that 60% of the respondents indicated that the institutions faced challenges in its internal control systems, 33.3% of the respondents indicated that the institutions faced challenges in its internal control systems to a very great extent, the council decisions were made collectively and not controlled by different stakeholders to a moderate extent as shown by a mean of 3.4, policies and procedures existed to provide that decisions were made with appropriate approvals to a moderate extent as shown by a mean of 3.1

5.3 Conclusion

The research concludes that assignment of authority was commensurate with responsibility to a great extent, integrity and ethical values were held with high esteem to a moderate extent and the internal control structure was based on the division of labor between the university council its committees and departmental heads to a moderate extent.

The research further concludes that assessment of risk associated with company-wide objectives was carried out to a great extent, the institutions practiced adequate controls in custody and disposal of assets including cash to a great extent and risks of material misstatements in financial reporting occurred in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure to a moderate extent

The study further concludes that mandatory authorization and approval of transaction by relevant officers was mandatory to a moderate extent, presence of an effective internal audit enhanced performance to a moderate extent and confirmation of arithmetic accuracy was a common practice to a moderate extent.

The study further concludes that periodic reports were made to top management of the institutions to a great extent, the Company's information and communication channels supported complete, correct and timely financial reporting by making all relevant internal process instructions and policies were accessible to all the employees concerned to a moderate extent and communication facilitated regular updates and briefing of documents regarding changes in accounting policies, reporting and disclosure requirements which influenced performance in the long run.

The study further concludes that presence of an effective internal audit facilitated monitoring of efficiency of operations to a great extent and the company's process for financial reporting was reviewed annually by the management. This formed a basis for evaluating the internal management system and internal steering documents to ensure that they covered all significant areas related to financial reporting to a moderate extent.

The study further concludes the institutions faced challenges in its internal control systems, the institutions faced challenges in its internal control systems to a very great extent, the council

decisions were made collectively and not controlled by different stakeholders to a moderate extent and policies and procedures existed to provide that decisions were made with appropriate approvals to a moderate extent.

5.4 Recommendations

The study recommends integrity and ethical values be held with high esteem. This is to enhance proper operation of the controls put in place.

The study further recommends assessment of risk associated with company-wide objectives be carried out regularly so that the management can know whether or not the company objectives will be met. The study further recommends the institution to practice adequate controls in custody and disposal of assets including cash and to reduce the risk of material misstatements in financial reporting in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure. This could be achieved by employing competent staff, putting in place an audit committee to supervise the work of the audit staff.

The study further recommends that mandatory authorization and approval of transaction by relevant officers be made mandatory. This is to ensure that there is no misappropriation of the institution resources. Presence of an effective internal audit is recommended as it enhances performance.

The study further recommends that periodic reports be made to top management of the institution .This is to ensure that errors are corrected in time. The Company's information and communication channels should complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned since communication facilitates regular updates and briefing of documents regarding changes in accounting policies, reporting and disclosure requirements which influences performance in the long run.

The study further recommends the institution to put in place effective internal audit as it facilitates monitoring of efficiency of operations and the company's process for financial reporting be reviewed annually by the management. This forms a basis for evaluating the internal

management system and internal steering documents to ensure that they cover all significant areas related to financial reporting.

The study further recommends the institution to mitigate the challenges in its internal control systems by ensuring there is an effective audit committee, the council decisions be made collectively and not be controlled by different stakeholders and policies and procedures be put in place. This provides that decisions are made with appropriate approvals.

5.5 Recommendation for Further Studies

This study has reviewed the effect of internal control on financial performance of public universities in Kenya. To this end therefore a further study should be carried out to establish the effect of internal controls on financial performance of the private companies and the public sector.

This study has reviewed the effect of internal control on financial performance of public universities in Kenya with a small sample involving only heads of finance department in the respective institutions. A bigger sample of respondents of at least 30 respondents should be used to facilitate a more informative conclusion.

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APPENDICES

Appendix I: Research Questionnaire.

Instruction

This questionnaire consists of two parts. Please answer all the questions by ticking on the spaces provided or use the spaces left for you.

PART A: GENERAL INFORMATION

1. What is your gender?

Male []

Female []

Please tick (√) on the age bracket best describes the range in which your age falls

Below 20 Years []

Between 20 to 30 Years []

Between 30 and 40 Years []

Between 40 and 50 Years []

Over 50 Years []

2. What is your highest level of education? (Tick appropriately)

Never attended school []

Primary school education/or its equivalent []

Secondary School Level/or its equivalent []

Certificate/Diploma/or its equivalent []

University level of education/or its equivalent []

Others (Specify.....) []

3. For how long have you been working in this institution?

Less than 1 year [] 6 to 9 years []

2 to 5 years [] 10 years and above []

PART B: INTERNAL CONTROL SYSTEMS AND EFFECTS ON PERFORMANCE

Internal Control Systems

4. To what extent does the following aspects of internal control systems apply in the institution regarding the control environment ?Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent

NO.	ITEM	1	2	3	4	5
1	The institutions' Organizational Policies are Committed to Competence					
2	Directives are centrally issued and a strong code of business ethics is followed in the institution					
3	The institution practices a Strong corporate culture					
4	Assignment of Authority is commensurate with Responsibility					
5	Integrity and Ethical Values are held with high esteem					
6	There are well defined processes for planning purposes					
7	There are well defined operations and support systems including Human Resource Policies and Procedures					
8	The internal control structure is based on the division of labor between the university council its Committees and departmental heads.					
9	The most essential parts of the control environment relative to financial reporting are included in steering documents and processes for accounting and financial reporting.					
10	Steering documents are updated regularly to include, among other things, changes to retirement benefits laws, International Financial Reporting Standards and listing requirements, such as IFRS					
11	Steering documents are updated regularly to include specific controls to be performed to ensure high quality reports					

b. Risk Assessment

5. To what extent does the following aspects of internal control systems apply in the institution regarding risk assessment ?Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent

NO.	ITEM	1	2	3	4	5
1	The institution practice adequate controls in custody and disposal of Assets including cash					
2	Risk Identification and Analysis is regularly carried out					
3	Due care is taken in Management of Change					
4	Assessment of Risk associated with Process-level Objectives are carried regularly					
5	Assessment of Risk associated with Company-wide Objectives are carried out					
6	Risks of material misstatements in financial reporting may occur in relation to recognition and measurement of assets, liabilities, revenue and cost or insufficient disclosure.					
7	Risks related to financial reporting include fraud, loss or embezzlement of assets and undue favorable treatment of counterparties at the expense of the Company					
8	Risks are mitigated through well defined business processes with integrated risk management activities and segregation of duties and appropriate delegation of authority to influence performance					

c. Control Activities

6. To what extent does the following aspects of internal control systems apply in the institution regarding the control activities ?Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent

NO.	ITEM	1	2	3	4	5
1	Control activities are all of the policies and procedures that have been instituted by the company to direct the staff in carrying out the directives of both board and management that influence performance.					
2	Control activities are engaged in at various levels within the company's organizational structure and include information processing, and activities such as verification of the accuracy and completeness of company transactions to determine whether they had been properly authorized.					
3	There is Proper documentation of transactions					
4	Confirmation of arithmetic accuracy is a common practice					
5	Presence of an effective internal audit enhances performance .					
6	Mandatory authorization and approval of transaction by relevant officers is mandatory					
7	Work of a junior officer is checked by a senior officer before further processing					
8	General controls are oversight over data center operations, including mainframes and servers, and system software procurement, maintenance and access.					

d. Information and Communication

7. To what extent does the following aspects of internal control systems apply in the institution regarding reporting and communication ?Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent

NO.	ITEM	1	2	3	4	5
1	Periodic reports are made to top management of the institution					
2	Quality of Information is ensured at all levels					
3	Effective Communication is practiced across all levels					
4	The Company's information and communication channels have built-in systems to support internal control.					
5	The Company's information and communication channels support complete, correct and timely financial reporting by making all relevant internal process instructions and policies accessible to all the employees concerned.					
6	Communication facilitates regular updates and briefing of documents regarding changes in accounting policies, reporting and disclosure requirements to influence performance in the long run.					

e. Monitoring

To what extent do the following aspects of internal control systems apply in the institution regarding the monitoring? Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent

NO.	ITEM	1	2	3	4	5
1	Presence of an effective internal audit facilitate monitoring of efficiency of operations.					
2	Presence of-going Monitoring of internal controls					
3	There is Separate Evaluations of the strength of various internal control procedures					
4	Deficiencies in control activities are reported and addressed effectively.					
5	The Company's process for financial reporting is reviewed annually by the management. This forms a basis for evaluating the internal management system and internal steering documents to ensure that they cover all significant areas related to financial reporting					
6	The shared service center management continuously monitors					

	the accounting quality through a set of performance indicators.					
7	The committees of the Board fulfill important monitoring functions regarding remuneration, borrowing, investments, customer finance, cash management, financial reporting and internal control.					

Challenges Facing Internal Control Systems

8. Does this institution face challenges in its internal control systems?

Yes [] No [] Don't know []

9. To what extent does this institution face challenges in its internal control systems?

Very great extent [] Great extent []
Moderate extent [] little extent []
Not at all []

10. To what extent do you agree with the following statements about the steps taken to counter the challenges facing internal control systems? Use a scale of 1 to 5 where 1 is to a very great extent and 5 is to no extent

Steps taken to counter the challenges facing internal control systems	1	2	3	4	5
Policies and procedures exist to provide that decisions are made with appropriate approvals					
Policies and procedures periodically reviewed by the management to ensure that appropriate Internal Controls have been established					
The institutions's accounting, information and communication systems able to identify whether all risk taking activities within the institution are within the company's policy guidelines					
The council decisions made collectively and not controlled by different stakeholders					

11. What are the other steps taken towards coping with the challenges facing internal control systems?.....

{THANK YOU FOR YOUR ASSISTANCE}