Advances in Social Sciences Research Journal – Vol. 8, No. 8
Publication Date: August 25, 2021
DOI:10.14738/assrj.88.10799.
Nyaga, E. N., Gweyi, M., & Kiganane, L. (2021). Influence of Internal Controls on Financial Perfromance of Dairy Cooperative Societies in Meru County, Kenya. Advances in Social Sciences Research Journal, 8(8). 748-754.

Influence of Internal Controls on Financial Perfromance of Dairy Cooperative Societies in Meru County, Kenya

Emmanuel Njeru Nyaga
Student, The co-operative University of Kenya

Dr. Moses Gweyi, PhD, CCOP
Lecturer, School of Co-operatives and Community Development
The co-operative University of Kenya

Dr. Lucy Kiganane (PhD)
Senior Lecturer, Entrepreneurship Expert, & Director
Postgraduate Studies, The Co-operative University of Kenya [CUK]

ABSTRACT

Internal control systems have been a challenge to the performance of Dairy Cooperative Societies in Kenya. Incidences of total disregard to rules and procedures, adherence to cooperative management regulations have been on the rise. The ability of the management to adhere to the internal controls systems is of importance and it's bound to affect the financial performance of the societies. The purpose of this study was to determine influence of internal control on financial performance of Dairy Cooperative Societies. The study was restricted to Dairy Cooperative Societies licensed to operate in Meru County. . The study adopted a descriptive research design and made use of purposive sampling to generate a sample of 72 respondents. A questionnaire was utilized to collect data from the respondents. Data was analyzed and evaluated through the use of descriptive statistics; standard deviation, mean and percentages, and made use of ordinary linear regression models to generate the size of effects of independent variables on the dependent variable. Analyzed data was presented in tables and pie charts. The response rate of the administered questionnaires stood at 88.88%. This response rate was found to be sufficient for inferential statistical analysis. The coefficient of determination indicated that internal control contributed 65.7% of the variation in financial performance as explained by coefficient of determination which stood at 0.657. The p-value and regression coefficient internal control generated after running the regression model was (β= 0.232, p = 0.026). These results indicate that internal controls positively and significantly influenced the financial performance of Dairy Cooperative Societies in Meru County. This study therefore, recommends the implementation of internal control mechanisms in all Dairy Cooperative Societies in Meru County.

Key Words: Internal Control, Financial Performance, Control Environment, Control Activities, Monitoring, Information and Communication

INTRODUCTION

Financial performance of cooperative societies in Kenya remains the core indicator of the initial and basic mission of the cooperative society (Kyazze, Nkote & Wakaisuka-Isingoma, 2017). This has been rooted in the many empirical studies conducted on the growth and development of cooperative societies in developing societies (Waithaka, 2013). This culminated in the labelling of the cooperative societies in Africa as pro-poor with sole responsibility of alleviating their members from poverty. To meet the noble goal of alleviating members from poverty through profitability of the cooperative societies, governance issues have been found to be critical in safeguarding the member's wealth. According to Bii (2017) the institutional management carried out through good internal control systems and timely performance reports in conducting the cooperative societies business are important in influencing their financial performance. This is buttressed by the study conducted by Mohan and Chadramohan (2018) who established a direct relationship between the corporate governance principles and organizational financial performance.

The study sought to answer the following question:

i. What is the influence of internal controls on the financial performance of Dairy Cooperative Societies in Meru County, Kenya?

The study is supported by the stewardship theory which contends that managers works for and protect the interest of the shareholder's. Under the stewardship theory the superiority of performance of the organization is associated with the management capability of internal directors as their interests is to maximize shareholders returns (Subramanian, 2018). It is based on two premises, that managers are trustworthy and the agency costs are going to reduce as they work for the interest of shareholders and community. This may hold true as there is no conclusive of positive effect between external and outside directors, and financial performance of the organization. The role of outside directors as premised in agency theory is monitoring the management activity but with the assumption that the management is trustworthy, this reduces the cost of internal monitoring control systems (Subramanian, 2018).

According to Hussein and Muhammed (2018) internal control are the "processes designed and effected by the management and the employees for providing reasonable assurances on the attainment of organizational objectives of efficiency and effectiveness in operations and compliance with applicable laws and regulations towards reliable financial reporting". This definition is in tandem with the internal control framework provided by Committee of Sponsoring Organization (COSO). The framework provides the five components of internal control; control environment, entity risk assessment process, information and communication system, control activities and monitoring. These elements according to Aralik, Unkuyu and Altintas (2017) ensure that the amounts contained in the financial reports are accurate and true reflection of the organizations status and they can be relied upon when making decisions.

Internal control elements being implemented vary from one organization to another as established by Wangechi and Muturi (2017) in their study on the effect of control systems on financial performance of cooperative societies. The elements of internal control system adopted by Wangechi and Muturi (2017) in their study were; internal administrative control systems, accounting and risk assessment control systems. These elements though considered in our current study did not encompass the same latitude of application as in Wangechi and Muturi (2017) study. The internal control system elements were combined to form a single indices in

URL: http://dx.doi.org/10.14738/assrj.88.10799

order to run the regression model which encompassed other variables like monitoring, information communication technology and challenges of implementing the control systems. This study is similar to our current study as they are situated in the descriptive research design and utilize the regression model to establish the size of effect of independent variables on the dependent variable. The studies differ when it comes to their geographical location and the size of the population beside the choice of independent variable.

In a study conducted by Anania and Gikuru (2015) established that internal conflicts as well as external conflicts had a negative effect on the performance of SACCOs. This study was conducted on the SACCOs operating within Tanzania. The external and internal factors tended to affect the control systems within the SACCOs. The management within the SACCOs experienced institutional challenges the moment the management and the other employees were in conflict thus affecting the internal control systems that would eventually lead to below performance of the SACCOs. This study results are similar to those generated by Mwangi (2015) when conducting a study on factors influencing the performance of UNAITAS SACCO in Kenya established that conflicts brought about organizational subcultures and rewarding schemes had a significant effect on the performance of the SACCO. The study utilized both quantitative and qualitative data unlike the Anania and Gikuru (2015) study which was a qualitative study. In a study conducted by Kiyieka and Muturi (2018) to investigate the effect of internal controls on financial performance of deposit SACCOs in Kisii County established a positive and significant relationship between internal control and financial performance. This study by Kiyieka and Muturi (2018) adopted the internal audit controls, internal information system controls, internal risk assessment controls and internal corporate controls as the measures of internal control systems. This study focused primarily on 10 deposit taking SACCOs located in Kisii County while the present study focused on the more than 70 registered Dairy Cooperative Socities in Meru County. The Kiyieka and Muturi (2018) study was situated within the descriptive research design and they made use of regression and correlational analysis to conduct data analysis in a bid to establish the size of effect. The present study also made use of regression and correlational analysis. The study conducted in Kisii established that information system control did not return a positive and significant relationship with financial performance. The current study deviates from the Kiyieka and Muturi study as internal control system is considered as a combination of several independent variable whereas in the current study internal control was considered as a singular independent variable.

The study conducted by Mbaka (2018) established a positive and significant relationship between internal control system elements and financial performance of SACCOs within Nyeri Central Sub- County in Kenya. The study had four independent variables; the control environment, control activities, control assessment and monitoring whereas the current study had four independent variables. The monitoring variable returned statistically insignificant effect on financial performance whereas the other three variables had a positive and statistical significant effect. The Mbaka (2018) study made use of cross-sectional research design due to its versatility in describing the study's phenomena, whereas the present study utilized a descriptive research design. Regression modelling is the preferred statistical method of establishing the size of effect between the independent variables and the dependent variable, this is the same model that the current study is going to utilize though with additional independent variables. The studies by Kiyieka and Muturi (2018) and the one by Mbaka (2018) though conducted in different geographical regions and with different target populations retuned the same results when comparing the relationship between internal control systems and financial performance of SACCOs.

The Conceptual Framework of the Study

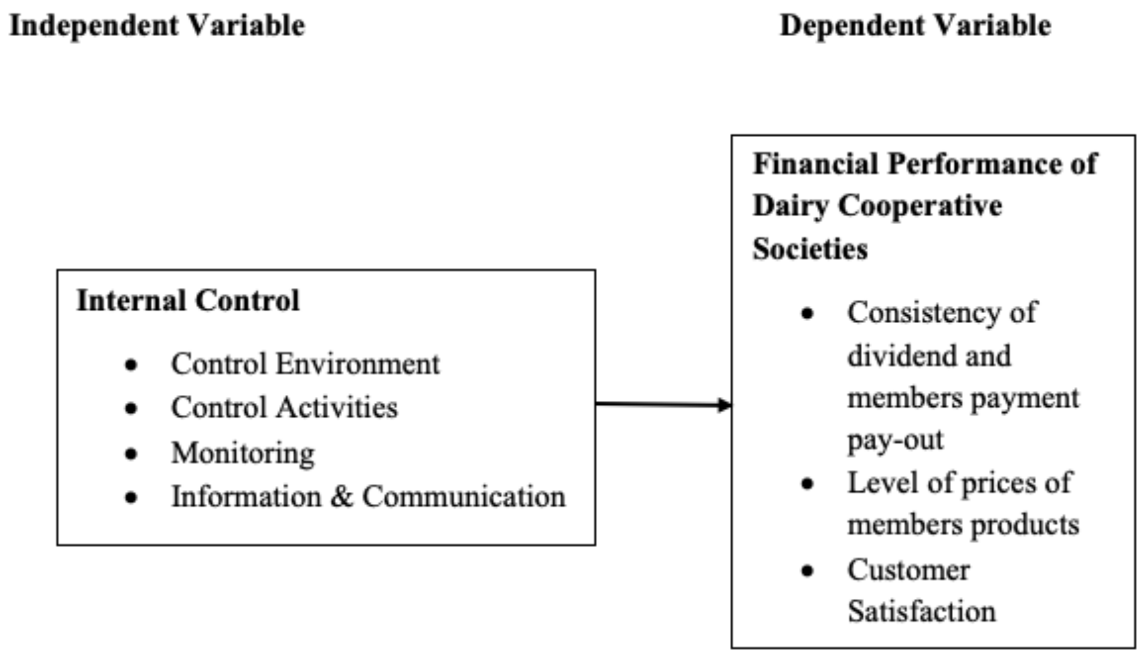

Figure 1: Conceptual Framework

Internal controls is one of the pillars of corporate governance and is usually designed to mitigate deviation from the set standards. It tends to influence and affect operational and management decision making in the organization (Wangechi & Muturi, 2017). It is designed in such a way that provides reasonable assurance on the performance of the organizational activities within the rules, regulations and procedures governing the organization (Jenning *et al.,* 2008). The internal control systems ensures that issues that have financial implications to the organization are carried out as per the dictates of the system. The internal control system put in place ensure records are kept appropriately, tasks are completed on time and all authorizations are carried out as spelt out in the organizational policy. This eventually leads to improvement in the overall financial performance of the organization.

RESEARCH METHODS

The study was designed to establish the influence of internal controls on the financial performance of Dairy Cooperative Societies in Meru County. The study adopted a descriptive research design due to its ability to describe the phenomenon surrounding the effect of internal controls on financial performance of the societies. The target population comprised the 72 Secretary Managers of all the registered Dairy Cooperative Societies in Meru County. The study adopted a census due to the size of the population and the need to establish credible data on the study variables. Data was collected using a questionnaire that was dropped for the respondents to fill and then collected later on.

RESULTS OF THE STUDY

The study identified a population of interest comprising of 72 respondents who represented the target population. The filled questionnaires from the secretary managers that could be utilized for data analysis were 64 representing 88.88 per cent response rate. The response rate was considered adequate for inferential statistics. This is supported by Mugenda and Mugenda (2008) who indicated that a response rate of more than 60 per cent is adequate for inferential statistics. In terms of gender distribution the male respondents comprised of 26.6 per cent of the total respondents while female respondents represented 73.4 per cent of the total number of respondents. Those who had work experience of less than five years were found to represent 70 per cent of the total respondents while those with more than five years of work experience in the Dairy industry represented 30 per cent of the total respondents. In terms of education majority of the respondents had gained higher education certifications like Diplomas, Degrees and Masters and represented 60 per cent of the respondents while 40 per cent of the respondents had Secondary School Certificate only.

The reliability of the study instrument was established by the use of Cronbach Alpha Test. The analysis indicated that the Cronbach Alpha coefficient was 0.57 which was more than 0.5 as per Cooper and Schindler (2013) argument. The relationship between the constructs was measured by using Pearson's correlation analysis. The relationship between internal control and financial performance was at $r = 0.307$, $p < 0.05$.

The study sought to establish the contribution of the independent variable internal controls on financial performance of Dairy Cooperative Societies in Meru County. The regression model is summarized as below;

Table 1.1 Regression Model Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.792[a]	.627	.557	.523	1.984

a. Predictors: (Constant), Internal Control
b. Dependent Variable: Financial Performance

The Table 1.2 below indicates the effect of the independent variable (Internal Control) on the dependent variable (Financial Performance). The results of the simple regression analysis is indicted in Table 1.2 below. This shows a positive and significant effect on the relationship between internal controls and financial performance of Dairy Cooperative Societies ($\beta=0.026$, $p< 0.05$). This means that an increase of 0.232 on internal controls would lead to a unit increase on financial performance of Dairy Cooperative Societies.

Table 1.2 Regression Size of Effects

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	1.348	0.654		5.850	.000
Internal Controls	.232	.343	.452	3.272	.026

a. Dependent Variable: Financial Performance

POLICY IMPLICATIONS

The study determined the influence of internal control on the financial performance of Dairy Cooperative Societies in Meru County. It was established that internal control had a positive and significant effect on the financial performance of the societies. The regression coefficient of internal control stood at 0.232 which is statistically significant as the p-value is 0.026 which is less than 0.05.This therefore indicates that a unit increase in internal control results to a 0.232 increase in financial performance of Dairy Cooperative Societies in Meru County.

The study concludes that internal control is a pertinent factor in influencing the financial performance of Dairy Cooperative Societies in Meru County. The regression model reveals that internal controls had a significant effect of 0.232 on financial performance. This is a good indicator that the internal control system should be well set out before implementing it. The organization should be in a position to institute a working internal control support system that supports all activities within the organization. This safeguards the organization from implementing strategies that are not linked to the purpose and mission of the organization.

Based on the findings and conclusions of the study the Cooperative Societies in Meru County should improve on the internal control systems. The ability to conduct internal audit of their processes should be prioritized for the societies to work within the budgeted resources and fulfill the aspirations of the members'. The societies should deploy their policies and procedures and ensure that they are observed by each of the employees and management. This will only work if the hierarchy of authority is observed. Thus this study recommends the institution of the organizational charts and implementation of service charter to help in bolstering the complete implementation of the internal control systems.

References

Anania, P., & Gikuri, A. (2015). SACCOs and members expectations: Factors affecting Sacco's capacity to meet member's expectations. *Paper Submitted to the Cooperative Research Workshop Held on 24th March 2015, Moshi, Tanzania*.

Aralik, B., Unkuyu, G., & Altintas, T. (2017). Exploring the effects of business performance on small and micro enterprises to establish an internal control committee: A binary logistic model. *Marmara Üniversitesi İktisadi ve İdari Bilimler Dergisi, circli* 39 (2), 473-486

Cooper, D. R., & Schindler, P. S. (2013). *Business Research Methods.* New York, McGraw-Hill

Hussein, U., & Muhammed, U. (2018). The effect of internal control and performance of commercial banks in Nigeria. *International Journal of Management Research & Review*, Vol. 8 (6), 13-32

Kiyieka, E., & Muturi, W. (2018). Effect of internal controls on financial performance of deposit taking savings and credit cooperative societies in Kisii County, Kenya. *International Journal of Social Sciences & Information Technology*, Vol. IV(X), 30-40.

Kyazze, L., Nkote, Isaac, N & Wakaisuka-Isingoma, J. (2017). Cooperative governance and social performance of cooperative societies, *Cogent Business & Management*, Vol. 4(1), 1-14

Mbaka, M. (2018). Effects of internal control systems on financial performance of SACCOs in Nyeri Central Sub County, Kenya. *An Unpublished MBA Thesis Submitted to School of Business Management and Economics, Dedan Kimathi University of Technology.*

Mohan, A., & Chandramohan, S. (2018). Impact of corporate governance on firm performance: empirical evidence from India. IMPACT: *International Journal of Research in Humanities, Arts and Literature* (IMPACT: IJRHAL) ISSN (P), 2347-4564.

Mugenda & Mugenda (2008) Building theories from case study research. *Academy of Management Review,* 14(4): 532-550.

Mwangi, E. (2015). Factors influencing performance of SACCOs in Kenya. A case of UNAITAS SACCO. *An Unpublished MBA Research Project Submitted to Management University of Africa.*

Subramanian, S. (2018). Stewardship Theory of Corporate Governance and Value System: The Case of a Family-owned Business Group in India. *Indian Journal of Corporate Governance*, *11*(1), 88–102. https://doi.org/10.1177/0974686218776026

Waithaka, M. (2013). *Factors that influence the social performance of microfinance institutions in Kenya* (Doctorof Philosophy in Entrepreneurship). Jomo Kenyatta University of Agriculture and Technology, Nairobi.

Wangeci, C. & Muturi, W. (2017). The effects of internal control systems on the performance of SACCOs in Kenya. A case study of SACCOs in Kisii County. *International Journal of Social Sciences & Information Technology*, Vol. 3 (2), 1862 - 1869.