

CONTROL ACTIVITIES AND INFORMATION AS FACTORS OF INTERNAL CONTROL SYSTEMS ON FINANCIAL PERFORMANCE AMONG LISTED COMMERCIAL BANKS IN KENYA

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ABSTRACT

The purpose of the study was to assess the effect of Control Activities and Information as factors of internal control systems on financial performance among listed commercial banks in Kenya. Descriptive research design was used in the study. The target population was a total of 379 employees while the sample size was a total of 191 employees. Data was collected by use of self-administered questionnaires. Descriptive statistics including means, standard deviation and frequency distribution were used to analyze the data. In addition, the study used correlation and multivariate regression analysis to assess the effect of the independent variables on the dependent variable. The study found that Control

activities had a positive and significant influence on commercial bank performance ($\beta_1 = 0.459$; $t = 2.107$; $p < 0.05$). Information and communication had a positive and significant influence on the performance of the commercial banks surveyed ($\beta_2 = 0.272$; $t = 2.125$; $p < 0.05$). The study concluded that control activities at the listed commercial banks had a positive and significant influence on performance, while information and communication was significant in influencing financial performance.

Keywords: Internal Control Systems, Control Activities, Information, Return on Assets (ROA).

INTRODUCTION

Internal control is a crucial aspect of an organization's governance system and ability to manage risk. It ensures the achievement of an organization's objectives and creating, enhancing, and protecting stakeholder value (IFAC, 2012).

In Ghana, there is an increasing fraud in the Ghanaian business circles, therefore vigilance is needed to prevent it through good internal controls. 10% of employees will steal, and 10% will not steal, 80% are not decided but when given the opportunity, they will steal hence lack of effective controls is the cause of fraud in Ghanaian business circles and the world at large (Offori, 2011).

In Nigeria, the major causes many government parastatals or industries which started off well later falling or remaining stagnant in their operations were traced down to low accountability which emanated from a lot of factors, part of which are poor accountability and inadequate provision of fund in an organization. Accountability has always been an important feature of life. In fact, it is

said to be life blood of any organization. Without accountability it is impossible to run any activities of any organization (Adewale, 2014).

In Kenya, according to Anyanzwa (2013) noted that the failure in companies internal control structures preceded corporate failures and accounting frauds. Additionally, data from the Capital Markets Authority (CMA) depicted a 18% rise in reported fraud cases to 460 in 2011 from 390 in 2010, making fraud an area of concern for the financial sector due to its potential impact on market's confidence.

Statement of the Problem

According to Duggan (2016), fraud and theft are a result of inappropriate or lack of internal controls. In turn, monetary loss as a result of accounting frauds and corporate scandals and accounting frauds often leads to corporate failure.

Recent examples of corporate scandals in Kenya including CMC Group, Mumias Sugar Co., Uchumi Ltd, NSSF, NYS, Imperial Bank and Chase Bank have brought to the fore poor business practices and ineffective management leading to considerable monetary losses. Further, Banking fraud has been detrimental towards banks directly, and the banking industry as a whole, affecting their financial bottom line, customer relations and investor relations. As a result, fraud, alluding to poor internal controls, has had a severe negative impact on banks financial performance; For instance, Ochieng (2016) noted that senior management at Imperial Bank and Chase Bank perpetrated fraud leading to the loss of ksh 38 billion and 8 billion respectively which eventually led to their closure.

Therefore, the study sought to assess the effect of Control Activities and Information as factors of internal control systems on financial performance among listed commercial banks in Kenya.

Purpose of the Study

The purpose of the study was an assessment of Control Activities and Information as factors of internal control systems on financial performance among listed commercial banks in Kenya.

Objectives of the Study

The specific purpose of the study was:

- i. To evaluate the effect of control activities on financial performance among listed commercial banks in Kenya.
- ii. To investigate the effect of information & communication on financial performance among listed commercial banks in Kenya.

Research Questions

- i. Do control activities affect financial performance among listed commercial banks in Kenya?
- ii. To what extent does information & communication affect financial performance among listed commercial banks in Kenya?

Theoretical Review

Systems Theory

Hegel developed in the 19th century a theory to explain historical development as a dynamic process. Marx and Darwin used this theory in their work. System theory (as we know it) was used by L. von Bertalanffy, a biologist, as the basis for the field of study known as 'general system theory', a multidisciplinary field (1968). Some influences from the contingency approach can be found in system theory (UOT, 2015). System theory is the transdisciplinary study of the abstract organization of phenomena, independent of their substance, type, or spatial or temporal scale of existence. It investigates both the principles common to all complex entities, and the (usually mathematical) models which can be used to describe them. The Internal control variables of Control Activities and Information & Communication are subcomponents of the internal control system that have to work together if the whole system is to be effective. In this regard the systems theory impacted highly on Control Activities and Information & Communication.

Institutional Theory

Institutional theory is a widely accepted theoretical posture that emphasizes rational myths, [isomorphism](#), and legitimacy. Institutional theory focuses on the deeper and more [resilient](#) aspects of social structure. It considers the processes by which structures, including schemes, rules, norms, and routines, become established as authoritative guidelines for social behavior (Scott, 2004). The institutional theory impacted highly Control Activities.

Empirical Literature

Control Activities

Deshmukh (2004) investigated the relationship between online internal controls and financial performance. The study was guided by the following objectives: to analyze the relationship between the control Environment, risk assessment, control activities, information & communication and monitoring and Financial Performance. The study used a sample of 44 listed companies in the USA and data was analyzed using multivariate regression analysis. The study concluded that control activities positively influence a firm's financial performance. The study recommended that in order for internal controls to be effective in positively influencing financial performance a firm should pay close attention to appropriate authorization of transactions; Separation of duties; Proper design and usage of documents and records; Safeguarding of assets and records via adequate access controls; Independent verification, for example, internal and external audits.

Arad & Navid (2009) examined a clear look at internal controls on achievement of a firm's objectives. The study was guided by the following objectives: To examine the influence of the control environment, risk assessment, control activities, information & communication and monitoring activities on achieving a firm's objectives. The study used a sample size of 67 internal auditors from various firms in Iran and data was analyzed using correlation analysis and multivariate analysis. The study concluded that control activities help ensure that management

directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. The study recommended that generally, control activities that may be relevant to an audit may be categorized as policies and procedures that pertain to the following: Performance reviews; Information processing; Physical controls; Segregation of duties. The auditor should obtain an understanding of those control activities relevant to planning the audit.

Information and Communication

Arad & Navid (2009) examined a clear look at internal controls on achievement of a firm's objectives. The study was guided by the following objectives: To examine the influence of the control environment, risk assessment, control activities, information & communication and monitoring activities on achieving a firm's objectives. The study used a sample size of 67 internal auditors from various firms in Iran and data was analyzed using correlation analysis and multivariate analysis. The study concluded and recommended that information and communication are essential to effecting control. Information about an organization's plans, control environment, risks, control activities, and performance must be communicated up, down, and across an organization.

Financial Performance

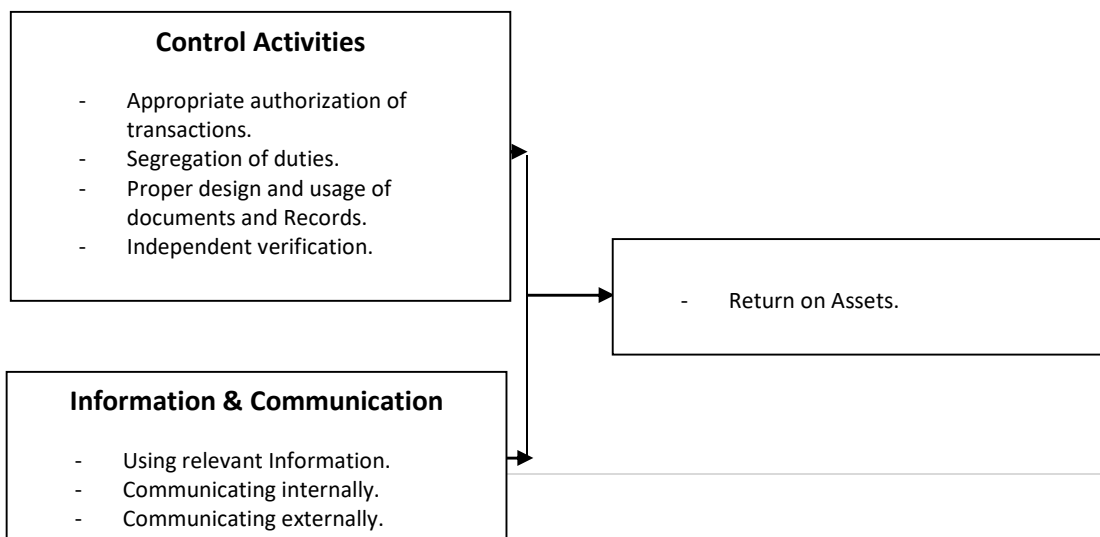
Nyakundi, Nyamita & Tinega (2014) analyzed the effect of internal control systems on financial performance of small and medium scale business enterprises in Kisumu City, Kenya. The findings depicted a significant positive relationship between internal control system and financial performance.

Muraleetharan (2010) investigated internal control and impact of financial performance of organizations (special reference public and private organizations in Jaffna district, Sri Lanka). The findings showed that control activities and information & communication positively influence financial performance.

Conceptual Framework

Independent Variables

Dependent Variable



Control activities are the actions established through policies and procedures that help ensure that management’s directives to mitigate risks to the achievement of objectives are carried out.

On information & communication pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities.

In this study financial performance has been measured by ROA. This ratio is calculated as net profit after tax divided by the total assets. This ratio measures the operating efficiency of a company based on the firm’s generated profits from its total assets. ROA is a useful measure of how well a bank manager is doing on the job because it indicates how well a bank’s assets are being used to generate profits.

RESEARCH METHODOLOGY

Target Population

The study targeted the managers (heads of department) and assistant managers (assistant heads of department) within the key departments of the banks stated. It also included key accounting personnel and auditors from the stated banks.

Target Population

	Name of Listed Bank	No. of Managers &		No. of key	
		Accounting	Total		Assistant Managers
				Auditors	
1.	Barclays Bank		30	9	39
2.	CFC Stanbic Holdings		28	5	33
3.	I&M Holdings		24	6	30
4.	Diamond Trust Bank Kenya		28	6	34
5.	Housing Finance Co Ltd		20	6	26
6.	Kenya Commercial Bank		30	9	39
7.	National Bank of Kenya		28	7	35
8.	NIC Bank Ltd		28	5	33
9.	Standard Chartered Bank		30	6	36
10.	Equity Bank		36	9	45
11.	The Co-operative Bank of Kenya		22	5	27
TOTAL			304	75	379

Source: NSE (2016)

Sample Size

Sample size	Name of Listed Bank	No. of Managers & Assistant Managers		No. of key Accounting personnel & Auditors	
		Total			
1.	Barclays Bank	30	9	20	
2.	CFC Stanbic Holdings	28	5	17	
3.	I&M Holdings	24	6	15	
4.	Diamond Trust Bank Kenya	28	6	17	
5.	Housing Finance Co Ltd	20	6	13	
6.	Kenya Commercial Bank	30	9	20	
7.	National Bank of Kenya	28	7	18	
8.	NIC Bank Ltd	28	5	17	
9.	Standard Chartered Bank	30	6	18	
10.	Equity Bank	36	9	22	
11.	The Co-operative Bank of Kenya	22	5	14	
TOTAL		304	75	191	

Source: NSE (2016)

The sample size was the total of 191 managers (heads of department), assistant managers (assistant heads of department), key accounting personnel and auditors.

Data Collection Methods & Procedures

The data used included both primary and secondary data. Primary data was collected by use of questionnaires that were hand delivered to the relevant institutions. A five-point Likert scale was used to analyze the key internal control factors influencing financial performance among listed commercial banks in Kenya.

Data Analysis techniques & Procedures

Descriptive statistics including means, standard deviation and frequency distribution were used to analyze the data. In addition, inferential statistics including multiple regression analysis were used to assess the influence of the independent variables on the dependent variable. The regression model to be used was:

$$y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \varepsilon$$

Whereby:

y = Financial Performance.

β_0 = constant

β_1, β_2 , = coefficients of Control Activities and Information & Communication influencing Financial Performance.

X_1 = Control Activities.

X_2 = Information & Communication.

ε = Error term

Findings, Analysis & Interpretation

Statements were listed and respondents required to indicate the extent on a five-point likert scale. The scale used was 1 = Very low extent, 2 = Low extent, 3 = Moderate extent, 4 = High extent and 5 = Very high extent. Percentages were used to analyse the responses and results are presented.

Control Activities

Statement	Moderate extent (%)	High extent (%)	Very high extent (%)
Ensuring Appropriate authorization of transactions	0	11	89
Segregation of duties	0	18	82
Proper design and usage of documents and Records	0	21	79
Independent verification, for example, internal and external audits	1	8	91

Source: Research (2016)

These results are similar to the findings by Deshmukh (2004) that control activities positively influence a firm's financial performance. The study by Deshmukh noted that appropriate authorization of transactions, separation of duties, proper design and usage of documents and records and safeguarding of assets and records via adequate access controls were critical in providing an environment for high performance.

Information & Communication

Statement	Moderate extent (%)	High extent (%)	Very high extent (%)
Using relevant Information	0	25	75
Communicating internally	0	28	72
Communicating externally	15	20	65

Source: Research (2016)

These findings concur with the results by Arad and Navid (2009) that information and communication of an organization's plans and control activities enhances working relationships and hence improving performance.

Performance of the Banks

An average ROA (%) for five years (2011-2015) was computed.

Performance of the Banks

Bank	Average ROA (5 years) (%)
Barclays Bank	4.25
CFC Stanbic Holdings	2.99
I&M Holdings	3.30
Diamond Trust Bank Kenya	3.24
Housing Finance Co Ltd	1.60
Kenya Commercial Bank	3.76
National Bank of Kenya	1.71
NIC Bank Ltd	3.06
Standard Chartered Bank	4.06
Equity Bank	9.51
The Co-operative Bank of Kenya	3.29

Correlation Matrix

		Control activities	Information and Communication	Performance
Control activities	Pearson Correlation Sig. (2-tailed) N	1 100		
Information and Communication	Pearson Correlation Sig. (2-tailed) N	.534** .001 100	1 100	
Performance	Pearson Correlation Sig. (2-tailed) N	.664** .000 100	.403** .011 100	1 100

The results indicate that all the variables were significantly related to performance. Control activities in the commercial banks had a positive and significant relationship with bank performance ($r = 0.664$; $p < 0.05$). This implied that control activities in the commercial banks positively associated with bank performance and hence improvement in control activities would hence be associated with improvement in bank performance. These results related with the findings by Arad and Navid (2009) that control activities help ensure that management directives are carried out and hence ensuring that necessary actions are taken to address risks for the achievement of the entity's objectives.

Information and communication facets had a significant positive relationship with bank performance ($r = 0.403$; $p < 0.05$). These findings indicated that information and communication facets at the commercial banks surveyed were significantly and positively associated with performance implying that improvement in information and communication was expected to lead to improvement in bank performance. These results agree with the findings by Arad and Navid (2009) that information and communication are essential for effecting control. Arad and Navid established that information about an organization's plans, control environment, risks, control activities, and performance must be communicated up, down, and across an organization.

Significance of Independent Variables

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.259	.123		2.109	.039
Control activities	.459	.218	.228	2.107	.038
Information and communication	.272	.128	.186	2.125	.031

The resulting regression equation was of the form

$$y = 0.259 + 0.459X_1 + 0.272X_2$$

The results indicated that information and communication had a positive and significant influence on the performance of the commercial banks surveyed ($\beta_2 = 0.272$; $t = 2.125$; $p < 0.05$). These findings reveal that improving information and communication by a unit would result in improvement of bank performance by 0.272. These findings relate with the findings by Musya (2014) that information & communication helps to evaluate how well guidelines and policies of the organization are working and being implemented and thus effectively attaining their revenue collection targets.

Secondly, the regression results established that control activities had a positive and significant influence on commercial bank performance ($\beta_1 = 0.459$; $t = 2.107$; $p < 0.05$). This was the least significant variable in the model with a t statistic of 2.107. However, the variable was significant in influencing commercial bank performance. A unit improvement in control activities would result to an improvement of 0.459 in bank performance. These results agree with the findings by Arad and Navid (2009) that having effective control activities enhances firm’s performance.

Conclusion

The study makes the following conclusions. First, control activities at the listed commercial banks had a positive and significant influence on performance. The banks undertook independent verification through internal and external audits and also implemented measures that ensured that there was appropriate authorization of transactions. The banks also reduced risk by engaging in effective segregation of duties and had a proper design and usage of documents and records. These practices were instrumental in enhancing financial performance of the listed commercial banks.

Second, information and communication at the listed commercial banks was significant in influencing financial performance of the banks. Moreover, information and communication facets positive related with bank performance. In the listed commercial banks, there was use of current and relevant information, effective internal as well as external communication. This effectiveness in communication was instrumental in enhancing performance in the listed commercial banks.

Recommendations of the Study

Ensuring adequate control activities would be imperative towards a firm's financial performance. These activities include appropriate authorization of transactions, suitable segregation of duties, proper design and usage of documents and records and ensuring independent verification. This is recommended because control activities help ensure that necessary actions are taken to address risks to achievement of the entity's objectives.

Second, pertinent information must be identified, captured and communicated in a form and time frame that enables people to carry out their responsibilities. Use of relevant Information, effective internal communication and external communication are critical towards a firm's performance.

Recommendations for Further Research

A future study should also be conducted in other sectors beyond the commercial banks and most preferably SMEs. This would provide a deeper insight into how internal controls are implemented in SMEs as they are not as highly regulated as commercial banks. The need for a study on SMEs is due to their role in industrializing the county and provision of employment.

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