EFFECT OF INTERNAL CONTROLS ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY

BY

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UNITED STATES INTERNATIONAL UNIVERSITY- AFRICA

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EFFECT OF INTERNAL CONTROLS ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY

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A Research Project Report Submitted to the Chandaria School of Business in Partial Fulfilment of the Requirements Master of Business Administration (MBA)

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SUMMER 2019
STUDENT’S DECLARATION
I declare this work has not been submitted to any other university other than United States International University-Africa, it’s my original work which has been submitted for the Academic purposes.

Signed: ___________________________  Date: ___________________________

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This project has been presented for examination with my approval as the appointed supervisor.

Signed: ___________________________  Date: ___________________________

Timothy C. Okech, (PhD)

Signed: ___________________________  Date: ___________________________

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ABSTRACT

The purpose of the study was to establish the effect of internal controls on financial performance of small and medium enterprises in Nairobi county in Kenya. The study was guided by the following research questions; what is the relationship between internal controls and financial performance of SMEs in Nairobi County in Kenya? What is the effect of monitoring on financial performance of SMEs in Nairobi county in Kenya? and how do risk assessment affect financial performance of SMEs in Nairobi County in Kenya?

The study adopted a descriptive research design. The study used descriptive design which enabled the researcher to collect in depth information about the population being studied. This study focused on the population of employees who are in working with the small and medium enterprise in Nairobi county. The target employees included the ones from the following departments, human resource, financial managers, procurement, and accountings. A population of 387 employees for the hundred SMEs in Nairobi. This research used probability technique and under this technique the research specifically used the Stratified Random Sampling approach. A sample size of 116 employees was targeted for this particular study.

Primary data was collected using a structured questionnaires. Statistical Package for Social Sciences (SPSS version 24). Computer software program was used in analyzing the data which was collected from the field. Quantitative data was analyzed, and the output presented using descriptive statistics namely: mean, standard deviation, percentages. A multiple linear regression model was used to assess whether internal controls has an effect on the performance of SMEs.

The first research question sought to determine the relationship between internal controls on financial performance. Pearson correlational analysis was conducted to determine the relationship between the independent variable internal controls and dependent variable financial performance. The findings revealed that there is a positive and significant relationship between internal controls and financial performance, $r (0.738); p-value < 0.05$. The findings of this study revealed that 53.6% of the variability in financial performance can be attributed to internal controls. The second research question sought to determine the effect of monitoring on financial performance. The findings revealed that there was a positive and significant influence between monitoring and financial performance, $r (0.804)$;
p-value < 0.05. The findings also show that 64% of the variability in financial performance can be attributed to monitoring.

The third research question sought to determine the effect of risk assessment on financial performance. The findings revealed that there was a positive and significant influence between risk assessment and financial performance, \( r (0.616); p\text{-value} < 0.05 \). The result of the findings show that 36.9% of the variability in financial performance can be attributed to risk assessment.

This study concludes that there exists a significant relationship between internal controls and financial performance. Internal control activities should highlight policies and procedures that help ensure management directives are carried out. They help to ensure that necessary actions are taken to address risks to the achievement of the entity’s objectives. This study concludes that there is a significant and positive relationship between monitoring and financial performance. This study concludes that monitoring influences quality and effectiveness in the organization, effectiveness of internal control systems and audit reviews. This study concludes that there is a significant relationship between risk assessment and financial performance. This study concludes that risk assessment is crucial for risk identification in the business environment. Risk assessments enhances risk evaluation and risk mitigation in the company by putting risk factors into consideration.

This study recommends that SMEs should develop internal control systems that are in line with their financial performance of the organization. Internal controls will help the organization in tracking its business performance including profitability, control and effectiveness of the entire organization as a whole. This study recommends that SMEs should constantly monitor their financial performance by implementing audit reviews as well as performance reviews to make sure that organizational objectives are achieved accordingly. This study recommends that risk assessments practices should be adopted by all small and medium-sized enterprises operating in Nairobi since it is critical for enhancing financial performance of the company without being exposed to environmental risks in which they operate.
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LIST OF ABBREVIATIONS

SME: Small Medium Enterprise

SPSS: Statistical Package for Social Sciences

ANOVA: Analysis for Statistical Package for Social Sciences

MBA: Master of Business Administration

GNP: Gross National Product

ISA: International Standard on Auditing
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DEDICATION
The project report is dedicated to my family for their love, understanding, encouragement and support while conducting this study and throughout my MBA course.
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

The survival of an organization depends on the effective and efficient utilization of resources at the disposal of the organization (Ojera, 2018). In order to optimize the utilization of resources entrusted to all employees in an organization, various forms of control are put in place by management of the organization, including these major controls are internal control and internal audit to mention a few. Internal control can be defined as a set of mechanism designed to motivate an individual or a group towards achievement of a desired objectives while internal control must be able to achieve the objective of bringing about cooperation among people with divergent objectives in an organization (Eniola, & Oluwafemi, 2016). International Standard on Auditing (ISA 400) defines internal control as all policies and procedure adopted by the management of an entity to assist in achieving the primary objectives of the management by make sure the business is conducted in the most possible efficient way and also ensuring strict adherence to management policies, safeguarding of asset, prevention and detection of fraud and timely preparation of reliable account (Chorafas, 2010). On the other hand, Financial Performance of an organization can be described in various forms including return on assets, return on sales, return on equity, return on investment, return on capital employed and sales growth (Sarens, Abdolmohammadi, & Lenz, 2012). It is also a measure of the excess value a company has provided to its shareholders over the total amount of their investments.

Internal controls has various interconnected components including risk assessment, control activities, information and communication and monitoring (Akisik & Gal, 2017). Control Environment considerably influences and determines organizational tone, has a significant impact on the perception relating to control system and also serves as a foundation for effective functioning of the internal control system. Risk assessment as the procedure employed by the management of the firm to handle the risks that act as hurdles in accomplishing the objectives. Risk assessment is the identification, assessment and supervision of risks. These risks involve misstatement of financial data or even the inefficient utilization of assets. Control activities comprise a variety of tasks such as agreements, endorsements, certification, reconciliation, conducting reviews, providing security, and the development and maintenance of data which serve as proof of
implementation of these activities along with suitable documentation. Information and communication as procedures adopted by a firm to gather, process and report authentic information within the appropriate time to ensure employees perform their duties punctually (Channar et al., 2015).

Internal controls are designed to provide reasonable assurance regarding the achievement of an organization’s objectives in terms of effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations (Ibrahim, Diibuzie, & Abubakari, 2017). A major problem that small enterprises face is that these objectives may not be met due to a miscellany of factors. These include, but not limited to management override of internal control systems for the purposes of manipulating financial reporting, collusion by personnel to overcome controls, human error, and cost benefit considerations (Oseifuah & Gyekye, 2013). SMEs are the most vulnerable to fraudulent schemes, scams, employee embezzlement, pilferage, and other sundry crimes in the work place because they often do not have effective internal control systems. It has further been established that poor internal controls account for 30 percent of small business failures in the USA.

Globally, internal control systems not only contribute to managerial effectiveness but are also important duties of corporate boards of directors. Accounting literature likewise emphasizes the importance of an organization’s integrity and ethical values in maintaining an effective control system. A focus on integrity and ethical values was the principal contribution of Internal Control Integrated Framework published by the Committee of Sponsoring Organizations of the Tread way Commission on fraudulent financial reporting (Phiri & Mbetwa, 2017).

The benefits of an internal controls include effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations (Gift, 2018). The small and medium scale business enterprises have been recognized not only to play a major role in Kenya’s economy but also provide the much-needed employment opportunities. Studies have shown that the sector has the necessary ability of alleviating poverty through the creation of employment opportunities and generation of income. In recognition of the steady increase in unemployment, the Kenyan government has appreciated the within the business population, small and medium-sized businesses are the
predominant form of business organization, a factor that has contributed to the urgent need for ICSs. They provide extensive contributions to Gross National Products (GNP), job generation and wealth creation. Nevertheless, in ICS, this form of business group is largely underrepresented (Nyakundi, Nyamita, & Tinega, 2014).

SMEs have tended to have a more relaxed attitude towards fraud. This could be attributed to the increased difficulties in implementing solid internal controls or the closer working relationships within SMEs (KPMG, 2013). Whatever the reason, SMEs experienced a higher incidence of fraud with 50% of SME respondents experiencing at least one fraud in the past 2 years. One of the difficulties facing SMEs is their ability to absorb the cost of a fraud if it occurs. The survey identified that in over 40% of the fraud incidents none of the money lost was recovered, whilst the actual recovery rate of around 37% of the total dollar amount lost is very low. This research project sought to investigate the extent to which small firms engage in internal control practice to ensure its future survival from the introductory phase to the growth phase of the organizational life cycle (Njaramba & Ngugi, 2014).

Financial performance is the firm’s ability to efficiently operate, be more profitable, to grow and survive for a long period of time (Akisik & Gal, 2017). All organizations strive to utilize it resources effectively to achieve a high-performance level especially in financial terms. Thus, financial performance is the outcome of any of many different activities undertaken by an organization. Financial performance is an indication of how a firm can utilize its current assets from the firm’s main business mode and operations and generate revenues for the business (Harash, Al-timimi, & Alsaadi, 2014). Financial performance also shows how health a firm is in financial terms over a certain period. Financial performances is applied in weighing up firms from same industry or in comparison to other firms in different industries or sectors with intention to come up with a decision on how to improve on the prevailing situation or sustain a desirable position within the market (Anigbogu, Okoli, & Nwakoby, 2015).

Systems of internal control play an important role in every organization as it assists in realization of their financial performance goals. As such, strong and effective internal control system has the potential of strengthening a firm’s governance, help in achievement of set goals and objectives by the management and risk mitigation (Shanmugam & Ali, 2012). IFAC (2012) posits that effective internal control has a potential of creating a
competitive advantage since a firm with an effective control system is able to take on additional risk.

Sanusi, Johari, Said, & Iskandar, (2015) assessed internal control effectiveness, financial management and accountability practices of mosques in Malaysia and revealed that systems of internal control and enhances the performance of Malaysian Mosques to achieve their mission and goals. A study by Muraleetharan, (2013) assessed whether internal control system can lead to an increased performance in financial perspective of organizations. The findings of the study established that internal control and performance in financial perspective are statistically significant and a positive relation between communication and information, environment control and performance in financial perspective.

Internal control system in small scale manufacturing enterprises in Ondo State, Nigeria and the challenges encountered in the implementation of internal control system (Adedeji & Olubodun, 2018). Most small-scale manufacturing enterprises had control activities in place, with employment of competent staff in the first position (29.8%) while segregation of duties coming eighth (1%) in the rank order. It was also established that some internal control activities such as job description, organizational chart and procedures for transactions were absent. The study also revealed that the main challenges encountered in the implementation of internal control system in the small scale manufacturing enterprises were employees’ lateness to work (28.5%) in the first position, and fatigue and stress (4.1%) coming last. In conclusion, the major challenges associated with the implementation of internal control system in small scale manufacturing enterprises are employee related. It is recommended that small scale manufacturing enterprises should pay particular attention to human resource management practices.

The Top 100 Mid-Sized Companies in Kenya’s is the fastest growing medium-sized companies to showcase business excellence and highlight some of the country’s most successful entrepreneurship stories. SMEs account for 85 per cent of Kenya’s private sector employment. Hence, it is not an understatement to claim that the SME sector is the key engine of the country’s growth and jobs creation (KPMG, 2017). It is with this realization that Nation Media Group in partnership with KPMG made a conscious decision to support the growth of the sector through Top 100 Mid-Sized Companies Survey initiative. The success of Top 100 has seen it grow and expand to the other East African countries Uganda, Tanzania and Rwanda. Into the future, we are exploring various ways of utilizing mobile
first technology to create an SMEs’ community that will enable cross-sector partnerships that will generate sustainable value not only amongst the companies themselves but also for the regional economies.

The initiative will be the impetus for strengthening the broad-based SME sector through real time-sharing experiences, creating linkages and as a result scaling up. The vision is to see more and more companies scaling up to a turnover of more than Sh1 Billion and joining Club 101. Top 100 has become embedded in the commercial fabric of our society as a benchmarking and capacity building opportunity bringing together diverse entrepreneurs to offer critical learnings and inspiration (Davila, Gupta, & Palmer, 2017) The inspirational stories have defined our SME sector, but these are not just stories, they are steps taken, journeys travelled, and experiences encountered, that companies have undergone demonstrating courage, resilience, agility and dynamism. These are experiences that will continue to shape the economic destiny of our country.

1.2 Statement of the Problem

Internal controls have been in existence for many years in most organization, the problem of financial crimes, have continued to be on the increase (Chorafas, 2010). Examples of this financial crimes include; financial irregularities within the departments, collusion among senior or highly-trusted employees, breaches of control, to mention a few. Various researchers have affirmed that internal control set by management in most organization has not been able to completely prevent these fraudulent occurrences because these controls have not significantly reduced the reoccurring fraud and corruption perpetuated by employees in most organizations. As such, an effective internal control in SMEs has the potential of enabling them to succeed and reducing employee fraud (Pathak, 2005).

Several studies have also been undertaken on the effect of internal control on performance. Dineshkumar and Kogulacumar (2013), did a study on the influence of internal control systems on the performance of the Sri Lankan Telecom limited. The findings of the study showed there is a strong relationship between internal control system and organizational performance of the Sri Lanka Telecom limited. A study by Niyonsenga and Olang’o (2017) on the relationship between internal control system and financial performance in financial institutions in Rwanda. Poor internal control system leads to poor performance of an organization as the organization is exposed to different types of risks such as fraud,
embezzlement and waste, among others. The findings indicate that internal control system has positive strong correlation to financial. This study thus concludes that internal control systems (directive, preventive, compensating and detective controls) contribute highly to financial performance inform of increased capital, return on asset, loan and equity, increase in the bank deposit and profitability.

Kisanyanya (2018), investigated the internal control systems and financial performance of public Institutions of Higher learning in Vihiga County. The study found that the institutions had adequate and effective control activities which included regular internal audit reports, adequate segregation of duties in the finance and accounts departments and physical controls to prevent excess allocated funds. Control activities were found to have a positive significant effect on the financial performance of the institutions under study. Muhunyuo and Jagongo (2018), survey of internal control systems on financial performance in public institutions of higher learning in Nairobi City County. The findings indicated that internal control systems have a significant influence on the financial performance of the institutions of higher learning in Nairobi City County.

Most of the studies indicate that internal controls are vital to any business organization. Despite a fact that internal control is a vital factor affecting a firm regardless of its size, there is little evidence on the effect of internal controls on financial performance of small and medium enterprises since most of studies on internal controls globally and in Kenya focus more on large firms than SMEs. Thus, a literature gap that this study intended to fill.

1.3 Purpose of the Study

The purpose of the study was to examine the effect of internal controls on financial performance of small and medium enterprises in Nairobi County.

1.4 Research Questions

1.4.1 What is the relationship between internal controls and financial performance of SMEs in Nairobi County?

1.4.2 What is the effect of monitoring on financial performance of SMEs in Nairobi County?

1.4.3 How does risk assessment affect financial performance of SMEs in Nairobi County?
1.5 Justification of the Study

1.5.1 Management of SMEs

The Directors and managers of small and medium enterprises are expected to appreciate the importance of internal control system practices and assist in rating their level of compliance against those of their competitors. The management will get to know the various mechanisms through which they can exercise their control in the management of small and medium enterprises. Potential investors will also benefit as they will be able to determine which companies are properly governed hence make more informed investment decisions.

1.5.2 Researchers and Academicians

The study contributed to the existing body of knowledge on internal controls and financial performance. Researchers will benefit from both in literature review and the findings of this study which aimed at establishing the link between internal control and financial performance. The study will also identify further research areas where other researchers would have an opportunity to carry out further research and grow knowledge in internal controls and financial performance for the small and medium enterprises.

1.5.3 Policy Makers

The policy makers will gain insight on the effect of internal controls on financial performance of small and medium enterprises. The policy makers will be informed on the type of internal controls to incorporate in small and medium enterprises. Other institutions will benefit through the understanding of internal control systems play in enhancing accountability and transparency and effect on financial performance. The management of different business organizations will also benefit from the study through the understanding of internal controls and their role in financial performance.

1.6 Scope of the Study

The study was limited to the scope of Top 100 small and medium enterprises in Nairobi County in Kenya. The SMEs are located within industrial area, westlands area, Nairobi central business district and along Mombasa road. The sample population is based on the list of SMEs according to the KPMG and Nation Media Group survey of the 2017. The study only targeted employees from the finance department who gave information in regard
to the study. The time frame of the study was from January 2019 to April 2019 in which the study was conducted and analysis reported.

1.7 Definitions of Terms

1.7.1 Internal Controls

The Committee of Sponsoring Organizations defines internal control as a process effected by the entity's board of directors, Management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: Effectiveness and efficiency of operations; Reliability of financial reporting; Compliance with applicable Rules and laws and regulations (Integrated Framework 2013).

1.7.2 Small and Medium Enterprises

Small and medium-sized enterprises (SMEs) are independent firms which employs fewer than a given number of employees. This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as per the European Union definition. However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are generally those with fewer than 50 employees, while micro-enterprises have at most 10, or in some cases 5, workers.

1.7.3 Top 100 Small and Medium Enterprises

The Top 100 small and medium sized companies are normally ranked on the annual basis by survey which is carried by the KPMG and Nation Media Group. The survey collects general and financial information from all participating companies. In addition to the top100 ranking, the survey provides insights into the key market dynamics, industry benchmarking, human resource development, future expectations, and obstacles to growth, business confidence and drivers of success.

1.8 Chapter Summary

The chapter has presented the background of the study, the statement of the problem, purpose of the study, the research questions, and significance of the study to the different stakeholders, scope of the study and the definition of important terms used in the study. The next chapter reviewed literature about the three research questions. Chapter three offers the research methodology used to conduct the study. Chapter four presented the results and
findings obtained from the study. Chapter five offered the discussion, conclusion and recommendations of the study.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The chapter summarizes the literature review in existence regarding the effect of internal controls on financial performance of small and medium enterprises in Kenya. The first objective to be presented is the effect of control activities on financial performance of SMEs, effect of monitoring on financial performance of SMEs, and lastly how risk assessment affects financial performance of SMEs. It presents an overview of previous work on related topics that provides the necessary background for the research from the scholars.

2.2 The Relationship between Internal Controls and Financial Performance

Control activities are the policies and procedures that help ensure management directives are carried out. They help to ensure that necessary actions are taken to address risks to the achievement of the entity’s objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, and reviews of operating performance, security of assets and segregation of duties (Muraleetharan, 2013).

According to Gamage, Lock, and Fernando (2014), control activities are defined as the tools both manual and automated that help prevent or reduce the risks that can impede accomplishment of the organization's objectives and mission. Management should establish control activities to effectively and efficiently accomplish the organization's objectives and mission. Control activities are the policies and procedures that help ensure that necessary actions are taken to address the risks involved in the achievement of the entity’s objectives.

2.2.1 Approvals of Transactions

This duty belongs to people who have authority and responsibility for initiating or approving transactions. The authorization may be general, based on a class of transactions or it may be specific, on a specified transaction. These people initiate and approve transactions subject to subject matter limit and as prescribed by the management policy. Authorized transactions are those deemed to have been sanctioned by the authorized
officials, with clearly defined limits of authority for the various transactions (Kiprop, 2017). Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor’s approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.

2.2.2 Controls over Information Systems and Communications

Controls over information systems are grouped into two broad categories—general controls and application controls. General controls commonly include controls over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance (Muhunyo & Jagongo, 2018). Application controls such as computer matching and edit checks are programmed steps within application software; they are designed to help ensure the completeness and accuracy of transaction processing, authorization, and validity. General controls are needed to support the functioning of application controls; both are needed to ensure complete and accurate information processing.

It is believed that the information and communication control environment, risks, control activities and their implementation should be reported to superiors and move from the highest to the lower level of management, as well as horizontally in an enterprise. There is no doubt that information is needed for all levels of management to support their operations and to meet the objectives in terms of financial reporting and their compliance. All information used in business are so closely related to each other (Cika, 2018). For example, financial reporting is not only used from third parties or public, but also it plays an important role in the decision-making process or budget. Moreover, the quality of information affects the ability of managers to make decisions and control of business operations. Also shows the appropriateness of the data in the respective reports. Communication is one of the most natural attribute of information systems. Communication is defined as the availability of information from external or internal parties of the entity, in such ways as; from higher levels to lower ones, from the lowest levels in the higher ones, as well as between units connected horizontally. It is noted that internal control (Cika, 2018).
2.2.3 Preventive and Detective Controls.

Controls can be either preventive or detective. The intent of these controls is different. Preventive controls attempt to deter or prevent undesirable events from occurring. They are proactive controls that help to prevent a loss. Examples of preventive controls are separation of duties, proper authorization, adequate documentation, and physical control over assets. Detective controls, on the other hand, attempt to detect undesirable acts. They provide evidence that a loss has occurred but do not prevent a loss from occurring. Examples of detective controls are reviews, analyses, variance analyses, reconciliations, physical inventories, and audits. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role providing evidence that the preventive controls are functioning and preventing losses.

A study by Shanmugam, Haat, and Ali (2012), on the relationship between internal control on SME performance. For the sampling purpose, a set of questionnaires was distributed to the owners of SME and statistical tools were used to analyze them. The results of the study indicated that there was a significant relationship between the implementation of internal control and performance of SMEs. Most of the SMEs in Malaysia are ready to implement internal control but it is still in primitive stage and they may have lack of awareness on the advantages of internal control to their businesses.

2.2.4 Reconciliations and Internal Controls

Reconciliation is a comparison of different sets of data to one another, identifying and investigating differences, and taking corrective action, when necessary, to resolve differences. Reconciling monthly financial reports from the Accounting Department (e.g., Statement of Accounts, Ledger Sheets, etc.) to file copies of supporting documentation or departmental accounting records is an example of reconciling one set of data to another. This control activity helps to ensure the accuracy and completeness of transactions that have been charged to a department's accounts. To ensure proper segregation of duties, the person who approves transactions or handles cash receipts should not be the person who performs the reconciliation. Another example of a reconciliation is comparing vacation and sick leave balances per departmental records to vacation and sick leave balances per
the payroll system. A critical element of the reconciliation process is to resolve differences. It does no good to note differences and do nothing about it (Muhunyo & Jagongo, 2018). Differences should be identified, investigated, and explained—corrective action must be taken. If an expenditure is incorrectly charged to a department’s accounts, then the approver should request a correcting journal entry; the reconciler should ascertain that the correcting journal entry was posted. Reconciliations should be documented and approved by management.

A study by Shkurti (2017), on the effectiveness of internal control systems in Albanian small and medium size enterprises. They adopted the COSO framework definition for the internal control activities and, through a questionnaire, carried out a study of 86 Small and Medium Enterprises operating primarily in the area of Tirana, the capital and the industrial center of Albania. The findings of the study revealed that Albanian SMEs generally maintain transparent internal policies and regulations and that their employees are properly informed about these policies and regulations. Another finding is that the Albanian SMEs try to keep record of their employees’ trainings and achievement which is an important tool for personnel control. Furthermore, these entities prove to have an adequate level of segregation of duties, which they maintain for a considerable time, this makes it easier for employees to learn and perform their tasks better in the long run as it creates stability and increases economies of scale. Finally, it was found that in the Albanian SMEs fraud reporting from employees is encouraged and adequate measures are taken to counteract them for the future.

A study by Nuhu, Salisu, Kofarnaisa, and Nadu (2017), on the effect of internal accounting control, top management team characteristics, audit committee qualities on the financial fraud prevention. The target populations under this study consists of all the quoted DMBs on the Nigerian stock exchange as at 2015. A sample of two hundred and seventy-four (274) respondents were selected from the internal audit and the internal control unit staff of fifteen (15) quoted banks in Nigeria. The principal instrument used for the purpose of this study was a questionnaire and annual report and account of the sample banks. The Structural Equation Modelling (SEM) was employed to test the hypothesized model of the study. The result of structural equation modelling in this study showed that internal accounting control system and the audit committee quality does not influence financial fraud prevention of the quoted DMB banks in Nigeria. Top management team positively affect financial fraud prevention of the quoted DMB banks in Nigeria.
According to Muraleetharan (2013), The face of change in the fast moving world becomes more complex. Evaluating and monitoring of all organizational operations are vital issues for survival and growth of the organization. This study was undertaken with the objective of finding out the relationship between control activities and performance of the organizations in Jaffna District, Sri Lanka. The study was based on hundred and twenty employees in the organizations. Control and performance measured by chi square and regression analysis. The study finds control activities and organizations performance are statistically significant in determining performance. Perhaps most importantly, the study finds positive relationship between control activities and performance. Adequate supervision with a clear and up to date supply of information should be there. There must be maintenance of adequate recording and duplicating systems and also must be an efficient staff control with written directions as to responsibilities and duties of both management and staff.

Nqala and Dubihlela (2017), they carried out a study to understand how internal controls are utilized by manufacturing SMEs to mitigate and prevent risks, and how internal controls are implemented by manufacturing SMEs. The study was conducted on selected manufacturing SMEs in the Western Cape, South Africa. The study follows a qualitative research paradigm, adopting case-based interpretive approach employed to support the data collection, data analysis and data presentation methods. Manufacturing SMEs that are in process of implementing effective internal controls within their businesses would have a better understanding of the importance and value of preventing or mitigate risk. An analysis of interviews with managers and owners from manufacturing SMEs indicates that businesses that often create contingency risk plans and implement internal control systems are less exposed to risk. Their risk-buffer strategies towards perceived risks helps them achieve higher risk performance.

Asiligwa and Rennox (2017), objective of the research was to establish the Effect of Internal Controls on Financial Performance of Commercial Banks in Kenya. Internal Controls were measured using the five elements of internal control as stipulated by the Committee of Sponsoring organizations of Treadway Commission framework of internal controls while Financial Performance was measured using the historical average of Return on Equity. A descriptive research design was adopted due to its ability to describe the relationship between elements of Internal Controls and Financial Performance. The study used the 43 commercial banks in Kenya. Primary data was collected using a structured
questionnaire. Descriptive statistics obtained from data analysis were presented using frequency tables, while inferential data findings were presented using correlation and regression tables. The study findings revealed that the banking sector enjoys a strong financial performance partly because of implementing and maintaining effective internal controls. The existence of effective internal control is attributed to the highly regulated and structured environment in the banking sector. The study recommends banks should effectively implement and maintain internal controls due to the nature of the riskiness of the banking sector and its impact on financial performance.

2.3 Effect of Monitoring on Financial Performance

Monitoring refers to the process of assessing the quality of the internal control structure over time. Since internal controls are processes, it is usually accepted that they need to be adequately monitored in order to assess the quality and the effectiveness of the system’s performance over time. By monitoring, the organization gets provided with assurance that the findings of audits and other reviews are promptly determined (Karagiorgos, Drogalas, & Giovanis, 2011). Monitoring of operations ensures effective functioning of internal controls system. It’s through monitoring that an organization determines whether its policies and procedures designed and implemented by management are being carried out effectively by employees (Ewa & Udoayang, 2012).

According to Ershaid, Diala and Mohamed (2017), monitoring can be achieved by regularly supervising and managing activities like monitoring of customer complaints and feedback and audits conducted periodically by internal auditors. Internal auditors can investigate and appraise internal control structure and the efficiency with which the various functions are performing their assigned duties. This way, they can bring a systematic and disciplined approach for the evaluation and improvement of risk management activities and good governance process by examining of the internal controls and evaluating how adequate and effective the controls are. Monitoring ensures that the findings of audits and other reviews are promptly resolved (Karagiorgos et al., 2011).

Internal control system and application of controls change overtime. This can be due to the arrival of new personnel, varying effectiveness of implementing the procedures or supervision, time and resource constraints or changes in the circumstances for which the internal control system originally was designed. Thus, the management needs to determine and observe whether the internal control system continues to be relevant and effective in
the entity as intended. The purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Internal control is adequately designed and properly executed if all five internal control components (Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring) are present and functioning as designed (Ofori 2011).

Monitoring, the last component of internal control, is a process that assess the quality of internal control over time. Also, monitoring is the evaluation of an organization's events and transactions to gauge the quality of performance throughout the period and to decide whether controls are effective (Muhunyo & Jagongo, 2018). Management should emphasize monitoring efforts on internal control and accomplishes the organization objectives. It is important to monitor internal control to determine whether it is operating as intended and whether any modifications are necessary. All employees need to understand the organization's mission, objectives, and responsibilities and risk tolerance levels for monitoring to be most effective. Monitoring can be done through on-going activities or separate evaluations (Gamage et al., 2014).

Monitoring provides assurance that the findings of audits and other reviews are promptly determined. Theofanis (2011), also notes monitoring of operations ensures effective functioning of internal controls in an organization. Hence, monitoring determines whether or not policies and procedures designed and implemented by management are being carried out effectively by employees. According to Sarens, Abdolmohammadi, and Lenz (2014), Organizational performance encompasses accumulated end results of all the organization’s work processes and activities. The most effective way to improve financial performance is by reducing the level of irregularity and fraud through improvements in the firm’s systems of internal financial control. Shareholders need to be assured that their resources are being used efficiently and effectively in providing the right service at the least cost.

Monitoring is the assessment of internal control performance over time; it is accomplished by ongoing monitoring activities and by separate evaluations of internal control such as self-assessments, peer reviews, and internal audits (Nqala & Dubihlela, 2017). The purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Internal control is adequately designed and properly executed if all five internal control components (Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring) are present and functioning
as designed. Internal control is effective if management and interested stakeholders has reasonable assurance. Just as control activities help to ensure that actions to manage risks are carried out, monitoring helps to ensure that control activities and other planned actions to effect internal control are carried out properly and in a timely manner and that the end result is effective internal control. Ongoing monitoring activities include various management and supervisory activities that evaluate and improve the design, execution, and effectiveness of internal control. Separate evaluations, on the other hand, such as self-assessments and internal audits, are periodic evaluations of internal control components resulting in a formal report on internal control. Department employees perform self-assessments; internal auditors who provide an independent appraisal of internal control perform internal audits (Mustafa, Fatima, Saleem, & Ain, 2016).

2.3.1 Physical monitoring controls

These activities encompass the physical security of assets, including adequate safeguards such as secured facilities over access to assets and records; authorization for access to computer programs and data files; and periodic counting and comparison with amounts shown on control records (Ljubisavljević & Jovanović, 2011). Losses may occur if for example there is no comparing of the results of cash, security and inventory counts with accounting records. Frauds are discovered in these controls and, hence improving the organizational performance. The extent to which physical controls intended to prevent theft of assets are relevant to the reliability of financial statement preparation, and therefore the audit, depends on circumstances such as when assets are highly susceptible to misappropriation. For example, these controls would ordinarily not be relevant when any inventory losses would be detected pursuant to periodic physical inspection and recorded in the financial statements. However, if for financial reporting purposes management relies solely on perpetual inventory records, the physical security controls would be relevant to the audit. Stealing of assets as commented on by can range from shoplifting an accessory, diskettes and software from a store to taking a whole large asset. This when prevented enhances organizational performance (Abbas & Iqbal, 2012).

Performance reviews are independent checks on performance by a third party. They include review of actual performance versus budgets and surprise checks of procedures. Periodic comparisons of accounting records and physical asset like stocktaking, and a review of functional or activity performance like review of reports on branch performance. The duties
entail making comparisons at regular intervals and taking appropriate action with respect to any differences (Ljubisavljević & Jovanović, 2011).

2.3.2 Internal Management controls

According to Oseifuah, (2015), control activities and the control environment are manifested as policies and procedures that help to ensure management directives are carried out. They are critical, and they ensure that the necessary actions are taken to address risks necessary for the achievement of the organization’s objectives. Management is responsible for establishing and maintaining a system of internal control, identifying proper internal control frameworks to be used when evaluating internal controls, providing an assessment on the effectiveness of internal controls and identifying any evident material weaknesses in the existing system of internal control. As embedded in management’s day-to-day duties they should not only ensure the optimal utilization of internal control systems, but also ensure that internal controls are strategically positioned to achieve the objectives of their business, namely fortifying business sustainability (Ewa & Udoayang, 2012).

The role of the entire management and the capacity that is entrusted to them by the stakeholders cannot be however ignored. As the responsible faction of the entire organization, they must provide the organization with the right directives and quality at all time that the internal control is working to ensure that the resources of the enterprise are protected for the behest of the stakeholders. Segregating employee duties is an important internal control system feature for better resources management, as well as any other asset. Dividing specific duties between employees helps minimize risk and fraud and maximize resources protection. For all the organization activities authorizing, recording, custody and reconciliation must be core to any resource’s security (Heirer, 2015). Employee should oversee and authorized to complete the ordering function. However, if a specific act exceeds pre-established levels, the practice manager or owner must intervene. Similarly, (Cheruiyot, 2014) argues management authorization should play a pivotal role in ensuring that the resources of a firm in procurement of inventory are used in an optimal manner and that inventory or any other asset is acquired at the best cost in the market to prevent fraud and misappropriation. Cheruiyot, (2014), further asserts that it is the role of management in ensuring verification of contents to assure complete order receipt.
As pointed out by Jough (2010), desired levels of effectiveness can be accomplished through regular management and supervisory activities, monitoring adherence to policies and procedures, and other routine actions such as comparisons and reconciliations, supplemented by internal audit or other compliance functions that test, monitor, and evaluate the functioning of controls, or by various self-assessment programs to ensure revaluation of the risk in response to the organizations objectives. If management cannot identify current procedures that provide a basis for concluding the control operates effectively, it should develop procedures to test and evaluate the operating effectiveness of the controls (Ernst & Young, 2013).

The evaluation may point out redundant controls or other procedures that are no longer necessary hence call for self-monitoring and self-correcting. This means an enterprise should establish mechanisms to continually evaluate and maintain the system of internal control and, when necessary, take corrective action in a timely manner. Several previous studies (Pathak, 2005) have found that effective internal management control if implemented effectively leads to success in key business parameters. Strong internal control system strengthens enterprise governance, allows management objectives to be achieved and mitigates the risk of fraud by increasing employee perception of detection.

According to Muio, (2012), investigated on the impact of internal control systems on the financial performance of private hospitals in Kenya. The study was anchored on monitoring, control activities, risk assessment, information and communication, control environment as the variables representing internal control systems. A descriptive research design was adopted while the target population consisted of all the private hospitals accredited by National Hospital Insurance Fund (NHIF) operating within the County of Nairobi. Linear regression analysis was used to find the relationship between monitoring, control activities, risk assessment, information and communication, control environment and financial performance of private hospitals in Kenya. The findings of the study indicate that all the five components that are Monitoring, Control Activities, Risk Assessment, Information and Communication and Control Environment must be present for an internal control system to be considered effective. The findings also indicated that Monitoring had the highest influence on the financial performance of private hospitals in Kenya followed by control environment, information and communication, risk assessment and control activities respectively.
2.4 Effect of Risk Assessment on Financial Performance

Risk assessment refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved. It refers to the identification and analysis of relevant risks associated with achieving the objectives of the organization (Karagiorgos et al., 2009). They add that risk assessment is the process of identifying and analyzing management relevant risks to the preparation of financial statements that would be presented fairly in conformity with general accepted accounting principles. In organizations, management must determine the level of risk carefully to be accepted and try to maintain such risk within determined levels. It is therefore the management’s responsibility to design internal controls to ensure efficiency and effectiveness, reliability of financial reporting as well as compliance with laws and regulations. This is ensured by periodic performance review and evaluation of the adequacy and effectiveness of the controls designed by the internal auditor department.

According to McCord (2002), risk assessment of material misstatement at the financial statement level and also at the planning stage, clarifies the direction on performing a combined assessment of inherent and control risk, thus leaving the ability for the auditors to assess other risk factors in an audit. In their examination of the effects of the role of the board of directors in assisting in the formulation of corporate strategies on the auditors’ planning judgments, they established that auditors respond to the role of the board when making judgments with respect to control risk assessments.

2.4.1 Risk management and internal controls

Risk management has moved from the narrow view that focuses on evaluation of risk from a narrow perspective to a holistic, all-encompassing view (Pagach & Warr, 2011). Enterprise risk management requires the operation of risk evaluation and mitigation. This can only be successful if there is strong leadership support and top management buy-in without which the ERM process is destined to fail. The board of directors and top management needs to be involved in setting the tone from the top and creating a risk culture across the SMEs. The board also secures the integration of ERM in all processes, making available adequate resources and sustained continuous improvement of the level of ERM practices (Manab & Kassim, 2012).
A study on the impact of risk-based audit on financial performance in Kenya’s insurance companies conducted by Kasiva (2012) among 44 respondents that included finance officers, internal auditors, credit officers, relationship officers, and accountants found out that risk-based auditing through risk management should be enhanced to enable the organization concerned to detect risks on time. Kasiva (2012) further argues that fraud risk assessment is one area that deserves significant reliance on internal audit work. In this light, it is reasoned that due to the fact that internal auditors are privier with the operations of the firm they work for than external auditors, are particularly suited to carry out fraud risk assessment. In a survey of internal auditors’ risk management practices in the Kenya’s banking sector, Kibaara (2007) investigated bank internal auditors’ risk assessment practices and established that, most banks in Kenya were in the process of drafting the ERM process and strategies in line with risk assessment.

A study by Nqala and Dubihlela (2017), on the investigations of how small and medium manufacturers are optimizing their internal control systems in order to mitigate risk. The study seeks to understanding how internal controls are utilized by manufacturing SMEs to mitigate and prevent risks, and how internal controls are implemented by manufacturing SMEs. The study was conducted on selected manufacturing SMEs in the Western Cape, South Africa. The study followed a qualitative research paradigm, adopting case-based interpretive approach employed to support the data collection, data analysis and data presentation methods. Manufacturing SMEs that are in process of implementing effective internal controls within their businesses would have a better understanding of the importance and value of preventing or mitigate risk. An analysis of interviews with managers and owners from manufacturing SMEs indicated that businesses create contingency risk plans and implement internal control systems are less exposed to risk. Their risk-buffer strategies towards perceived risks helps them achieve higher risk performance.

It is necessary for every small business to manage its risks in order to minimize the loss exposure. SMEs in their operations encounter many risks such as political, natural disaster, credit and operation risks. Poor performance of SMEs is becoming concern as many of them die immaturely. Madembu and Namusonge (2017), the role of risk management on financial performance of small and medium enterprises in Kenya. The study was guided by the following objectives; to examine the role of enterprise risk management on the financial performance of SMEs; to analyses the role of strategic risk management on the financial
performance of SMEs; to evaluate the effect of financial risk management on financial performance of SMEs and to establish the role of operational risk management on the financial performance of SMEs. SMEs should focus on implementing comprehensive risk management systems in their businesses. (Madembu & Namusonge, 2017).

2.4.2 Enterprise Resource Planning

Rosenfield and Beckman (2014), ERP's real value is that it connects all information flows within the firm, theoretically, specific transactions taking place in each business process is accessible and visible to everyone in the organization. For example, anyone wanting to find out how much inventory is in the warehouse, whether a particular order has been shipped, or when a supplier was paid can obtain this information by going through the system.

According to Dunne and Lusch (2013), Enterprise resource planning (ERP) systems are viewed with both great optimism and serious skepticism. Some managers really believe they are the answer to the vast array of human, inventory, facility, and equipment management problems facing firms today. Others are confident that ERP systems will never deliver on promised benefits. Experience suggests that both arguments possess an element of truth. Some companies have been able to seamlessly integrate their ERP systems with suppliers and customers, demonstrating that such integration is possible (Woolf, 2015). However, for many organizations, implementation problems lead managers to claim that ERP providers have overpromised and under delivered. ERP has become known for the challenge’s company’s encounter during implementation.

The concepts behind ERP systems make such good sense that it seems as though companies should have implemented them a long time ago. However, the process of implementing an ERP system in an environment where people are reluctant to change from their familiar legacy systems has proven to be a huge undertaking in most companies). Many firms adopt ERP systems module by module, which makes the implementation, seem like an endless nightmare. Even simple implementations take a year or more. Complex implementations have taken close to a decade. Each application captures data for and about a process. Planning for implementation requires that the process be well understood. Process mapping can help. As processes are mapped out in detail, managers gain a real understanding of how the processes work.
A study by Nee et al., (2017) on the role of internal control system in good risk management practice with reference to Sarbanes-Oxley (SOX) Act or equivalent Japan-SOX (J-SOX) or Malaysian Code on Corporate Governance, MCCG. This study focused on a multinational corporation (MNC) hosted in Malaysia. The enterprise’s risk management practices to be analyzed. It was found that the successful implementation of ERM relies on corporate governance, especially periodic monitoring. Originality: The study contributes to the literature as an in-depth study providing practical insights in terms of implementation of enterprise risk management in the industry on importance of internal auditing in managing risk.

According to Mahadeen, Al-Dmour, Obeidat, and Tarhini (2016), they investigated the impact of the internal control system on organizational effectiveness in Jordan. The organizational effectiveness was studied through three approaches namely; organizational ability to achieve its goals and the (Multiple Constituency approach) which deals with organizational competitiveness, job satisfaction, customer satisfaction and complaints. To achieve the objectives of the study, a theoretical framework was developed, and some hypotheses were proposed. Data were collected using a self-administrated questionnaire from 151 employees occupying different managerial levels in Jordan. The results of the multiple regression test showed a high positive impact of the study variables on organizational effectiveness with (R = 87.9%) and (R square =77.3%). Based on the findings of the research, the researchers suggest a number of relevant recommendations related to improving awareness about the importance of internal control system components, and mechanisms to improve internal procedures and processes for improving the organizations’ effectiveness using different approaches.

### 2.4.3 Internal Audit function

Internal audit The Company aims much and success to implement the strategy. Internal audit, management and the audit committee is responsible for strengthening. Similarly, internal audit, management at all levels of the relevant business decisions, are based on units of different organizations coming from the reliability of financial and operational information, the truth and establish integrity. The successful implementation of the internal audit function, which means it must be independent, the company should work, data, results, and are not affected by the measures. Internal audit and management in the internal audit reports and the company (Asiligwa & Rennox, 2017). The key to the successful
management of common principles has become a means of communication between them. In addition, the internal audit function, the audit objective supervision of compliance with reporting obligations as Audit Committee financial resources to facilitate the effective operation and work in the organization.

Mustafa, Fatima, Saleem, and Ain (2016), they argued that the use of the financial system is considered an important factor for the presence of the internal audit department to review the work. Internal audit is a key corporate message, and for a sector that tracks all of its related companies viewed as. Development of the company's internal audit effectiveness of health care, the financial statements reflect the quality of the internal audit. In addition, internal audit and corporate governance structure of the organization is an important part of corporate governance (CG) process, reliable financial reporting to ensure, by the Board of Directors and Audit Committee oversight activities. The importance of internal audit in line with previous research, the study of the relationship between internal audit and business decisions give full bypass.

2.5 Chapter Summary
The literature review highlights the important aspects of effects of internal controls on the financial performance of the small and medium enterprises and large companies. The literature highlighted in this study is on the following; is on the effect of control activities on financial performance, the effect of monitoring on financial performance and lastly effect of risk assessment on financial performance of small and medium enterprises. The next chapter will present the research methodology that will be used in the entire research.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research methodology that will be used for the study. The chapter defines the target population of the study, the sampling size to be used, sampling procedure to be followed as well as the type of instrument that will be used. The data collection procedures and data analysis techniques used in analyzing the results of the study are also discussed.

3.2 Research Design

A research design describes the arrangement and procedure utilized with an aim of solving the research problem. The study used a descriptive research design. According to Cooper and Schindler (2014), descriptive statistics discover and measure cause and effect relationships among variables. Descriptive studies try to reply the questions who, what where and sometimes how depending on the research question. A descriptive design represents the process where data is gathered in order to produce and test the hypothesis with the aim of providing answers to research objectives of the study. The study used descriptive design because it enabled the researcher to collect in depth information about the population being studied. This design also allowed the researcher to obtain information from the respondents without bias.

3.3 Population and Sampling Design

3.3.1 Population

A research population is a large collection of individuals or objects that is the main focus of a scientific query (Cooper, Schindler, & Sun, 2013). This study focused on the population of employees who are in working with the small and medium enterprise in Nairobi County. The target employees included were from the following departments, human resource, financial managers, procurement, and accounting. A population of 382 employees working at Central Business District were targeted.
Table 3.1: Population Distribution

<table>
<thead>
<tr>
<th>Departments</th>
<th>Target Population</th>
<th>Percent Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Resource</td>
<td>94</td>
<td>24%</td>
</tr>
<tr>
<td>Finance</td>
<td>95</td>
<td>25%</td>
</tr>
<tr>
<td>Procurement</td>
<td>74</td>
<td>19%</td>
</tr>
<tr>
<td>Accounting</td>
<td>124</td>
<td>32%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>387</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

3.3.2 Sampling Design

Sampling design is defined as a strategy that describes the population, technique of sample selection, the sample size and the method of approximation in detail. The fundamental intent of the sampling design is to provide a detailed description of the properties of the population and select a sample that to be representative of the population.

3.3.2.1 Sampling Frame

The sampling frame comprises of a comprehensive list of all the sampling units from which a sample could be selected. A sampling frame is required to define the universe (population). The frame (data sources) could be a list from households, establishments, and industries with detailed addresses, products produced and/or consumption, expenditure, revenue data, and so on (Kothari, 2011). In this light, the sample frame for this study was obtained from the Business Registry Service.

3.3.2.2 Sampling Technique

A sample is a small portion of a target population selected using some systematic procedure for study (Babie, 2008). This research used probability technique and under this technique the research used the Stratified Random Sampling approach. Stratified Random Sampling is sampling involved in dividing the population into smaller sections called strata and within each stratum sample elements to be selected on a random basis. Proportionate approach was used when selecting the sample in each stratum. This means that the sample number to be picked from each stratum depends on the size of the strata.
3.3.1.3 Sample Size

Sample size is an important aspect of the research as the sample is intended to make inference to the total population of the research. The sample size is a term used to describe the number of subjects that are in a sample, the subjects being part of the total population. (Munjal et al. 2016). In order to get an appropriate sample size that represented the populations one has to compute based on the population size. The sample size of this study was determined using Yamane’s formula.

\[ n = \frac{N}{(1 + Ne^2)} \]

Where, \( n \) = sample size

\( N \) = Study Population

\( e \) = Alpha level of 0.1

\[ n = \frac{387}{1 + 387(0.1^2)} \]

\[ n = 79 \]

The Table 3.2 below indicates the summary of the sample size distributions.

**Table 3.2: Sample Size Distributions**

<table>
<thead>
<tr>
<th>Departments</th>
<th>Target Sample Size</th>
<th>Percent Distribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Human Resource</td>
<td>19</td>
<td>24%</td>
</tr>
<tr>
<td>Finance</td>
<td>21</td>
<td>27%</td>
</tr>
<tr>
<td>Procurement</td>
<td>16</td>
<td>20%</td>
</tr>
<tr>
<td>Accounting</td>
<td>23</td>
<td>29%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>79</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
3.4 Data Collection Methods

Data collection refers to the process of gathering information from the respondents in a coherent manner to address the research problem effectively (Cooper & Schindler, 2014). This study will use primary data. Primary data is the data collected directly from firsthand experience while secondary data is data that has already been collected by someone else for a different purpose to the researcher’s but has some relevance and utility for one’s research. Primary data was collected using semi-structured questionnaires through the drop and pick method in an effort to conserve time and money as well as to facilitate in easier analysis as they are in immediate usable form. The semi-structured questionnaires consisted of open and closed ended questions (Akisik & Gal, 2017). Self-administered questionnaires were used to capture needed data from the population. The questionnaire that was used applied a Likert scale. The researcher used Likert scale which was designed to examine how strongly linked subjects agree or disagree with statements usually on a five-point scale. The scale allowed respondents to rate their opinion with each statement using the scale provided. The Likert Scale is easy and quick to construct, reliable and provides a greater volume of information than other scales.

3.5 Research Procedures

Research procedures is the blueprint that depicts step by step on how the study will be carried out with the purpose of responding to the research questions or research objectives (Cooper & Schindler, 2014). Upon completion of the proposal, the researcher sought approval form the supervisor. After the approval of the proposal is granted, a letter of introduction was drafted to the target SMEs asking for their permission to allow the researcher to carry out a study in their place of work. Then a pilot test was carried out to test the reliability of the study instrument. The researcher assistant adopted a drop and pick method in collecting the data. This method involved handing out the questionnaires to the respondents and picking them at a later date. This method is favored since it allows the respondent to have ample time in giving out their responses. The researcher then went ahead and distribute the questionnaires on hard copies. The respondents were taken through the purpose of the research and their contribution toward answering the research questions via the questionnaire. The researcher established a time frame based on the pilot by which the questionnaires were collected.
3.6 Data Analysis Methods

Data analysis is the systematic process of applying statistical and or logical techniques to condense and recap, describe and illustrate, and evaluate data. Statistical Package for Social Sciences (SPSS version 24), computer software program was used in analyzing the data which was collected from the field. Data collected was reviewed and the variables coded, the coded variables from the data is keyed into the variable view of SPSS and then the actual data entered in the data view of SPSS. Through a descriptive analysis with graphs and frequency tables, the keyed in data at the data view of the SPSS was analyzed and the result were explained in relation to the objectives of the study. Quantitative data was analyzed and the output presented using descriptive statistics namely: mean, standard deviation, percentages. A multiple linear regression model was used to assess whether internal controls has an effect on the performance of SMEs as indicated on the specific objectives. The regression mode of the study used was as follows;

\[ Y = a + \beta x_1 + \beta x_2 + \beta x_3 + e \]

Where \( Y \) = financial performance
\( a \) = Constant (Regression coefficient)
\( X_1 \) = internal controls,
\( X_2 \) = monitoring Activities,
\( X_3 \) = Risk Assessment,
\( e \) = Standard error

3.7 Chapter Summary

The chapter has highlighted the various methods and procedures the researcher adopted in conducting research. The chapter has equally highlighted the research design that to be used as well as the target population and sampling design, the research instruments utilized; the research procedures followed by the data analysis methods. The next chapter presents the findings and results of the study using methodologies identified in this chapter.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
Chapter four presents the results and findings based on the research questions guiding the study. The first section presents the demographic information of the respondents, second section presents the findings on the relationship between initial controls and financial performance, third section offers the findings on the effect of monitoring on financial performance and fourth section offers the findings on risk assessment and financial performance.

4.2 Demographic Information
This section presents the general information of the respondents, the variables include the response rate, gender, age, and years in service, level of education, business type, and number of employees.

4.2.1 Response Rate
This study had a response rate of 72% meaning that out of 79 questionnaires that we administered to the target respondents, only 57 questionnaires were dully filled while 28% accounting for the remaining 22 questionnaires that were not attended to as shown in Table 4.1.

Table 4.1: Response Rate

<table>
<thead>
<tr>
<th>Response</th>
<th>Distribution (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Responded</td>
<td>72</td>
</tr>
<tr>
<td>Did Not Respond</td>
<td>28</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.2.2 Respondents Gender
When the respondents were asked to indicate their gender, 40% of the respondents were male while 60% were female as shown in Figure 4.1. This means that the respondents of this study were diversely represented.
4.2.3 Respondents Age

When the respondents were asked to indicate their age, 26% of the respondents aged between 21-25 years, 35% aged between 26-30 years, 23% aged between 31-35 years, and 16% aged above 36 years as shown in Figure 4.2. This means that the study had diverse age groups presented.

4.2.4 Level of Education

The respondents were asked to indicate their level of education, 21% had a diploma, and 18% had a post graduate while 61% had a graduate level of education as presented in Figure 4.3.
4.3. This means that the respondents had the ability to read and interpret the information sought in this study.

Figure 4.3: Level of Education

4.2.5 Respondents Year in Service

When the respondents were asked to indicate the number of years they had been in service, 26% of the respondents had been in service for more than 16 years, and 23% had been in the service for a period of 11-15 years, 39% between the period of 6-10 years and 12% between 1-5 years as shown in Figure 4.4. This implies that the respondents had sufficient information about their organization.

Figure 4.4: Respondents Year in Service
4.2.6 Size of the Organization

When the respondent were asked to indicate the size of their organization by indicating the number of employees they have in the company, 23% had more than 200 employees, 47% had employees between 11-100 and 30% had between 101-199 employees as shown in Figure 4.5. This means that the majority of SMEs had more than 100 employees.

![Figure 4.5: Size of the Organization](image)

4.2.7 Business Type

When the respondents were asked to indicate the type of their business, 7% were operating as sole traders, 26% as partnership and 67% as private limited company as shown in Figure 4.6. This means that the majority of SMEs operate as private limited companies.

![Figure 4.6: Business Type](image)
4.3 The Relationship between Internal Controls and Financial Performance

This study sought to determine the relationship between internal controls and financial performance. The findings obtained are presented as follows:

4.3.1 Organizational Policies and Procedures

When the respondents were asked to indicate whether the organization has policies and procedures on how directives should be carried on, Table 4.2 shows that 4% of the respondents strongly disagreed, 5% disagreed, 4% were neutral, 54% agreed and 33% strongly agreed. This means that most SMEs have organizational policies and procedures on how directives should be conducted.

Table 4.2: Organizational Policies and Procedures

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strongly Disagree</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Disagree</td>
<td>3</td>
<td>5.0</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Agree</td>
<td>31</td>
<td>54.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>19</td>
<td>33.0</td>
</tr>
<tr>
<td>Total</td>
<td>57</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.3.2 Control Activities

When the respondents were asked to indicate whether they had established control activities to effectively accomplish the objectives of the organization, 4% of the respondents disagreed, 5% were neutral, 42% strongly agreed, 49% agreed while 0% strongly disagreed as shown in Figure 4.7. This implies that the SMEs have established control activities to effectively accomplish the objectives of the organization.
When the respondents were asked whether employees are allowed to perform certain activities within limited parameters, a majority of employees at 68% strongly agreed, 32% agreed, 0% were neutral, 0% disagreed and 0% strongly disagreed as shown in Figure 4.8. This means that employees are allowed to perform certain activities within limited parameters.
4.3.4 Information Accessibility
On the question whether information from internal and external parties is easily accessible, 55% of the respondents agreed, 40% strongly agreed, 5% disagreed, 0% were neutral neither strongly disagreed as shown in Figure 4.9. This means that information is easily accessible in SMEs.

![Information Accessibility Chart]

Figure 4.9: Information Accessibility

4.3.5 Implementation of Internal Controls
When the respondents were asked to indicate whether they implement internal controls to enhance performance of the organization, 2% of the respondents were neutral, 3% disagreed, 51% strongly agreed and 44% agreed while 0% strongly disagreed as shown in Figure 4.10. This means that SMEs implement internal controls in order to enhance performance of their organization.
4.3.6 Documenting of Reconciliation

The respondents were asked to indicate whether reconciliation is always documented and approved by the management, 3% disagreed, 4% were neutral, 33% agreed, and 60% strongly agreed while 0% strongly disagreed as shown in Figure 4.11. This signifies that reconciliation in the SMEs is always documented and approved by the management.

4.3.7 Record Keeping

On the question whether the company keeps records on employees’ trainings and achievement of the organization, 5% were neutral, 35% agreed, 60% strongly agreed, 0%
disagreed and 0% strongly disagreed as shown in Table 4.3. It implies that the SMEs keep records of employees’ training and achievements of the company.

**Table 4. 3: Record Keeping**

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Neutral</td>
<td>3</td>
<td>5.0</td>
</tr>
<tr>
<td>Agree</td>
<td>20</td>
<td>35.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>34</td>
<td>60.0</td>
</tr>
<tr>
<td>Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>57</td>
<td>100.0</td>
</tr>
</tbody>
</table>

### 4.3.8 Fraud Reporting

On the question whether fraud reporting from employees is encouraged to counteract them in future, 51% of the respondents agreed, 49% strongly agreed, 0% disagreed, 0% were neutral and 0% strongly disagreed as shown in Figure 4.12. This implies that fraud reporting is encouraged to counteract them in future.

![Figure 4.12: Fraud Reporting](image)

0% 
49% 
51%

Agree
Strongly Agree
Neutral
Disagree
Strongly Disagree
4.3.9 Top Management and Fraud Prevention

On the question whether top management team positively affects financial fraud prevention, 4% disagreed, 4% were neutral, 57% agreed and 35% strongly agreed as shown in Table 4.4. It implies that top management team positively influences financial fraud prevention.

Table 4.4: Top Management and Fraud Prevention

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Agree</td>
<td>33</td>
<td>57.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>20</td>
<td>35.0</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>57</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.3.10 Staff Control

On the question whether SMEs maintain adequate recording and duplicating systems for efficient staff control, 5% of the respondents disagreed, 2% were neutral, 37% agreed, 56% strongly agreed while 0% strongly disagreed as shown in Figure 4.13. This means that SMEs maintain adequate recording and duplicating systems for efficient staff control in the organization.

Figure 4.13: Staff Control
4.3.11 Contingency Risk Plans

The respondents were asked whether they create contingency risk plans and implement internal control systems to avoid risk exposure, 4% of the respondents were neutral, 3% disagreed, 0% strongly disagreed, 44% agreed, and 49% strongly agreed as shown in Figure 4.14. This implies that SMEs create contingency risk plans and implement internal control systems to avoid risk exposure.

![Contingency Risk Plans](image)

**Figure 4. 14: Contingency Risk Plans**

4.3.12 Regulations in SME Sector

On the question whether effective internal control systems are attributed to a highly regulated and structured environment in SME sector, 3% were neutral, 0% strongly disagreed, 0% disagreed, 44% agreed and 53% strongly agreed as indicated in Figure 4.15. This means that effective internal control systems in SMEs are influenced by regulated and structure environment in which they operate.
4.3.13 Correlational Analysis between Internal Controls and Financial Performance

Pearson correlational analysis was conducted to determine the relationship between the independent variable internal controls and dependent variable financial performance. The result of the study shown in Table 4.5 revealed that there was a positive and significant influence between internal controls and financial performance, r (0.738); p-value < 0.05.

Table 4.5: Correlational Analysis between Internal Controls and Financial Performance

<table>
<thead>
<tr>
<th>Correlations</th>
<th>Financial Performance</th>
<th>Internal Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>57</td>
</tr>
<tr>
<td>Internal Controls</td>
<td>Pearson Correlation</td>
<td>.738**</td>
</tr>
<tr>
<td>Sig. (2-tailed)</td>
<td>N</td>
<td>.000</td>
</tr>
<tr>
<td>N</td>
<td>57</td>
<td>57</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
4.3.14 Regression Analysis

Regression analysis was conducted in order to show the nature of the relationship between study variables. In this section R squared value is commonly used and referred as coefficient of determinations which shows model explanatory power summarized in model summary matrix. The findings in Table 4.6 revealed r squared value of 0.537 ($R^2 = 0.537$) at 0.05 significance level. This implies that there is a liner relationship between internal controls and financial performance. The result of the findings show that 53.7% of the variability in financial performance can be attributed to internal controls while the remaining 46.3% can be accounted to other factors excluded in the model.

Table 4. 6: Model Summary for Internal Controls and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.738&lt;sup&gt;a&lt;/sup&gt;</td>
<td>.545</td>
<td>.537</td>
<td>.15100</td>
</tr>
</tbody>
</table>

<sup>a</sup> Predictors: (Constant), Internal Controls

4.3.15 ANOVA between Internal Controls and Financial Performance

The findings in Table 4.7 reveals that internal controls had a significant influence on financial performance for SMEs in Nairobi since p-value < 0.05, F = 65.991 and p-value < 0.05. This implies that there is a liner relationship between internal controls and financial performance.

Table 4. 7: ANOVA between Internal Controls and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig. &lt;sup&gt;b&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>1.503</td>
<td>1</td>
<td>1.503</td>
<td>65.911</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>1.254</td>
<td>55</td>
<td>.023</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>2.757</td>
<td>56</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<sup>a</sup> Dependent Variable: Financial Performance
<sup>b</sup> Predictors: (Constant), Internal Controls
4.3.16 Regression Coefficients for Internal Controls and Financial Performance

The findings of regression coefficients as shown in Table 4.8 shows a positive and significant influence between internal controls and financial performance ($\beta= 0.738$, p value <0.05). This means that a unit change in internal controls increases financial performance for SMEs by units 0.738.

The resultant regression model was established as follows:

Financial Performance = 1.734 + 0.607 internal controls.

<table>
<thead>
<tr>
<th>Coefficientsa</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>Unstandardized Coefficients</td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>1.734</td>
</tr>
<tr>
<td>Internal Controls</td>
<td>.607</td>
</tr>
</tbody>
</table>

Table 4.8: Regression Coefficients for Internal Controls and Financial Performance

4.4 The Effect of Monitoring on Financial Performance

This study sought to determine the effect of monitoring on financial performance. The findings are presented as follows:

4.4.1 Quality and Effectiveness

When the respondents were asked whether they invest in monitoring to assess the quality and effectiveness of the company’s performance over time, 51% agreed, 49% strongly agreed, 0% disagreed, 0% were neutral and 0% strongly disagreed as shown in Figure 4.16. This implies that SME invest in monitoring in order to assess the effectiveness of their company’s performance over time.
4.4.2 Effectiveness of Internal Control System

On the question whether monitoring ensures functioning of internal control system, 33% of the respondents agreed, 62% strongly agreed, 5% disagreed, 0% neither were neutral nor strongly disagreed as shown in Figure 4.17. This implies that monitoring ensures functioning of internal control system.
4.4.3 Audit Reviews

On the question whether monitoring ensures that audit reviews are promptly resolved, 65% of the respondents strongly agreed, 35% agreed, 0% were neutral, 0% disagreed and 0% strongly disagreed as shown in Figure 4.18. This implies that monitoring ensures that audit reviews in SMS are promptly resolved.

![Pie Chart](image)

**Figure 4.18: Audit Reviews**

4.4.4 Events and Transaction Monitoring

When the respondents were asked to indicate whether the organization is monitored for the events and transactions to gauge the quality of performance in the company, a majority at 53% agreed, 47% strongly agreed, 0% were neutral, 0% disagreed and 0% strongly disagreed as shown in Figure 4.19.
Figure 4.19: Events and Transaction Monitoring

4.4.5 Monitoring and Activities

The respondents were asked whether monitoring can be through on-going activities, 4% disagreed, 4% were neutral, 45% agreed, 47% strongly agreed and 0% strongly disagreed as shown in Table 4.9. This means that monitoring can be done through on-going activities in SMEs.

Table 4.9: Monitoring and Activities

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Agree</td>
<td>26</td>
<td>45.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>27</td>
<td>47.0</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
</tbody>
</table>

4.4.6 Level of Irregularity and Fraud

On the question whether the reduction of irregularity and fraud would enhance financial performance, 55% strongly agreed, 40% agreed, 5% disagreed, 0% were neutral and 0% strongly disagreed as shown in Figure 4.20. This implies that the reduction of irregularity and fraud would enhance financial performance.
4.4.7 Management and Maintenance System

The respondents were asked whether management of an SME is responsible for establishing maintaining system for internal control, 28% of the respondents strongly agreed, 63% agreed, 7% were neutral, 2% disagreed and 0% strongly disagreed as shown in Figure 4.21. This implies that SMEs are responsible for establishing maintenance system for internal control.

Figure 4. 20: Level of Irregularity and Fraud

Figure 4. 21: Management and Maintenance System
4.4.8 Management Authorization and Resources

When the respondents were asked to indicate whether management authorization ensures effective use of resources in the organization, 2% of the respondents disagreed, 4% were neutral, 45% agreed, 49% strongly agreed, and 0% strongly disagreed as shown in Table 4.10. This implies that management authorization influences effective use of resources in the organization.

Table 4.10: Management Authorization and Resources

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td>Neutral</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Agree</td>
<td>26</td>
<td>45.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>28</td>
<td>49.0</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>57</td>
<td>100.0</td>
</tr>
</tbody>
</table>

4.4.9 Governance

The respondents were asked whether strong internal control system enhances governance in the organization, 61% of the respondents agreed, 39% strongly agreed, 0% disagreed, 0% were neutral and 0% strongly disagreed as shown in Figure 4.22. This means that strong internal control system enhances governance in the organization.

Figure 4.22: Governance
4.4.10 Control Environment

The respondents were asked to indicate whether control environment must be present for an internal control system to be considered effective, 44% of the respondents strongly agreed, 56% agreed, 0% disagreed, 0% were neutral and 0% strongly disagreed as shown in Figure 4.23. This implies that control environment must be present for an internal control system of SME to be considered effective.

![Figure 4.23: Control Environment](image)

4.4.11 Monitoring and Financial Performance

The respondents were asked to indicate whether monitoring enhances financial performance of the company, 4% of the respondents disagreed, 2% were neutral, 49% agreed, 45% strongly agreed and 0% strongly disagreed as shown in Table 4.11. This implies that monitoring enhances financial performance.

Table 4.11: Monitoring and Financial Performance

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Neutral</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td>Agree</td>
<td>28</td>
<td>49.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>26</td>
<td>45.0</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>57</td>
<td>100.0</td>
</tr>
</tbody>
</table>
4.4.12 Correlation between Monitoring and Financial Performance

Pearson correlational analysis was conducted to examine the relationship between the independent variable monitoring and dependent variable financial performance. The result of the study shown in Table 4.12 revealed that there was a positive and significant influence between monitoring and financial performance, \( r (0.804); p\text{-value} < 0.05 \).

Table 4. 12: Correlation between Monitoring and Financial Performance

<table>
<thead>
<tr>
<th>Variable</th>
<th>Financial Performance</th>
<th>Monitoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Performance</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>57</td>
</tr>
<tr>
<td>Monitoring</td>
<td>Pearson Correlation</td>
<td>.804**</td>
</tr>
<tr>
<td></td>
<td>Sig. (2-tailed)</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td>N</td>
<td>57</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

4.4.13 Regression Analysis

Regression analysis was conducted in order to show the nature of the relationship between study variables. In this section R squared value is commonly used and referred as coefficient of determinations which shows model explanatory power summarized in model summary matrix. The findings in Table 4.13 revealed adjusted r squared value of 0.640 \( (R^2 = 0.640) \) at 0.05 significance level. This implies that there is a liner relationship between monitoring and financial performance. The result of the findings show that 64% of the variability in financial performance can be attributed to monitoring while the remaining 36% can be accounted to other factors excluded in the model.

Table 4. 13: Model Summary for Monitoring and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.804a</td>
<td>.646</td>
<td>.640</td>
<td>.13319</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Monitoring
4.4.14 ANOVA between Monitoring and Financial Performance

The findings in Table 4.14 reveals that monitoring had a significant influence on financial performance for SMEs in Nairobi since p-value < 0.05, F = 100.405 and p-value < 0.05. This implies that there is a linear relationship between monitoring and financial performance.

Table 4.14: ANOVA between Monitoring and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>1.781</td>
<td>1</td>
<td>1.781</td>
<td>100.405</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>.976</td>
<td>55</td>
<td>.018</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>2.757</td>
<td>56</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

4.4.15 Regression Coefficients for Monitoring and Financial Performance

The findings of regression coefficients as shown in Table 4.15 shows a positive and significant influence between monitoring and financial performance (β= 0.804, p value < 0.05). This means that a unit change in monitoring increases financial performance for SMEs by units 0.804.

The resultant regression model was established as follows;
Financial Performance = 0.241 + 0.943 monitoring.

Table 4.15: Regression Coefficients for Monitoring and Financial Performance

<table>
<thead>
<tr>
<th>Coefficientsa</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>B</td>
<td>Std. Error</td>
</tr>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>.241</td>
</tr>
<tr>
<td></td>
<td>Monitoring</td>
<td>.943</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance
4.5 Effect of Risk Assessment on Financial Performance

This study sought to determine the influence of risk assessment on financial performance. The findings are presented as follows:

4.5.1 Risk Identification

The respondents were asked whether their firm attempts to determine risk within determined levels, 4% disagreed, 2% strongly disagreed, 47% agreed and 47% strongly agreed as shown in Figure 4.24. It means that SMEs attempt to determine risk within determine levels.

Figure 4. 24: Risk Identification

4.5.2 Control Risk Assessments

When the respondents were asked to indicate whether external auditors are in line with control risk assessments in the organization, 3% of the respondents were neutral, 2% disagreed, 35% agreed, 60% strongly agreed, and 0% strongly disagreed as shown in Figure 4.25.
When the respondents were asked to indicate whether SME risk management requires operation of risk evaluation and mitigation, 54% of the respondents agreed, 46% strongly agreed, 0% were neutral, 0% disagreed and 0% strongly disagreed as shown in Figure 4.26. This implies that risk management in SMEs requires risk evaluation and mitigation.

The respondents were asked whether SME risk buffer strategies enhances financial performance by avoiding risk, 35% strongly agreed, 65% agreed, 0% were neutral, 0%
neither disagreed nor strongly disagreed as shown in Figure 4.27. This implies that SME risk buffer strategies enhances financial performance.

Figure 4.27: Risk Strategies

4.5.5 Significance of Risk Management

On the question whether it is necessary for every SME to manage risks in order to minimize the loss of exposure, 4% disagreed, 2% were neutral, 45% agreed, 49% strongly agreed and 0% strongly disagreed as shown in Table 4.16. This means that it is necessary for every SME to manage risks in order to minimize the loss of exposure.

Table 4.16: Significance of Risk Management

<table>
<thead>
<tr>
<th>Scale</th>
<th>Frequency</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disagree</td>
<td>2</td>
<td>4.0</td>
</tr>
<tr>
<td>Neutral</td>
<td>1</td>
<td>2.0</td>
</tr>
<tr>
<td>Agree</td>
<td>26</td>
<td>45.0</td>
</tr>
<tr>
<td>Strongly Agree</td>
<td>28</td>
<td>49.0</td>
</tr>
<tr>
<td>Strongly Disagree</td>
<td>0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>57</td>
<td>100.0</td>
</tr>
</tbody>
</table>
4.5.6 Internal Audit

On the question whether development of SME internal audit enhances their financial performance, 56% strongly agreed, 39% agreed, 3% disagreed, 2% strongly disagreed, and 0% were neutral as presented in Figure 4.28. This implies that the development of SME internal audit enhances financial performance of SMEs.

![Figure 4.28: Internal Audit](image)

4.5.7 Internal Audit and SME Structure

The respondents were asked whether internal audit and SME structure were important part of reliable financial reporting, 49% of the respondents agreed, 44% disagreed, 4% were neutral, and 3% disagreed while 0% strongly disagreed as presented in Figure 4.29. This implies that internal audit and SME structure is important part of a reliable financial reporting.
4.5.8 Designing of Internal Controls and Efficiency

The respondent of this study were asked to indicate whether its SME’s management responsibility to design internal controls to ensure efficiency and effectiveness, 3% disagreed, 4% were neutral, 49% agreed, 44% strongly agreed and 0% strongly disagreed as shown in Figure 4.30. This means that SMEs’ management is responsible for designing internal controls to ensure efficiency and effectiveness.
4.5.9 Periodic Performance Review

The respondents were asked to indicate whether there is always a periodic performance review, 58% agreed, 42% strongly agreed, 0% were neutral, 0% neither disagreed nor strongly disagreed. This means that SMEs carry out a periodic performance reviews.

![Figure 4.31: Periodic Performance Review](image)

4.5.10 Factors Assessment

When the respondents were asked to indicate whether they undertake a careful assessment of factors that affect possibility of objectives to be achieved by the organization, 55% of the respondents agreed, 40% strongly agreed, 5% disagreed, and 0% disagreed while 0% strongly disagreed. This implies that SMEs undertake careful assessment of factors that affect possibility of objectives to be achieved by the organization.

![Figure 4.32: Factors Assessment](image)
4.5.11 Management Relevant Risks

The respondents were asked to indicate whether SMEs evaluate management relevant risks in preparation of financial statements, Figure 4.33 shows that 39% strongly agreed, 61% agreed, 0% were neutral, 0% disagreed and 0% strongly disagreed. This implies that SMEs evaluate management relevant risks in preparation of financial statements.

Figure 4. 33: Management Relevant Risks

4.5.12 Correlation between Risk Assessment and Financial Performance

Pearson correlational analysis was conducted to examine the relationship between the independent variable risk assessment and dependent variable financial performance. The result of the study shown in Table 4.17 revealed that there was a positive and significant influence between risk assessment and financial performance, $r (0.616); p-value < 0.05$.

Table 4. 17: Correlation between Risk Assessment and Financial Performance

<table>
<thead>
<tr>
<th>Correlations</th>
<th>Financial Performance</th>
<th>Risk Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable: Financial Performance</td>
<td>Pearson Correlation</td>
<td>1</td>
</tr>
<tr>
<td>Variable: Risk Assessment</td>
<td>Pearson Correlation</td>
<td>.616**</td>
</tr>
<tr>
<td>N</td>
<td>.000</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>57</td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>57</td>
<td></td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
4.5.13 Regression Analysis

Regression analysis was conducted in order to show the nature of the relationship between study variables. In this section R squared value is commonly used and referred as coefficient of determinations which shows model explanatory power summarized in model summary matrix. The findings in Table 4.18 revealed adjusted r squared value of 0.369 ($R^2 = 0.369$) at 0.05 significance level. This implies that there is a linear relationship between risk assessment and financial performance. The result of the findings show that 36.9% of the variability in financial performance can be attributed to risk assessment while the remaining 63.1% can be accounted to other factors excluded in the model.

Table 4.18: Model Summary for Risk Assessment and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.616(^a)</td>
<td>.380</td>
<td>.369</td>
<td>.17628</td>
</tr>
</tbody>
</table>

\(^a\) Predictors: (Constant), Risk Assessment

4.5.13 ANOVA between Risk Assessment and Financial Performance

The findings in Table 4.19 reveals that risk assessment had a significant influence on financial performance for SMEs in Nairobi since p-value < 0.05, F = 33.715 and p-value < 0.05. This implies that there is a linear relationship between risk assessment and financial performance.

Table 4.19: ANOVA between Risk Assessment and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>1</td>
<td>1.048</td>
<td>33.715</td>
<td>.000(^b)</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>55</td>
<td>.031</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>56</td>
<td>2.757</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^a\) Dependent Variable: Financial Performance
\(^b\) Predictors: (Constant), Risk Assessment
4.5.14 Regression Coefficients for Risk Assessment and Financial Performance

The findings of regression coefficients as presented in Table 4.20 shows a positive and significant influence between risk assessment and financial performance ($\beta = 0.616$, p value <0.05). This means that a unit change in risk management increases financial performance for SMEs by units 0.450.

The resultant regression model was established as follows;
Financial Performance = 2.439 + 0.450 risk assessment

Table 4.20: Regression Coefficients for Risk Assessment and Financial Performance

<table>
<thead>
<tr>
<th>Model</th>
<th>Coefficients</th>
<th>Std. Error</th>
<th>Beta</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>(Constant)</td>
<td>2.439</td>
<td>.341</td>
<td>7.151</td>
<td>.000</td>
</tr>
<tr>
<td></td>
<td>Risk Assessment</td>
<td>.450</td>
<td>.078</td>
<td>.616</td>
<td>5.806</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Financial Performance

4.6 Chapter Summary

Chapter four has presented results and findings of the study. The first section highlighted demographic details of the respondents involved in the study followed by the findings on the relationship between internal controls and financial performance. Third section of the chapter has provided the findings on the effect of monitoring on financial performance and fourth section covers the findings on the effect of risk assessment on financial performance. The next chapter presents the discussion, conclusion, and recommendations.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This chapter presents the discussion, conclusion and recommendations of the study. The first part of the chapter provides a summary of the study, second part covers the discussion followed by conclusion and recommendations of the study.

5.2 Summary
The purpose of the study was to establish the effect of internal controls on financial performance of small and medium enterprises in Nairobi county in Kenya. The study was guided by the following research questions; what is the relationship between internal controls and financial performance of SMEs in Nairobi County in Kenya? What is the effect of monitoring on financial performance of SMEs in Nairobi county in Kenya? and how do risk assessment affect financial performance of SMEs in Nairobi County in Kenya?

The study adopted a descriptive research design. The study used descriptive design which enabled the researcher to collect in depth information about the population being studied. This study focused on the population of employees who are in working with the small and medium enterprise in Nairobi county. The target employees included the ones from the following departments, human resource, financial managers, procurement, and accountings. A population of 387 employees for the hundred SMEs in Nairobi. This research used probability technique and under this technique the research specifically used the Stratified Random Sampling approach. A sample size of 79 employees was targeted for this particular study.

Primary data was collected using a structured questionnaires. Statistical Package for Social Sciences (SPSS version 24). Computer software program was used in analyzing the data which was collected from the field. Quantitative data was analyzed, and the output presented using descriptive statistics namely: mean, standard deviation, percentages. A multiple linear regression model was used to assess whether internal controls has an effect on the performance of SMEs.

The first research question sought to determine the relationship between internal controls on financial performance. Pearson correlational analysis was conducted to determine the relationship between the independent variable internal controls and dependent variable
financial performance. The findings revealed that there is a positive and significant relationship between internal controls and financial performance, $r (0.738)$; $p$-value $< 0.05$. The findings of this study revealed that 53.6% of the variability in financial performance can be attributed to internal controls.

The second research question sought to determine the effect of monitoring on financial performance. The findings revealed that there was a positive and significant influence between monitoring and financial performance, $r (0.804)$; $p$-value $< 0.05$. The findings also show that 64% of the variability in financial performance can be attributed to monitoring.

The third research question sought to determine the effect of risk assessment on financial performance. The findings revealed that there was a positive and significant influence between risk assessment and financial performance, $r (0.616)$; $p$-value $< 0.05$. The result of the findings show that 36.9% of the variability in financial performance can be attributed to risk assessment.

5.3 Discussion
5.3.1 The Relationship between Internal Controls and Financial Performance

This study sought to determine the relationship between internal controls and financial performance. The findings revealed an existence of a significance relationship between internal control and financial performance. According to Muraleetharan (2013), control activities are the policies and procedures that help ensure management directives are carried out. They help to ensure that necessary actions are taken to address risks to the achievement of the entity’s objectives. Control activities occur throughout the organization, at all levels and in all functions. According to Gamage, Lock, and Fernando, (2014), defined control activities as the tools both manual and automated that help prevent or reduce the risks that can impede accomplishment of the organization's objectives and mission. Management should establish control activities to effectively and efficiently accomplish the organization's objectives and mission. Control activities are the policies and procedures that help ensure that necessary actions are taken to address the risks involved in the achievement of the entity’s objectives.

The findings of this study revealed that internal controls enhances management authorization for employees to perform certain activities. According to Kiprop (2017). This duty belongs to people who have authority and responsibility for initiating or approving transactions. The authorization may be general, based on a class of transactions or it may
be specific, on a specified transaction. These people initiate and approve transactions subject to a matter limit and as prescribed by the management policy. Authorized transactions are those deemed to have been sanctioned by the authorized officials, with clearly defined limits of authority for the various transactions (Kiprop, 2017). Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor’s approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures (Cheruiyot, 2014).

This study revealed that internal controls enhances information accessibility in the organization. According to Mahunyo and Jagongo (2018), controls over information systems are grouped into two broad categories—general controls and application controls. General controls commonly include controls over data center operations, system software acquisition and maintenance, access security, and application system development and maintenance. Cika (2018), suggests that it is believed that the information and communication control environment, risks, control activities and their implementation should be reported to superiors and move from the highest to the lower level of management, as well as horizontally in an enterprise. There is no doubt that information is needed for all levels of management to support their operations and to meet the objectives in terms of financial reporting and their compliance. All information used in business are so closely related to each other. For example, financial reporting is not only used from third parties or public, but also it plays an important role in the decision-making process or budget. Moreover, the quality of information affects the ability of managers to make decisions and control of business operations. Also shows the appropriateness of the data in the respective reports. Communication is one of the most natural attribute of information systems. Communication is defined as the availability of information from external or internal parties of the entity, in such ways as; from higher levels to lower ones, from the lowest levels in the higher ones, as well as between units connected horizontally.

The findings of the study show that internal controls enhances preventive and detective controls in the organization. According to Davila, Gupta and Palmer (2017), controls can be either preventive or detective. Preventive controls attempt to deter or prevent undesirable events from occurring. They are proactive controls that help to prevent a loss. Examples
of preventive controls are separation of duties, proper authorization, adequate documentation, and physical control over assets. Detective controls, on the other hand, attempt to detect undesirable acts (Pathak, 2005). They provide evidence that a loss has occurred but do not prevent a loss from occurring. Examples of detective controls are reviews, analyses, variance analyses, reconciliations, physical inventories, and audits. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventive controls are essential because they are proactive and emphasize quality. However, detective controls play a critical role providing evidence that the preventive controls are functioning and preventing losses (Heirer, 2015).

A study by Shanmugam, Haat, and Ali, (2012), on the relationship between internal control on SME performance. For the sampling purpose, a set of questionnaires was distributed to the owners of SME and statistical tools were used to analyze them. The results of the study indicated that there was a significant relationship between the implementation of internal control and performance of SMEs. Most of the SMEs in Malaysia are ready to implement internal control but it is still in primitive stage and they may have lack of awareness on the advantages of internal control to their businesses.

The findings revealed that internal controls enhances reconciliation in the organization. These findings are in with Muhunyo and Jagongo (2018), reconciliation is a comparison of different sets of data to one another, identifying and investigating differences, and taking corrective action, when necessary, to resolve differences. Reconciling monthly financial reports from the Accounting Department to file copies of supporting documentation or departmental accounting records is an example of reconciling one set of data to another. This control activity helps to ensure the accuracy and completeness of transactions that have been charged to a department's accounts. To ensure proper segregation of duties, the person who approves transactions or handles cash receipts should not be the person who performs the reconciliation. (Davila, Gupta, & Palmer , 2017) Another example of a reconciliation is comparing vacation and sick leave balances per departmental records to vacation and sick leave balances per the payroll system. A critical element of the reconciliation process is to resolve differences. It does no good to note differences and do nothing about it.
5.3.2 The Effect of Monitoring on Financial Performance

This study sought to determine the effect of monitoring on financial performance. These findings are in line with the findings of Karagiorgos, Drogalas and Giovanis (2011), who indicate that monitoring refers to the process of assessing the quality of the internal control structure over time. Since internal controls are processes, it is usually accepted that they need to be adequately monitored in order to assess the quality and the effectiveness of the system’s performance over time. By monitoring, the organization gets provided with assurance that the findings of audits and other reviews are promptly determined. According to Ewa and Udoayang (2012), monitoring of operations ensures effective functioning of internal controls system. It’s through monitoring that an organization determines whether its policies and procedures designed and implemented by management are being carried out effectively by employees.

According to Ershaid, Diala and Mohamed, (2017), monitoring can be achieved by regularly supervising and managing activities like monitoring of customer complaints and feedback and audits conducted periodically by internal auditors. Internal auditors can investigate and appraise internal control structure and the efficiency with which the various functions are performing their assigned duties. This way, they can bring a systematic and disciplined approach for the evaluation and improvement of risk management activities and good governance process by examining of the internal controls and evaluating how adequate and effective the controls are. Monitoring ensures that the findings of audits and other reviews are promptly resolved (Karagiorgos et al., 2011).

The findings of this study show that SME’s management is responsible for establishing internal control systems for effective monitoring of activities. Akiski and Gal (2017), suggest that internal control system and application of controls change overtime. This can be due to the arrival of new personnel, varying effectiveness of implementing the procedures or supervision, time and resource constraints or changes in the circumstances for which the internal control system originally was designed. Thus, the management needs to determine and observe whether the internal control system continues to be relevant and effective in the entity as intended. Ofsori (2011), suggests that Monitoring, the last component of internal control, is a process that assess the quality of internal control over time. Also, monitoring is the evaluation of an organization's events and transactions to gauge the quality of performance throughout the period and to decide whether controls are
effective. Gamage et al., (2014), argue that management should emphasis monitoring efforts on internal control and accomplishes the organization objectives. It is important to monitor internal control to determine whether it is operating as intended and whether any modifications are necessary. All employees need to understand the organization's mission, objectives, and responsibilities and risk tolerance levels for monitoring to be most effective.

The findings of this study revealed that monitoring can be done through on-going activities or separate evaluations. According to Ofsori (2011), monitoring provides assurance that the findings of audits and other reviews are promptly determined. Theofanis (2011), also notes monitoring of operations ensures effective functioning of internal controls in an organization. Hence, monitoring determines whether or not policies and procedures designed and implemented by management are being carried out effectively by employees.

According to Sarens, Abdolmohammadi, and Lenz, (2014), Organizational performance encompasses accumulated end results of all the organization’s work processes and activities. The most effective way to improve financial performance is by reducing the level of irregularity and fraud through improvements in the firm’s systems of internal financial control. Shareholders need to be assured that their resources are being used efficiently and effectively in providing the right service at the least cost.

The findings of this study show that monitoring enhances internal management controls within the company. According to Oseifuah, (2015), control activities and the control environment are manifested as policies and procedures that help to ensure management directives are carried out. They are critical, and they ensure that the necessary actions are taken to address risks necessary for the achievement of the organization’s objectives. Management is responsible for establishing and maintaining a system of internal control, identifying proper internal control frameworks to be used when evaluating internal controls, providing an assessment on the effectiveness of internal controls and identifying any evident material weaknesses in the existing system of internal control. As embedded in management’s day-to-day duties they should not only ensure the optimal utilization of internal control systems, but also ensure that internal controls are strategically positioned to achieve the objectives of their business, namely fortifying business sustainability (Ewa & Udoayang, 2012).
5.3.3 The Effect of Risk Assessment on Financial Performance

The third research question of this study sought to determine the effect of risk assessment on financial performance. The findings of this study revealed that there exists a significant relationship between risk assessment and financial performance. According to Karagiorgos et al., (2009), risk assessment refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved. It refers to the identification and analysis of relevant risks associated with achieving the objectives of the organization. The authors further add that risk assessment is the process of identifying and analyzing management relevant risks to the preparation of financial statements that would be presented fairly in conformity with general accepted accounting principle. In organizations, management must determine the level of risk carefully to be accepted and try to maintain such risk within determined levels. It is therefore the management’s responsibility to design internal controls to ensure efficiency and effectiveness, reliability of financial reporting as well as compliance with laws and regulations. This is ensured by periodic performance review and evaluation of the adequacy and effectiveness of the controls designed by the internal auditor department (Heirer, 2015).

According to McCord (2002), risk assessment of material misstatement at the financial statement level and also at the planning stage, clarifies the direction on performing a combined assessment of inherent and control risk, thus leaving the ability for the auditors to assess other risk factors in an audit. In their examination of the effects of the role of the board of directors in assisting in the formulation of corporate strategies on the auditors’ planning judgments, they established that auditors respond to the role of the board when making judgments with respect to control risk assessments.

The findings of the study revealed that risk assessment enhances internal audit enhances financial reporting. A study on the impact of risk-based audit on financial performance in Kenya’s insurance companies conducted by Kasiva (2012) among 44 respondents that included finance officers, internal auditors, credit officers, relationship officers, and accountants found out that risk-based auditing through risk management should be enhanced to enable the organization concerned to detect risks on time. The author further argues that fraud risk assessment is one area that deserves significant reliance on internal audit work. In this light, it is reasoned that due to the fact that internal auditors are privier with the operations of the firm they work for than external auditors, are particularly suited
to carry out fraud risk assessment. In a survey of internal auditors’ risk management practices in the Kenya’s banking sector, Kibaara (2007) investigated bank internal auditors’ risk assessment practices and established that, most banks in Kenya were in the process of drafting the ERM process and strategies in line with risk assessment.

The findings of the study also revealed that internal controls enhances risk mitigation in SMEs. These findings are in line with Nqala and Dubihlela, (2017) conducted a study on the investigations of how small and medium manufacturers are optimizing their internal control systems in order to mitigate risk. The study seeks to understanding how internal controls are utilized by manufacturing SMEs to mitigate and prevent risks, and how internal controls are implemented by manufacturing SMEs. The study was conducted on selected manufacturing SMEs in the Western Cape, South Africa. The study followed a qualitative research paradigm, adopting case-based interpretive approach employed to support the data collection, data analysis and data presentation methods. Manufacturing SMEs that are in process of implementing effective internal controls within their businesses would have a better understanding of the importance and value of preventing or mitigate risk. An analysis of interviews with managers and owners from manufacturing SMEs indicated that businesses create contingency risk plans and implement internal control systems are less exposed to risk (Davila, Gupta, & Palmer, 2017). Their risk-buffer strategies towards perceived risks helps them achieve higher risk performance.

The findings of this study revealed that it is necessary for every small business to manage its risks in order to minimize the loss exposure. SMEs in their operations encounter many risks such as political, natural disaster, credit and operation risks. Poor performance of SMEs is becoming concern as many of them die immaturely. Madembu and Namusonge, (2017), the role of risk management on financial performance of small and medium enterprises in Kenya. The study was guided by the following objectives; to examine the role of enterprise risk management on the financial performance of SMEs; to analyses the role of strategic risk management on the financial performance of SMEs; to evaluate the effect of financial risk management on financial performance of SMEs and to establish the role of operational risk management on the financial performance of SMEs. SMEs should focus on implementing comprehensive risk management systems in their businesses. (Madembu & Namusonge, 2017).
5.4 Conclusion

5.4.1 The Relationship between Internal Controls and Financial Performance

This study concludes that there exists a significant relationship between internal controls and financial performance. Internal control activities should highlight policies and procedures that help ensure management directives are carried out. They help to ensure that necessary actions are taken to address risks to the achievement of the entity’s objectives. This study concludes that internal controls are crucial for employee management, information accessibility in the organization, fraud reporting as well as prevention. This also concludes that internal controls enhances implementation of record keeping mechanisms in the organization.

5.4.2 The Effect of Monitoring on Financial Performance

This study concludes that there is a significant and positive relationship between monitoring and financial performance. This study concludes that monitoring influences quality and effectiveness in the organization, effectiveness of internal control systems and audit reviews. This study concludes that monitoring enhances events and transaction monitoring, governance and resources utilization in the organization is achieved through management authorization.

5.4.3 The Effect of Risk Assessment on Financial Performance

This study concludes that there is a significant relationship between risk assessment and financial performance. This study concludes that risk assessment is crucial for risk identification in the business environment. Risk assessments enhances risk evaluation and risk mitigation in the company by putting risk factors into consideration. This study also concludes that internal audit and SME structure are significant and reliable for financial reporting. This study concludes that designing of internal controls is important for enhancing efficiency and effectiveness in the organization.
5.5 Recommendations

5.5.1 Recommendations for Practice

5.5.1.1 The Relationship between Internal Controls and Financial Performance

This study recommends that SMEs should develop internal control systems that are in line with their financial performance of the organization. Internal controls will help the organization in tracking its business performance including profitability, control and effectiveness of the entire organization as a whole.

5.5.1.2 The Effect of Monitoring on Financial Performance

This study recommends that SMEs should constantly monitor their financial performance by implementing audit reviews as well as performance reviews to make sure that organizational objectives are achieved accordingly. This study recommends that small and medium-sized enterprises should develop mechanisms for events and transaction monitoring to ensure that financial performance is achieved in the organization.

5.5.1.3 The Effect of Risk Assessment on Financial Performance

This study recommends that risk assessments practices should be adopted by all small and medium-sized enterprises operating in Nairobi since it is critical for enhancing financial performance of the company without being exposed to environmental risks in which they operate. This study also recommends that SMEs should develop internal audit and organizational structure to enhance reliable reporting.

5.5.2 Recommendation for Further Studies

This study investigated the effect of internal controls on financial performance of small and medium enterprises in Nairobi County. This study was limited to Nairobi County. Future studies should investigate the effect of internal controls on financial performance of SMEs in other counties like Mombases, Kisumu, Nakuru, Kisii and Machakos.
REFERENCES


Interdisciplinary, (JUNE), 1–12.


APPENDICIES

APPENDIX 1: INTRODUCTION LETTER

Dear Sir/ Madam,

RE: REQUEST FOR CONDUCTING A STUDY ON SMEs

I am a graduate student undertaking Master of Business Administration and Finance in United States International University-Africa, undertaking a research study on “Effect of Internal Controls on Financial Performance of Small and Medium Enterprises in Nairobi County in Kenya”

I am carrying out the research as part of the requirements of obtaining my degree certificate. You have been selected to form part of this study and am kindly requesting you to assist in data collection by responding to questions in the attached questionnaire.

The information you will provide will only be used for academic purposes only and will be treated with utmost confidence. You are free to request for a soft copy of this questionnaire which can be sent to you via email. Your assistance and cooperation will be highly appreciated.

Yours Faithfully,

..........................
Akimana Kelly Joelle
APPENDIX II: QUESTIONNAIRE

This questionnaire seeks to collect information on *Effect of Internal Controls on Financial Performance of Small and Medium Enterprises in Nairobi County in Kenya*. Please provide information in the spaces provided unless indicated as optional and tick or circle the appropriate boxes. All the information received will be treated confidentially and will only be used for academic purposes.

SECTION A: RESPONDENTS INFORMATION

1. What is your gender?
   - Male [ ]
   - Female [ ]

2. What is your age group
   - Less than 20 years [ ]
   - 21-25 years [ ]
   - 26-30 years [ ]
   - 31-35 years [ ]
   - Over 36 years [ ]

3. Please indicate your level of education.
   - Diploma [ ]
   - Graduate [ ]
   - Post Graduate [ ]

4. How long have you been working in the organization?
   - 1-5 years [ ]
   - 6-10 years [ ]
   - 11-15 years [ ]
   - 16 years and above [ ]

5. How many employees do you have in your firm?
   - Less than 10 [ ]
   - Between 11-100 [ ]
   - Between 101-199 [ ]
   - 200 and Above [ ]

6. What form of business do you operate?
   - Sole trader [ ]
   - Private limited company [ ]
   - Partnership [ ]

SECTION B: EFFECT OF CONTROL ACTIVITIES ON FINANCIAL PERFORMANCE

Indicate your level of agreement with the following aspects by using a scale of 1-5, where 1- Strongly Disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly Agree.

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<tr>
<th>STATEMENTS</th>
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<tbody>
<tr>
<td>1. The organization have policies and procedures that help ensure management directives are carried out</td>
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2. Management establish control activities to effectively and efficiently accomplish the organization's objectives and mission

3. Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters

4. Availability of information from external and internal parties is easily accessible

5. The organization implements internal control which enhances performance of SMEs

6. The person who approves transactions is the same person who performs the reconciliation.

7. Reconciliations is always documented and approved by management

8. The SMEs keeps record of employees’ trainings and achievement for the organization

9. SMEs fraud reporting from employees is encouraged and adequate measures are taken to counteract them for the future

10. Top management team positively affect financial fraud prevention of the SMEs

11. The SMES Maintain adequate recording and duplicating systems have efficient staff control

12. SMEs often create contingency risk plans and implement internal control systems are less exposed to risk.

13. Existence of effective internal control is attributed to the highly regulated and structured environment in SMEs sector.

**SECTION C: EFFECT OF MONITORING ON FINANCIAL PERFORMANCE**

Indicate your level of agreement with the following aspects by using a scale of 1-5, where 1- Strongly Disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly Agree.

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<tbody>
<tr>
<td>1. The SMEs is monitored in order to assess the quality and the effectiveness of the system’s performance over time</td>
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<td>2. Monitoring of operations ensures effective functioning of internal controls system.</td>
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<td>3. Monitoring ensures that the findings of audits and other reviews are promptly resolved</td>
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<td>4. Internal control is adequately designed and properly executed</td>
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<td>5. The SMEs is monitored for the events and transactions to gauge the quality of performance throughout the period</td>
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<td>6. Monitoring can be done through on-going activities or separate evaluations</td>
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<td>7. The SMEs effective way to improve financial performance is by reducing the level of irregularity and fraud</td>
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<td>8. The SMEs Periodic comparisons of accounting records and physical asset and a review of activity performance like review of reports on performance.</td>
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<td>9. The management of SMEs is responsible for establishing and maintaining a system of internal control, to be used</td>
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</table>
Management authorization play a pivotal role in ensuring that the resources of a firm in procurement of inventory are used in an optimal manner.

Strong internal control system strengthens enterprise governance, allows management objectives to be achieved.

Control Environment must be present for an internal control system to be considered effective.

Monitoring has the highest influence on the financial performance of SMEs.

SECTION D: EFFECT OF RISK ASSESSMENT ON FINANCIAL PERFORMANCE

Indicate your level of agreement with the following aspects by using a scale of 1-5, where 1- Strongly Disagree, 2- Disagree, 3- Neutral, 4- Agree, 5- Strongly Agree.

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<tr>
<td>1. The management of SMEs determine the level of risk carefully and try to maintain such risk within determined levels.</td>
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<td>2. The external auditors respond to the role of the board when making judgments with respect to control risk assessments.</td>
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<td>3. The SME risk management requires the operation of risk evaluation and mitigation</td>
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<td>4. The SMEs risk-buffer strategies towards perceived risks helps them achieve higher risk performance.</td>
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<td>5. It is necessary for every SMEs to manage its risks in order to minimize the loss exposure</td>
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<td>6. Development of the SMEs internal audit effectiveness of health care, the financial statements reflect the quality of the internal audit</td>
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<td>7. Internal audit and structure of the SMEs is an important part of reliable financial reporting</td>
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<td>8. The SMEs management’s responsibility is to design internal controls to ensure efficiency and effectiveness</td>
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<td>9. There is always periodic performance review and evaluation by the internal auditor for the SME</td>
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<td>10. There is careful assessment of factors that affect the possibility of objectives of the organization not being achieved.</td>
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<td>11. The Organization identifies and analyzes management relevant risks to the preparation of financial statements</td>
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</table>
APPENDIX III NACOSTI RESEARCH PERMIT

This is to Certify that Miss. Akimana Joelle of United States International University Africa, has been licensed to conduct research in Nairobi on the topic: EFFECT OF INTERNAL CONTROLS ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN NAIROBI COUNTY for the period ending: 23/August/2020.

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