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Role of Internal Control Systems on the Financial Performance of Banking Institutions in Kenya

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Abstract: The banking sector in Kenya has faced a lot of crises as a result of under-capitalization, towering levels of non-performing loans and weak internal control systems. Effectiveness and efficiency of internal control systems therefore on financial performance should be considered essential in banking institutions because of the tasks that internal control system are designed to achieve. Internal control is an essential part of good corporate governance. The general purpose of the survey is to assess the role of the internal control systems on the financial performance of banking institutions. The study used descriptive research design, the population target were the employees of the banking institutions registered by the Central Bank of Kenya. The sample size was 20% of the target population which was randomly drawn from each stratum to form the sample for the study. A pilot study was conducted to test the instrument before the actual research. Pilot test of this study gave a Cronbach's Alpha coefficient of 0.826. A self-administered, questionnaire was used to collect data from the target respondents. Data analysis was conducted using statistical package for social sciences (SPSS) to generate descriptive and inferential statistics. The results indicated that control activities, risk assessments, and information and communication systems had positive and significant effect on financial performance of banking institutions in Kenya at 5% significance level while monitoring procedures had positive but insignificant effect. In addition, the finding of the study revealed that bank institutions had a well elaborate organization structure, management moves with a great integrity in execution of its roles, ethical values and morals are observed in management decisions, top management are committed to the operation efficiency of the system and the concerned parties take necessary action to enhance efficiency of the internal control system. Further result indicated that top management were reluctant to share feedback with junior staff, it takes time to communicate to parties responsible for taking corrective measures and there has been inadequate periodical evaluation and monitoring undertaken by the internal audit department.

Keywords: *Control activities, Risk assessment measures, Information and communication, Monitoring procedures, financial performance*

Introduction

Firms are always keen on their financial performance and they usually engage in activities to appraise their financial performance and thus, make changes in their operations (Visser, Matten & Pohl, 2010). However, some firms that are more successful than others. These firms employ better internal controls to ensure the outstanding performances. Internal control system is the process designed and effected by those charged with governance, management together with other stakeholders to provide reasonable assurance about the achievement of the entity`s objectives with regard to reliability of financial reporting, effectiveness of operation and compliance with applicable laws and regulations (Ayagre, 2014). Internal control systems are established and implemented to address identified business risk that threatens the achievement of the objectives of the organization. Internal control is an essential part of good corporate governance. Directors are responsible for maintaining a system of scrutiny that will safeguard the company`s assets (ACCA, 2009/2010). Internal control systems are essential to management as they contribute to; Safeguarding the business's assets, Helping to prevent and detect fraud, Safeguard the shareholder`s investment (ACCA, 2011). In Africa, Saren and Beelde (2008) did a study to establish the impact of internal control design on banks' ability to staff fraud and staff life style and fraud detection in Nigeria. The study established that if an organization pursues integrity and clear ethical values reflected in a formal code of conduct, the internal control will take a greater importance. it was also established that Internal control design influences staff attitude towards fraud such that a strong internal control mechanism is deterrence to staff fraud while a weak one exposes the system to fraud and creates opportunity for staff to commit fraud.

Statement of the Problem

Internal system controls enables the banks to conduct its business efficiently in order to achieve its set objectives, also the internal system controls are crucial to enhance customer expansion and sustaining the existing ones as well as ensuring the shareholders are getting their profits as their portfolios expand due to growth in assets (Andrei, 2015).Internal control system work well in environments that influence their operations also each bank internal control system is different to other banks .thus there are those banks that generate profits as other suffer losses. The possibility of making profits depends on how a bank will utilize its internal control system to motivate its employees to deliver to customers and how the control system enables the bank to evaluate risks associated in its operations of extending loans for example is a significant risk due to default and nonperformance of loans (Yan, 2013).

The banking sector in Kenya has faced a lot of crises as a result of under-capitalization, towering levels of non-performing loans and weak internal control systems. According to CBK, (2015) failing commercial banks have increased leading to systematic banking instability (Honohan, 2005). Levine, 2009 indicates that the percentage of private credit was 23.7% and liquid liabilities 36.0% compared to GDP. The Kenyan statistics are the worst in when compared to those of Uganda and Tanzania. Non-performing loans to gross loans have been on an increasing trend from the year 2004 to present (CBK, 2015). Return on equity and assets are however on an upward trend over the years. The sector registered returns of 23.3% on equity and 2.74% on assets in the year 2006. Effectiveness and efficiency of internal control systems therefore on financial performance should be considered essential in banking institutions because of the task that internal control system.

The role of the system is to safeguard all asset, to avoid misuse or misappropriation of the firm's assets and to detect and protect against probable frauds (Schwartz, 2013).Without adequate risk assessment at the bank on the loan appraisal process, inadequate communication and information flow within the banking industry, insufficient procedures on the banking operations among the stakeholders including the employees and poor monitoring of the activities it lowers the productivity and thus reduces the amount of profits earned within the organization thus reducing the return on assets index (Jin, et al. 2014). Due to the above mentioned issues, the study sought to ascertain the role of internal control systems on the financial performance of banking institutions in Kenya.

Objectives of the Study

i. To assess the role of control activities on the financial performance of banking institutions.
ii. To assess the role of risk assessment measures on the financial performance of banking institutions.
iii. To assess the role of information and communication on the financial performance of the banking institutions
iv. To assess the role of monitoring procedures on the financial performance of banking institutions.

Theoretical Review

Theory of the firm

The development of the theory is credited to Michael Jensen, an American economist. Economist have argued that perhaps the theory is the best known work of the economist (Jensen & Meckling, 1976).In simplified terms, the theory of the firm aims to answer these questions: Existence, Boundaries, Organization, why are firms structured in such a specific way, for example as to hierarchy or decentralization?, heterogeneity of firm actions and performances, what drives different actions and performances of firms, and lastly, the evidence, what tests are there for the respective theories of the firm (Thomas, 2008). The theory of the firm consists of a number of economic theories that describe, explain and predict the nature of the firm, company, or corporation, including its existence, behavior, structure, and relationship to the market. In regard to this study, the theory of the firm find application in that the firm applies internal controls that describes its behaviour to meet the relevant marginal conditions that could be described as enhanced performances.

Agency Theory

The first scholars to propose, explicitly, that a theory of agency be created, and to actually begin its creation, were Stephen Ross and Barry Mitnick. Agency Theory describes firms as necessary structures to maintain contracts, and through firms, it is possible to exercise control which minimizes opportunistic behavior of agents. Accordingly, Barlie & Means (1932) posit that in order to harmonize the interests of the agent and the principal, a comprehensive contract is written to address the interest of both the agent and the principal. They further explain that the relationship is further strengthened by the principal employing an expert to monitor the agent. This position is also supported by Coarse (1937) who maintains that the contract provides for conflict resolution between the agent and principal, the principal determines the work and agent undertakes the work.

Stakeholders Theory

This study was informed by the Stakeholder Theory as suggested by Miles and Friedman (2006), who illustrated it through two principles, the organisation legitimacy and stakeholder fiduciary principles. The principle of organisation legitimacy which argued for the management of the organisation by considering the benefit of the stakeholders, the rights of various groups are considered as well as their participation in decisions that substantially affect their welfare. On the other hand, the stakeholder fiduciary principal proposed that of manager were to act in the interests of the stakeholders as well as the corporate while safeguarding the long-term stakes of each party. Jensen (2002) considers the linkage of objective function and stakeholder theory as enlightened value maximization: implying that whenever managers make trade-offs, they consider how the value gets created.

Contingency Theory

In 1957, Robert Tannenbaum and Richard Schmidt developed a leadership continuum with relationship orientation characterized by high employee freedom on one extreme and task oriented behavior characterized by high use of leader authority at the other extreme. Contingency theory is an approach to the study of organizational behavior in which explanations are given as to how contingent factors such as technology, culture and the external environment influence the design and function of organizations. The assumption underlying contingency theory is that no single type of organizational structure is equally applicable to all organizations. Rather, organizational effectiveness is dependent on a fit or match between the type of technology, environmental volatility, the size of the organization, the features of the organizational structure and its information system.

Conceptual Framework

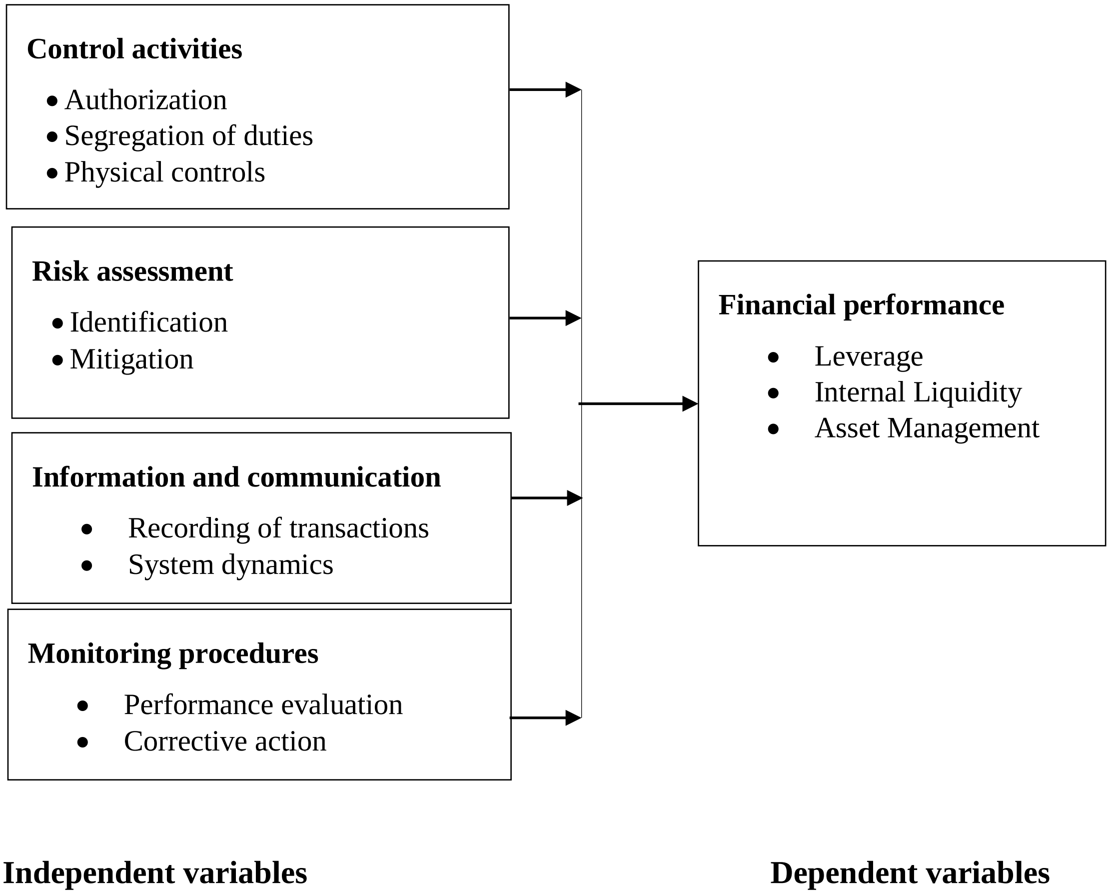

Figure 1: Conceptual Framework

Research Methodology

The study relied on a descriptive research design that sought to investigate the study variables without manipulating any of them or tampering with any of them in an attempt to understand, it focused on how internal control systems measures influences the performance. The population was the employees in 41 commercial banks in Kenya. The target population defines the classes for which findings are to generalize. It is what the research seeks to generalize the result of the study about (Sampling, 2016). The target population for this research was 41 commercial banks targeting the managers. It is important that the target group shows the geographical location and specifies exclusions of possible subgroups. The sample size for the study was drawn from the management. These employees are deemed knowledgable on the subject matter and therefore best suited for the study.

From the 520 managers in the commercial banks targeted in the study, the study took a sample of 20%. The study used both primary and secondary data. The researcher adopted the use of questionnaires in data collection since polls give respondents ample time to fill, are convenient and profitable. The questionnaires were self-administered questionnaires (SAQs). This approach enabled the researcher to cover a large population quickly and at affordable cost; further SAQs were very suitable for the target respondents on account of their knowledge in English (Saunders, et al, 2003). Structured interviews was applied to administrators since they were few, and were able to give in-depth information which could be left in SAQs. Quantitative data was coded and entered into Statistical Packages for Social Scientists (SPSS Version 21.0) and analyzed using descriptive statistics. Qualitative data was analyzed based on the content of the responses. Responses with common themes or patterns were grouped together into coherent categories. Descriptive statistics involved the use of absolute and relative (percentages) frequencies, measures of central tendency and dispersion (mean and standard deviation respectively). Quantitative data was presented in tables and graphs and explanation was presented in prose. Also the study used a multivariate regression model to determine the relationship between the independent variables and the dependent variable. The reason for using the regression model is because of its ability to test the nature of influence of independent variables on a dependent variable. The specific model to be used in this study is;

$Y = \beta 0 + \beta 1X1 + \beta 2\ X2 + \beta 3\ X3 + \beta 4\ X4 + \varepsilon$ Where Y = Financial Performance, $\beta 1 \ldots \beta 4$= Regression Coefficient of five variables, $\beta 0$= Interception Coefficient, X1 = Control Activities, X2=Risk Assessment, X3= Information and Communication, X4= Monitoring procedures

ε = Error Term

Data Analysis and Interpretation of Results

Response Rate

Data that was analyzed was obtained from eighty nine (89) respondents out of the targeted one hundred and four (104) employees of banking institutions. Thus the response rate achieved was 85.6%, this is a response rate of above 80% which is referred as very good according to (Mugenda & Mugenda, 2003).

Demographic Information of the Respondents

Position or role of the respondents

The researcher sought to evaluate the position or role that the respondents played in their bank.

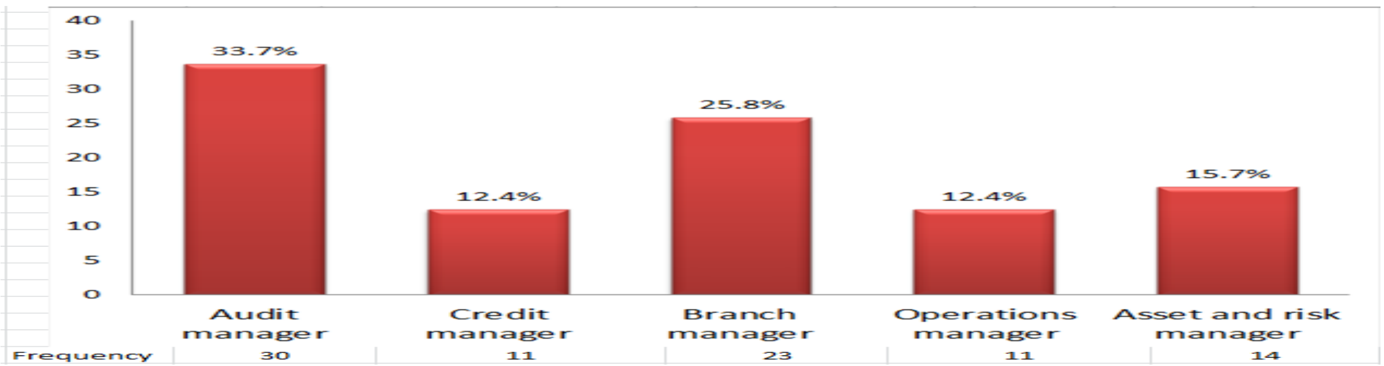

Figure 2: Respondents Role in the Bank

The total respondents 30 were audit managers, 11 credit managers, 23 branch managers, 11 operations managers and 14 asset and risk managers. The researcher targeted employees in managerial positions due to the fact that managers were expected to have good understanding of the operations of the banks. Moreover, the managers were expected to have worked in the banks for longer periods of time.

Education Level of Respondents

Details about the education levels of respondents were obtained in order to establish whether the respondents would fill the questionnaire and internalize the intended purpose with ease. The results are presented in the Figure 3.

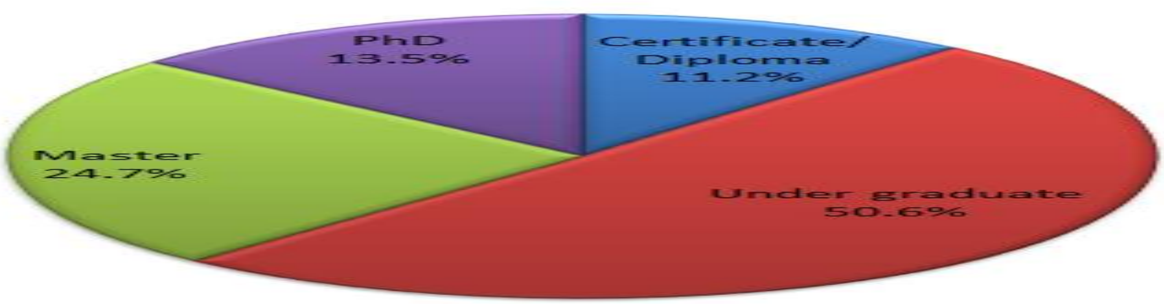

Figure 3: Education Level of Respondents

The findings in Figure 3 indicate that, 11.2% of the total respondents stated that they possessed certificate or diploma level of education. On the other hand, 50.6% alluded that they possessed undergraduate degree of education. Those that stated that they had a Masters degree were 24.7% while 13.5% of the respondents stated that they possessed a doctorate degree. Based on the results of the study regarding the educational levels of the respondents, it is fair to allude that the respondents were well educated.

This means that they could read and understand the questions asked by the researcher as well as provide detailed and in depth information that would greatly improve on the results of the study.

Work experience in the bank

With respect to the duration of service in the bank, the researcher sought to understand how long the respondents had worked in their bank. The researcher considered this information relevant given that the longer the period they had worked in the bank, the more familiar they would be to the internal control systems, their challenges and what could be done to improve them thus improving the financial performance of the banks they work for.

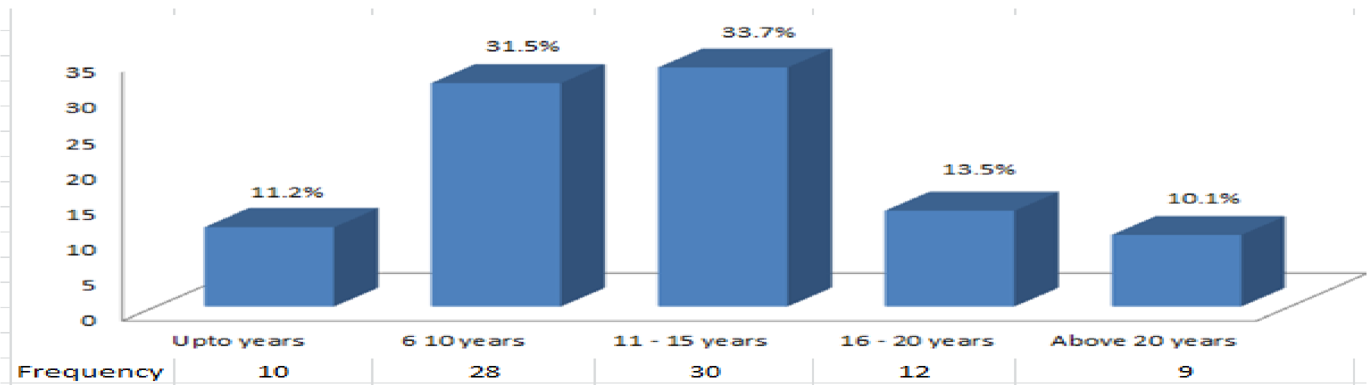

Figure 4: Number of years the respondent has worked with the institution

Based on Figure 4 above, majority of the respondents are experienced due to their long service in the banking sector. 10 of the total respondents alluded that they had between 0 and five years of experience working with the bank, 28 declared that they had between 6 and 10 years duration of service with the bank. Meanwhile, 30 affirmed that they between 11 and 15 of experience with 12 stating that they had 16 and 20 while 9 had more than 20 years in service for their respective banking institutions. In this case, given that more than 70%of the total respondents had more than 6 years in service in the banking institutions, it is expected that the respondents had in-depth information regarding the operation of the internal control system in the bank and its relationship with the financial performance of the banks.

Financial Performance

Performance refers to the ability of the firm to operate efficiently, profitability, survive, grow and react to the environmental opportunities and threats. Performance is measured by how efficient the enterprise is in use of resources in achieving its objectives. Internal control would be judged as effective if its components are present and function effectively for operations, financial reporting, and compliance. In addition effective controls provide reasonable assurance regarding the accomplishment of established objectives.

It is on this basis that the researcher sought to establish how the respondents would rate the internal control system as a factor that influences financial performance in Sacco. The responses were tabulated in Table 1 below.

Table 1: Effect of Internal Control Systems on Financial Performance

Extent internal control systems	Frequency	Percent (%)
Small extent	3	4.4
Great extent	12	17.7
Very great extent	53	77.9
Total	68	100.0

From Table 1, it is evident that majority of the respondents which accounted for 95.6% were of opinion that internal control systems is a factor that affect financial performance in banking institutions to the great extent. The finding of this study supports earlier finding by Kopp and Bierstaker (2006), who noted that internal control promotes effectiveness and efficiency of operations, reduces the risk of asset loss, and helps to ensure compliance with laws and regulations hence enhancing financial performance.

Role of Control Activities on the Financial Performance of Banking Institutions

Controls activities relates to policies and procedures maintained by an organization to address risk prone areas. These activities aid the management of the firm to achieve their objectives by aiding the detection and correction of errors. Elder (2010) espouses that the system is supposed to provide the management of the firm with reasonable assurance that the firm achieves its objectives through undertaking of such procedures as trial balances, reconciliations and comparison of the cash records with accounting balances to ensure that no errors have been committed or fraud committed. In light of this, the first objective of the study sought to assess the role of control activities on the financial performance of banking institutions.

Table 2: Descriptive Analysis of Control Activities

	N	Mean	Std. Error	Std. Deviation
There is a well elaborate Organization Structure in the bank that ensure transaction authorization	89	4.6966	.06856	.64675
Top Management is committed to the operation efficiency of the system	89	4.1798	.13612	1.28419
Specific lines of authority and responsibility have been established to ensure compliance with the policies and procedures	89	4.1011	.14737	1.39027
Management moves with a great integrity in execution of its roles	89	4.5618	.10595	.99949
Ethical values and morals are observed in management decisions	89	4.5056	.11086	1.04581
Valid N (listwise)	**89**			

Based on Table 2, it is evident that the majority of the respondents of the study concurred that bank institutions has well elaborate organization structure that ensure transaction authorization. This is espoused by the mean of 4.67 out of 5. This means that the majority of the respondents of the study concurred that banks has well elaborate organization structure in the bank that ensure transaction authorization. Based on the stakeholder's theory, the management of the firm is not only charged with the responsibility of maximizing the value of their shareholders but also ensuring that it takes into consideration the needs of other stakeholders in the firm. The efficiency of the management in ensuring a trade-off in the interests of the stakeholders and the shareholders of the firm largely depends on the on the controls established by the firm to protect the organization from both external and internal threats. On this premise, the researcher sought to evaluate the commitment of the management of the banking institutions towards ensuring the efficiency of their internal control systems. The responses drawn from the statement 'Management is committed to the operation efficiency of the system' meaning that the majority of the respondents believed that the management in their banks is committed to ensuring that the internal control systems operated efficiently derived a mean of 4.18 out of 5.

The primary role of the procedures and policies established by the bank's internal control system and the segregation of duties is the detection and correction of errors as well as prevention of fraud. In light of this, the researcher sought to understand whether the banks have specific lines of authority and responsibility to ensure compliance with the policies and procedures. The responses drawn from the statement 'Specific lines of authority and responsibility have been established to ensure compliance with the policies and procedures' derived a mean of 4.10 out of 5 as shown in Table 2 above. This shows that majority of the respondents of the study. Based on the postulation of the agency theorem, the moral hazards and adverse selection may impact on the output of the managers in cases where the manager either does not understand their role or choose not to do what they are appointed to do by their principals. On this regard, the researcher sought to evaluate the integrity of the management in execution of their roles.

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The respondent's responses drawn from the statement 'Management moves with a great integrity in execution of its roles' derived a mean of 4.56 out of 5. This means that majority of the respondents for the study agreed that the management of the firm executed their duties with integrity in such ways that ensure the safeguarding of the assets of the banking institutions. Moreover, integrity on the part of the management being the preparers of the financial reports is likely to be reflected in the accuracy and correctness of the financial reports delivered to the owners of the firm as well as other stakeholders. ACCA (2011) espouses that based on the postulations of the agency theorem, information asymmetry between the managers and the owners of the firm may result a scenario where the principal does not know what the manager or agent is doing. In this case, unethical management may take the opportunity to be insensitive and invest in high risky projects which promises more bonuses for them. However, such risk attitudes expose the firm's assets to credit risk. As such, the researcher sought to understand whether ethical and moral values are adhered to by the management. The responses drawn from the statement 'Ethical values and morals are observed in all management decisions' drew a mean of 4.51 out of 5 as shown in Table 4.8 above. This means that the majority of the respondents of the study concurred that the management of the firm adhered both to the ethical and moral values in making decisions in the firm.

Functional Internal Control

The researcher sought to find out from the research respondents whether they had a functioning internal control system. The results were presented in Figure 5 below.

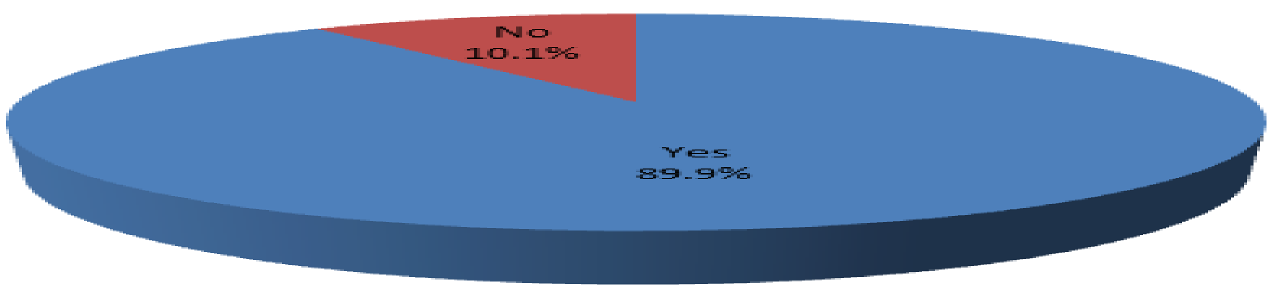

Figure 5: Functioning Internal Control

The majority of the respondents stated that the internal control systems in the banks they worked for were functioning. Of the 89 respondents, 89.9% agreed that their banks had functioning internal control systems while 10.1% alluded that their banks lacked functioning internal control systems. Based on this results, it is fair to espouse that majority of the banking institutions have functional internal control systems.

Role of Risk Assessment Measures on the Financial Performance of Banking Institutions

Risk assessment refers to the process of risk identification, assessment of the effects of the risk, assessment of likelihood of the risk to occur and determination of the actions to take upon occurrence of the risk. According to Cadez and Guilding (2008), there are several aspects risk management control systems established by the organizations. One of these aspects is the external environment which exposes the firm to several risks.

Simkins and Fraser (2010) postulates that the internal control system should be capable of assessing these risks posed by the external environment. According to CAI (2003) the management of the firm has to aware of the business environment that they operate in for the purposes of identifying, analysis and managing risk. However, there are two types of risks; systematic risks or market risk which the firm is not capable of manage through diversification and the unsystematic risks which the firm can control through diversification. On this regard, the second objective of the study sought to assess the role of risk assessment measures on the financial performance of banking institutions.

Table 3: Descriptive Analysis of Risk Assessment

	N	Mean	Std. Error	Std. Deviation
Credit risk minimizes returns in investment	89	4.5618	.09174	.86544
Interest rate risk lowers the rate of expected income	89	4.2584	.12535	1.18253
High operating expense limits the ability of the Bank to manage its daily obligations	89	3.8539	.15621	1.47364
The management evaluate the risks and take precaution measures	89	4.1011	.14737	1.39027
Valid N (listwise)	**89**			

Based on the evaluation in Table 3 above, it is evident that the respondents whom comprised on managers of banks were conscious of the risks that credit and interest rates posed on the financial performance of the banks. They tend evaluate the risks and take precaution measures. This is espoused by the mean of more than 4.10 out of 5. This means that the majority of the respondents of the study concurred that management have put in place mechanism to evaluate the risks and ensure that precaution measures are taken. The researcher also sought to understand from the respondents the effect that credit risk poses to the investments made by the banks. The responses drawn from the statement ‘Credit risk minimizes returns in investment’ derived a mean of 4.56 out of 5 as Table 4.9 above espouses.

This means that majority of the managers believed that credit risk results in the decline on the bank’s return on investment. On the other hand, the researcher sought to understand the impact of interest rate on the expected income of the banks. The responses drawn from the study respondents on the statement ‘Interest rate risk lowers the rate of expected income’ derived a mean of 4.26 out of 5 as shown in Table 4.5 above, meaning like in the case of credit risk, the managers perceived interest rate risk as a having a negative impact on the rate of expected income for the banks.

Finally, the researcher sought to evaluate the effects of high operating costs on the ability of the banks to manage its operations. It is vital to understand that costs and profits have an inverse relationship in such way that if there is an increase in the operating costs of the firm with revenues being held constant, the profits derived by the banks will inevitably decrease. The responses drawn from the respondents on the statement 'High operating expense limits the ability of the Bank to manage its daily obligations' derived a mean of 3.85 out of 5. This means that majority of the respondents concurred that higher operating costs for the banks impact directly on the profitability of the banks.

The finding of study, management has put in place mechanism to evaluate the risks and ensure that precaution measures are taken assert earlier finding by Meisser (2003) who noted that the management of risk largely relies in the awareness level that the management of the banks have on the business environment that they are operating in as well as their direct involvement in day to day operations with their clientele. He concluded that managers should then undertake to analyse the risk with regards to their likelihood of occurrence and the effects that the risk have on the performance of the banks as well as on the objectives of the management in maximizing the wealth of their owners. Jin et al. (2014) espouses that inadequate assessment of risk lowers the productivity of the banks by reducing on the profits of the firm as well as the returns that the banks earn from their assets. The postulations of Jin et al. (2014) are backed by the postulations of CBK, (2015). According to CBK (2015) inadequate assessment of risk by banking institutions in Kenya has resulted in the growth of non-performing loans meaning that Kenyan Banks are at higher risk of default for loans and lower returns for their assets (loans).

Market risk effect on bank financial performance

The researcher sought to find out from the research respondents whether they market risk effect on bank financial performance. The results were presented in Figure 6 below.

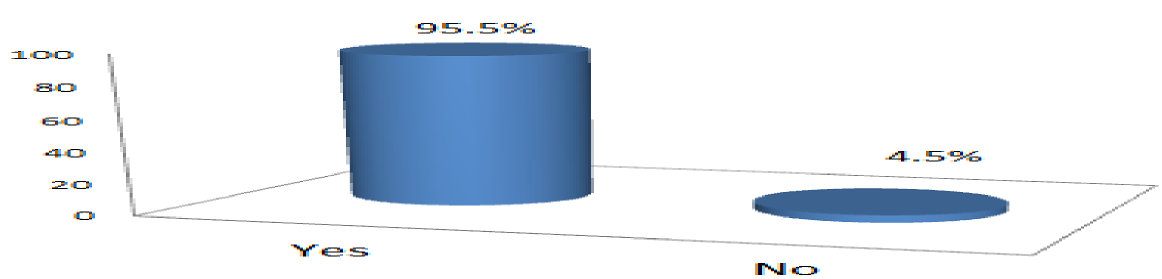

Figure 6: Market risk effect on bank financial performance

As Figure 6 below shows, 95.5% of the study respondents agreed that market risk faced by their banking institutions affected on the financial performance of the firm.

Strategies banks use to address risk

The researcher sought to understand how in the opinion of the respondents are the strategies that the banks can use in the management of risk. Majority of the respondents agree that credit risk or the risk of default of the loan borrowers to pay back their obligation formulates the most potent risk on the performance of the banking institutions. To manage credit risk, the respondents espouse that the banking institutions should undertake to operate under sound credit conditions by lending to individuals and firms that have the ability to pay back the loans within the required period. Secondly, majority of the respondents concur that the firm should always maintain sufficient amounts of capital that could provide cover incase of massive defaults in their loans. Thirdly, majority of the respondents espouse that the management should undertake an analysis of the economic trends in the nation so as to understand the potential risk that the changes in the growth of the economy affect on the ability of the borrowers in regards to paying back their loans. On the other hand, majority of the respondents espouse that the banks should manage interest rate risks faced by the banks, by undertaking hedging strategies such as interest rate swaps to improve the level of certainty on the returns derived by the banking institutions.

Role of Information and Communication on the Financial Performance of the Banking Institutions

According to ACCA (2011) the information system that facilitates financial reporting in firms formulates an important component of the internal control system. The system classifies transaction undertaken by the firm into classes that relate directly to financial reporting as well as established a trail of how the firm creates, records, processes, corrects and transfers information from the general ledgers to financial reports. In light of this, the third objective of the study sought to assess the role of information and communication on the financial performance of the banking institutions.

Table 4: Descriptive Analysis of Information and Communication

	N	Mean	Std. Error	Std. Deviation
Information system is relevant to the financial reporting objective	89	3.7528	.16781	1.58316
Related accounting records, support information and financial performance reporting	89	3.8202	.15621	1.47372
Free circulation of information enhances teamwork	89	3.6517	.16226	1.53075
Management provides feedback to the junior officers concerning operation of the system	89	3.5281	.17218	1.62432
Valid N (listwise)	89			

As Table 4 above espouses, majority of the study respondents concurred that the information systems set in place in the banks aided in achieving of the financial reporting objective. The responses drawn from the statement 'Information system is relevant to the financial reporting objective' drew a mean of 3.75 out of 5. This means that the system set in place by the firm aligns with the postulations of ACCA (2011) in that it allows for the initiation, recording, processing and reporting of transactions. Moreover, majority of the respondents for the study, concurred that the related transactions aided the management of their banks achieve their financial reporting objectives. The responses drawn from the statement 'Related accounting records, support information and financial performance reporting' derived a mean of 3.82 out of 5 as shown in Table 4.6 above. The results of the study with regards to the information system align with the postulations of the theory of the firm in that the setting up of an appropriate systems by the banks aids in translating the transactions (inputs) into financial reports (output) that are reliable for the decision making of both the bank's shareholders and stakeholders. In addition, the researcher sought to understand whether the free circulation of information enhances teamwork in the banks. The responses drawn from the statement 'Free circulation of information enhances teamwork' derived a mean of 3.65 out of 5 as shown in Table 4.6 above. This means that the respondents believed that the information system set up by their banking institutions facilitated teamwork among the employees of the bank allowing the managers of the banks to achieve their objectives as agents of the shareholders of the banks. Based on the postulation of the respondents with regards to information and communication systems in the banks, it is fair to assert that information and communication has a positive impact on the financial performance of banking institutions.

The researcher further sought to evaluate whether the management of the firm provides feedback to their junior officers in the banks with regards to the operations of the internal control system as a form of communication. The provision of feedback would in this sense aid the efficiency in operation of the bank's internal control system. The responses drawn from the statement 'Management avails feedback to the junior officers concerning operation of the system' derived a mean of 3.53 out of 5 as shown in Table 4.6 above. Though, the results drawn of the respondents showed that the majority of the respondents agreed with the statement, it is evident that the respondents concurring with the statement was lower than that of the statement on free circulation of information enhances teamwork. This espouses that the managers of the banks may not be all too willing to share feedback with their juniors in the banks.

Availability of detailed information

The researcher sought to understand whether the information available in the banks was detailed enough to provide a glimpse of the actual status of the banks.

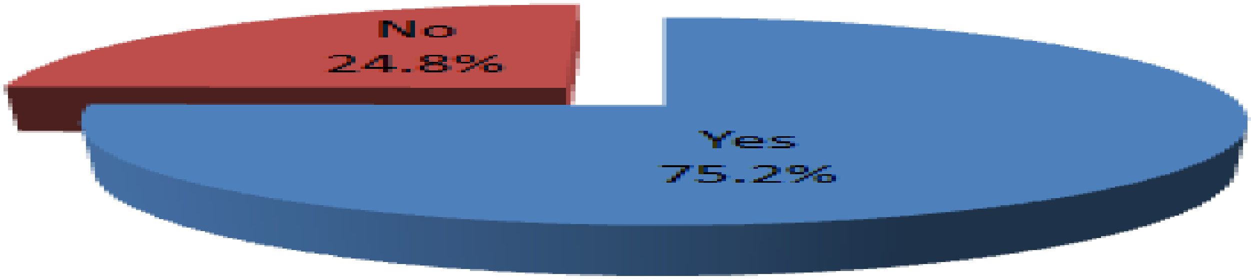

Figure 7: Availability of detailed information

Based on the responses drawn from the research respondents on the statement 'Are the available information detailed enough to reveal the actual status of the Bank?' it is evident that the majority of the respondents concurred with the statement. As Figure 7 above shows, 75.2% of the respondents concurred that their banks provide them with detailed information detailing the actual status of the banks. Though about a quarter felt that more information needs to be availed.

Role of Monitoring Procedures on the Financial Performance of Banking Institutions

Monitoring controls play a key role in the assessment of the effectiveness of the performance of internal controls over time. According to ACCA (2011) monitoring controls involve three steps; assessment of the performance of the internal control systems, communication of the deficiencies of the system to people charged with corrective action and the undertaking of corrective action to enhance the efficiency of the system. In this regard, the four objective of the study sought to assess the role of monitoring procedures on the financial performance of banking institutions.

Table 5: Descriptive Analysis of Monitoring Procedures

	N	Mean	Std. Error	Std. Deviation
The concerned parties take necessary action to enhance efficiency of the internal control system.	89	3.0225	.18839	1.77724
There is timely communication to those parties responsible for taking corrective measures	89	2.7753	.18062	1.70396
Appropriate actions are taken to correct misfeasance in operation of the accounting management system	89	2.7191	.18703	1.76448
Organization has an active, independent and objective audit committee	89	3.1124	.19005	1.79290
There is periodical evaluation and monitoring undertaken by the internal audit department	89	2.7416	.18740	1.76795
Valid N (listwise)	**89**			

Based on the evaluation in Table 5 above, the responses drawn from the statement 'There is a periodic evaluation, monitoring and undertaken by the internal audit department' derived a mean of 2.74 out of 5. This shows that majority of the study respondent disagreed that there was periodic evaluation and audit of the internal control system. Moreover, the researcher sought to understand whether there is timely communication of the deficiencies in the system to parties charged with corrective action. The responses drawn from the respondents on the statement 'There is timely communication to those parties for taking corrective measures on inefficiencies in the system' derived a mean of 2.78 out of 5 as Table 4.7 above shows. The indication is that many respondents were not convinced that communication regarding the inefficiencies in the internal control system was done in a timely manner. This means that the process of monitoring the system is impacted by the slow process of communication of the inefficiencies in the system following the evaluation by the internal audit department.

Lastly, the researcher sought to evaluate whether the concerned parties charged with corrective action actually undertake to make changes in the system so as to optimize its effectiveness. The responses drawn from the respondents on the statement 'The concerned parties take necessary corrective action to enhance the efficiency of the internal control system' derived a mean of 3.02 out of 5 as Table 4.7 above shows. This shows that majority of the study respondents agreed that corrective action on the deficiencies in the bank's internal control system were undertaken by the concerned parties. Overall, it is evident from the above evaluation that monitoring controls play a positive control on the financial performance of the banks. However, the majority of the respondents agreed that the periodic audits on the system were not undertaken or in cases where the audits were undertaken, there was no timely communication of the deficiencies to the parties charged with undertaking corrective action.

Management influence on external auditors

External auditors play a critical role in evaluating the internal control system of any with the purposes of evaluating whether the system can be relied upon with regards to production of accurate and reliable financial reports. The external auditors following their audit usually provide recommendations on how the management of the firm can improve their internal control system. The information is usually addressed in a management letter. On this regard, the researcher sought to understand from the respondents whether the management in their banks influenced the opinion espoused by the external auditors.

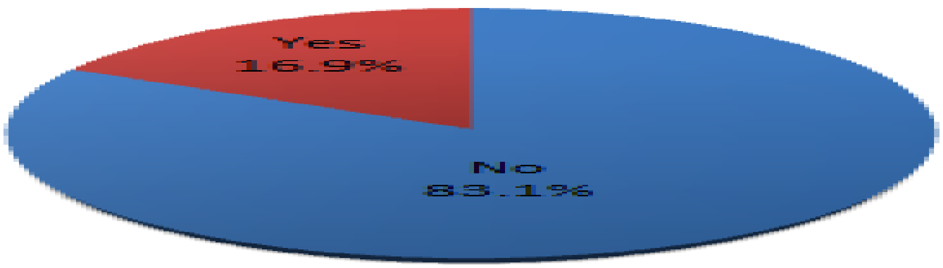

Figure 8: Management influence on external auditors

Based on the responses derived from the study respondents, it is evident that majority of the respondents espoused that the management in their banking institutions did not influence the opinion of the external auditors auditing the banks. Based on Figure 8 below, 83.1% of the respondents alluded that the management in the banks they work did not influence the opinion made by the external auditors. Manuele (2013) explicates that the reliability of the audit opinion espoused by the external auditors relies majorly on whether the auditor conducted the audit professionally and independently.

Multiple regression of Internal Control System on Financial Performance

Widespread literature both empirical and theoretical espouses that the internal control system of an organization has a direct effect on the performance of the organisation. In this light, this section sought to establish the relationship between control activities, risk assessment, information and communication and monitoring factors on financial performance of banking institutions. Multiple regression analysis was applied using mean score for each variable to determine the effect of independent variables (control activities, risk assessment, information and communication, and monitoring) on dependent variable (financial performance of banking institutions). This was performed using the field data and the results interpreted according to the R values, R^2 values, the beta values and F ratio at the 95% confidence level. Explanation and interpretation of the multiple regression output are as indicated in table 6, 7 and 8.

Table 6: Multiple Regression Model Summary for Internal Controls

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.605[a]	.366	.336	1.00736

a. Predictors: (Constant), Monitoring, Risk assessment, Control Activities, Control environment

The model summary in Table 6 shows the R value was 0.605 indicating that there is a positive relationship between internal control systems factors (control activities, risk assessment, information and communication, and monitoring) and financial performance in banking institutions. The R squared (R^2) value of 0.366 shows that 36.6 percent of financial performance in banking institutions is explained by internal control systems factors considered under this study. The remaining 63.4 percent is explained by other factors not put into consideration in this study.

Table 7 ANOVA for Internal Controls

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	49.253	4	12.313	12.134	.000[b]
	Residual	85.241	84	1.015		
	Total	**134.494**	**88**			

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Monitoring, Risk assessment, Control Activities, Control environment

The results of ANOVA revealed that the entire model was significant with the F ratio = 12.134 at p value 0.000 < 0.05. This is an indication that the model can be relied upon.

Table 8: Coefficients of Internal Controls

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.857	.741		-1.156	.251
	Control activities	.424	.088	.460	4.801	.000
	Risk assessment	.414	.082	.442	5.058	.000
	Information and communication	.406	.119	.325	3.414	.001
	Monitoring	.010	.071	.012	.139	.890

a. Dependent Variable: Financial performance

Table 8 shows that the beta coefficients of the resulting model indicate that control activities, risk assessment, information and communication, and monitoring had positive effect on financial performance in banking institutions with slopes of β_1=0.424, β_2= 0.414, β_3= 0.406 and β_4= 0.010 respectfully. This implies that holding all other variables constant, the financial performance in banking institutions increase by 0.424 units when control activities goes up by one unit, increase by 0.414 units when risk assessment goes up by one unit, increase by 0.406 units when information and communication goes up by one unit, and increase by 0.010 units when monitoring goes up by one unit. The beta values in Table 4.10 can be substituted into the model adopted by the study to solve the equation as shown below.

$Y= -0.857 + 0.424X_1 + 0.414X_2 + 0.406X_3 + 0.010 X_4 + \alpha.$

This implies that holding all factors constant, financial performance in banking institutions would be -0.857. Whereby Y = the dependent variable (Financial Performance) X_1 = Control Activities, X_2 = Risk Assessment, X_3 = Information and Communication, X_4 = Monitoring procedures, α = error term. The study found out that there was positive and statistically significant relationship between control activities and financial performance in banking institutions at β_1=0.424 with p value 0.000 which is less than 0.05. The finding of the study that control activities had positive and significant effect concurs with earlier finding by Simmons (1999), who observed that control activities was greatly influenced by the extent to which individuals recognize that they will be held accountable. The emphasis is to ensure that employees and management are committed to following an organization's policies and procedures and its ethical and behavioral standards. Hence the management attitude toward internal controls and control activities established may greatly enhance banking institutions financial performance. Further risk assessment had positive and statistically significant relationship on financial performance in banking institutions at β_1=0.414 with p value 0.000 which is less than 0.05.

The finding of this study asserts Douglas (2011), who noted that risks are the happenings that threaten the achievement of objectives. Therefore if these threats are timely assessed and controlled the banking institutions financial performance would be enhanced as the cost associated with occurrence of these risks would be reduced significantly. In addition, information and communication was found to have positive and statistically significant relationship on financial performance in banking institutions at β_1=0.406 with p value 0.001 which is less than 0.05. This mean that if the banking institutions managements are able to provide information and communicate effectively banking operations may be carried out effectively and efficiently with a view to accomplish the organization's objectives and mission. Monitoring had positive but insignificant effect on relationship on financial performance in banking institutions at β_1=0.010 with p value 0.890 which is greater than 0.05. According to Anduuru (2005), monitoring is keeping internal system controls under systematic review, observing and checking the progress in order to determine whether it is operating as intended and whether any modifications are necessary. The general observation from the study was that compared to control activities, risk assessment, and information and communication all the parameters used to evaluate monitoring were lowly rated leading to positive but insignificant effect. Therefore banking institutions management should ensure monitoring is undertaken regularly and the feedback received from continuous monitoring of effectiveness of internal control system is evaluated and precaution measures put in place in order to enhance financial performance.

Conclusion

The study concluded that control activities is an integral part of internal control system that banking institutions has to focus on in order to enhance financial performance. The study concluded that the people responsible for risk assessment and controls should focus on minimizing credit risk, interest rate risk and operating cost in order to improve financial performance. The study also concluded that the management should now lay more emphasis on information and communication systems and provide feedback to juniors in the banks with a view improving financial performance. The study revealed that banking institutions had has an active, independent and objective audit committee. The banks were found to undertake corrective action on the deficiencies in the bank's internal control system although communication to responsible parties who are tasked with responsibility to take appropriate action takes time. Moreover periodical evaluation and monitoring undertaken by the internal audit department was inadequate. Therefore management should develop policies and procedures that must be adhered to ensure that there is timely communication of deficiencies in the system to the responsible person in order to take appropriate action and the evaluation and monitoring is done regularly.

Recommendations

Following the findings of this study, a number of recommendations can be made. To start with, the findings of study clearly show that control activities are major factors that influence financial performance of the banking institution in Kenya. Following these findings, this study recommends that banks need to have clear segregation of duties for the individuals charged with the responsibility. Lack of clear segregation of duties places a huge risk on the tangible assets of the bank. To improve on this, the banks need to ensure that the no single officer in the bank undertakes more than one duty. The segregation of duties will not only aid in preventing fraud and correcting of errors but also create an audit trail that would aid in establishing the individuals responsible for fraud and errors in the bank.

Risk assessment had a significant effect on financial performance of banking institutions. Risk assessment and controls relates to the process of identification, analysis and management of uncertainty facing an organization. This study recommends that banking institutions should come up with policy and procedures to ensure that risk assessment and control is done at different levels and corrective and/or preventive measures are taken in order to mitigate the effect. Information and communication systems in Kenyan Banks had positive and significant influenced on financial performance of the banks. This study recommends that the management of the banks should improve on the communication systems and the teamwork of the parties charged with the responsibility of taking corrective action on the inefficiencies in the ICS. The firms should also come up with policies that guide how, to whom and within which period of time information concerning the inefficiencies discovered in the system should be transferred. Faster and more efficient transfer of this information will greatly aid in the discovery of areas of potential fraud thus safeguarding the bank's assets.

Monitoring procedures had positive but statistically insignificant effect on financial performance of banking institutions in Kenya. With the responses drawn from the respondents of the study, it is evident that there are obvious concerns with regards to monitoring activities set up by the management of the firm. This espouses that while the control activities and risk assessment procedures may be effective, the operation of the ICS for the banks may be failing due to weak monitoring activities. This study recommends that the internal audit departments of the banks should undertake periodic assessment of the banks internal control system so as to ensure the policies and procedures set in place are working. However, the monitoring activities should also be random and impromptu so as to allow the internal audit department to leverage on the element of surprise and discover potential areas of fraud and errors.

Conflict of Interest

No potential conflict of interest was reported by the authors.

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