

**ASSESSING THE EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL
PERFORMANCE OF COMMERCIAL BANKS IN MOMBASA COUNTY, KENYA**

DICKSON KAZUNGU THOYA

**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILLMENT OF
REQUIREMENTS FOR THE AWARD OF MASTER OF BUSINESS
ADMINISTRATION DEGREE IN FINANCE OF
MOUNT KENYA UNIVERSITY**

NOVEMBER 2024

DECLARATION AND APPROVAL

Declaration by the student

This research project is my original work and has not been submitted for a degree in any other University any other award.

Signed:  Date: 14/11/2024

Dickson Kazungu Thoya

MBA/43836/2016

Approval by University Supervisor

I confirm that the work submitted in this project was carried out by the candidate under my supervision.

Signed:  Date: 14/11/2024

Dr. Martin Onsiro

School of Business and Economics

Mount Kenya University

DEDICATION

I dedicate my research project to my lovely wife Victoria Vidzo Kadenge for her support.

May the blessings of the Lord be upon her.



ACKNOWLEDGEMENTS

I appreciate the important assistance provided by my Supervisor, Dr. Martin Onsiro in developing the research idea. I will always be inspired by his ideas and leadership even after

leaving the university. I am grateful to all Mount Kenya fraternity lecturers whom I have had the pleasure to work with during my course work and this period of project. All my professors in the Finance department have influenced my knowledge in accounting and finance. Thank you all. Further acknowledgement to my brother, my mentor and my superior at work place Mr. Jarvis Mwahendo whom has been on continuous basis encouraging me to finish the research project. He has served as a role model; a motivator and his skills and knowledge have been my baseline in achieving the successful completion as he has taught me a great deal on both the issues pertaining research and life in general



ABSTRACT

Banks drive financial development and general economic growth in both developed and developing countries globally. However, the banking sector has continued to face several constraints leading to their collapse. In Kenya, commercial banks are protected by regulations formulated by the government and reviewed regularly to prevent collapsing. Despite these

efforts, 17 banks have collapsed from 1990 to 2023. The Central Bank of Kenya (CBK) has revised commercial banks' capital requirements to avoid banking crises and also set minimum lending interests. These reforms are in line with the prevailing global financial conditions to ensure that banks are mitigated against risks associated with lending operations. The general objective of the study was to assess the effect of internal control systems on the financial performance of commercial banks in Kenya. The specific objectives of the study were: to assess the effect of the internal control environment on the financial performance of commercial banks in Mombasa County; to assess the effect of information and communication on the financial performance of commercial banks in Mombasa County; to analyze effect of risk assessment on the financial performance of commercial banks in Mombasa County; and to examine the effect of internal control activities on the financial performance of commercial banks in Mombasa County and. The study used a descriptive research design through census method. The primary data was collected using questionnaire feedback from 43 commercial banks as unit of analysis. The research philosophy of the study was positivism. The unit of observation in the commercial banks were the senior operations manager, finance officers, departmental heads and accountants per each bank. The study sample size was 209 participants. Qualitative data was analyzed using content analysis with themes being developed as per the responses obtained. Reliability of the research instrument was done using Cronbach's alpha value analysis while validity of the instruments considered both the face and content validity of the questionnaire. Quantitative data was analyzed by use of SPSS software. Means and standard deviations were used as descriptive statistics for data analysis. Inferential statistics including multiple regression model was analyzed at 95% significance. Findings were presented and organized in charts and tables for easy interpretation. Findings showed that there was positive relationship between internal control environment and financial performance with a beta value of 0.644 and p-value of 0.000; information and communication recorded a beta value of 0.111 and a significant p-value of 0.001; risk assessment versus financial performance showed a beta value of 0.714 and a significant p-value of 0.009 while effect of internal control activities against financial performance was significant with a beta value of 0.996 and p-value of 0.003. In conclusion, the findings established that there was a positive relationship between tested independent variables (internal control environment, information and communication, risk assessment and internal control activities) and financial performance with a beta value of 1.921 and pvalue of 0.002. The findings of this study will contribute to the formulation of appropriate guidelines and policies that will enhance financial performance among commercial banks in Kenya.

TABLE OF CONTENTS

DECLARATION AND APPROVAL.....i

DEDICATIONi

ACKNOWLEDGEMENTS	ii
ABSTRACT.....	iii
LIST OF TABLES	viii
LIST OF FIGURES	viii
LIST OF ABBREVIATIONS AND ACRONYMS	x
CHAPTER ONE	1
INTRODUCTION	1
1.1 Background of the study.....	1
1.1.1 Internal Control Systems.....	4
1.1.2 Financial Performance	5
1.1.3 Internal Control Systems and Financial Performance.....	6
1.1.4 Measure of financial performance in commercial Banks in Kenya.....	8
1.1.5 CBK Prudential Guidelines.....	9
1.2 Statement of the Problem	10
1.3 Objectives of the Study	12
1.3.1 General Objective	12
1.3.2 Specific Objectives.....	12
1.4 Research Questions	13
1.5 Significance of the Study	13
1.5.1 Academicians and Researchers	13
1.5.2 Policy Regulators.....	13
1.5.3 Commercial banks of Kenya	14
1.6 Scope of the Study	14
1.7 Limitation of the Study	15
1.8 Delimitation of the Study	15

1.9 Assumptions of the Study	15
1.10 Operational Definition of Key Terms	16
CHAPTER TWO	18
LITERATURE REVIEW	18
2.0 Introduction	18
2.1 Theoretical Review	18
2.1.1 Agency Theory	18
2.1.2 Contingency Theory	20
2.1.3 Theory of the Firm.....	21
2.1.4 Accountability Theory	22
2.2 Empirical Review	24
2.2.1 Internal Control System and Financial performance	33
2.2.2 Risk Assessment and Financial Performance	34
2.2.3 Information and communication system and financial performance	36
2.2.4 Internal control activities and Financial Performance	39
2.3 Conceptual Framework	42
2.4 Literature Recap	43
2.5 Research Gap.....	45
CHAPTER THREE.....	47
RESEARCH METHODOLOGY	47
3.0 Introduction	47
3.1 Research Design	47
3.2 Target Population.....	47
3.4 Sample Size	49
3.5 Construction of Research Instruments	49

3.6 Validity and Reliability of Research Instruments	50
3.6.1 Piloting	50
3.6.2 Validity	50
3.6.2 Reliability	51
3.7 Data collection methods and procedures.....	51
3.8 Data Analysis and Presentation.....	51
3.8.1 Multiple Regression Model	52
3.9 Ethical Consideration	52
CHAPTER FOUR	53
RESEARCH FINDINGS AND DISCUSSION	53
4.0 Introduction	53
4.1.1 Response Rate	53
4.1.2 Education level of the respondents.....	54
4.1.3 Years worked in the bank.....	55
4.2 Descriptive analysis	55
4.3 Diagnostic Test Results.....	63
4.3.1 Multicollinearity Test	63
4.3.2 Heteroscedasticity.....	64
4.3.3 Normality Test Results	65
4.3.4 Regression results	67
CHAPTER FIVE	70
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS	70
5.0 Introduction	70
5.1 Summary of the Findings	71
5.2 Conclusions.....	71

5.3 Recommendations	73
5.4 Suggestions for Further Study.....	74
LIST OF REFERENCES.....	75
APPENDICES.....	80
Appendix I: Consent Form.....	80
Appendix II: Research Questionnaire	82
Appendix III: Operational Commercial Banks in Mombasa County.....	86
Appendix IV: Financial Performance of Commercial Banks	87
Appendix V: Ethics Review Certificate	88
Appendix VI: Introduction Letter	89
Appendix IX: NACOSTI Research Permit	90
Appendix X: Plagiarism Report	91
 LIST OF TABLES	
Table 3.1: Target population	48
Table 3.2: Sample size distribution	49
Table 4.3: Risk Assessment in the Commercial Banks	60
Table 4.4: Control Activities	62
Table 4.5: Multicollinearity Test statistics	64
Table 4.6: Heteroscedasticity	65
Table 4.7: Normality Test Result	66
Table 4.8: Multiple Regression Result	68
 LIST OF FIGURES	
Figure 2.1: Theoretical Framework	24
Figure 4.2: Response Rate (Researcher, 2024)	53

Figure 4.3: Level of Education Achieved (Researcher, 2024) 54

Figure 4.4: Years Worked in the Bank (Researcher, 2024) 55



LIST OF ABBREVIATIONS AND ACRONYMS

BCBS:	Basel Committee on Banking Supervision (BCBS)
GDP:	Gross Domestic Product
CBK:	Central Bank of Kenya
INTOSAI:	International Organization of Supreme Audit institutions
COSO:	Committee of Sponsoring Organizations
IAASB:	International Audit and Assurance Standards Boards
SACCO:	Savings and Credit Cooperative Organisation or Society
ICT:	Information and Communication Technology
KPMG:	Klynveld Peat Marwick Goerdeler
NHIF:	National Hospital Insurance Fund
NSSF:	National Social Security Fund
AfDA:	African Development Bank
RMCs:	Regional Member Countries
CEO:	Chief Executive Officer
SEC:	Securities and Exchange Commission
NALD:	National Association of Corporations
SPSS:	Statistical Package for Social Sciences
NGO:	Non-Governmental Organization
IUCN:	International Union for Conservation of Nature

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

National economic progress depends on financial institutions. Poor bank management threatens the financial system. Efficiently managing the national financial system requires measures to help financial institutions rapidly identify management difficulties. Measures may be taken to protect both people's savings and the overall system (Hunjak, 2019). Japan's attempts to deregulate financial institutions in the 1970s were marked by notable financial disruptions and banking problems.

The smooth transition in the beginning led to a significant increase in asset values and currency growth, followed by a decline in asset prices in the early 1990s. Financial institutions in Japan were overwhelmed by almost US\$500 billion in significant bad loans, leading to the downfall of several financial institutions (Cheserek, 2017). From 1979 to 1987, the United States faced a significant danger to its financial system. Bank failures in the United States exceeded those in the whole post-recession era during this time frame. In 1988, the OCC examined 171 bankrupt banks to determine their common features and situations throughout the recession. Additionally, 51 banks that had been restored were analyzed. Restored banks had successfully navigated substantial obstacles.

Only 10% of the failed banks investigated by the OCC were found to be unaffected by mismanagement. 90% of the remaining portion disintegrated as a result of insufficient management (OCC, 2018). The impact of a collapse on other financial institutions and the entire economy in a financial crisis is significant and should not be underestimated. Banco de Intercambio Regional, one of Argentina's major private banks, failed in March 1980. The central bank acted promptly to save three additional banks, two of which were later

liquidated. This incident signaled the beginning of a serious crisis in the Argentine financial sector, leading to the closure of 71 financial institutions in the next two years (3rd World Bank, 1984). The financial crisis in Chile occurred between 1982 and 1984.

Chile's economy suffered a 30-40% GDP loss due to inadequate macroeconomic policies and relaxed restrictions. The country's GDP dropped by 14% in 1982, leading to an increase in the jobless rate of over 11% within a year. Inflation increased from 10% in 1982 to 23% in 1983 (Sundararajan & Balino, 2021). The global financial crisis of 2007-2008 had significant consequences after the Great Recession. This led to the failure or government takeover of some of the world's most famous financial organizations. Many others survived only because of significant government support. The crisis had a greater impact on the main financial centers globally than any previous postwar financial crises (Reinhart & Rogoff, 2019). The OCC's 2018 assessment on the causes of domestic bank failures in the United States found that internal factors had a substantial role in these collapses. The inadequacies include issues with the board and administration, as well as instances of internal abuse and fraud. External problems are a sluggish economy. Adeniyi and Kenneth (2019) did research on bank collapses in a specific group of Nigerian banks. This research indicated that high risk-taking and low-quality evaluations caused these failures. Cheserek (2017) performed a review of 21 Kenyan commercial banks, finding that bank failures between 1998 and 2015 were caused by issues such as asset quality, capital sufficiency, and total assets.

In Africa, by 1988, Ghana had 11 commercial banks and 112 rural banks regulated by the national bank, the Bank of Ghana. The banking sector reform program began in 1988 and ended in 1991, costing over US\$300 million or 6% of GDP (Tannar, 2017). Regionally, the breakdown of the Continental and Union banking groups and rural-urban loan financing

between 1984 and 1986 marked the beginning of banking failures at that time. The banks were unable to return the monies borrowed from government entities and as a result, had to undergo liquidation (Martin, 2018).

This resulted in the potential collapse of other commercial banks such as Commercial Bank and Euro Bank. Daima Bank, on the other hand, came under the regulatory control of the Central Bank. Financially struggling institutions were merged to become current consolidated banks, such Nationwide Finance Corporation. The economic impacts of these failures have not been evaluated yet.

Three commercial banks in Kenya fell bankrupt from August 2015 to April 2017. Many depositors were surprised by the sudden reappearance of bank failures in Kenya. At times, many people and groups were unable to access their finances. The failure of three banks in under a year was a significant point in contemporary financial history. The rapid disclosure of credit problems in the prestigious banking industry may quickly lead to a liquidity crisis, putting the bank's existence and the financial system's stability at risk. Ngunjiri (2016) and Gilbert, Menon, and Schwartz (2020) identify the main reasons for financial collapse as a combination of assets, financial structure, and corporate governance. In his 2017 research, Wulandari examined how internal and external factors affect the Indonesian banking business. Economic growth is seen as the most critical external component, while internal variables inside the bank include capital, asset quality, management, and profitability. This study focused on the assessment of the effect of internal control systems on the financial performance of commercial banks in Mombasa County, Kenya. Previous studies have focused on the assessment of effect of technology such as the Information management integrated system (IFMIS) on financial performance among commercial banks in Mombasa

County. No single study has looked at the effect of internal environment control systems on financial performance in commercial banks in Mombasa County.

1.1.1 Internal Control Systems

Internal control involves supervisory methods entity management to mitigate risks and guarantee integrity, efficiency, and compliance with regulations. The measures attempt to encourage frugality, efficiency, and moral conduct while meeting responsibilities and safeguarding resources. Their ultimate goal is to improve organizational performance. Machu (2019) states that internal control adapts to organizational structure changes to align with alterations in the organization. The involvement of both management and staff at all levels in implementing controls helps with risk management, ensuring that the purpose is achieved and overall goals are met, as recognized by INTOSAI (2017). INTOSAI (2017) categorizes organizational control systems into five distinct groups. Information and communication systems, operational monitoring, risk assessment, control environment, activities. COSO (2018) also created an internal control framework to help companies assess their control systems. The COSO (2017) framework requires Management, the board, and others must supervise internal control for effective operations. Goals include accurate financial reporting and legal compliance. COSO (2017) classified internal control systems as control environment, risk assessment, operations, communication, and monitoring.

The AICPA defines internal control as a company's methodologies, integrated processes, and assessments. These help a business protect its assets, verify its financial records, improve efficiency, simplify processes, and comply with laws. Board of directors supervises the bank extensively over the bank's activities, assets, and resources, as seen in the annual statements from 2014 to 2017 (Kinya, 2019). The report states that the Board would prioritize corporate

governance in executing its power, because bank shareholders and stakeholders hold it responsible. The report covers the systems, processes, and procedures used to safeguard stakeholders' investments and satisfy top corporate governance standards. Bank Board guarantees compliance with all applicable legislation, particularly the Banking Act. The updated Corporate Governance Code for Kenyan Listed Public Companies, together with requirements mandated by the Capital Markets Authority regulates.

We ensure compliance with the Central Bank of Kenya's Banking Supervision Guidelines (CBK, 2017) and internal bank regulations. The bank upholds a strict charter for its board of directors, as well as essential rules that deal with conflicts of interest and codes of ethics and conduct. These policies regulate the actions of the board and management in guaranteeing the bank's charter compliance (Renox, 2017). The Management Board is committed to overseeing the bank's operations with integrity, in compliance with the law, international standards, and ethical business practices. The Board of Directors ensures the bank follows the Banking Act and Muthusi (2017) Central Bank of Kenya Regulations.

1.1.2 Financial Performance

Banks' financial performance is assessed numerous ways. Adhiambo & Member (2021) identified the key characteristics as: Customer satisfaction and revenue growth are key performance indicators for commercial banks. The 2020 KPMG poll shows that internal control offers efficient methods for decreasing operational costs, leading to maximum profitability. Dong (2018) describes CAMEL as a framework used by academics to illustrate bank-specific features. CAMEL is capital, asset quality, management, profitability, and liquidity. CAMEL measurements assess the banking system's performance and identify

operational strengths and shortcomings, improving banking safety and stability (Assigwa and Renox, 2017).

Thus, bank finances rely heavily on efforts of its top management to streamline all banking procedures related to service delivery. The bank's strong internal control system ensures the growth of a large customer base, retention of current customers, early detection and prevention of fraud and errors, maintenance of high asset quality, resolution of liquidity problems, recovery of return on investment expenses, and improvement of earnings per share. Overall, achieving broad financial goals becomes possible. Stoner (2020) defines performance as the ability to function effectively and lucratively, to withstand, thrive, and respond to external opportunities and challenges. Successful financial performance for a corporation involves reducing inefficiencies in employee benefit procedures and systems. Success for a firm relies on its capacity to meet its performance, efficiency, and profitability goals. The financial statements represent data obtained from a strong Organizational financial snapshot from internal control system. The report is valuable for users in assessing management's company operations and making financial choices (Davis, 2020).

1.1.3 Internal Control Systems and Financial Performance

Accounting controls exist in all businesses based on substantial operational risks. Cunningham (2019) argues that the internal audit system should provide insights into the evolving risks present in an organization's internal and external environment, using them as a tool to achieve a goal rather than an end goal in itself. The researcher emphasizes that persons, rather than just manuals or policy papers, have an impact on internal control systems. Minimizing process inefficiencies may boost a company's finances. The key factor for success is how well a firm accomplishes its objectives and missions related to performance,

efficiency, and profitability. Insights into the company's financial performance and condition are provided to consumers of financial statements via a strong internal control system represented in the financial statements. This helps evaluate leadership and guide company choices (Davies, 2020).

Internal accounting control gives management confidence in operational performance and timely accounting reporting. Relevant rules have been met according to Kaplan (2018). Internal control encourages management to comply with laws, rules, contracts, and policies, keep accurate financial and management data and report it promptly (Trivedi, 2020). Financial performance, as per Trivedi (2020), refers to quantifying Organizational strategy and activities' financial outcomes. Companies must assess financial performance to solve complicated service concerns. Profitability and liquidity are indicators of an organization's financial performance.

The IAASB (2021) definition, established by the international organization in charge of establishing standards for assurance and auditing, outlines internal controls in depth. It covers policies and procedures used by senior management to accomplish corporate goals. These procedures include assuring operational efficiency, compliance with established regulations, detecting and avoiding fraud and mistakes, protecting assets, maintaining financial record integrity and completeness. They also ensure accurate and timely financial data. Azizi (2019) highlights the need of strong internal control mechanisms in cooperatives. Cooperative management holds the belief that enhancing profitability is dependent on creating innovative strategies and enforcing efficient internal controls. These controls improve stability, promote development, and directly impact cooperative finances.

1.1.4 Measure of financial performance in commercial Banks in Kenya

Worku (2018) says performance reflects an organization's policies financially and operations. The researcher argues that it provides a comprehensive evaluation financial health of a corporation over time. Performance enables comparisons between companies in the same industry. Financial performance analysis uncovers a company's financial strengths and shortcomings by checking balance sheet components against comprehensive income (Joetta, 2017). ROE evaluates the return produced by equity in a corporation. Equity includes all forms of capital except for debt, including both long-term and short-term sources. The calculation may alternatively be determined by subtracting total liabilities from total assets (Joetta, 2017). Internal control changes effect company finances. The Enron case in the United States demonstrates how the failure of its operations led to the need for stricter internal controls.

The autonomy of auditors and audit committees, alongside Sarbanes Oxley Act implementation, have resulted in the creation of strict regulations and principles for organizational functions (Worrior, 2020). The Basel III capital requirements were included into the calculation of return on equity as stipulated by the Basel Committee on Banking Supervision. This technique helps banks manage risk by setting minimum capital requirements (Werner, 2019). Banking capital must grow to 4.5% of high-risk assets under this law. Divide equity and reserves by total capital to determine the at-risk asset. There is a clear research deficit that has to be addressed (Werner, 2019). The present issue is that the information supplied does not distinguish between the strength of individual and combined operational independent variables in connection to the two functional scenarios and financial results.

A better indicator of bank profitability is provided by Return on Assets (ROA) which measures the profitability from the point of view of the overall efficiency of a bank's utilization of total asset. ROA is often accepted as the most comprehensive accounting measure of a bank's overall operating performance. ROA gives information about how much profits are generated on average by each unit of asset (Windle, 2019). Analysts use ROA to assess managerial performance, or asset and liability management skill as it their efficiency in creating values. An extended or modified decomposition of ROA also exists and can be used to address a certain industry. It provides a good insight into profitability structure especially for banks without a sophisticated management control systems which is often the case of banks in less developed countries (Abiti, 2012; Tumenjargal, 2009).

1.1.5 CBK Prudential Guidelines

The Banking sector is so sensitive and sacrosanct to the economy in term of stability and growth that it must not be let loose by the Government. Regulations and supervisions have therefore become imperative not only in the enforcement of rule and regulation but also judgment concerning the soundness of bank asset, its capital adequacy, and management (CBK, 2013). This regulatory structure creates transparency between banking institutions and the individuals and corporations with whom they conduct business with (Oloo, 2010). The goal of regulatory reforms and guidelines is to help banks and other financial institutions become stronger players and in a manner that will ensure longevity and hence higher returns to the shareholders over time as well as greater impacts on the Kenyan economy (Ndung'u, 2020).

Prudential guidelines are issued by CBK to reduce the level of risk to which bank creditors are exposed whereas Bank supervision entails not only enforcement of rules and regulations but also judgment concerning the soundness of bank assets, its capital adequacy and management. It's, therefore, imperative that an effective supervision is expected to lead to a healthy banking industry that possesses the power to propel the economic growth (Soludo, 2017). The reform programme is also expected to engender a diversified, strong and reliable banking sector in the country. Studies have shown that the objectives of financial sector reforms are broadly the same in most countries of Sub-Saharan Africa (Balogun, 2017).

Oluyemi (2016) studied the effect of banking sector reforms on corporate governance and concluded that to check abuses in the emerging consolidated banking system, Institutionalization of good corporate governance practice is both necessary and desirable. Pasiouras, Tanna, and Zopounidis (2019) assessed the impact of regulatory conditions on profit and cost efficiency of banks using similar data. The authors found that regulations that improve supervisory power and market discipline tended to have a positive impact on both of the measures.

1.2 Statement of the Problem

Banks employ internal control systems to attain targets faster. Bank stakeholders generally see control measures as well-established and effective. Commercial banks often integrate several elements of their internal control systems to prevent, identify, and resolve any cases of fraud and mistakes in financial transactions (Mati, 2022). However, many businesses, such as banks, have experienced bankruptcy, resulting in the disposal of assets to provide cash for paying off debts to creditors or being taken over by rivals.

Despite the guidelines set out by Central Bank of Kenya in accordance with the Banking Act Cap, there has been numerous cases of bank failures in performance due to fraud and lack of elaborate internal controls as well as compliance with internal and external regulations within the industry (FLSTAP, 2011). For instance within a period of nine months, the Central Bank of Kenya put three banking institutions under receivership. Imperial bank of Kenya the 19th largest bank in Kenya was put under Central Bank of Kenya receivership due to what the regulator termed as inappropriate banking practices that led to loss of about 58 billion Kenya shillings (Gathaiya, 2015; Kuo, 2015). In another case the Dubai Bank of Kenya was put under receivership for flouting banking guidelines for a spate of years. Dubai bank was estimated to have lost close to 3 billion Kenya shillings (Gathaiya, 2015). Chase bank was later on put under receivership in what the regulator termed as unsafe financial conditions thus; leaving the questions of the gaps that exist within the banking sector owing to such multiple breaches without any action being taken (Ngigi, 2015). Chase bank collapsed due to estimated loss of about 142 billion Kenya shillings (Gathaiya, 2015).

Muio (2022) studied the impact of internal control systems on the financial performance of private hospitals in Nairobi. This study however, did not incorporate the commercial banks. Olumbe (2022) studied the relationship between internal control systems and corporate governance in commercial banks in Kenya. This study, however, did not measure the moderating effect of the CBK prudential guidelines. Njenga and Osiemo (2018) studied the effect of fraud detection through an internal control on the performance of deposit-taking microfinance institutions in Kenya. However, this research did not review in detail all the internal control system aspects. Ochoye (2021) was emphasizing on the internal control and organizational performance, the above research failed to show the direct contribution of internal control to the financial performance.

From the mentioned literature it was evident that internal control systems influence the performance of both financial and non-financial institutions. In the current market environment where financial institutions have been on the receiving end due to unethical issues and increase in banking fraud it's imperative to assess the role of internal control systems in mitigating losses and fraud in the banking industry. The scanty evidence on the relationship between internal control systems and performance of commercial banks has motivated the current research. Research on internal controls has mostly concentrated on analyzing the characteristics of companies that exhibit notable deficiencies in internal control. Al-Matari (2021) notes a significant absence of studies studying how internal control mechanisms affect financial performance in developed and developing nations.

1.3 Objectives of the Study

1.3.1 General Objective

The general objective of this study was to assess the effect of internal control systems on the financial performance of commercial banks in Kenya.

1.3.2 Specific Objectives

The specific objectives of the study were;

- i. To assess the effect of the internal control environment on the financial performance of commercial banks in Mombasa County.
- ii. To assess the effect of information and communication on the financial performance of commercial banks in Mombasa County.
- iii. To analyse the effect of risk assessment on the financial performance of commercial banks in Mombasa County.
- iv. To examine the effect of internal control activities on the financial performance of commercial banks in Mombasa County.

1.4 Research Questions

The research questions of the study were informed by the following;

- i. What is the effect of the internal control environment on the financial performance of commercial banks in Mombasa County?
- ii. What is the effect of information and communication on the financial performance of commercial banks in Mombasa County?
- iii. How does risk assessment affect the financial performance of commercial banks in Mombasa County?
- iv. Do internal control activities affect the financial performance of commercial banks in Mombasa County?

1.5 Significance of the Study

These stakeholders and groups to benefit from the study:

1.5.1 Academicians and Researchers

This work impacts the academia and researchers interested in further research on this issue. By conducting further research in this area, it broadens the knowledge base on how stabilizing commercial banks' financial performance through regulation of internal control systems.

1.5.2 Policy Regulators

Knowledge generated by this study has a positive impact on the government and other policy stakeholders regarding regulation of implementing internal control mechanisms to improve financial performance in commercial banks. Through capacity-building workshops and seminars, target policy makers and regulators be educated on importance of these internal control systems which they will mainstream into commercial banks in Kenya. In addition to commercial banks, other organizations/firms will also benefit from good internal control

system practices as well as policies and regulations thereby improving their financial performance.

1.5.3 Commercial banks of Kenya

Commercial banks management team benefits from study by understanding how internal controls affect financial performance. Through knowledge sharing and capacity-building of their employees, banks will be able to develop new strategies or mechanisms to deal with internal control systems to boost bank profits. Stable financial performance by commercial banks will be key to attracting potential investors in future.

The management team of commercial banks may benefit from the research by understanding how internal control mechanisms affect financial performance. Banks may enhance their profitability by promoting knowledge-sharing and capacity-building among staff to develop new methods or techniques for improving internal control systems. Commercial banks' sustained financial soundness will be crucial for attracting potential investors in the future.

1.6 Scope of the Study

This research examined Kenyan commercial banks that are functioning inside Mombasa County. The Headquarters of Mombasa County is at Mombasa town. It is one of the 47 counties and it is located at the Coast of Kenya. It has 6 sub-counties namely; Mvita, Changamwe, Kisauni, Jomvu, Nyali and Likoni. Mombasa County is an economic hub for Kenya due to strategic location of the Mombasa port. This economic strength has attracted various commercial businesses, such as the 43 tier 1, 2, and 3 commercial banks in the Country, particularly in Mombasa County.

The research aimed to investigate how internal control systems, Internal control environment affects commercial bank financial performance, control, communication, and risk assessment. The study investigated how independent factors impact financial performance,

which acts as the dependent variable. The research identified and assessed the moderating or intermediary factors linked to each independent variable.

The study only obtained recent information not older than 4 years from the selected banks running from 2020-2023. This is because the project aimed to obtain current information that is useful to the researcher draw constructive and current conclusions that can assist with the reformation of Kenya's commercial banks.

1.7 Limitation of the Study

The study experienced participant's resistance to provide sensitive information. In addition, policies of some commercial banks did not allow its employees to give information on specific matters regarding financial performance. To ensure such limitations are overcome, the researcher sought official authorization from top management of target commercial banks before the study was conducted. Official authorization allowed participants to respond to questions in a free and fair manner without any fears or biasness. Furthermore, all collected data and files were kept secret only for this research.

1.8 Delimitation of the Study

The investigation only concentrated on four internal control systems, notwithstanding the possibility of other internal control elements affecting Kenyan commercial banks' financial performance.

1.9 Assumptions of the Study

This work primary premise was respondents would answer all questions without

contradiction or prejudice from internal or external influences. In addition, the study assumed that respondents' responds to the questionnaires on time to ensure the researcher complete this research as outlined the work plan.

1.10 Operational Definition of Key Terms

Financial Performance: An organization's subjective assessment which utilizes its resources (assets and cash) to generate more profit. This phrase is also used as a broad indication of an organization's financial condition within a given timeframe.

Internal Controls: An organization's efforts and coordinated techniques to protect assets, assure accurate accounting records, improve efficiency, and comply with management regulations.

Risk Assessment: Risk assessment entails detecting possible adverse events that might impede an organization's performance development. It is essential in identifying inherent business risks and establishing procedures, processes, and controls to reduce their influence on corporate operations.

Conducting risk assessments is crucial for recognizing inherent company risks and implementing procedures, processes, and controls to minimize their influence on business operations.

Control Activities: An organization's everyday operations are regulated by control activities. Control operations include regular processes, stated rules, and internal mechanisms established to improve efficient and effective management.

Control Environment: A framework for overseeing internal controls throughout the business, consisting of standards, methods, and structures. The board and senior management generally establish internal control and behavior criteria.

Return on Assets: a profitability ratio that provides how much profit a company can generate from its assets. In other words, return on assets (ROA) measures how efficient a company's management is in earning a profit from their economic resources or assets on their balance sheet.

Return on Equity: is the measure of a company's net income divided by its shareholders' equity. ROE is a gauge of a corporation's profitability and how efficiently it generates those profits. The higher the ROE, the better a company is at converting its equity financing into profits.



Mount Kenya

University

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter reviews the theoretical literature on how internal control mechanisms affect Kenyan commercial banks' financial performance. The analysis involves reviewing empirical research and the conceptual underpinning of the investigation. This review aims to provide a theoretical foundation for the study by pinpointing research gaps that need attention and offering a comprehensive overview of key ideas and elements.

2.1 Theoretical Review

The study focused on the agency theory, contingency theory, the theory of firm and accountability theory. The review examined the common systems of internal controls employed by organizations, the theories surrounding systems of internal control, and the methods used by previous researchers in dealing with internal control systems.

2.1.1 Agency Theory

Agency relationships are contractual agreements between one or more parties, according to Jensen and Meckling (1976). Hire an agent to provide particular services by providing the agent decision-making power. Berle and Means (1932) posit that in principle, the individual or group owning all shares is deemed the owner (shareholder), and managers are responsible for maximizing profits for the shareholders. Principals and agents are considered to be rational individuals driven only by their self-interest. Eisendhart (1976) put up several ideas that constitute the basis of agency theory, which are classified into three sorts of hypotheses: assumptions about human nature, assumptions about organizations, and assumptions about

information. The theory on human nature emphasizes that people are essentially selfinterested, have limited reasoning, and tend to avoid risks. Organizational assumptions highlight friction among organization members and unequal information between the principal and the agent, while information assumption states that information may be traded. Agency theory involves analyzing the connection between a principle and an agent. According to Scott (1967), there are two types of asymmetric information. The first form is negative selection. In this situation, those who feel they have less knowledge than others may be hesitant to make agreements with other parties. If they choose to go forward with agreements, they can face strict constraints and substantial expenses. Conflicts may occur between insiders, such as management, and outsiders, such prospective investors. Regulators may have access to more information than investors by ways of withholding, obfuscating, or altering information shared with investors. As a result, investors could be unsure about the company's quality or may buy its shares at greatly discounted rates. Asymmetric information arises when creditors and minority shareholders have less information compared to management and majority shareholders.

Another kind of asymmetric knowledge is moral hazard. Moral hazard occurs when managers take measures that benefit themselves at the expense of the owner's interests without the owner's knowledge. In a large firm with clear ownership and management control, shareholders and creditors may struggle to evaluate how well the manager's performance matches shareholders' expectations, perhaps resulting in decreased effectiveness in managerial decisions. Moral hazard hinders the efficient operation of enterprises. Yolanda (2016) states that an agency relationship is a contract between shareholders and the company's owners and management. Agency theory revolves on the differentiation between shareholders who own the firm and managers who oversee its operations.

Agency theory stems from the separation between company owners (shareholders) and managers responsible for running the firm. It suggests that management serves as an agent of shareholders, focusing on its self-interest rather than serving as a cautious and unbiased representative of shareholders. Conflicting interests between the two parties might result in agency disputes. Febriani (2019) explains that agency theory aims to tackle challenges that arise when participants in a collaborative relationship inside a corporation have diverse interests in managing the business. This idea of agency arises from a Contractual connection between the agent (management) and principle (owner). The management has more extensive information of the business's condition than the owner.

Noorlaila (2019) explains that agency theory arises from the separation between company owners (shareholders/owners) and business leaders. Empirical data shows that leaders do not always prioritize the interests of the firm's owners; rather, corporate executives (directors and managers) often focus on the company's interests. Meisser et al. (2016) identified two main problems in the agency relationship: (a) the presence of asymmetric information, where management usually has more knowledge about the entity's financial status and performance than the owners; and (b) a conflict of interest due to differing goals, leading to situations where management may not prioritize the owners' best interests. Ulfa (2017) asserts that the agency connection is fundamental for understanding effective corporate governance.

2.1.2 Contingency Theory

Fred Edward Fielders (1964) proposed this idea in his influential study "A Stochastic Model of Leadership Effectiveness." Companies are affected by both their internal and external surroundings, hence there is no one best method for managing a firm, doing business, or making business choices according to the idea proposed by Fielder in 1964. The

organizational environment is dynamic and requires constant evolution. Survival requires adaptability. The notion underlines the need of a dynamic corporate environment, a problem many Kenyan commercial banks face, making it important to investigate. Contingency theory is used to explain how the environment and structure of an organization affect its effectiveness, specifically in regard to the precision financial reporting, internal controls. Research shows that experienced internal auditors can examine internal control efficiency, benefiting the organization (Cadez and Guilding, 2018).

Lawrence and Lorsch (1967) made substantial contributions to organizational theory by focusing on change, relationships, and uncertainty, while facing some criticisms. Bruce (2017) lists many aspects that external environment, technology, organizational structure and size, strategy, and nation culture affect management control systems. He emphasizes corporate technical responsibilities need creating methods to coordinate and manage internal processes. Technology integration with environmental data significantly impacts organizational structure. Contingency theory suggests that the organizational environment significantly impacts the design and execution of control systems inside an organization (Fisher, 1998). Contingency theory emphasizes that the proper administration of control systems depends on internal and external indications. Several aspects, including ICT technology, external and internal environments, organizational structures, legislation, strategy, and cultural norms, impact an organization's control systems.

2.1.3 Theory of the Firm

Coase (1937) was the first proponent to provide a theory focused on defining the company in relation to the market. He defined the Firm's Theory as a synthesis of ideas aimed at elucidating and characterizing the environment or behavior within a market context. This

idea suggests that a firm operates like a black box, according to limits related to resources spent and profits/losses incurred. The Firm's Theory highlights how a corporation, using financial mechanisms like debts and assets, choose a variety of activities to ensure that the organization's total worth is lower than it would be if the entrepreneur or management were the only owner. This outcome remains consistent regardless whether the company works in monopolistic or competitive product or factor marketplaces (Kantarelis, 2017). This idea emphasizes the significance of a firm having diversified financial systems, such as accounts payable and receivable, and choosing a variety of operations to reduce the company's total worth in comparison to if the entrepreneur were the only owner. This result remains consistent regardless if the organization works in a monopolistic or competitive factor or product market (Kantarelis, 2017).

2.1.4 Accountability Theory

Tetlock and Lerner proposed this hypothesis in 1999. Liability theory explores how the need to protect oneself from the acts of another person influences decision-making, judgment, and a feeling of responsibility. This need to examine the decision-making process and its results increases one's inclination for thorough and methodical reflection on behaviors. The former emphasizes the significance of distinguishing between the two prevalent uses of something, either as a virtue or as a way to comprehend responsibility. Accountability is seen as a quality where a person is ready to take on responsibility, a quality valued in leaders, government entities, or corporations, making it a valuable part of an organization. (Tetlock & Lerner, 1999). Recent studies have shown that system design artifacts may influence four key aspects of accountability theory: identification capacity, assessment expectations, supervisory perception, and social presence. This increases employee responsibility for the safety of the

organizational structure without the need for intervention or training (Trevor, Anderson, & Didier, 2016). Identity refers to an individual's belief that their activities may be linked to them and reflect their genuine self. Anticipating an audit involves a person assessing their performance against certain benchmarking standards and underlying consequences. Cognitive monitoring is when a user is consciously aware that their system's activities are being watched. Social presence is the awareness and responsiveness of other users inside the system (Wainaina, 2011). Responsibility theory is important for the research since it helps uncover ways to improve responsibility via internal control. Management is aware that the government will review its financial statements through external audits and prepare an audit report, as irresponsibility is seen as a punishable offense. The figure below has summarized the theories that were in the study

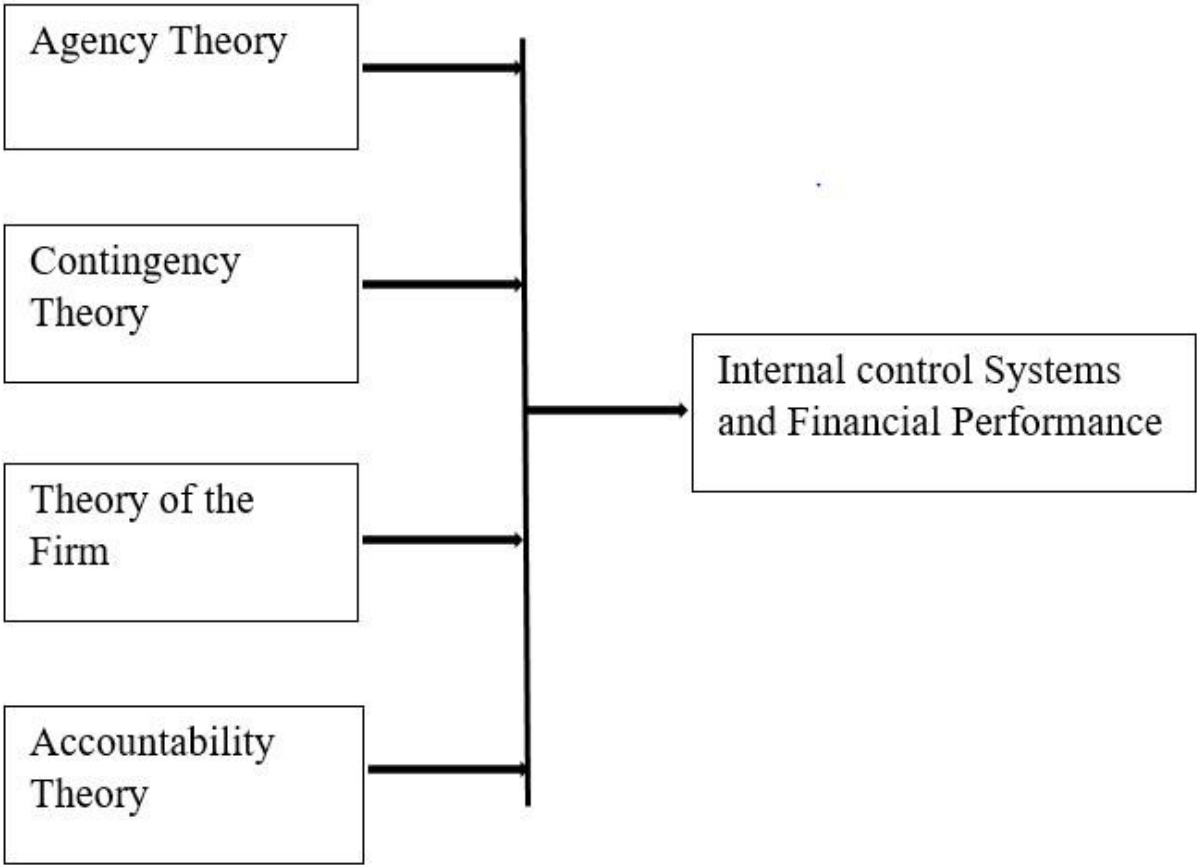


Figure 2.1: Theoretical Framework

Source: Researcher (2024)

2.2 Empirical Review

Empirical literature review is an account of what has been published on a topic by accredited scholars and researchers. It brings out the knowledge and ideas that have been established on a topic, and what their strengths and weaknesses are. It uses secondary sources, and do not report new or original experimental work.

Mwachiro (2018) investigated the internal controls in operation at Kenya Revenue Authority with a view to establishing whether such internal controls have produced any meaningful results in increased collected revenue. The study used control environment, risk assessment, control activities, Information and communication and monitoring components of internal controls as the variables. The study was conducted using descriptive case study using causal/explanatory research design.

The data was analyzed using both statistical and narrative methods while correlation was used as a way of assessing the effect of internal controls and revenue collection. The findings revealed that the five components of the control environment, risk assessment, control activities, information and communication and monitoring must be available for internal controls to work. The study established that weak internal controls and especially poor ethical values in the organization have encouraged collusion to fraud, loss of revenue and embezzlement of collected revenue. The study, therefore, concluded that internal controls do function although with hiccups and that there is a significant effect between internal controls and revenue collection in KRA.

Magara (2016) sought to find out the effect of internal controls on the financial performance of deposit taking Savings and Credit Cooperative Societies (SACCOs) in Kenya. The independent variables for the study included; control environment, risk assessment, control activities and monitoring mechanisms while the dependent variable was financial performance. The findings of this study conducted on 122 deposit taking SACCOs in Kenya relied on both primary and secondary data which was obtained from the annual reports of the SACCOs. A multiple regression model was adopted to check the form of relationship between the dependent and the independent variables. The regression analysis conducted established that the independent variables have a positive strong correlation with the dependent variable. Each of the independent variables namely, the control environment, risk assessment, control activities and monitoring mechanisms contribute positively to the financial performance of SACCOs in Kenya. It is also evident from the study that without the presence of strong internal controls within these institutions, the SACCOs would be performing poorly with the risk of eventual collapse as a result of poor financial performance.

Ondieki (2013) conducted a study on effects of internal audit on financial performance of commercial banks. The independent variables for the study included; control environment, risk assessment, control activities and monitoring mechanisms while the dependent variable was financial performance. The findings of the study were that internal controls can have features built into them to ensure that fraudulent truncations are flagged or made difficult, if not impossible, to transact. Internal control audits provide assurance that controls are working, but they do not necessarily detect fraud or corruption. The objectives of internal controls audit relate to management's plans, methods, and procedures used to meet the organization's mission, goals, and objectives.

Muio (2021) 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.

Olumbe (2012) carried out a study to establish the relationship between internal control and corporate governance in commercial banks in Kenya. The variables included; equity structure, enterprise internal and external supervision vacancy, the board of directors and board of supervisors. The study adopted a descriptive research design and all the 43 commercial banks in Kenya were considered. The primary data was collected by use of a structured questionnaire and an unstructured interview guide. Data was analyzed through a linear regression analysis on the basis of descriptive statistics and performance comparison done across time between the years

2009-2011. The study found that most of the banks had incorporated the various parameters which are used for gauging internal controls and the corporate governance as was indicated

by the means which were obtained enquiring on the same and this showed that the respondents agreed that their banks had instituted good corporate governance with a strong system of internal controls, and there is a relationship between internal control and corporate governance.

Ewa and Udoayang (2017) carried out a study to establish the impact of internal control design on bank's ability to investigate staff fraud and staff lifestyle and fraud detection in Nigeria. The study found that internal control design influences staff attitude towards fraud. Strong internal control mechanism is deterrence to staff fraud since all the necessary checks are in place and hence limiting staff from succeeded in any planned fraudulent activity. Contrally a weak mechanism exposes the system to fraud and creates opportunity for staff to commit fraud due to the existing gaps. The study therefore emphasized on the need to have a strong internal control mechanism in order to curb fraud.

Wainaina (2016) investigated on internal control function of the Kenya Polytechnic University College. The variables for the study included; Control environment, Risk assessment, Control activities, Information & Communication, Monitoring and Information technology. The finding of the study showed that as a substitute for its presence on the scene of operations, management must rely on internal control techniques to implement its decisions and to regulate the activities for which she would ultimately be responsible for. It is in this light that use of effective Internal Control Systems (ICS's) is deemed crucial in the management of business resources. As a result, the management of any organization designs internal control procedures to allocate, control and ensure efficient utilization of resources, in order to achieve the overall corporate goals. It was found that Internal Control Systems

(ICS's) play an important role in preventing and detecting fraud and protecting the organization's resources, both physical and intangible. This is achieved through proper authorization controls and documentation.

Ngungi (2011) carried out research aimed to find out the practice in regard to design and implementation of internal control systems in the private and the public sector and whether there was any difference in effectiveness and efficiency as the result. The research focused on the key components of internal control systems namely control environment, risk assessment, control procedures, information and communication and finally monitoring. The study explored the designs of the respective sectors to find out their similarities and differences. Data of this study was collected by questionnaires and focused group discussion. The data collected was analysed by use of descriptive and inferential statistics. The results showed that the private sector has a strong internal control system than the public sector in all the component of internal control. However both the public and private sector do not have a significant difference in monitoring and control activities and the public sector even has stronger elements of preventive controls.

Barra (2010) investigated on the effect of penalties and other internal controls on employee's propensity to be fraudulent. The results showed that the presence of the control activities and separation of duties, increases the cost of committing fraud. Thus, the benefit from committing fraud has to outweigh the cost in an environment of segregated duties for an employee to commit fraud. Further, it was established that segregation of duties is a "least-cost" fraud deterrent for non-managerial employees, but for managerial employees, maximum penalties are the "least-cost" fraud disincentives. The results suggest the effectiveness of preventive controls control activities such as segregation of duties is dependent on detective controls.

Kakucha (2009) evaluated the level of effectiveness of internal controls operating in Nairobi. The study was based on a number of variables including: age of an enterprise and effectiveness of its system of internal control; the amount of resources held by an enterprise and its effectiveness of its system of internal control; the nature of the relationship between internal control and financial performance. The study was quantitative and used a sample of 30 small businesses as listed in the National Social Security Fund (NSSF) Register of Kenya, 2008. The study found that there are deficiencies in the systems of internal controls, with the degree of deficiencies varying from enterprise to another. The components of internal control that were missing in most businesses surveyed were: firstly, risk analysis, and secondly lack of proper flows of information. In addition, the study established that the sample population lacked awareness of what constituted an effective system of internal control. The study also found that there is significant statistical evidence to support the negative relationship between the age of an enterprise and the effectiveness of its system of internal control. In addition, the study established that there is a negative correlation between the resources held by an enterprise and its internal control weaknesses. Finally, the study found that there is a weak negative relationship between the internal control weaknesses and financial performance. However, this study did not take into account the effects of the specific aspects of internal control such as the monitoring and evaluation and risk auditing and management within small businesses. Amudo and Inanga (2019) carried out an evaluation of Internal Control Systems in the Regional Member Countries (RMCs) of the African Development Bank Group (AfDB) focusing on Uganda in East Africa. The variables included; monitoring, control activities, risk assessment, information and communication and control environment. The study established that some control components of effective internal control systems lack in these projects which render the current control structures ineffective. The study

recommended an improvement of the existing internal control systems in the projects. Wee Goh (2019) studied on audit committees, boards of directors, and remediation of material weaknesses in internal control. He measured the effectiveness of the audit committee by its independence, financial expertise, size, and meeting frequency, and the effectiveness of the board by its independence, size, and meeting frequency, and by the duality of the chief executive officer (CEO) and chair positions (CEO duality). He also examined other factors that can affect firms' timeliness in the remediation of material weaknesses, such as the severity of material weaknesses, firms' profitability, the complexity of firms' operations, and so on. He found out that the proportion of audit committee members with financial expertise is positively associated with firms' timeliness in the remediation of material weaknesses. Second, firms with larger audit committees are more likely to remediate material weaknesses in a timely manner. Third, that a more independent board is less susceptible to the undue influence of management and more likely to exert pressure on management to remediate material weaknesses.

Olatunji (2009) Sought to find out the impact of internal control system in banking sector. The study categorized controls into three major classifications: Preventive controls, detective controls and corrective controls. Data, from which the information constitutes the findings, were collected from fifty branches of Wema Bank Plc. This involved traveling to all the above mentioned states and asking the officers in charge, some prepared questions in which answers were provided accordingly. Data were obtained from both the primary and secondary sources, which includes; interview, structured questionnaire, journal publications, textbooks, newspapers, internet facilities. Secondary data are used to complement the primary data as the primary data is the original work. Data captured for this study were analyzed through descriptive and inferential statistical methods. The descriptive analysis

involves the use of percentages, tabulation and graphical presentation. While, the inferential statistical method involved the use of the chi- square. According to his findings, the lack of an effective internal control system is the major cause of bank frauds in Nigeria. It is then concluded that the management of every bank should create and establish a standard internal control system, strong enough to stand against the wiles of fraud in order to promote continuity of operations and to ensure the liquidity, solvency and going concern concept of the bank.

Jones (2018) investigated on internal controls, accountability and corporate governance in medieval and modern Britain. The variables included control environment, risk assessment, information and communication, monitoring and control activities. He used a modern referential framework as a lens to investigate medieval internal controls used in the twelfth century royal exchequer and other medieval institutions. He demonstrated that most of the internal controls found today were present in medieval England. Stewardship and personal accountability were found to be the core elements of medieval internal control. The recent recognition of the need for the enhanced personal accountability of individuals is reminiscent of medieval thinking.

Mawanda (2015) conducted a research on effects of internal control systems on financial performance in institution of higher learning Uganda. In his study he investigated and sought to establish the relationship between internal control systems and financial performance in an Institution of higher learning in Uganda. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls. The study established a

significant relationship between internal control system and financial performance. The investigation recommends competence profiling in the Internal Audit department which should be based on what the University expects the internal audit to do and what appropriate number staff would be required to do this job. The study therefore acknowledged role of internal audit department to establish internal controls which have an effect on the financial performance of organizations.

Crutchley et al. (2017) studied the likelihood of a firm being involved in an accounting scandal. The study found that certain characteristics increased the likelihood of a firm being involved in an accounting scandal. The characteristics included high levels of growth of a firm, engaging in earnings management techniques, audit committees composed of few directors and overextended outside directors. However, firms with low level of growth and having audit committees composed of more directors had a lesser likelihood of being involved in accounting scandal. Strong internal controls and an ethical organizational culture were found key in preventing a firm from being involved in accounting scandal.

Beasley et al. (2020) examined the differences in corporate governance mechanisms between organization that were guilty of financial reporting fraud and those that were not. Unlike previous researchers, Beasley et al 2020. segmented the organizations by industry concentration, technology, health care and financial services. Beasley et al used allegations made by the Securities and Exchange Commission (SEC) during the period 1987 and 1997 of fraudulent financial reporting to establish fraud organizations and data from the National Association of Corporations (NALD) to match the fraud organizations and establish a no fraud company comparison base. Beasley et al.'s

findings indicated that organizations found guilty of financial reporting fraud had less independent boards, had few audit committees, the audit committee met less often, the audit

committees were less independent, the board and audit committees had less internal audit support.

2.2.1 Internal Control System and Financial performance

In 2017, Nyaga conducted a research to examine the correlation among several aspects of NSE manufacturing companies' corporate governance and performance. Data was collected directly from the Nairobi Stock Exchange, spanning from 1996 to 2006. The research found a clear correlation between governance arrangements, various business entities, and the success of manufacturing businesses listed on the NSE. The results indicated a direct correlation between performance metrics and variables such as board meeting frequency, monitoring, makeup, insider ownership, and others. Scott (1995) argues that organizations need to follow regulations and rely on environmental structures to guarantee their longevity. Arwinge (2013) suggests that controls should be created and put into action to achieve legitimacy and fulfill the need for existence, in accordance with corporate governance and Sarbanes-Oxley law. The 2002 Sarbanes-Oxley Act requires companies to disclose their internal controls' effectiveness together with their performance and financial status reports. This is intended to prevent fraud and enhance integrity in the financial industry after the Enron crisis. In 2008, Mawanda studied how the Ugandan institutions' financial performance was impacted by internal control. Internal audit, control environment, and control activities were investigated, as well as financial performance in accountability, liquidity, and reporting. Olumbe (2020) studied investigate Kenyan commercial banks' internal control and corporate governance, examining factors including capital structure, internal and external control mechanisms, and management and supervisory board. The descriptive research study collected primary data using structured questionnaires and unstructured interviews. Analyzed

the data with a linear regression model, which revealed a significant correlation between internal control and corporate governance.

Olumbe and Mawanda conducted their study in Kenya. Magara (2017) investigated how Kenyan SACCOs' financial success depends on internal control. Using independent factors such control environment, risk assessment, controls, and monitoring. The study collected primary and secondary data obtained via SACCO yearly reports.

The analysis used several regression models and determined that the independent factors had a beneficial impact on SACCO's financial performance in Kenya. Magara covered all aspects of the internal control system except for one element of information and communication, whereas Olumbe emphasized internal corporate governance control in Kenyan commercial banks. The research did not analyze the financial performance of specific commercial bank branches.

2.2.2 Risk Assessment and Financial Performance

Risk management increases financial institution consumer and shareholder value, according to Pagano (2019). Corporate finance links risk management to shareholder value. Ali & Luft (2022) suggest that corporations are more likely to use risk management measures when shareholder value rises. The effectiveness of risk management has increased expectations for firm value and shareholder wealth in both non-bank and bank organizations. Pagano focuses exclusively on risk management inside the internal control system, with a significant emphasis on increasing shareholder value. This scholar differs from other academics by extensively incorporating principles from agency theory into the study framework. Linbo Fan (2014) found that the profits performance of major domestic banks in the United States is mostly influenced by bankruptcy risk rather than liquidity risk or a mix of loan products.

HoHahm (2014) performs an extensive literature analysis on foreign currency rates, focusing on interest rate risk inside Korean institutions. The results show that commercial banks and banking enterprises engaged in commodities trading in Korea encounter substantial interest rate and foreign currency risks, Commercial banks' profitability is significantly influenced by the extent of these risks. HoHahm's research only examines risk management and overlooks the four remaining internal control system components.

Not all internal controls consistently affect financial performance of a certain organization. Mwangi (2017) did a research to see whether risk management affects the Kenyan commercial banks' finances. A descriptive study was utilized to obtain secondary data from the central bank and bank financial statements. Multiple regression was used. The research showed a strong and beneficial relationship between risk management and Kenyan commercial banks' financial performance. Mwangi's study used a multiple regression model for data analysis, making it similar to the analytical method used by Olumbe and Magara. Mwangi's inquiry is notably comparable to HoHalm's study because they primarily focus on risk management in internal control.

Kimotho (2015) found that credit risk management boosts bank profits. The researcher conducted a study to evaluate how Credit risk management affects Kenyan commercial banks' performance. The scientist gathered primary data using a semi-structured questionnaire in a descriptive research approach. The researcher performed data analysis using SPSS version 20. Kimotho's study design closely resembled that of Mwangi (2014), as both were descriptive researchers. Like Olumbe and Mwangi, Kimotho concentrated on internal control risk management, perhaps limiting the ability to assess how internal control affects financial performance. Oyoo (2018) utilized a descriptive research methodology and

correlation to explore how internal control influences microfinance institution financial performance in Kenya's Kisumu Central Constituency. The researcher utilized primary and secondary sources. A semi-structured questionnaire collected primary data, while audited annual financial records of microfinance organizations analyzed provided secondary data. Data analysis employed Pearson product moment correlation. Oyoo's analysis confirmed a direct correlation between the financial performance of microfinance firms and their internal controls. Oyoo's study methods closely mirrored the approaches used in studies conducted. The variation in these research arises from the institutions being examined for their internal controls.

2.2.3 Information and communication system and financial performance

Mwangi (2021) examined how ICT advancements affect Kenyan commercial banks' financial performance. The researcher gathered data from primary sources using a descriptive study approach and questionnaires. The researcher used numerous regression models for data analysis. Research demonstrated a considerable positive correlation between e-banking services and bank performance, as well as an improvement in customer-bank relationships resulting from electronic banking.

The research only examined information and communication systems, which may not fully demonstrate how Internal controls impact bank finances. The study focused only on internal control's information and communication systems, which may limit its impact on banks' financial performance. Etengu and Amony (2016) conducted a research to study how internal control methods impact Ugandan NGO finances.

Etengu and Amony (2016) conducted a research to study Ugandan NGO financial performance and internal control methods. They examined the IUCN case study. The researchers gathered data using structured questionnaires and interviews, employing a survey methodology. They used primary data for their study. The results indicated that each financial performance was linked to internal control measures such control activities, environment, and monitoring. Improve the International Union for Conservation of Nature's finances, they recommended fortifying these components. The study specifically analyzed three of the five components of the internal control system. Concentrating on an NGO in Uganda distinguishes their study from studies focusing on the banking industry. Mensah (2016) conducted a descriptive research to explore how information and communication technology affects the Ghanaian rural bank finances.

The researcher used a mix of primary and secondary resources to compile the data. For the purpose of data analysis, they used a regression model. Based on the findings, the researcher was confident in the model's predictive capabilities. The factors and their interactions provide useful information for forecasting how rural banks in Ghana would be affected financially by ICTs. Every one of internal control's five components was investigated. Therefore, it is not reasonable to assume that a single factor is solely responsible on how internal control affects rural Ghanaian bank profitability.

A research was carried out by Kariuki (2017) to study how ICT affects Kenyan commercial banks' finances. In order to compile information from the Central Bank of Kenya's audited reports, the researcher used a data collecting template and conducted qualitative research.

After that, Excel and SPSS were utilized for data analysis. The research found that information and communication technologies significantly affected Kenyan commercial banks' financial performance.

Conclusions on its effect on organizational financial performance are constrained by this method. Muthusi (2017) examined how internal controls affect Kenyan commercial banks' financial performance. Considerations such as control activities, risk assessment, communication, information technology, and control environments were taken into account by the researcher. The study design that was used in the research was a descriptive one. In order to compile this data, we combed through a variety of main and secondary resources. Questionnaires were sent in order to collect primary data. SPSS analyzed data using multiple linear regressions.

The academic analysis confirmed a strong and significant association between Kenyan commercial banks' internal control and operational performance. Muthusi's study follows research methodologies similar to those found in the works of Mwangi (2014) and Kimotho (2015), among others. Gift (2018) conducted a research to evaluate if internal control affects Rivers State hotel operators' financial performance. The researcher collected data using structured questionnaires in a survey-based research approach, using primary sources together with secondary sources such as internet resources, textbooks, and academic publications. Gift analysed data using descriptive statistics, linear regression, and correlation. The author's research highlights the substantial influence of internal control on hotel finances. Hotel financial performance in Rivers State is positively correlated with internal control measures, according to the study's results. Gift's study from 2018 and Entengu and Amony's study from 2016 both use a survey design technique in their research. Gift's study results align with those of peer-reviewed academic research, especially how different types of internal control systems relate to a company's bottom line.

2.2.4 Internal control activities and Financial Performance

The researcher used analytical approaches and focused on monitoring and surveillance operations. The study's findings suggest that implementing safeguards, including segregating responsibilities, leads to higher expenses when workers engage in fraudulent activities. Barra's research concentrates only on control activities inside internal control. Barra's study lacks a clearly defined framework for the use of internal control, unlike previous academic studies. Ejoh and Ejom (2017) examined internal control methods affected the financial performance of Nigerian institutions.

The researchers used variables including accountability, liquidity, and reporting to measure success. They collected primary data via structured questionnaires and interviews, and secondary data from scholarly papers, textbooks, and journals for their research. Tables and percentages were used to analyze data using Pearson's correlation coefficient. The researchers discovered that all projects were started by leaders, with distinct division of responsibilities among the financial, organizational, and accounting departments, and consistent evaluation of employees' tasks by managers. External auditors annually review businesses' financial accounts. Moreover, the results indicated that individual workers may get important financial data without authorization from others. The research found no influence of internal control on financial performance of Nigerian organizations. Mawanda (2008) focused on educational institutions whereas Ejoh and Ejom (2017) focused on Nigerian educational institutions. Research by Ejoh and Ejom yielded different results significantly from the academic evaluations previously mentioned. They accepted null hypotheses whereas other academics did not, even though they had comparable research objectives.

Barra (2015) conducted a research to investigate how internal controls and fines affect employees' efforts at fraud. The researcher used analytical techniques, focusing on monitoring and surveillance tasks. Data was gathered from both upper-level and lower-level employees. According to the findings of the research, implementing safeguards, including segregating responsibilities, leads to significant expenses related to employee fraud. One aspect Barra studies internal control activities equivalent to Kariuki (2017), Kimotho (2015), Mensah (2014), and Mwangi (2012). Barra's paper lacks information on the organization responsible for instituting internal controls, in contrast to previous scientific studies. Ejoh and Ejom (2017) examined how internal controls affect Nigerian enterprises' financial performance. Responsibility, cash flow, and reporting were the performance indicators taken into consideration. We consulted primary and secondary sources. Secondary data came from academic publications, textbooks, and journals, whilst interviews and structured surveys provided the primary data. Analysis was carried out using Pearson's correlation coefficient, tables, and percentages are shown.

The researchers' results suggest that all actions are instigated by leadership from higher ranks. Their inquiry revealed specific responsibilities in the finance department that were different from those in the organizational and accounting divisions. Subordinate tasks were consistently evaluated by supervisors. Furthermore, external auditors do yearly audits on firms' financial reports. Their results indicate that individual workers may get vital financial information independently. The study's overall conclusion is the lack of a substantial correlation between internal control and Nigerian institutions' financial performance. Like Mawanda (2008), Ejoh and Ejom's study focuses only on educational institutions, with Mawanda's research carried out in Uganda and Nigeria's Ejoh and Ejom. Ejoh and Ejom's

results vary greatly from past academic efforts by accepting null hypotheses, unlike other scientists with comparable goals.

Adagye (2015) did a research on Nasarawa State higher education institutions' internal control system effectiveness, specifically focused on Nasarawa State Polytechnic University in Lafia. The researcher collected data using a survey and a basic closed-ended questionnaire. Researchers employed evaluative sampling. CHI square analysis was used and the results were shown in straightforward tables and percentages. The investigation found that the organization's assets were well protected, responsibilities were properly allocated, transactions were carefully documented, and approvals were officially approved. Adagye's research approach is similar to that of Gift (2018) and Entengu and Amony (2016) used surveys. Adagye's work is similar to Ejoh and Ejom (2014) and Mawanda (2018) in that they all center on organizations that adopt internal control inside educational institutions. The researcher examined many elements concentrate on internal control system control tasks, although this may not be sufficient to completely justify the conclusion reached.

Kariuki(2017), Kimotho(2015), Mensah(2014), Mwangi(2012), and Ejoh and Ejom (2014) all zero in on different parts of the internal control system, potentially lacking comprehensive evidence to definitively determine how internal control affects financial results. Ngari's (2017) research shows that protections, work distribution, and internal audit methods influence the profitability of Kenyan microfinance institutions. Ngari investigated how internal control affects Kenyan microfinance firms' profitability, focusing on the division of roles, underwriting methods, and internal audit procedures as control measures. The researcher used descriptive surveys and a diagnostic study design as research tools, guided by a positivist ideology. Data was gathered from primary and secondary sources, how internal control impacts Kenyan microfinance enterprises' profits. Ngari's (2017) countrywide

research and Oyoo's (2014) study in Kisumu County, Kenya, both center on microfinance organizations. Ngari's research results are consistent with other academic articles evaluated, except for Ejoh and Ejom's (2014) study in higher education institutions, which showed different outcomes. Research conducted by Naibei and Kipyego in 2017 validates a strong connection between tier 1 bank performance and internal accounting standards.

Naibei and Kipyego (2017) used descriptive research like Mwangi (2014), Oyoo (2014), Kimotho (2015), and Ngari (2017). Like Kariuki (2017), Kimotho (2015), Ejoh and Ejom (2014), Mensah (2014), and Mwangi (2012), with three subcomponents as independent research variables, Naibei and Kipyego examined one control system component: internal control.

Renox (2017) found a strong and meaningful connection between Kenyan commercial banks' financial success and internal control emphasizing the benefits of effective internal control systems. The researchers sought to determine whether Kenyan commercial banks' financial success is linked to internal control. Renox analyzed primary and secondary data using descriptive and cross-sectional methods. A structured questionnaire gathered primary data for correlation and regression analysis, given in frequency tables. Research shows that commercial banks that use internal controls tend improve financial performance. Renox uses a descriptive study approach. Renox's findings are consistent with the majority of researchers in the examined papers, except for the results of Ejoh & Ejom (2014).

2.3 Conceptual Framework

Conceptual framework is presented in a schematic format as in Figure 1.1 below. According to Kothari (2014), conceptual framework is a structure explaining dependent-independent relationships. These factors explain the issue of inter-related or influence each other.

Conceptual framework therefore was designed to connect research title, objectives of the study, methods used and reviewed literature to make the study relevant.

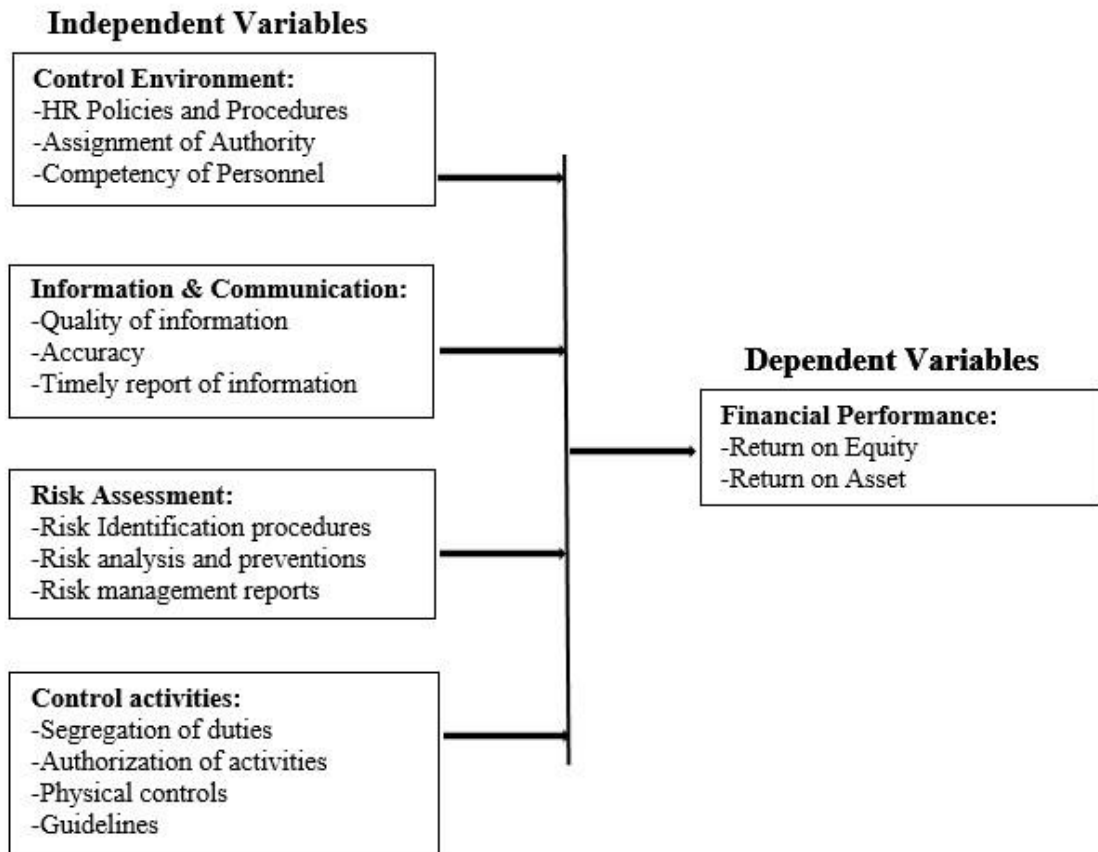


Figure 2.2: Conceptual Framework

Source: Researcher (2024)

2.4 Literature Recap

Many studies have been conducted to evaluate how internal controls impact organizational performance. Muhammed (2015) studied how the auditing function and control system affect Pakistani university finances. Results indicate a link between internal audit, internal control, and institution financial performance. Study addresses internal audit and control but does not explore the roles of risk assessment and governance in company efficiency. The study's exclusive emphasis on one business restricts its applicability to other companies with

different operational features. Mugo (2013) investigated how internal control affects the financial performance of technical training schools. The study links internal control to financial success but does not examine corporate governance and government regulations. Ugandan higher education institutions' internal control mechanisms affect financial performance, according to Mawanda (2018). In Ugandan universities, Mawanda examined internal control and financial success. Research evaluated internal control by examining the control environment, audit activities, and internal control systems. Effectiveness was measured by liquidity, accountability, and reporting.

The researcher wants to investigate internal controls to determine why financial performance is low. Research shows a strong correlation internal controls and financial performance. A competency structure for the internal audit department that matches university standards is suggested by the research standards and identifying the ideal workforce numbers needed. The study recognizes the importance of internal audit in influencing internal control systems that affect organizational performance.

A case study in Belgium identified several control environment features including tone, danger level, control perception, and the degree of responsibility for risk management. The text emphasized the crucial significance of well-defined and effectively communicated internal controls in internal audit processes and the identification of fraud inside a business (Sarens, 2016). Kakucha (2020) assessed Nairobi-based firms' internal controls. This quantitative study examined 30 National Social Security Fund of Kenya-registered small businesses from September 2007 to June 2009. Primary data was gathered by conducting interviews with small company managers and reviewing documents pertaining to internal controls. The findings showed weaknesses in the internal control systems, with different levels of defects found in the organizations that were examined. Jones (2019) performed a

comparative study of medieval and modern British business governance, accountability, and internal control. The research analyzed internal control techniques in the royal treasury and other organizations throughout the 12th century using a contemporary framework that encompasses environmental control, risk assessment, communication, surveillance, and control operations.

He points out that several internal controls now in use have origins in medieval England. Principles of authority and individual responsibility were key components of internal control throughout that period. The current focus on increased individual accountability mirrors this medieval point of view. Olumbe (2016) examined Kenyan commercial banks' internal control and corporate governance. The research discovered that several of commercial banks, according survey of 45 institutions, had used several measures to evaluate internal control and governance. The data shows that the respondents in the study think their banks have excellent corporate governance policies with effective internal controls, linking internal control to corporate governance.

2.5 Research Gap

He points out that several internal controls now in operation have origins dating back to medieval England. This approach does not have the capability to ascertain the precise correlations between variables. A more appropriate method may be the correlational design, which reveals the extent and nature of the link between study variables. In their investigation, Naibei and Kipyego (2017) employed causal and correlational designs focusing only on the control actions component of internal control. The reviewed studies focused on individual elements of the internal control system, as shown in the study of Naibei and Kipyego (2017), Adagye (2015), and Ejoh and Ejom (2014). Kariuki (2019) and Mensah (2016) examined the

information and communication aspect, whilst Kimotho (2018) concentrated on risk assessment. The researcher plans to include all four components of the internal control system to meet study objectives. Some academics have used correlational designs, however they have mostly focused on businesses outside of banking. Several studies in the same subject have examined the financial performance of commercial banks in Kenya from a larger viewpoint, as seen in the works of Muthusi (2017), Kariuki (2017), and Mwangi (2014), among others. The study examined commercial banks in Bomet and Kericho counties, Kenya. Causal and correlational designs were utilized to properly prove research variables' causality. The literature research indicates a lack of comprehension of the influence risk assessment on financial performance and ICT systems. This research aims to investigate the degree and importance of how each internal control aspect affects financial performance and their combined impact. This research attempts to provide fresh insights in areas that have not been thoroughly covered in previous literature. The research aimed to show that proficient administration of internal control systems may greatly improve the profitability in Kenyan commercial banks.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This part talks about the different ways to do study and reach its goals. A breakdown of the link between each part of internal control and financial success. The methods include research methodology, target population, sampling technique, data collecting tools, data gathering methodologies, and ways to look at the facts.

3.1 Research Design

The study used descriptive research without modifying factors (Kombo & Tromp, 2016). A quantitative technique was used to explore the connection between factors in Mombasa County. This study used a descriptive survey research approach to collect data. Information was gathered via organized questionnaires given to participants. The research took place in Mombasa County, focusing on evaluating how Regional commercial banks' financial performance is affected by internal control systems.

3.2 Target Population

The target population as per Sakho (2018) is the specific group to whom the research results are meant to be generalized. The study used 43 commercial banks operating banks in Mombasa County as the unit of analysis. The sample size was drawn from a target population of 437 who are employees of the commercial banks. The target population was stratified into strata consisting of Bank managers, Heads of departments, Finance officers and accountant staff. Random sampling was conducted in each stratum to give a sample size of 209 as shown in table 3.1 below.

Table 3.1: Target population

Category	Population	Percentage (%)
Branch Manager	43	10
Finance Officer	128	29
Departmental Head	164	37
Accountant staff	102	24
Total	487	100

Source: Researcher (2024)

3.3 Sampling Procedure and Techniques

The study used purposive sampling to achieve its objective. The target population was stratified into strata (branch managers, accountants, department heads, and financial executives) followed by random sampling in each category giving a population of 437. To achieve stratified sampling, participants were divided into homogeneous sub-populations based on bank department influencing internal control environment. Random sampling was then used to obtain a sample population of 209 as shown by Slovin's approach below. Mugenda and Mugenda (2008) suggested that at least half of the target population should be included in the study when dealing with different types of data. The sample size was calculated using Slovin's approach, as shown below:

$$n = N/1+N(e)^2$$

Where; n is

sample size.

N is target population.

E is level of significance, set at 0.05.

Therefore, $n = 437/1+437 (0.05)^2 = 209$

3.4 Sample Size

A sample is a small portion of a target population selected using some systematic procedure for study (Babie, 2018). Census sampling method will be used because data was drawn from all the local commercial banks. Unit of analysis comprised of employees of all the 43 commercial banks operating in Mombasa County, Kenya. The sample population included personnel with knowledge on internal control systems as well as financial performance of the commercial banks. Unit of observation therefore targeted the senior branch manager, financial officers, departmental heads and accountant staff of all the commercial banks in Mombasa County, Kenya. Thus, the sample size for the study comprised of 209 respondents.

Table 3.2: Sample size distribution

Category	Population	Sample Size	Percentage (%)
Branch Manager	43	26	12
Finance Officer	128	55	26
Departmental Head	164	79	37
Accountant staff	102	49	24
	437	209	100

Source: Researcher (2024)

3.5 Construction of Research Instruments

Structured questionnaire was constructed to collect primary data from respondents. The first section of the questionnaire captured the demographic information of the respondents. The second section captured the research variables that constituted the study objectives. Firsthand information was used in the study which consist of material gathered directly from the original sources and personal experiences. A questionnaire is a systematic collection of

written inquiries designed to get information from participants. Closed-ended surveys was used to quickly gather data, save time and money, and simplify analysis due to their efficiency and simplicity. The questionnaire approach was selected for its simplicity in administration and convenience for participants (Creswell, 2019).

3.6 Validity and Reliability of Research Instruments

3.6.1 Piloting

Piloting was conducted in Kilifi County that neighbours Mombasa County which was the research site. During piloting, 21 questionnaires was administered to 21 (10%) respondents as follows; Branch Manager (5), Finance Officer (5), Departmental Head (6) and Accountant staff (5). Piloting was conducted to test the fitness of the questionnaire before actual data collection. After the piloting, necessary adjustments to the questionnaire was done based on the feedback of respondents such time taken to complete filling the questionnaire, clarification sought from unclear questions and length of the questionnaire.

3.6.2 Validity

The researcher made sure the study tool works before presenting it to the respondents. This was to ensure that the developed research tool fulfill the intended use without deviation as a measure to collect accurate data relevant to the study. Validity as noted by Robinson (2002) is the degree to which result obtained from the analysis of the data actually represents the phenomenon under study. It is used to ensure that the study actually measures what it intends to measure from the beginning. To ensure validity of the instruments, the study considered both the face and content validity of the questionnaire. To ensure validity of the instrument, face to face validity was assessed by having all the questions phrased in line with the study objectives. Content validity was undertaken through a review of the questionnaire by the

supervisor (expert) in the study field. The researcher relied on the supervisor to assist in undertaking the content validity of the data collection instrument.

3.6.2 Reliability

A set of ten extra questionnaires were pre-tested to a separate population in the neighboring Kilifi County to assess the reliability of the tool. This was meant to help bridge any gaps within the research tool or from the respondent's point of view. A Cronbach's alpha reliability rating of 0.7 or above was deemed satisfactory (Nassiuma, 2004) and was adopted to estimate reliability and consistency of the research tool.

3.7 Data collection methods and procedures

Before embarking on data collection, the researcher sought for authorization documents that included; Ethics clearance certificate, introduction letter and NACOSTI research permit from the national government of Kenya. Both Primary and secondary data was collected from respondents using closed ended questionnaires and audited reports, books and journals respectively.

3.8 Data Analysis and Presentation

The collected data was entered into excel sheet, cleaned and transferred to SPSS version 14 for analysis. For descriptive statistics, data was analyzed into means and standard deviations. Regression analysis was used an inferential statistics to examine the relationship between variables. Findings were presented in tables, percentages, graphs, and charts. Kothari (2004) identified bar graphs, pie charts, frequencies, percentages, and tables as essential statistical approaches for effectively presenting analyzed data to facilitate understanding.

3.8.1 Multiple Regression Model

Multiple regression model was used to analyse the relationship between internal control systems and financial performance.

$$Y = \alpha + \beta_1 CE_i + \beta_2 IC_i + \beta_3 RA_i + \beta_4 CA_i + \varepsilon$$

Y = Financial Performance α = constant

term

Regression = $\beta_1 - \beta_4$ Independent-variable coefficients

CE_1 = control environment.

IC_2 = risk assessment.

RA_3 = control actions.

CA_4 = information and communication system.

The symbol "e" represents the error term.

3.9 Ethical Consideration

The researcher complied with the ethical requirements mandated by the MKU-Ethics Review Committee (MKU-ERC). The researcher received an Ethics Clearance Approval from the MKU-ERC and a Research Approval from NACOSTI. The researcher guarantees the protection of respondents' privacy and upholds the utmost secrecy of the information they supplied. The researcher maintained good faith throughout the study procedure to achieve the most objective outcomes.

CHAPTER FOUR

RESEARCH FINDINGS AND DISCUSSION

4.0 Introduction

The chapter presents the study results which were obtained from the analysis of the collected secondary data. Both descriptive and inferential statistics were used in the study and the results are presented in tables and figures for ease of interpretation.

4.1.1 Response Rate

High survey response rates help to ensure that survey results are representative of the target population. A survey must have a good response rate in order to produce accurate, useful results. (Sheehan, K. 2001). Figure 4.1 below represents response rates of the targeted population.

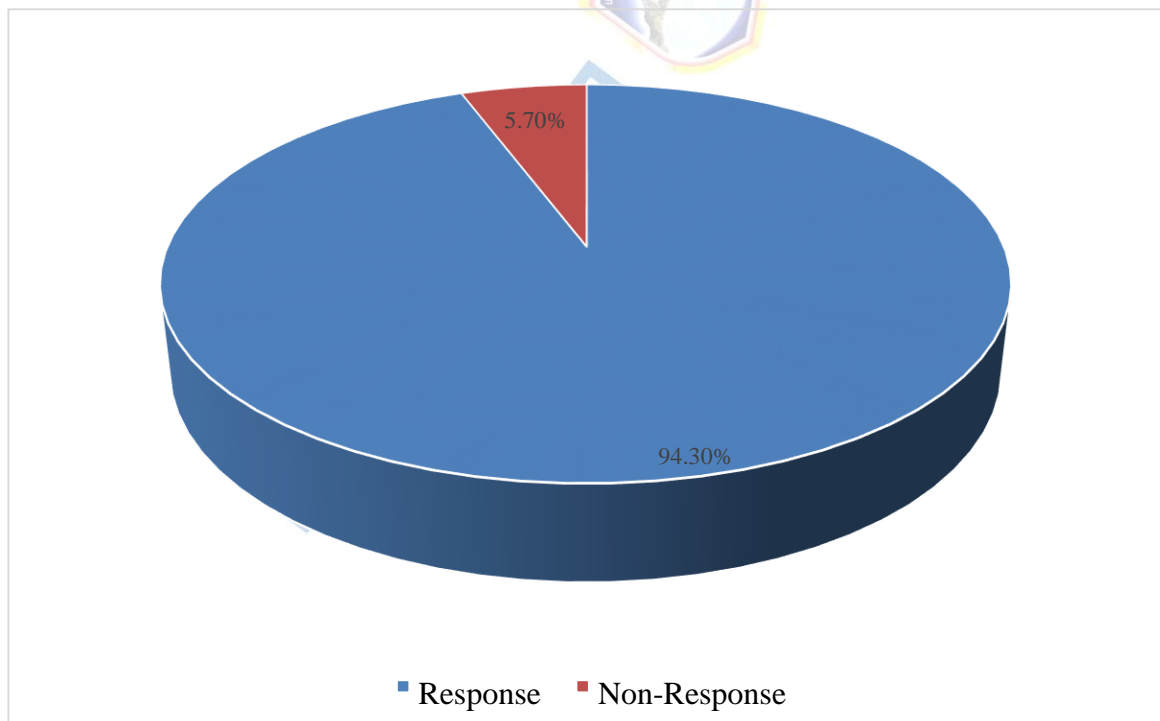


Figure 4.2: Response Rate (Researcher, 2024)

The study realized a response of 94.3% and a Non-response of 5.7%. Out of the 209 participants, 197 responded to the study while 12 participants declined to participate in the study. Based on the above finding, the study recorded a response above 70% which is considered excellent as outlined by Mugenda and Mugenda (2003).

4.1.2 Education level of the respondents

The target bank employees holds different levels of education ranging from diploma to doctoral. The difference in education level plays a big role in diverse responses to similar questions (Gilovich et al., 2006). Figure 4.2 below represents the nature of education of respondents.

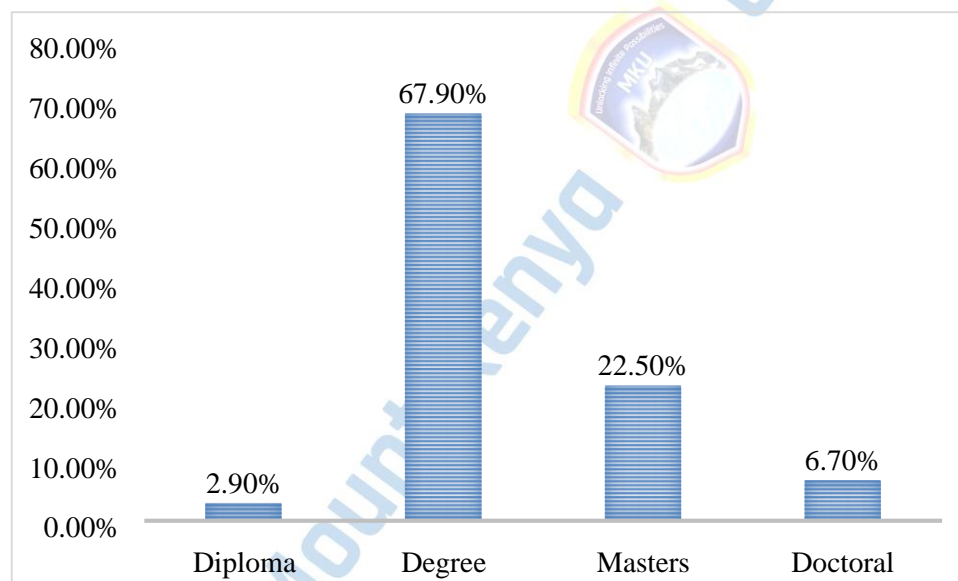


Figure 4.3: Level of Education Achieved (Researcher, 2024)

From the findings in Figure 4.2, majority of employees of the selected banks in Mombasa County attained the first degree (67.90%) while low number of employees attained diploma (2.9%) academic level. In addition, some staff members have attained doctoral

(6.7%) academic level. The respondents were well educated and could give the relevant information requested by the researcher through a questionnaire.

4.1.3 Years worked in the bank

The number of years an employee has taken to work for an organization is the basis for work experience.

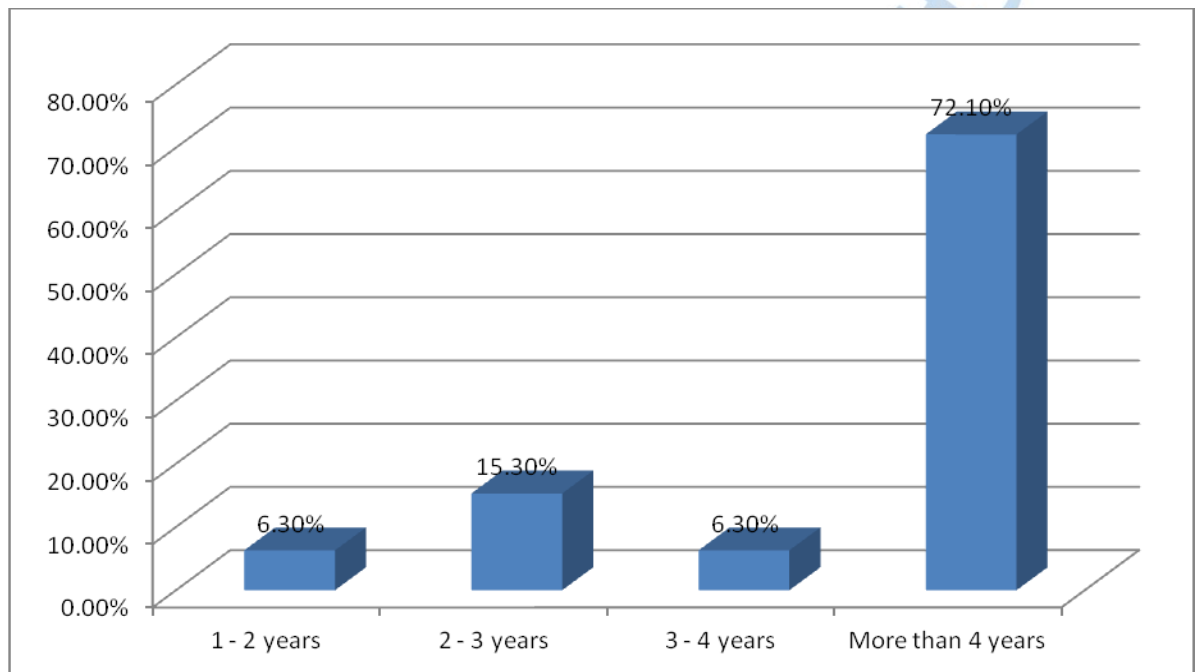


Figure 4.4: Years Worked in the Bank (Researcher, 2024)

From figure 4.3 above, the findings outline that many employees have been employed for more than 4 years (72.10%) while low less employees have been employed for less than 2 year (6.7%). The findings in the study clearly shows employees of the selected banks have been employed through different years.

4.2 Descriptive analysis

The study used descriptive research without modifying factors (Kombo & Tromp, 2016) to collect data. A quantitative technique was used to explore relationship between internal

control systems with financial performance for commercial banks in Mombasa County. Information was gathered via organized questionnaires given to participants. To understand the level of agreement by the respondents, the researcher used the likert scale with a scale of 1 to 5, where 1-illustrated strongly disagree while 5-indicated strongly agree. The responses from participants were analyzed and presented in the form of means and standard deviations for easier interpretation. In summary, results were presented on a scale interval as follows: mean value of 0-1 indicates strongly disagree; 1.1 – 2.0 is disagree; 2.1 – 3.0 is note sure, 3.1 – 4.0 agree and 4.1 and above indicates strongly agree. **4.2.1 Effect of internal control**

environment on the financial performance of commercial banks in Mombasa County

The first objective of the study was to assess the effect of internal control environment on financial performance of selected commercial banks in Mombasa. To ascertain the effect, the project aimed to establish the views of employees of banks through agreement on specific outlines statements in the questionnaires. Findings on the effect of the internal control environment on the financial performance of commercial banks in Mombasa County are as presented in table 4.1;

Table 4.1: Control environment

Statements	Mean	Std. Deviation
Fraud detection activity are intertwined. They affect bank performance by	3.567	1.1039
Improving auditors' performance is essential for effective fraud detection.	4.405	0.7055
Auditing standards and regulations impact audit and audit-related services commercial banks' performance	4.045	0.7433

Internal audit assesses and helps enhance a systematic approach to banking risk management, control, and governance.	3.667	0.3372
--	-------	--------

Source: Researcher (2024)

From table 4.1 above, the respondents agreed with a mean of 3.567 and standard deviation of 1.1039) to the statement that fraud detection activities are intertwined making it difficult and unpredictable to easily detect then in commercial banks in Mombasa County. The respondents strongly agreed that improving auditors' performance is essential for effective fraud detection as shown by a mean of 4.405 and a standard deviation of 0.7055. Respondents agreed that auditing standards and regulations affect audit and audit-related services of commercial banks' performance with a mean of 4.045 and a standard deviation of 0.7433. Respondents also agreed that internal audit assesses and helps to enhance a systematic approach to banking risk management, control, and governance through a systematic banking procedure with a mean of 0.337 and a standard deviation of 3.667. The findings in the current study are in agreement with a separate study conducted by Ewa (2021) which revealed that internal control has the potential to curb the fraudulent activities if monitoring and evaluation is carried out consistently. Another study conducted Mwachiro (2013), pointed out that internal control is a critical tool for commercial bank's financial performance in Kwale County since it has the potential to identify fraudulent activities within the banking operations but has to be implemented regularly and effectively by the implementers. Again, the findings are in tandem with a study conducted by Wee Goh (2019) which established that well audit system is a key component to management of bank's resources (both capital and assets) thereby promoting good management and governance structure within banking environment.

4.2.2 Effect of information and communication on the financial performance of commercial banks in Mombasa County.

The second objective focused on assessing the effect of information and communication on the financial performance of commercial banks in Mombasa County. The results were analyzed as means and standard deviations for each statement contained in the questionnaire. The findings of the effect of information and communication on the financial performance of commercial banks in Mombasa County is represented in table 4.2 below.

Table 4.2: Information and communication system

Statements	Mean	Std. Deviation
Management chose responsible parties for coordinating efforts throughout the bank to ensure proper communication about	3.982	0.8126
All workers communicate the idea and significance of internal controls, including the division of responsibilities.	4.177	0.8317
Effective communication helps in assessing the efficacy and	3.801	0.8937
The financial structures reporting system delineates the duties of each section/unit inside the bank.	4.385	0.8071

Source: Researcher (2024)

From table 4.2, the respondents strongly agreed that management choose responsible parties for coordinating efforts throughout the bank to ensure proper communication about internal controls to ensure appropriate communication on internal controls with a mean of 3.982 and standard deviation of 0.8126. Respondents also strongly agreed on the statement that workers communicate the idea and significance of internal controls, including the division of responsibilities with a mean of 4.177 and standard deviation of 0.8317. Respondent agreed to the statement that effective communication helps in assessing the efficacy and

implementation of the bank's guidelines and policies with a mean of 3.801 and standard deviation of 0.8937. Respondents also strongly agreed to the statement that the financial structures reporting system delineates the duties of each section/unit inside the bank with a mean of 4.385 and standard deviation of 0.8071. The findings are in agreement with a study conducted elsewhere by Wainaina (2021) who established efficient communication through correct channels as well as documentation is key for the commercial banks to achieve good financial performance. In addition, the results are also in agreement with Kakucha (2019) who demonstrated that lack of superior internal controls including communication can be manifested in weak systems in unstable commercial banks and are associated with poor management including lack of qualified personnel as the top level. The above findings is in agreement with a study conducted by Beasley (2000) which showed the importance of subdividing the responsibilities through divergent reporting structure in banking industry. He further stated that, reporting in a bank set up can also be moderated by other factors not limited to composition, independence and the size which may affect the reporting channel.

4.2.3 Effect of risk assessment on the financial performance of commercial banks in Mombasa County.

The third objective focused on assessing the effect of risk assessment on the financial performance of commercial banks in Mombasa County, the researcher utilized the likert scale to rate the statements and analyze the data in form of means and standard deviations.

The overall results on risk assessment are as presented in Table 4.3 below;

Table 4.3: Risk Assessment in the Commercial Banks

Statements	Mean	Std. Deviation
Bank management has set appropriate aims.	4.179	0.8915
Bank management identifies threats to aims.	4.651	0.5124

Management has criteria for recognizing the biggest bank risks.	3.901	0.6317
Management has implemented strategies to reduce significant risks that might result in financial losses for the bank.	3.222	1.137
Management has implemented strategies to reduce significant risks that might result in financial losses for the bank.	3.197	0.9582
For early loss prevention, the bank's departmental risks are escalated and reported often.	4.720	0.4982

Source: Researcher (2024)

As shown in the table 4.3, the respondents strongly agreed with a mean of 4.179 and standard deviation of 0.8915 that banks in Mombasa County have invested in setting up concise management goals that propel them in the market and safeguard the financial performance. To a closely related statement on the setting up of the management goals, the respondents were also in agreement that commercial banks works towards identification of risks in order to achieve the set bank's goals or milestones as shown by a mean of 4.651 and a standard deviation of 0.5124. Regarding the statement on that the management has criteria for recognizing the biggest bank risks, the respondents agreed strongly with a mean of mean 4.651 and standard deviation of 0.5124. Further, the respondents agreed that management has implemented strategies to reduce significant risks that might result in financial losses for the bank with a mean of 3.222 and standard deviation of 1.137 .This is a good indication that commercial banks are committed towards safeguarding financial performance to ensure they remain competitive to the market and attract more customers. Findings from the table 4.3 also demonstrate that management has implemented strategies to reduce significant risks that might result in financial losses for the bank with a mean of 3.197 and standard deviation of 0.9582. Further, respondent strongly agreed to the statement that early loss prevention, the bank's departmental risks are escalation and reporting play critical role in enabling banks to

improve financial performance with a mean of 4.720 and standard deviation of 0.4982. The current findings conquer with a study conducted by Magara (2013) that highlighted the importance of internal risk management and mitigation measures. He further noted that, commercial banks with weak or ineffective internal risks identification systems are likely to experience poor financial management compared to banks with vibrant and strong ways to identify risks internally. The findings can be supported by a separate study conducted by Ondieki (2023) who emphasized that internal control audit must be streamlined together with the vision of management for commercial banks to realize a strong financial performance. The overall findings correlates to a study conducted by Olatunjii (2019) which highlighted the importance of identification of internal risks as way to improve financial performance by establishing potentials threats and putting in place the recommended measures.

4.2.4 Effect of internal control activities on the financial performance of commercial banks in Mombasa County.

The fourth objective focused on assessing the effect of internal control activities on the financial performance of commercial banks in Mombasa County the study utilized likert scale to measure the intent of agreement on internal control activities. The findings were presented as means and standard deviation to provide an understanding as presented in table 4.4;

Table 4.4: Control Activities

Statements	Mean	Std. Deviation
Corrective actions are implemented to address errors in the functioning our Accounting & Finance Management System.	4.191	0.7216
Access to the bank system is limited to authorized users.	4.493	0.7509

Only bank employees may access accounting records specifically assigned to handle such documents.	4.917	0.9811
Bank accounts are reconciled regularly to prevent any pending item which might cost the bank money.	3.9701	1.097
All bank procedures include efficient control mechanisms such as maker, checker, and verifier.	3.517	1.1582
Management closely oversees internal control system implementation at the bank.	4.1104	0.7391
Regular evaluations of operational efficiency conducted for both employees (appraisals) and the bank's systems.	3.899	1.217
Management informs junior officials on system operation.	3.7012	1.1956

Source: Researcher (2024)

Findings as presented in table 4.4 shows that respondent strongly agreed that corrective actions are implemented to address errors in the functioning our accounting & finance management system with a mean of 4.191 and standard deviation of 0.7216. Respondents strongly agreed to the statement that access to the bank system is limited to authorized users with a mean of 4.493 and standard deviation of 0.7509. Respondents agreed to the statement that regular evaluations of operational efficiency conducted for both employees (appraisals) and the bank's systems with a mean of 4.493 and standard deviation of 0.7509. The findings also show that only bank employees may access accounting records specifically assigned to handle such documents with a mean of 4.917 and standard

deviation of 0.9811. Respondents also agreed to the statement that bank accounts are reconciled regularly to prevent any pending item which might cost the bank money with a mean of 3.970 and standard deviation of 1.097. Further, respondents agreed to the statement that all bank procedures include efficient control mechanisms such as maker, checker, and verifier with a mean of 3.517 and standard deviation of 1.1582. Respondent strongly agreed to the statement that management closely oversees internal control system implementation at the bank with a mean of 4.1104 and standard deviation of 0.7391. The respondent agreed to the statement that regular evaluations of operational efficiency conducted for both employees (appraisals) and the bank's systems with a mean of 3.899 and standard deviation of 1.217. Respondents also agreed to the statement that management informs junior officials on system operation with a mean of 3.7012 and standard deviation of 1.1956. The findings above is in line with a study carried out by Barra (2010) who summarized that separation of internal control activities in a banking industry is key to lowering the operational costs and improving efficiency. The findings above conquers with the findings of Amudo and Inanga (2019) that commercial banks requires prudent internal control mechanisms to track specific activities and constant evaluation in order to improve the financial performance.

4.3 Diagnostic Test Results

4.3.1 Multicollinearity Test

Multicollinearity between the variables was analyzed using the Variance Inflation Factor (VIF).

Table 4.5: Multicollinearity Test statistics

Variables	Collinearity Statistics
-----------	-------------------------

	Sig.	Tolerance	VIF
Internal control environment	0.019	0.716	1.027
Information and communication	0.017	0.879	1.001
Risk assessment	0.005	0.941	1.019
Internal control activities	0.006	0.988	1.002

Source: Researcher (2024)

The results for Multicollinearity presented in table 4.8 provides detailed interpretation of the variance inflation factors (VIF) for each variable. The results reveal that there is no any problem among variables as indicated by the VIF value below 10. In summary, the results indicate that the independent variables (control environment = 1.027, risk assessment = 1.019, information and communication systems = 1.001 and control activities = 1.002, all recorded VIF values below 10 showing that there is non-collinearity problems in the data sets used in this study. This imply that, the low level of collinearity is useful because the result cannot be statistically different in any way. Therefore, use of regression analysis as a statistical methodology to establish the existing relationships among independent and dependent variable is approved.

4.3.2 Heteroscedasticity

In this study, the researcher employed use of the Levene test to check for heteroscedasticity before regression analysis was conducted as suggested by Field (2013). According to Field (2013), when the tested values of Levene test probability statistics are found to be greater than $p = 0.005$ (significant level), then it means that the variances are equal of independent variables are within same range or region or equal. In this case, such selected independent variables must be restudied or re-checked. In a normal scenario for regression analysis to be

conducted, the obtained independent variable values must be greater than $p = 0.005$ to agree with the Field's (2013) homoscedasticity hypothesis. Assuming homoscedasticity, the findings are given in table 4.9.

Table 4.6: Heteroscedasticity

	Heteroscedasticity	
	Levene Statistics	Sig
Internal control environment	1.785	0.398
Information and communication	0.410	0.291
Risk assessment	0.367	0.871
Internal control activities	1.298	0.589

Source: Researcher (2024)

Table 4.10 reveals findings of internal control environment in commercial banks in Mombasa County recorded with a p-value of $0.398 > 0.05$ and a Levene statistic of 1.785; information and communication reported 0.410 Levene's test statistic with a p-value of ≥ 0.291 ; risk assessment levene value of 0.367 at p-value > 0.05 (levене test) and Internal control activities recorded a levene statistic of 1.298 at a $p\text{-value} = 0.589 > 0.05$. This findings therefore revealed that it was necessary to reject the null hypothesis of independent variables that heteroscedasticity existed in the data therefore suggesting the need to carry out advanced data analysis using regression model. The study findings therefore indicate that the assumption was achieved and additional analysis of collected data using the regression analysis model was necessary.

4.3.3 Normality Test Results

According to Ghasemi & Zahediasl (2012), Normality test is used to make comparison of scores in the sample against normal distribution of mean and standard deviation. In this study

Normality test was conducted using the Shapiro-Wilk test. Through normality test, the study was able to project normal distribution of both means and standard deviations of descriptive data. Findings of this test for all the four independent variables namely; internal control environment, information and communication, risk assessment and internal control activities are summarized in the table 4.11 below. Shapiro- Wilk test scale ranges from 0 to 1, with values closer to 1 indicating normal distribution of data while figures between 0-0.4 indicating skewed data according to Field (2013).

Table 4.7: Normality Test Result

Variables	Shapiro-Wilk Test	
	Statistics	Sig
Internal control environment	0.991	0.55
Information and communication	0.911	0.064
Risk assessment	0.719	0.078
Internal control activities	0.815	0.088

Source: Researcher (2024)

From the findings of this research, the null hypothesis for normality tests was set that the data was not normally distributed. From the Normality test results in table 4.11, results clearly indicate that data was normally distributed since p – values for all independent variables were found to be greater than set significant level of 0.005. Internal control environment recorded $p=0.55$; information and communication, $p=0.064$; risk assessment, $p=0.078$ while internal control activities recorded a p value of $p=0.088$. Therefore, all independent variables were not significant at 95% which led to the researcher to reject the null hypothesis and concluded that the data was evenly/normally distributed. This was a good indication that data collected was validated and reliable to use it to come to research conclusions.

4.3.4 Regression results

Regression analysis was used in this study to demonstrate how the independent and dependent variables were related. The financial performance of the commercial banks as determined by ROA, which was derived from the supervision reports of the commercial banks for the corresponding years, was the dependent variable. In contrast, the independent variables were the control environment, information and communication systems, risk assessment and control activities. Hierarchical regression analysis was used to perform the regression test. The coefficients for the independent variable are shown in the first model, and the coefficients for the independent variables and the moderating variable are shown in the second model. The relationship test was conducted at the 0.05 significance level. The findings from the test of the relationship between the independent and dependent variables are shown in this section. A regression analysis was conducted to demonstrate the degree to which independent variables controls impacted the commercial banks' financial performance.

Table 4.8: Multiple Regression Result

Variables	Beta	Std. Error	t	Sig
Constant	0.921	1.851	2.613	0.002
Internal control environment	0.644	1.729	3.874	0.000
Information and communication	0.111	0.965	2.168	0.001
Risk assessment	0.714	1.638	1.952	0.009
Internal control activities	0.966	1.124	2.888	0.003

* Significant at 0.05 level

All of the independent variables displayed positive coefficients, indicating a positive impact on performance, in accordance with the results shown in Table 4.8. All of the significant values are less than 0.05, indicating a significant relationship between the dependent and independent variables, which is supported by the regression coefficients and p-values. Based on the coefficients, the regression model, Financial performance = $\alpha + \beta_1 CE_i + \beta_2 RA_i + \beta_3 IC_i + \beta_4 CA_i + \epsilon$ therefore becomes;

$$\text{Financial performance} = 3.212 + 0.416 CE_i + 0.635 RA_i + 0.475 IC_i + 0.923 CA_i$$

This clearly shows a significant positive relationship between the predictor variables and the performance of commercial banks.

According to table 4.8 above with a beta value of 0.644 and P-value of 0.000, there is a positive and significant relationship between the control environment and the financial performance of commercial banks in Mombasa County, Kenya. This is the first objective of the study and the findings were consistent with the results of a study by Mwachiro (2013), which revealed that weak internal control environment particularly those related to ethical values within the organization, have fostered fraud, revenue loss, and embezzlement of collected funds.

From table 4.8 above, the second objective which focused on assessing effect of information and communication on the financial performance of Kenyan commercial banks, also demonstrated that information and communication systems significantly and favorably affect organizational performance with a beta value of 0.111 and P-value of 0.001. Kakucha (2009) claims that the main cause of internal communication flaws is the use of subpar information and communication systems. According to the study, an organization's internal communication flaws and its resources have a statistically significant correlation that affects organizational performance. The

current study demonstrates that commercial banks in Mombasa County have established effective and efficient information and communication systems which are affecting financial performance positively.

Based on table 4.8 above, the third objective was on to assess effect of risk assessment on the financial performance of commercial banks in Mombasa County. The results showed that risk assessment had a positive and significant effect on the financial performance with a beta value of 0.714 and P-value of 0.009. This indicates that there is a substantial correlation between commercial banks' financial performance and risk assessment. Ondieki (2013) corroborated this relationship in his research, which found that internal control audits guarantee that controls are functioning but do not always identify corruption or fraud. However, the study demonstrated that the degree of commercial banks' financial performance is greatly affected by risk assessment during internal auditing.

In order to achieve the fourth objective which focused on assessing effect of internal control activities on financial performance of commercial banks in Mombasa County, table 4.8 above demonstrated a positive and significant correlation between internal control activities and the financial performance of commercial banks in Mombasa County with a beta value of 0.966 and P-value of 0.003. These results were consistent with those of a study by Barra (2010), which concluded that the existence of control activities and the division of labor raises the cost of staff fraud, ensuring the security of bank operations. The study concludes that since the reward for committing fraud must be greater than the cost in a setting where duties are segregated, employees find that they are not successful in such a situation, which consequently results in improved performance and operational efficiency. In conclusion, commercial banks in Mombasa County have established strong internal activities control mechanisms to ensure their financial performance index remains stable.



CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This chapter provides an overview of the study's findings, the conclusions drawn from them, and suggestions made for enhancing policy. In order to address banking fraud and enhance the financial performance of commercial banks, it is important to follow the recommendations made.

5.1 Summary of the Findings

The study was undertaken with the aim of assessing the effect of internal control on the financial performance of commercial banks in Mombasa County. The study was guided by four objectives; assessing effect of the internal control environment on the financial performance of commercial banks in Mombasa County; assessing effect of risk assessment on the financial performance of commercial banks in Mombasa County, assessing effect of information and communication on the financial performance of commercial banks in Mombasa County; and examining the effect of internal control activities on the financial performance of commercial banks in Mombasa County.

The study confirmed that most commercial banks in Mombasa County conducted the internal control mechanisms. The study findings also highlighted that the internal control mechanisms play a critical role in improving the financial performance of the commercial banks.

According to the multiple regression model's findings, internal control systems and financial performance of commercial banks in Mombasa County are positively correlated. The effectiveness and efficiency with which internal controls are implemented determines financial performance, holding all other variables constant. The study found that internal controls have a significant impact on the financial performance of commercial banks.

5.2 Conclusions

Based on the results presented in chapter four above, the study came to the conclusion that the control environment in commercial banks in Mombasa County has a positive and significant relationship with the financial performance of those banks. Commercial banks' ability to satisfy customer needs and carry out

their duties effectively, which improves organizational performance, is largely dependent on their ability to maintain an environment that is favorable to the application of internal control systems.

Information and communication has a significant positive impact on the financial performance of commercial banks in Mombasa County. The ability of banks to expand financially is significantly influenced by the effectiveness of their communication system and the degree of information accessibility provided to employees. Since unauthorized personnel can destroy a bank and increase the risk of losses, the study provides evidence that commercial banks' confidential information is a valuable asset.

Financial performance of commercial banks in Mombasa County is also impacted by the risk assessment techniques they use internally. The ability to identify operational risks that could lead to losses and take appropriate action to mitigate such risks is what gives banks with efficient risk assessment measures in place an advantage over their competitors. Increased financial performance is a given for a bank that operates with low risk.

Every commercial bank's management bears primary responsibility for the planning, execution, and oversight of its internal control activities. Commercial banks perform better when they implement the right internal activities controls to prevent fraud and other threats to their operations. Internal controls guarantee that all transactions involving the commercial bank are accurately and completely documented and that the clients are protected. The study established a significant positive relationship between the internal control activities with financial performance of commercial banks in Mombasa County.

5.3 Recommendations

Considering the results and conclusions of the study, the following suggestions were made for improving the policy: financial performance is positively correlated with the control environment. Therefore, the banking institutions should guarantee an appropriate control environment to ensure the security of the operations. To lessen frequent theft and threats to the operations and property of commercial banks, the management, particularly the senior risk manager and senior operations manager, should ensure that the security network is effective and efficient. Therefore, in order for commercial banks to perform better, the banks must guarantee an appropriate environment where internal controls are supported.

Financial performance has a significant positive relationship with information and communication. The effectiveness of commercial banks' information and communication systems is crucial to their ability to grow and perform better over time. The study makes the recommendation that there be adequate checks and balances in place for all financial transactions made in banks, and that the senior risk manager of the bank, in particular, arrange for staff members to receive regular training on risk assessment and control mechanisms in order to effectively secure the operations of the bank.

Risk assessment is positively correlated to the financial performance of commercial banks in Mombasa County. For this reason, it is crucial that commercial banks use appropriate risk assessment to direct their business. Internal controls are essential to commercial banks' operations. In order to guarantee efficient controls, the management of the bank, and in particular the senior audit manager, should support the implementation of routine assessments of the effectiveness of the internal control strategies with respect to effective risk

assessment. Therefore, in order to ensure that they are meeting all of their requirements for protecting themselves from losses, commercial banks should periodically review their operations and policies for handling threats.

Internal control activity has a positive relationship with the financial performance of commercial banks in Mombasa County, Kenya. To ensure that their operations are guided, commercial banks must put effective control measures in place. When assigning duties to staff members, the management of the banks, and in particular the senior human resource manager, should assess each employee's integrity, particularly in situations where workers handle sensitive data related to the banks' important records. As a result, it is important to verify an employee's integrity before allowing them to occupy sensitive positions in a bank to make sure that the people holding them would protect the institution from risk to its internal operations.

5.4 Suggestions for Further Study

A similar study should be carried out after five years to see if there are any areas of commonality or distinctive factors because of the innovative nature of the banking sector. This is a result of how quickly and continuously technology is advancing in the banking industry.

Further research in how internal controls impact financial performance of commercial banks in other counties would be intriguing since it would provide a more comprehensive understanding of how internal controls impact both Kenya's commercial banks and investment banks. In order to improve the banking industry, it will support management of commercial and investment banks alike.

LIST OF REFERENCES

- Abdel-Khalik, A. R. (1993). Why do Private Companies Demand Auditing? A Case for Organizational Loss of Control. *Journal of Accounting, Auditing and Finance*, 8 (1), 31- 52.
- Abit, M. (2012). Bank profitability: Insights from the rural banking industry in Ghana. *Cogent Econ. Finance*3, 1078270.
- Abu-Musa, & A., A. (2010). Investigating adequacy of security controls in Saudi Banking sector, An empirical study. *Journal of Accounting – Business & Management*, Vol. 17, No. 1, Pp.1-41.
- Adams, W. (2006). A Theoretical Comparison of the Models of Prevention of Research Misconduct, Accountability in Research. *Policies and Quality Assurance*, 51 – 66.
- Adhiambo, A. A., & Memba, M. S. (2012). Credit Cards and Performance of Commercial Banks Portfolio in Kenya. *International Journal of Arts and Commerce*, 1(6): 167 – 173. .
- Aikins, S. (2011). An Examination of Role of Government Internal Audits Improving Financial Performance. *Public Finance and Management*, 11(4), 306-337.
- Beasley, M. S., Carcello, J. V., Hermanson, D., & Capides, R. P. (2000). Fraudulent Financial Reporting: An Analysis of Technology, Health Care and Financial Services Fraud Cases. *Accounting Horizons*, 441-454.
- Bonner, S., Palmrose, Z., & Young, S. (1998). Fraud Type and Auditor Litigation: An Analysis of

SEC Accounting and Auditing Enforcement Releases. *The Accounting Review*, 73(4), 503-520.

Bowrin, A. K. (2004). Internal Control in Trinidad and Tobago Religious Organizations”.

Accounting, Auditing and Accountability Journal, 17 (1), 121-152.

Bronson, S. J., Carcello, P., & Raghunandan, K. (2006). Auditing: Firm Characteristics and Voluntary Management Reports on Internal Control. *Journal of Practice and Theory*, 25 (4), 25-39.

Carmichael, D. R., Willingham, J., & C.A., S. (1996). *Auditing Concepts and Methods: A Guide to Current Theory and Practice*. McGraw-Hill.

Central Bank. (2015). *Regulations and Guidelines*. Retrieved October 27th, 2015, from Central

Bank of Kenya: <https://www.centralbank.go.ke/index.php/regulations-and-guidelines>

Chambers, A. (2009). *Tolley's Internal Auditor's Handbook. (2nd edition)*. London: Lexis Nexis

Butterworths. .

Cieslewicz, J. K. (2012). The Fraud Model in International Contexts: A Call to Include the Societal-level Influences in the Model. *Journal of Forensic and Investigative Accounting*, 4 (1), 214-254.

Cooper, D., & Schindler, P. (2004). *Business Research Methods*. New Delhi: Tata McGraw Hill.

COSO. (1992). *Internal Control—Integrated Framework*. New York. Committee of Sponsoring

Organizations of the Treadway Commission.

Doyle, J. W., & McVay, S. (2015). Determinants of Weaknesses in Internal Control over

- Financial Reporting and the Implications for Earnings Quality. *Journal of Accounting, Auditing and Finance*, 8 (1), 31-52.
- Etuk, I. C. (2011). Evaluation of Internal Control System of Banks in Nigeria. A *PhD. Dissertation, St. Clements University*.
- Ewa, E. U., & Udoayang, J. O. (2017). The Impact of Internal Control Design on Banks' Ability to Investigate Staff Fraud, and Life Style and Fraud Detection in Nigeria. *International Journal of Research in Economics & Social Sciences*, 2 (2), 32-43.
- Fadzilah, W., Mohamed, Z., Mat Zain, M., Subramaniam, N., & Yusoff, W. (2015). Internal audit attributes and external audit's reliance on internal audit: implications for audit fees. .
- Gold, A. K., & Wallage, P. (2012). The Effect of the Strictness of Consultation Requirements On Fraud Consultation. *The Accounting Review*, 87 (3), 925-949.
- Goldberger, A. S. (1964). *Econometric Theory*. New York: John Wiley & Sons. pp. 238–243.
- Gilovich, Thomas; Keltner, Dacher; Nisbett, Richard E. (2006). *Social psychology*. W.W. Norton. pp. 467–468.
- Gilbert, R. A. (2021). Bank Market Structure and Competition: A Survey. *J. Money Credit Bank*.16, 617–645.
- Goddard, J., Molyneux, P., and Wilson, J. O. S. (2004). The Profitability of European banks: A cross-sectional and dynamic panel analysis. Guru, Staunton, and Shanmugam (2019). Determinants of Commercial Bank Profitability in Malaysia. In “Working Paper, Multimedia University.”
- Heffernan, S. and Fu, M. (2008). “The Determinants of Bank Performance in China,” Rep. No. ID 1247713. Social Science Research Network, Rochester, NY.
- Heggestad, A. A. and Mingo, J. J. (2017). The Competitive Condition of U.S. Banking Markets And the Impact of Structural Reform. *J. Finance*32, 649–661.
- Hsiu-Ling W, Chien-Hsun., and Fang-Ying S (2017). The impact of financial development and Bank characteristics on the operational performance of commercial banks in the Chinese Transitional economy“”, *Journal of Economic Studies*, 34:401-414

Jussi, N., & Petri, S. (2004). Does Agency Theory Provide a General Framework for Audit Pricing? *International Journal of Auditing*, 8 (2), 253-262.

Kakucha, W. (2009). An Evaluation of Internal Controls: The Case of Nairobi Small Businesses.

Unpublished MA Thesis, Strathmore University: Kenya.

Kantarelis, D. (2017). *Theories of the Firm*. Kenya Financial Sector Stability Report.

Kantzos, C., & Chondraki, A. (2006). *Auditing Theory and Practise III*. , Stamouli, Athens.

Karagiorgos, T., Drogalas, G., Gotzamanis, E., & Tampakoudis, I. (2009). The Contribution of

Internal Auditing to Management”. *International Journal of Management Research and Technology*, 3 (2), 417-427.

Kiganda, E. O. (2014). Effect of Macroeconomic Factors on Commercial Banks Profitability in Kenya: Case of Equity Bank Limited. *J. Econ. Sustain. Dev.*5, 46–56.

Keitany, J. L. (2000). The Internal Audit Control Function and its Implication for Risk Assessment by the External Auditor: A Case of Quoted Companies.

Unpublished MBA Project Report, School of Business, University of Nairobi.

Kenyon, W., & Tilton, P. D. (2006). *Potential Red Flags and Fraud Detection Techniques: A Guide to Forensic Accounting Investigation, (First Edition)*ll. New Jersey: John Wiley & Sons, Inc.

Kuo, L. (2015, October 15). *Kenya’s central bank is trying to stop a mid-size bank failure from triggering panic*. Retrieved October 27, 2015, from Quartz Africa:

<http://qz.com/524890/kenyas-central-bank-is-trying-to-stop-a-mid-size-bankfailure->

[From-triggering-panic/](http://qz.com/524890/kenyas-central-bank-is-trying-to-stop-a-mid-size-bankfailure-From-triggering-panic/)

Kothari, M. (2015). Bank profitability: Insights from the rural banking industry in Ghana.

*Cogent Econ. Finance*3, 1078270.

Muio, A. K. (2021). The Impact of Internal Control Systems On The Financial Performance Of Private Hospitals in Nairobi. *Unpublished Research Thesis. University of Nairobi.*

- Ndegwa, E. W. (2013). Strategic control systems in strategy implementation and financial performance of Bamburi cement limited, Kenya. (*Doctoral dissertation, University of Nairobi*).
- Njenga, N. M., & Osiemo. (2013). Effect of fraud risk detection through internal control systems on organization performance: A case of deposit-taking microfinance institutions in Kenya. . *International Journal of Social Sciences and Entrepreneurship*, 1 (7).
- Njui, R. W. (2012). The Effectiveness of Internal Audit in Promoting Good Governance in the Public Sector in Kenya”. *Unpublished MBA thesis, University of Nairobi*.
- Olatunji, O. (2009). Impact of Internal Control System in Banking Sector in Nigeria. *Pakistan Journal of Social Science*, 6(4), 181-189.a.
- Oloo, O. (2010). Banking Survey Report. The Best Banks this Decade 2000-2009. *Think Business Limited, Kenya*.
- Olumbe, C. O. (2012). The Relationship between Internal Controls and Corporate Governance in Commercial Banks in Kenya”. *Unpublished thesis, University of Nairobi*.
- Rezaee, Z. (2002). *Financial Statement Fraud: Prevention and Detection*|| New York: Wiley. *Managerial Auditing Journal*, 16(3), 150-158.
- Sheehan, K. (2001). E-mail survey response rates: a review. *Journal of Computer Mediated Communication*, 6 (2).
- Wells, T. J. (1997). *Occupational Fraud Abuse*|| London: Obsidian Publishing Co.
- Welton, R. E., & R., D. J. (1997). Understanding Ethics Development and Employee Behavior. *Internal Auditing Journal*, 8 (3), 243-251. .


APPENDICES

Appendix I: Consent Form

The Respondent,

Dear Sir/Madam,

Re: Request for Research Data



I am a graduate student registered in the Master of Business Administration program at Mount Kenya University. Presently, I am undertaking a research project titled “Assessment of effect of internal control systems on financial performance of commercial banks in Mombasa County, Kenya.” Your involvement in this study is optional, and you have been selected to contribute. I kindly seek your aid in completing the enclosed questionnaire. Be assured, all data provided will be kept private and utilized exclusively for academic and research purposes. Your identity will remain undisclosed and will not be revealed in the final document under any circumstances. Your collaboration and assistance are sincerely valued.

Thank you.

If you have any inquiries regarding this project, please don't hesitate to reach out to Dickson Kazungu Thoya at 0725202150 or Dr. Martin Onsiro Ronald at 0716939832. For any concerns about your rights as a participant in this study, you can reach the Chairman of the Ethical Review Committee at Mount Kenya University. The committee's address is P.O Box 342-01000, Thika. Your contribution to this important endeavor is greatly appreciated. Thank you.

CONSENT

I read, comprehended, and asked questions. I understand that the study is optional and I may leave at any time without explanation or cost. I consent to receiving this consent form. I volunteer for research.

Participant's signature _____ Date _____

Investigator's signature _____ Date _____

Appendix II: Research Questionnaire

Dear Sir/Madam

You are officially invited to join the research. It should take 10–15 minutes to finish the survey. Answers may remain anonymous without identification. Only academic data from this survey will be utilized.

1. Level of Education

- i) Certificate [] ii) Diploma []
 iii) Undergraduate degree [] iv) Master's degree []
 v) Doctorate []

2. Bank stay duration

- i) Less than 6 months []
 ii) 6 months-1 year []
 iii) 1-2 years [] iv) 2-3 years []
 v) 3-4 years [] vi) More than 4 years []

3. What is the frequency of your bank's internal control systems review? i) After 5 years [] ii) Annually [] iii) Half-yearly [] iv) When need arises []

4. Do you believe that your bank's internal control system adequately and efficiently contributes to income generation? How does your position contribute to it?

5. Are the internal control mechanisms mentioned in point 4 operating as intended? a) Yes ()

b) No () Explain:

6. How do you assess the internal control system of your firm regarding income generation?

- a) Very ineffective ()
 b) Ineffective ()
 c) Uncertain ()
 d) Effective ()
 e) Very effective ()

7. Score each statement in the internal control system on a Likert scale from strongly disagree to strongly agree: Ranks: 1 = strongly disagree, 2 = disagree, 3 = not sure, 4 = agree, and 5 = strongly agree.

Internal Control Environment	5	4	3	2	1
-------------------------------------	----------	----------	----------	----------	----------

i) Fraud detection and activity are intertwined. They affect bank performance by being unpredictable and evasive.					
ii) Improving auditors' performance is essential for effective fraud detection.					
iii) Auditing standards and regulations impact audit and audit-related services commercial banks' performance					
vi) Internal audit assesses and helps enhance a systematic approach to banking risk management, control, and governance.					
Risk Assessment					
	5	4	3	2	1
i Bank management has set appropriate aims.					
ii) Bank management identifies threats to aims.					
iii) Management has criteria for recognizing the biggest bank risks.					
iv) Management has implemented strategies to reduce significant risks that might result in financial losses for the bank.					
v) Management has implemented strategies to reduce significant risks that might result in financial losses for the bank.					
vi) For early loss prevention, the bank's departmental risks are escalated and reported often.					

v) Bank customers' instructions are carefully examined, such as signature verification, to avoid executing fraudulent transactions.					
Information and Communications System					
	5	4	3	2	1
i) Management chose responsible parties for coordinating efforts throughout the bank to ensure proper communication about internal					
ii) All workers comprehend the idea and significance of internal controls, including the division of responsibilities.					
iii) Effective communication helps in assessing the efficacy and implementation of the bank's guidelines and policies.					
iv) The financial structures reporting system delineates the duties of each section/unit inside the bank.					
Internal Control Activities					
	5	4	3	2	1
i) Corrective actions are implemented to address errors in the functioning our Accounting & Finance Management System.					
ii) Access to the bank system is limited to authorized users.					
iii) Only bank employees may access accounting records specifically assigned to handle such documents.					
iv) Bank accounts are reconciled regularly to prevent any pending item which might cost the bank money.					
v) All bank procedures include efficient control mechanisms such as maker, checker, and verifier.					

vi) Management closely oversees internal control system implementation at the bank.					
vii) Regular evaluations of operational efficiency conducted for both employees (appraisals) and the bank's systems.					
viii) Management informs junior officials on system operation.					



Appendix III: Operational Commercial Banks in Mombasa County

Tier 1 Banks

1. Kenya Commercial Bank
2. Equity bank
3. Cooperative Bank
4. Barclays Bank
5. Commercial Bank of Africa (CBA)
6. Standard Chartered Bank
7. Stanbic Bank
8. Diamond Trust Bank (DTB)

Tier 2 Banks

1. Family Bank
2. I&M Bank
3. NCBA Bank
4. Bank of Africa
5. Housing Finance
6. Ecobank
7. Prime Bank
8. Bank of Baroda
9. CFC Stanbic Bank
10. Citibank
11. Guaranty Trust Bank
12. National Bank
13. Bank of India

Tier 3 Banks

1. Consolidated Bank of Kenya Ltd.
2. Credit Bank Ltd.
3. Development Bank (K) Ltd.
4. Dubai Bank Ltd.
5. Equatorial Commercial Bank Ltd.
6. Fidelity Commercial Bank Ltd.
7. First Community Bank Ltd.
12. Habib Bank Ltd.
13. Kenya Women Microfinance Bank
14. Middle East Bank (K) Ltd.
15. Oriental Bank Ltd.
16. Paramount Universal Bank Ltd
17. Transnational Bank Ltd.
18. UBA Kenya Bank Ltd.

Appendix IV: Financial Performance of Commercial Banks

Bank	ROE/ROA	2020	2021	2022	2023
Tier I Banks					
KCB	ROE	14.4%	21.8%	22.0%	18.1%
	ROA	2.1%	3.2%	3.0%	2.7%
Coop Bank	ROE	14.2%	17.3%	21.2%	18.2%
	ROA	2.3%	3.0%	3.7%	3.6%
Tier II Banks					
NCBA Bank	ROE	6.6%	13.6%	17.2%	14.7%
	ROA	0.9%	1.8%	2.3%	2.2%
I&M Bank	<u>ROaE</u>	13.2%	12.2%	14.4%	14.3%
	<u>ROaA</u>	2.3%	2.1%	2.6%	2.7%
Tier III Bank					
HF Group	<u>ROaE</u>	18.1%	8.1%	3.1%	5.6%
	<u>ROaA</u>	3.0%	1.3%	0.5%	0.8%

Source: (Cyttonn Banking Sector Report, 2023; Coop Bank Financial Report, 2023)

KEY NOTES


ROE means Return on Equity

ROA means Return on Assets

ROaE means Return on Average Equity

ROaA means Return on Average Assets

Appendix V: Ethics Review Certificate


Mount Kenya University

REF: MKU/ISERC/4396 Date: 16 September 2024
TO: DICKSON KAZUNGU THOYA REG: MBA/43836/2016

Dear Sir/Madam,

RE: ASSESSING THE EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN MOMBASA COUNTY, KENYA


This is to inform you that **Mount Kenya University** has reviewed and approved your above research proposal. Your application approval number is **3116**. The approval period is **16/09/2024 - 15/09/2025**.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including informed consents, study instruments, MTA will be used
- ii. All changes including amendments, deviations and violations are submitted for review and approval by **Mount Kenya University**
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to **Mount Kenya University** within 72 hours of notification
- iv. Any changes, anticipated or otherwise that may increase the risks or affect the safety or welfare of study participants and others or affect the integrity of the research must be reported to **Mount Kenya University** within 72 hours
- v. Clearance for export of biological specimens must be obtained from relevant institutions
- vi. Submission of a request for renewal of approval at least 60 days prior to expiry of the approval period. Attach a comprehensive progress report to support the renewal
- vii. Submission of an executive summary report within 90 days upon completion of the study to **Mount Kenya University**

Prior to commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke> and also obtain other clearances needed.


Yours sincerely,


Dr. Alfred Owino, PhD
Chairman, Mount Kenya University ISERC

**MOUNT KENYA UNIVERSITY
ETHICS REVIEW COMMITTEE
P.O. Box 342 - 01000,
THIKA**

Main Campus, General Kago Road, P.O. Box 342-01000 Thika,
Cell: +254 709 153 000 / +254 709 153 200
Email: info@mku.ac.ke, Web: www.mku.ac.ke

Appendix VI: Introduction Letter



Mount Kenya University

DIRECTORATE OF GRADUATE STUDIES

MBA/43836/2016
25th September, 2024

National Commission for Science Technology & Innovation (NACOSTI)
Off Waiyaki Way, Upper Kabete,
P.O Box 30623- 00100
NAIROBI, KENYA

Dear Sir/Madam,


RE: DICKSON KAZUNGU THOYA- REGISTRATION NO. MBA/43836/2016

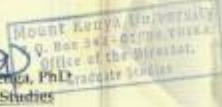
The purpose of this letter is to introduce the above named student who is pursuing **Master of Business Administration** in the department of **Accounting and Finance** in the school of **Business and Economics**.

The title of the research is "**Assessing the Effect of Internal Control Systems on Financial Performance of Commercial Banks in Mombasa County, Kenya.**" It has been cleared by the University's Ethics Review Committee (Certificate attached) and now has to proceed to the field to collect data between **October, 2024 and December, 2024.**

Any assistance accorded to the student will be highly appreciated.


Thank you.



Dr. Samuel M. Karega, PhD
Director, Graduate Studies
Enc.



Main Campus, General Kagio Road, P.O. Box 342-01000 Thika.
Cell: +254 709 153 000 | +254 709 153 200


Appendix IX: NACOSTI Research Permit


REPUBLIC OF KENYA
NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION


NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION
Date of Issue: 21/October/2024

Ref No: 236024


RESEARCH LICENSE




This is to Certify that Mr. Dickson Karungi Thoya of Mount Kenya University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Mombasa on the topic: **ASSESSING THE EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN MOMBASA COUNTY, KENYA** for the period ending : 21/October/2025.

License No: NACOSTI/P/24/41202.

236024
Applicant Identification Number


Director General
NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION

Verification QR Code


NOTE: This is a computer generated License. To verify the authenticity of this document,
Scan the QR Code using QR scanner application.

See overleaf for conditions

DICKSON KAZUNGU THOYA

ASSESSING THE EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN ...

- Researches
- Research
- Mount Kenya University

Document Details

Submission ID
mvald-1-9090987360

Submission Date
Oct 22, 2024, 8:19 AM GMT+3

Download Date
Oct 22, 2024, 8:54 AM GMT+3

File Name
Dickson_K_Thoya_Final_Research_Proposal_24.10.2024_1.docx

File Size
237.7 KB

94 Pages
20,803 Words
110,058 Characters



Appendix X: Plagiarism Report

81	Internet	deccz.com.br	0%
82	Internet	dispace.cbe.ac.tr:8080	0%
83	Internet	eprojournals.com	0%
84	Internet	ir-library.mmarau.ac.ke:8080	0%
85	Internet	kipdf.com	0%
86	Internet	kyuspace.kyu.ac.ug	0%
87	Internet	poffox.com	0%
88	Internet	repository.ams.ac.ke	0%
89	Internet	repository.dkut.ac.ke:8080	0%
90	Internet	repository.ju.edu.et	0%
91	Internet	www.tstu.ac.ug	0%
92	Internet	www.acipedia.com	0%