International Journal of Business and Management Invention
ISSN (Online): 2319 – 8028, ISSN (Print): 2319 – 801X
www.ijbmi.org || Volume 6 Issue 3 || March. 2017 || PP—30-36

Non-Governmental Organization Internal Control as a Compliance Mechanism for Financial Regulations in Kenya: A Case of Amref Health Africa in Kenya

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ABSTRACT: *The purpose of the study was to establish non-governmental internal controls as a compliance mechanism to financial regulations, taking the case of Amref Health Africa in Kenya. The study was guided by the following objectives: to determine the relationship between monitoring and compliance to financial regulation, establish the relationship between financial reporting and compliance to financial regulation, and asses the relationship between auditing and compliance to financial regulation within Amref Health Africa in Kenya. The study was conducted using cross sectional descriptive research design. Purposive sampling method was used where the target population of 90 members of Amref Health Africa in Kenya drawn mainly from the board of directors, line managers, finance and accounts, monitoring and evaluation, and information and communication, from where 79 respondents participated in the study. A semi structured questionnaire was the main instrument of data collection and the Statistical Package for Social Science (SPSS) was used for analysis. Chi Square was used to test for the relationship, while Phi and Cramer's value was used to test for the strength of association. The findings showed that there is a positive relationship between internal controls and monitoring, financial reporting and auditing to compliance with financial regulations. The study recommends that the management innovates better ways of embracing continuous quality improvement for internal control activities and regular systems audits to ensure loopholes in the system are sealed.*

KEYWORDS: *Internal Controls, Non-governmental Organizations, Financial Regulations, Monitoring, Auditing, Financial reporting, Compliance, Kenya, Amref Health Africa.*

I. BACKGROUND OF THE STUDY

Financial regulations give framework for administration organizations financial issues (Reinhart, 2009). Every person in an organization has the responsibility of taking reasonable action to ensure security of assets under their control. For an organization to be compliant with financial regulations, then it must ensure all its activities are done in a transparent manner, it is accountable to its stakeholders and it is accurate in its reporting (Asian Development Bank, 2005). Internal Controls are systems within an organization to ensure attainment of its objectives. They are methods and procedures designed to produce efficient and effective operations, establish accurate and reliable financial reporting, and maintain compliance with organizational regulations. The integrity of financial reports is a product of the reliability, efficiency and effectiveness of the internal controls which will help in early detection of fraud and safeguard assets (Asare, 2006). Zabihollah (2002) notes the importance of internal controls that usually provide a reasonable but not absolute assurance to an organization's management and the board of directors that its objectives will be attained. Internal controls help organizations to achieve performance and organizational goals, prevent loss of resources, ensure reliable reports are generated and ensure they comply with applicable laws and regulations (Hayes *et al.*, 2005).

A Non-Governmental Organization (NGO) is an organization that operates like a business but does not seek financial gains; they exist to serve a public need without intent of making a profit (Nzimakwe, 2008). According to Oyejide (2001) internal control comprises an organization's mechanisms to monitor risks before and after operations. Internal control principles suggest that an internal control system is the primary accountability and governance tool an organization can establish and use to provide accountability to its stakeholders (donors) and safeguard its assets. Objectives of internal control processes in an organization are meant to verify efficiency and effectiveness of the operations to ensure reliability and completeness of financial and management information which are fundamental to achieving key initiatives and goals. Dittenhofer (2001) argues that internal control process should be a tool for operation at all ladders of the organization. The process involves development of control procedures and techniques, communication, operational analysis, and monitoring. Internal control mechanisms work to improve decision making by ensuring information is timely, complete and accurate. Many NGOs get into financial difficulty either because they don't establish internal controls or do not implement them properly when they are in place (Chiappetta et al., 2009). According to Amudo (2008), Internal Controls have a meaning and relevance when it comes to the personnel system. To ensure a good system, managers must hire competent personnel with integrity, train them so that they understand their duties and responsibilities, and segregate certain responsibilities when it comes to handling cash. Amudo further explains that effective internal control systems operate on the principle that no one person should ever be placed in a position to carry out or conceal an error or irregularity without timely detection by others in the normal course of carrying out their duties and responsibilities (Whittington & Pany, 2004). Throughout the process, there should be free flow of communication in the form of training, awareness and feedback. However, when a communication gap exists for any reason, sub optimization results with adverse consequences (Cohen et al., 2002). Once in place, the control activities should be monitored and evaluated. This can be accomplished through a combination of external audits, internal audits, and self-audits. The feedback provided can be used to further improve the internal control systems (Goodwin-Stewart & Kent, 2006).

Compliance reporting is one of the pillars of internal controls and it entails specific reports in a predetermined format that a granting agency may require (COSO, 2004). The financial governance and control mechanism will be delivered through improved reporting. A 2007 survey (EIU) found that: 10% of directors admitted to making important decisions on the basis of inadequate information and 46% agreed that going through huge volumes of data impedes decision making while 56% are often concerned about poor choices because of faulty, inaccurate or incomplete data. All employees are responsible for compliance with organizational procedures.

Statement of the Problem

Internal control helps organizations to be effective and efficient in their operations in order to achieve desired performance, prevent loss of resources and ensure reliability in financial reporting. A well designed internal control system makes an organization achieve its objectives and ensure compliance with applicable financial regulations and laws (COSO Publications, 2005). However, the problem in many organizations is that assets are entrusted to a few individual employees without internal control mechanisms and as a result, some assets are directed to personal use or misuse without benefiting the organization. A study by Transparency International (2010) showed a prevalence of corruption in African countries leading to a risk where employees override weak internal controls to achieve their private gains. NGOs have gained integrity in developing countries in effective implementation and sustaining development programmes more so than state - owned organizations, thus attracting donor funding which is a mechanism used by NGO for improved accountability (Smith & Lumba, 2008). Furthermore, external factors such as globalization, dynamic environment and Technology has made NGO management very complex consequently adopting strong internal controls (Mitlin, Hickey & Bebbington, 2006). Over the last decade, Amref Health Africa in Kenya has developed internal control systems and all the programme areas and units have undergone positive transformations. With these measures in place, it would be expected that the safety of all assets in the organization are guaranteed to avoid misuse or misappropriation of the donor and organization's assets. However, the organization still struggles in terms of compliance with financial regulations. Financial reporting is not being done to the required standards, accountability for the organization financial resources is still wanting; fraud and misuse of the organization's resources have been discovered and the necessary steps made have not yielded the expected results (AMREF Financial Manual, 2013). This study therefore investigated the persistent noncompliance with the financial regulations from the perspective of internal controls.

Objective of the Study

The general objective of the study reported here was to establish the Non-Governmental internal controls as a compliance mechanism to financial regulations taking the case of Amref Health Africa in Kenya.

The specific objectives of the study were to:

1. Determine the relationship between monitoring and compliance to financial regulation.
2. Establish the relationship between financial reporting and compliance to financial regulation.
3. Assess the relationship between auditing and compliance to financial regulation.

II. RESEARCH METHOD

The study was a descriptive research design since it best describes data and characteristics about the population being studied. The study was conducted at Amref Health Africa in Kenya Offices in Nairobi and field offices dotted in various places in Kenya. Top and middle level managers drawn from the different departments were purposively sampled. The study used purposive sampling because it targeted the caretakers of the internal control systems as they were the only relevant respondents. A sample size of 90 Amref Health Africa in Kenya staff was sampled from finance and accounts department. Quantitative data was collected using self-administered closed ended questionnaires. The questionnaire developed sought to address the specific objectives and contained Likert scale questions which sought to measure the extent to which respondents agreed or disagreed with certain questions. Secondary data on the other hand was collected using data review of the financial records and management reports. Self-administered Questionnaires were distributed to the sampled respondents through an existing group survey mail system. Data was analysed using descriptive statistics then computed using the chi square test for categorical variables. Chi-square test of association was used to test for relationships**.** A further Phi and Cramer's V test was used to measure the strength of association.

III. RESULTS

The study targeted a sample of 90 Amref Health Africa in Kenya staffs drawn from top and middle level management that were basically care takers of the internal control out of which 79 responses were obtained. This represented 88% of the response rate which is a reliable response rate for data analysis as Cooper & Schindler (2003) argue that any response of 50% and above is adequate for analysis.

3.1 Relationship between monitoring and compliance to financial regulation

The chi-square test for independence, also called Pearson's chi-square test or the chi-square test of association was used to discover if there was a relationship between internal controls and monitoring**.** A relationship existed where the Pearson value is less than 0.05 while the strength of the relationship was shown by Phi and Cramer's value which was supposed to be more than 0.3. Table 3.1.1 below shows that there was a relationship between monitoring adherence to organization financial accounting guidelines using Pearson's chi-square which is (χ^2=15.640, df =8, p= 0.048). Since the P value is less than 0.05 then this implies that the more efforts that Amref Kenya puts towards its internal controls the more the adherence to organization financial accounting and reporting guidelines.

Table 3.1.1: Monitoring and compliance to financial regulation

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	15.640[a]	8	.048
Likelihood Ratio	17.653	8	.024
Linear-by-Linear Association	7.095	1	.008
N of Valid Cases	79		

a. 10 cells (66.7%) have expected count less than 5. The minimum expected count is .44.

To be able to measure the strength of association, Phi and Cramer's V was used. From the results as indicated in the Table 3.1.2, the strength of association between the variables was very strong (level of association= **.**315 to .445**).** In this case, there is a very strong association between internal controls and adherence to monitoring guidelines.

Table 3.1.2: Strength of association between monitoring and compliance to financial regulation

Symmetric Measures			
		Value	Approx. Sig.
Nominal by Nominal	Phi	.445	.048
	Cramer's V	.315	.048
N of Valid Cases		79	

3.2 Relationship between reporting and compliance to financial regulation

Table 3.2.1 indicates that there was a relationship between financial reporting and compliance to financial regulation using Pearson's chi-square which is (χ^2=10.054, df =4, p= 0.040). This implies that the more efforts that Amref Health Africa in Kenya puts towards regular review of its internal controls the more processing of data and reporting capabilities will improve in the organization.

Table 3.2.1: Reporting and compliance to financial regulation

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	10.054[a]	4	.040
Likelihood Ratio	12.443	4	.014
Linear-by-Linear Association	1.420	1	.233
N of Valid Cases	79		

a. 5 cells (50.0%) have expected count less than 5. The minimum expected count is 1.20

To be able to measure the strength of association, Phi and Cramer's V were used. From the results as indicated in the Table 3.2.2, the strength of association between the variables was very strong (level of association= .357 to .357). In this case, there was a very strong association between financial information reporting and compliance to financial regulation.

Table 3.2.2: Strength of association between financial reporting and compliance to financial regulation

Symmetric Measures			
		Value	Approx. Sig.
Nominal by Nominal	Phi	.357	.004
	Cramer's V	.357	.004
N of Valid Cases		79	

3.3: Relationship between auditing and compliance to financial regulation

Table 3.3.1 shows that there was a relationship between regular review of internal controls and periodic auditing of books of accounts and financial statements using Pearson's chi-square which was (χ^2=12.516, df =4, p= 0.014). This implies that the more efforts that Amref Kenya puts towards periodic audit of books of accounts and financial statements the more the compliance to financial regulation.

Table 3.3.1: Auditing and compliance to financial regulation

Chi-Square Tests			
	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	12.516[a]	4	.014
Likelihood Ratio	16.698	4	.002
Linear-by-Linear Association	9.498	1	.002
N of Valid Cases	79		

a. 4 cells (40.0%) have expected count less than 5. The minimum expected count is 1.71.

To be able to measure the strength of association, Phi and Cramer's V are used. The results table 3.3.2 indicated that the strength of association between the variables was very strong (level of association= .398 to .398). This therefore means that there was a very strong association between periodic auditing of books of accounts and financial statements and compliance to financial regulation.

Table 3.3.2: Strength of association between auditing and compliance to financial regulation

Symmetric Measures			
		Value	Approx. Sig.
Nominal by Nominal	Phi	.398	.014
	Cramer's V	.398	.014
N of Valid Cases		79	

IV. DISCUSSION

4.1 Monitoring and compliance to financial regulation

Monitoring involves systematic and routine collection of information from projects and programmes for four main purposes: to learn from experiences to improve practices and activities in the future; to have internal and external accountability of the resources used and the results obtained; to make informed decisions on the future of the initiative; and to promote empowerment of beneficiaries of the initiative. Oyejide (2010) asserts that managers are the link to the monitoring functions to ensure interests of stakeholders have been met. However, if not properly done they might pursue their own interest at the expense of stakeholders and defraud the company because of the weaknesses in the internal controls (Morris, 2011). Therefore, the organization needs to employ experts to monitor the activities of the organization as stated by Gupta (2001) which is one of the ways to address the agency conflict.

The findings showed the existence of a strong relationship between monitoring and compliance to financial regulations. This is because of the implementation of the enterprise resource planning system that has been implemented by the organization which has helped in monitoring of the project activities. This is in line with what Baker (2005) reported, that the use of technology assists organizations in evaluation of their internal control systems thus ensuring they are in compliance with applicable rules and regulations. Ultimately, compliance with financial regulations is the responsibility of all employees within an organization. However, commitment of leadership is a key factor in compliance according to Anthony (2005) as it is their responsibility to set the standards of behaviour that need to be followed by all. Arguably then, frequent reviews of internal controls and compliance policies will help improve compliance of financial regulations in the organization. Monitoring and frequent audits will help in identifying the strengths and weaknesses in the system which will ensure corrective measures are put in place on time to avoid losses. Miller (2003) notes that a weak internal control leads to asset misappropriations, corruption, fraud and fraudulent financial statements, thus the need to ensure that it is well designed and functioning properly to give reasonable assurance to the various stakeholders (Wilhelm, 2006).

4.2 Reporting and compliance to financial regulation

The aim of financial reporting is to provide high quality financial information that will be used by relevant stakeholders to make informed decisions (IASB, 2008). The study showed a positive relationship between financial reporting and compliance to financial regulations. Financial reporting controls were designed to produce reliable financial reports (Ratcliffe & Landes, 2009). The reliable financial reporting will ensure the organization meets its financial reporting objectives, which entails applicable financial reporting framework and laws and regulations. According to Whittington and Pany (2004), high quality financial reporting could only be achieved with well thought out and implemented internal controls. Enterprise Resource Planning system would provide a good system to deliver fast, accurate financial reporting that has inbuilt controls intended to ensure accuracy and reliability of financial information that is being reported to shareholders. Keating and Frumkin (2003) affirmed that the future of economic success of an NGO depended not only on quality of its social activities but also improving its internal and external financial reporting systems. This was agreed by Hughes (2003) when he posited that improving internal controls through developing organizational capacity should be first step since without them even plans would not be implemented. Transparency in financial reporting cannot be achieved without legal frameworks that govern the right to disclose information (Asian Development Bank, 2005). According to the Institute of Corporate Governance of Uganda (2001), there should be a legal framework in place to ensure timely and accurate disclosure of all material matters regarding an organization that includes financial situation, ownership, performance and management of the organization. Marshall (2002) emphasized that the only way to ensure transparency among NGOs was when they make full disclosure of their activities which would enhance public trust. Broody (2001) also affirmed that when an organization is building trust, transparency could be viewed as a way of promoting accountability collaboration and commitment. This was supported by Asare (2006) who argues that transparency is a navigating legitimacy in the eyes of donors.

4.3 Auditing and compliance to financial regulation

There are two kinds of controls namely preventive or detective (Lawrence, 2000). Preventive controls involve putting some effort to stop unwanted events from occurring meaning they are proactive controls that avoid losses from occurring. For example proper authorization, proper documentation, separation of duties and physical control of assets. On the other hand detective controls assist organizations to detect undesirable acts where auditing is a key component for this purpose to hold responsible people accountable. This study reported positive significant relationship between auditing and financial compliance to regulations. This is similar to Brinkerhoff's (2003) position that there are three categories of accountability that includes financial, performance and political accountability. Brinkerhoff further said that financial accountability is concerned with tracking, reporting on allocation, disbursement and utilization of financial resources, using the tools of auditing, budgeting and accounting. This study's third objective focused on using the tools of auditing to hold organizations' accountable in their financial management systems. This deals with compliance with law, rules and regulations regarding financial control and management. According to Miller (2003), weak internal controls where auditing is a key component, will lead to asset misappropriation, corruption, organizational fraud and fraudulent financial statements.

V. CONCLUSION

The study provided reasonable assurance both to the stakeholders and management about the status of the organization's internal control system. An effective internal control system supports transparency, accountability, and good financial reporting systems which will ensure the organization is compliant with financial regulations (Zabihollah, 2002). Based on the findings, it is evident that Amref Health Africa in Kenya had effective internal control systems as supported by the study. However, implementation of internal controls should be checked from time to time to ensure that it does not create an opportunity for projects to underperform. Internal control needs to be simplified and made user friendly without compromising their purpose in order to ensure there is efficiency and effectiveness during project implementation. It is the management's responsibility to set and improve the internal controls which confirms the assertion by Treadway commission of the committee of sponsoring organizations (COSO). The study shows that there is a significant positive relationship between internal controls system with financial regulations. This confirms the findings of Hughes (2003) that internal controls ensure a sound financial management leading to the organization achieving its set goals. However, they are supposed to be monitored from time to time to ensure corrective measures have been put in place and generally improve the system as the environment keeps on changing.

VI. RECOMMENDATIONS

The findings revealed that there were strong internal control activities existing in Amref Health Africa in Kenya. Bazzoil (2000) argued that if internal control activities are not implemented and designed properly, it will not help in revealing financial and compliance risks which will then affect performance and productivity of the organization. The study therefore recommends the need to strengthen the internal control activities by adding an element of continuous quality improvement. The management should identify innovators and early adapters of key internal control systems so that they can take a lead in rolling out to other staff members thus ensuring compliance with financial regulations.

The study further recommends that in order to ensure internal control activities remain strong the organization should employ staff that are competent in strategic planning, plan implementation, innovation, and system assessment as they are seen to influence the design of internal controls which then affects compliance with financial regulations. The management should set policies and systems and those in authority must adhere to them hence ensuring targets are achieved without compromising the laid down financial regulations. Furthermore, it should conduct system audits to ensure loopholes are picked early enough and adjustments made to the system ensuring compliance with policies and procedures.

This study focused on internal controls as a compliance mechanism with financial regulations among non-governmental organizations. There is limited study done on internal controls among non-governmental organizations hence the need to research more on the effects of internal controls on financial performance among non-governmental organizations and leadership and financial accountability among non-governmental organizations.

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