



EFFECT OF INTERNAL CONTROL ON FINANCIAL PERFORMANCE OF STAR RATED HOTELS AT THE KENYAN COAST

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ABSTRACT

The study sought to examine the effect of internal control on financial performance of hotels at the Kenyan Coast. The study was inspired by the poor performance of hotels that lead to closure of some. The study was guided by both general and specific objectives as follows: to examine the effect of control environment on financial performance of hotels at the Kenyan Coast; to examine the effect of risk assessment on financial performance of hotels at the Kenyan Coast; to evaluate the effect of information system on financial performance of hotels at the Kenyan Coast and to determine the effect of control activities on financial performance of hotels at the Kenyan Coast. To strengthen the conceptual framework, the study used theories such as agency theory, stewardship theory, reliability theory and attribution theory. The target population of the study was 180 hotels and the sample size were 124. A modified Likert scale questionnaire will be developed and divided into three parts. A pilot study was carried out to refine the instrument. The quality and consistency of the study was further assessed using Cronbach's alpha. Data analysis was performed on a computer using Statistical Package for Social Science (SPSS Version 24) for Windows. Data was presented in form of means, standard deviation, percentages and tables. The study showed that there was a strong positive correlation between the independent variable control activities, risk assessment, information system and control activities and the dependent variable financial performance of hotels at the Kenyan Coast. Further the study results rejected all null hypotheses that control activities, risk assessment, information systems and control activities have no significant effect on financial performance of hotels at the Kenyan Coast. The study concluded that all the independent variables control environment, risk management, information systems and control activities have an effect on financial performance of hotels at the Kenyan Coast. From the study findings the following are the recommendations; That hotels control environment should be enhanced, that managers should embrace enterprise risk management and good corporate governance to maximize on the financial benefits of internal control systems; that management should also ensure that their organizations have strong internal control environment where internal control activities inform of policies and procedures are adequate and that control environment and control activities should on a regular basis be evaluated by internal audit department to provide management with the assurance on the adequacy and effectiveness of mitigation controls that management has put in place.

1.0 BACKGROUND OF THE STUDY

Organizations have invested heavily in improving the quality of their internal control systems over the past decade arguing that a good internal control yields good business. Many organizations are required to report on the quality of internal control over financial reporting, compelling them to develop specific support for their certifications and assertions. The following five objectives help management in designing effective internal controls: maintaining reliable systems, ensuring timely preparation of reliable information, safeguarding assets, optimizing the use of resources, preventing and detecting error and fraud (Alvin, Brian, & Juliana, 2016).

The reliability of financial reporting is effective to internal control efficiency to ensure that transactions and bookkeeping are appropriate and properly authorized, valid, correctly recorded, complete, and on time. Moreover, it is very important that organizations have fairly summarized accounting information data disclosure Sebbowa (2014). However, in general, a quality reporting is affected by internal control mechanism. There is a general perception that institution and enforcement of proper internal control systems will always lead to improved financial performance. It is also a general belief that properly instituted systems of internal control improve the reporting process and also give rise to reliable reports which enhances the accountability function of management of an entity. According to Dixon, Nanni and Vollmann (2016), appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives.

Recently a number of financial scandals have been witnessed in quoted companies both in local and international scene. For example, in America, investors lost \$180 billion in World Com Scandal of 2002, \$150 million in Tyco Scandal of 2002, \$1.4 billion in Heath South Scandal of 2003 (the largest publicly traded company) and \$3.9 billion in America international Group (AIG) scandal of 2005, among several financial fraudulent activities affecting publicly quoted companies. In the early 2000s, a number of high-profile corporate accounting scandals resulted in some investors, company personnel and other stakeholders suffering significant losses. These scandals resulted in demands for a greater emphasis on corporate governance. In July 2002, the United States Congress(Kinyua, Gakure, & Gekara, 2016).

Kieu (2018) in his study on small business in Vietnam found out that efficiency in financial management practices such as accounting information system, financial reporting and analysis, working capital management, fixed asset management and financial planning and good performance in financial characteristics such as liquidity and business activity has a positive impact on performance of an organization. In addition, the study conducted by Chung & Chuang (2019), also reveals efficiency in capital structure management, working capital management, financial reporting and analysis; capital budgeting and accounting information system has a positive impact on profitability of business organizations.

In South Africa, cases of accounting scandals have been recorded in Randgold and Exploration companies. In Nigeria, the managing director and chief financial officer of Cadbury Nigeria were dismissed in 2006 for inflating the profits of the company for some years before the company's foreign partner acquired controlling interest. These scandals emphasize the need to evaluate, scrutinize, and formulate systems of checks and balances to guide corporate executives in decision-making. These executives are legally and morally obliged to produce honest, reliable, accurate and informative corporate financial reports periodically (Hayes, Dassen, Schilder, & Wallage, 2015).

In Kenya, Statistics available from CMA (2018) have shown that a high number of firms Especially quoted companies have registered declining financial performance in therecent years. Examples include Kenya Airways which reported a loss of KES 10 billion, Mumias Sugar Company Ksh3.4 billion loss, Uchumi Super Markets KES 226millionloss, Eveready East Africa limitedKES 248million loss, CMC Holding suspended fromNSE among others. Rezaee and Zabihollah (2018) revealed that financial reporting isineffective due to corruption, frauds, and ineffective regulations that have led to poorfinancial performance in publicly quoted companies. Further, there are three major classifications of internal controls; preventive, detective, and corrective (Singleton, 2016). Preventive controls predict potential problems before they occur, adjust, and prevent an error, omission or malicious act from occurring. The detective controls are used to detect and report the occurrence of an omission, an error or a malicious act. Finally, the corrective controls help in ensuring that the impact of a threat is minimized, identify the cause of a problem as well as the correct errors arising from the problem. Corrective controls correct problems discovered by detective controls and modify the processing system to minimize future occurrence of the problem.

2.0 STATEMENT OF THE PROBLEM

According to Karagiorgos, Drogalas, Gotzamanis, and Tampakodius (2017) efficient internal controls creates an organization's confidence in its ability to perform or undertake a particular task and prevents errors and losses through monitoring and enhancing organizational and financial reporting processes as well as ensuring compliance with pertinent laws and regulations. Organizations continue to experience low levels of revenue generation most of which are manmade and therefore avoidable. Despite the numerous rules and regulations, the varying levels in revenue generation occur across all entities in the government and private sectors. No matter how well it is designed and operated, an internal control system can only provide a reasonable, not absolute assurance that the objectives of the company's internal control system are met in terms of revenue generation.

However, related empirical literature such as Ndiwa (2014) and Ndifon (2014) found that organizational internal controls and financial performance is an understudied area, (Gerrit & Mohammed, 2016). Some of the challenges experienced concerning internal controls include; low liquidity ratios, untimely financial reporting, low accountability, frauds and mismanagement of funds. Mohammed, (2013) researched on the effect of the internal controls of Ethiopian Airlines in Nairobi, Muio (2016) studied the impact of internal control on the financial performance of private hospitals in Nairobi and established a significant relationship between internal control system and financial performance. Kakucha (2017) evaluated the level of effectiveness of internal controls operating in Nairobi and established that there are deficiencies in the systems of internal controls, with the degree of deficiencies varying from one enterprise to another. Simiyu (2016) found that middle institutions of learning in Kenya had a number of internal control challenges. They included liquidity problems, poor financial accountability, and untimely generations of financial reports, frauds, and misuse of cash received from sales. However, the study did not focus on the study variables of this study as well as none of them were conducted instar rated hotels at the Kenyan Coast. This study was motivated by the fact that there are many unaddressed areas about internal control in relation to financial performance of hotels and the fact that there are no earlier related empirical studies on internal control systems and financial performance of star rated hotels at the Kenyan Coast, Kenya.

3.0 OBJECTIVES OF THE STUDY

1. To examine the effect of control environment on financial performance of star ratedhotels at the Kenyan Coast.
2. To determine the effect of risk assessment on financial performance of star rated hotels at the Kenyan Coast.
3. To evaluate the effect of information system on financial performance of star ratedhotels at the Kenyan Coast.
4. To determine the effect of control activities on financial performance of star ratedhotels at the Kenyan Coast.

4.0 RESEARCH HYPOTHESES

This study was guided by null hypothesis as follows:

H₀₁: Control environment has no significant effect on performance of star ratedhotels at the Kenyan Coast.

H₀₂: Risk assessment has no significant effect on performance of star ratedhotels at the Kenyan Coast.

H₀₃: Information system has no significant effect on performance of star ratedhotels at the Kenyan Coast.

H₀₄: Control activities has no significant effect on performance of star ratedhotels at the Kenyan Coast.

5.0 LITERATURE REVIEW

5.1 Theoretical Literature

5.1.1 Agency Theory

The agency theory holds that a firm is made up of owners of the resource (principals) and the managements (agents) (Jensen & Meckling, 1976). The agents of the firm have more information than the principals which creates an information asymmetry which affects the ability of the firm's owners to monitor whether their interests are being protected by the agents (Jensen & Meckling, 1976).

In order to ensure harmonization of the interests of the principal and their agents the theory posits that a comprehensive contract is necessary to ensure that the interests of the principals are met. The relationship between the agent and principal is further strengthened by employing experts and systems such as audit and control environment (Jussi& Petri, 2014). Further, the theory recognizes that any incomplete information about the relationship, interests or work performance of the agent described could lead to selection problem. Adverse selection and moral hazard impact on the output of the agent in two ways; not possessing the requisite knowledge about what should be done and not doing exactly what the agent is appointed to do respectively. The agency theory, therefore, works on the assumption that principals and agents act rationally and use contracting to maximize their wealth (Jensen and Meckling, 1976). This theory was essential to the study since the internal control systems is one the mechanisms employed to ensure that no agency problem exists within the firm. The internal control system further helps to reduce information asymmetry within the firm.

5.1.2 Stewardship

Stewardship theory emanated from the research done by Schoorman and Donaldson (1997), who defined a steward as a person who ensures that the investor's wealth is well protected in order to maximize organizational profits. Donaldson and Davis (1991) stated that this theory focuses on

the ability of the management of the organization to align their goals with the institutional goals. They further stated that stewards' satisfaction and motivation is driven by the success of the organization. Donaldson and Davis (1991) argued that effective stewardship requires employee empowerment and provision of independence based on trust. This theory states that for maximum wealth creation, there should be maximum independence between employees or management and investors. Fama (1980) opposes that myth that advancement career development is necessary for managers to be good overseers while Shleifer, Andlei and Vishny (1997) claimed that the financial return given to the investors by the managers creates good reputation and it also encourages the investors to re-invest with them. In Agency theory, Meckling and Jensen (1994) stated that agency cost is usually lower when the investors form part of the management of the organization for monitoring purposes. However, stewardship theory is complete opposite of the agency theory since it does not advocate for investors monitoring of the organizational performance through internal audit. Nonetheless, Donaldson and Davis (1991) further noted that better financial returns are experienced when these theories are jointly exercised in an organization. Based on this theory, this study works on the view that managers of hotels of suppliers, shareholders, consumers, creditors and employees of these institutions.

5.1.3 Reliability Theory

Reliability theory simply describes the probability of a system completing its expected function during an interval of time (Gavrilov & Gavrilov, 2001). The theory has been used as a model by insurance and life insurance companies in computing profitable rates to charge their customers. The theory stipulates that internal control systems are primarily set up for assessment and control of risks. The theory further argues that weak internal control systems result in more substantive work and hence greater cost (Kinney, 2000).

According to Gavrilov and Gavrilova (2001), the determination of the "weakness" of any internal control system is primarily judgmental. Upon the formulation of the process and system reliability estimates, comparison with financial data from the organization's past performances may provide a more solid basis for judgment of the impact of an internal control system on the firm's income risk. Messier Jr. and Austen (2000) state that one of the primary advantages of the reliability theory is its close relationship to the needs of an organization regarding understanding the internal control system and control risk assessment. The reliability theory is based on the notion that an implemented system should be able to meet its expected function. The reliability theory is relevant to this study based on the second objective of the study. The theory focuses on the effect of risk assessment on financial performance of firms; in this case, the star rated hotels in the Kenyan Coast.

5.1.4 Attribution Theory

Attribution theory is a social psychology theory that explores how people interpret events and behaviors and how they ascribe causes to the events and behaviors. According to Schroth and Shah (2017), studies using attribution theory examine the use of information in the social environment to explain events and behaviors. Reffet (2016) asserts that when evaluators believe comparable persons would have acted differently in a given circumstance, they (evaluators) tend to attribute responsibility for an outcome to the person. According to Wilks and Zimbelman (2016), the first case refers to internal or dispositional attributions while the second one refers to external or situational attributions.

The auditor's accountability for detecting fraud is extended by Reffet (2016) study which predicted that auditors are more likely to be held accountable by evaluators when the auditors

fail to detect fraud after they had identified the fraud occurrence as a fraud risk. The result of Reffett’s study shows an increase in auditors’ liability when an audit fails after the auditors had identified the perpetrated fraud as a fraud risk and performed procedures to investigate the identified fraud risk.

Attribution theory thus advocates for auditors to report on the effectiveness of firms’ internal control. Auditors are therefore expected to gain a better understanding of the internal controls in place, assess the design and implementation of the internal controls, and test the operating effectiveness of the internal controls. This is deemed necessary for the auditors’ reliance and possibly scaling back of other substantive audit procedures for the required performance (Wilks & Zimbelman, 2016).

The attribution theory suggests that when fraud occurs, identified parties should be held accountable and auditors, being the “public watchdogs” are most likely to be held accountable if evaluators determine substandard audit services were provided (Reffett, 2016). In reference to the study the attribution theory places the burden of fraud reporting to the relevant individuals within the institutions. Despite growth in technology that has changed the internal control systems structure there will always be a need for a person to manage these systems. As such its upon such authority figures i.e. managers and the board of directors who should ensure that all the relevant regulatory and compliance issues are adhered with. In reference to our study this theory seeks auditors to be in the forefront of reporting fraud when it occurs.

6.0 Conceptual Framework

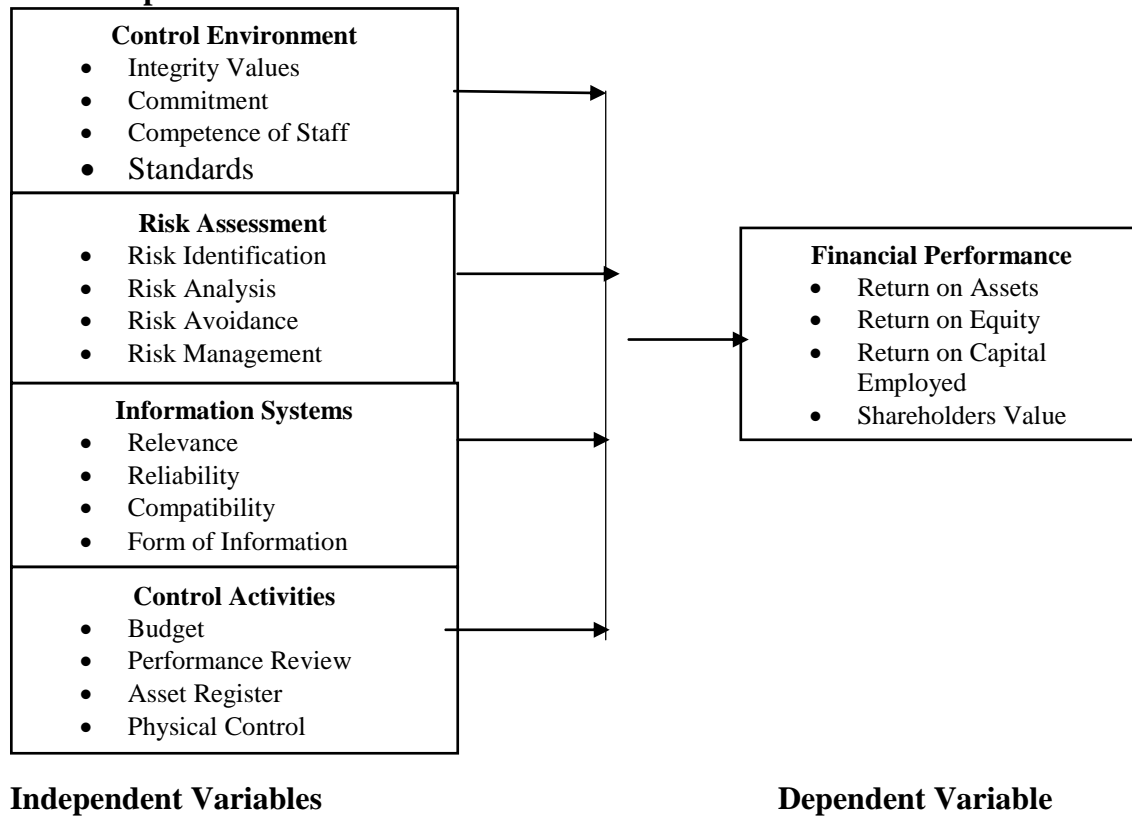


Figure 1 Conceptual Framework

6.1 Empirical Literature on Variables

6.1.1 Control Environment

According to COSO, the control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by the board of directors (Kinyua, *et al.*, 2016).

The control environment, as established by the organization's administration, sets the tone of an Institution and effects the control consciousness of its people. Management attitude should be committed to ethical business practices and to following the established control procedures. This is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include: Integrity and ethical values; the commitment to competence; leadership philosophy and operating style; and the way management assigns authority and responsibility, and organizes and develops its people (Whittington & Pany, 2016). Kakucha (2017) 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 Nairobi securities exchange. 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 consider the effects of the specific aspects of internal control such as the monitoring and evaluation and risk auditing and management within small businesses.

Njeri (2017) investigated the effect of internal controls on the financial performance of manufacturing firms in Kenya. The findings revealed that most manufacturing firms had a control environment as one of the functionalities of internal controls of the organization that greatly impacts on the financial performance of the firms. The results also revealed that the staffs were trained to implement the accounting and financial management systems, the security system identified and safeguarded organizational assets. The statistical result from the regression analysis shows that there is a positive relationship between internal control and financial performance of manufacturing firms in Kenya. The study recommends that both internal and external auditor should be constantly updated and well-grounded on international financial reporting standards (IFRS) and principles in order to enhance their knowledge and skills in application of accounting practices and to keep them updated on the contemporary issues.

6.1.2 Risk Assessment

Internal control should provide for an assessment of the risks the agency faces from both internal and external sources. Once risks have been identified, they should be analyzed for their possible effect. Management then has to formulate an approach for risk management and decide upon the internal control activities required to mitigate those risks and achieve the internal control objectives of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations. The objective of financial reporting and performance in the entity, the production of accurate, complete, relevant, timely and reliable financial information to demonstrate and maintain accountability, to meet statutory reporting requirements, to account for an organization's stakeholders for its financial performance. Cebenoyan and Strahan (2016) in their study found that banks which have advanced in risk management had greater credit availability. The greater credit availability leads to the opportunity to increase the productive assets and bank's profit.

Muio (2016) 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.

Ondieki (2015) conducted a study on effects of internal audit on financial performance of commercial banks. The independent variables for the study included; control environment, risk 27 assessments, 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.

6.1.3 Information Systems

A study carried out by Palfi and Muresan (2017) examined the importance of a well-organized system of internal control in regard to the banking sector, thus credit institutions of Romania. The analysis of the survey answers revealed that the continuous collaboration, based on periodical meetings, between all structures of bank, characterizes an effective internal audit department. The Abu Musa (2010) study investigated the existence and adequacy of implemented security controls of computerized accounting information systems in the Saudi banking sector. The results of study revealed that the vast majority of Saudi banks have adequate

security controls in place. The results also enable bank managers and practitioners to better secure their computerized accounting information systems and to champion the security of information technology for the success of their banks (Simiyu, 2011).

Olumbe (2015) 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.

6.1.4 Control Activities

Whittington and Pany (2016) asserts that control activities are another component of internal controls. These scholars note that control activities are policies and procedures that help ensure that management directives are carried out. Controls activities in an organization basically comprise; performance reviews (comparing actual performance with budgets, forecasts and prior period performance), information processing (necessary to check accuracy, completeness and authorization of transactions), physical controls (necessary to provide security over both records and other assets), and segregation of duties (where no one person should handle all aspects of a transaction from the beginning to the end).

Ewa and Udoayang (2016) 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. Controlee 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.

Mwakimasinde, Odhiambo and Byaruhanga (2014) analyzed the effect of internal control systems on the financial performance of sugarcane out grower companies in Kenya. The specific objective of the study was to determine the effect of internal control system components on the financial performance of the sugarcane out grower companies. Internal control system was characterized by control environment, risk assessment process, information system and control activities while financial performance was characterized by cost per unit, goal attainment and profitability or surplus. The regression results also show that internal control system helps increase financial performance of sugarcane out grower company's percent. Based on the findings and conclusions of the study, the following recommendations were made; Internal control system has been found to have a statistically positive effect on performance of sugarcane out grower companies hence there is need for the sugarcane out grower companies to improve on

their internal control system. Despite the fact that the study produced meaningful results it was subject to some limitations which provide avenues for further research.

Morteza, Parviz and Shima (2015) assessed the existence of the relation between internal control system and performance in financial perspective of Telecommunication Company of Golestan province in Iran. The study revealed a significant and positive relation between internal control system and performance in financial perspective of the Telecommunication Company of Golestan province. Thus, the study concluded that existence of system of internal control influence financial performance positively and an internal control system seems to be necessary for effective performance.

6.1.5 Financial Performance

Dixon, *et al.*, (2016) said that appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. Reid and Ashelby (2016) contends that performance is measured by either subjective or objective criteria, arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms.

In order to survive and succeed in a competitive market, firms must focus on maximizing profit or they will eventually be driven out of business (Dutta & Radner, 2017). Jovanovic (2017) supports this claim by saying that only efficient firms stay in the market, and that less productive firms will eventually exit many markets. Performance measures provide a mechanism for the organization to manage its financial and non-financial performance. Accountability is increased and enhanced, ensuring that projects support the organizational strategy and that better services and greater satisfaction are provided to a customer.

Whittington and Kurt (2017) found out that objective performance measures include indicators such as profit growth, revenue growth, return on capital employed. Financial consultants Stern Stewart and Co. created Market Value Added (MVA), a measure of the excess value a company has provided to its shareholders over the total amount of their investments (John & Morris, 2016). This ranking is based on some traditional aspects of financial performance including: total returns, sales growth, profit growth, net margin, and return on equity.

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 analyzed 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.

Magara (2017) 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.

7.0 RESEARCH METHODOLOGY

7.1 Research Design

The researcher used descriptive research design. Descriptive study is concerned with finding out who, what, where and how much of a phenomenon, which is the concern of the study. Sekaran, (2015) observes that the goal of descriptive research is to offer the researcher a profile or describe relevant aspects of the phenomena of interest from the individual, organization, industry or other perspective. In addition, the design best fit in the ascertainment and description of characteristics of variable in this research study and allows for use of questionnaires, interviews and descriptive statistics such as frequencies and percentages. In addition, a descriptive design is appropriate since it enables the researcher to collect enough information necessary for generalization.

7.2 Target Population

Target population is the entire spectrum of a system or process of interest. It is the universe of people to which the study can be generalized (Bryman & Bell, 2018). The study population was star-rated hotels in Kenya's coast ranging from 1 to 5star hotels (Uzel, Namusonge, & Obwogi, 2014). The selection of the star-rated hotels was justified by the fact that these hotels were assumed to have attained meaningful service levels (GoK, 2018). The hotels selected were deemed to have been operating in Kenyan Coast as at December 2018. The population of the study was highlighted in Table 1

Table 1 Target Population

Serial	Hotel Category	Number of Hotels	Percent
1	5 Star	23	13
2	4 Star	30	17
3	3 Star	59	33
4	2 Star	39	22
5	1 Star	29	15
TOTAL		180	100

7.3 Sample Size

Sample size determination is the act of choosing the number of observations or replicates to include in the statistical sample. Sample size is an important feature of any empirical study in which the goal is to make references about a population from a sample. The total sample size for

this study was obtained using the formulae developed by Yamane, (2017) at 95% confidence level and P = .5. Therefore, the sample size for the study was 124.

$$n = N / 1 + N (\alpha)^2$$

Where: n= the sample size,

N= the sample frame (population)

α= the margin of error (0.05%).

$$n = 180 / 1 + 180 (0.05)^2 = 124$$

Table 2 Sample Size

Serial	Hotel Category	Number of Hotels	Sample Size
1	5 Star	23	15
2	4 Star	30	23
3	3 Star	59	42
4	2 Star	39	26
5	1 Star	29	18
TOTAL		180	124

7.4 Data Analysis and Presentation

According to Zikmund, Babin, Carr and Griffin (2017), data analysis refers to the application of reasoning to understand the data that has been gathered with the aim of determining consistent patterns and summarizing the relevant details revealed in the investigation. The study expected to produce both quantitative and qualitative data. Therefore, both descriptive and inferential statistics was used to analyses the data. Qualitative as well as quantitative methods of data analysis was used to analyses the research variables. A Likert scale was adopted to provide a measure for qualitative data. The scale helped to minimize the subjectivity and make it possible to use quantitative analysis. The numbers in the scale was ordered such that they indicated the presence or absence of the characteristic to be measured(Kothari, & Garg, 2018). This mix of tools is necessary because whereas some aspects of the study was qualitative others were of quantitative nature. Analysis of variance (ANOVA) was used to test the significance of the model. R² was used in this research to measure the extent of goodness of fit of the regression model. The multiple linear to be used to estimate the coefficient is as follows:

$$Y = \alpha + \beta_1x_1 + \beta_2x_2 + \beta_3x_3 + \beta_4x_4 + e$$

Where: -

$$Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$$

Y = Represents the dependent variable, effect of internal control system on financial performance of star rated hotels at the Kenyan Coast

α= Constant

β₁, β₂, β₃, β₄ = Partial regression coefficient

X₁ = Control Environment

X₂ = Risk Assessment

X₃ = Information System

X₄ = Control Activities

ε = error term or stochastic term

8.0 Data Analysis Results

8.1 Descriptive Analysis

In the research analysis the researcher used a tool rating scale of 5 to 1; where 5 were the highest and 1 the lowest. Opinions given by the respondents were rated as follows, 5= Strongly Agree,

4= Agree, 3= Neutral, 2= Disagree and 1= Strongly Disagree. The analyses for mean, standard deviation was based on this rating scale.

8.1.1 Control Environment

**Table 3 Control Environment
Descriptive Statistics**

	N	Mean	Std. Deviation
The hotel has appropriate entity policies regarding such matters as acceptable business practices, conflicts of interest, and codes of conduct have been established and they adequately communicated.	100	3.71	1.465
Management dealings with employees, suppliers, citizens, bondholders, shareholders, and auditors are based on honesty and fairness.	100	3.63	1.338
Management determines the level of knowledge and skills needed to perform a particular job and this information is used in the hiring process.	100	3.88	1.458
All personnel, including key managers, possess adequate knowledge and experience to discharge their responsibilities.	100	3.50	1.655
Turnover of key personnel is relatively low	100	3.15	1.591
Valid N (listwise)	100		

The first goal of the study was to determine the effect of control environment on financial performance of hotels at the Kenyan Coast. The statement that the hotel has appropriate entity policies regarding such matters as acceptable business practices, conflicts of interest, and codes of conduct have been established and they adequately communicated had a mean score of 3.71 and a standard deviation of 1.465. The statement that Management dealings with employees, suppliers, citizens, bondholders, shareholders, and auditors are based on honesty and fairness had a mean score of 3.63 and a standard deviation of 1.338. The statement that Management determines the level of knowledge and skills needed to perform a particular job and this information is used in the hiring process had a mean score of 3.88 and a standard deviation of 1.458. The statement that All personnel, including key managers, possess adequate knowledge and experience to discharge their responsibilities had a mean score of 3.50 and a standard deviation of 1.655. The statement that turnover of key personnel is relatively low had a mean score of 3.15 and standard deviation of 1.591. These results agree with Njeri (2017) that The findings revealed that most manufacturing firms had a control environment as one of the functionalities of internal controls of the organization that greatly impacts on the financial performance of the firms. The results also revealed that the staffs were trained to implement the accounting and financial management systems, the security system identified and safeguarded organizational assets.

8.1.2 Risk Assessment

**Table 4 Risk Assessment
Descriptive Statistics**

	N	Mean	Std. Deviation
The hotel has a well-documented policy on risk management	100	3.76	1.512
The hotel regularly updates the risk register.	100	3.17	1.531
The hotel management encourage reporting of events in order to identify the risks.	100	3.14	1.831
There is adequate capacity to perform risk assessment in my hotel.	100	3.48	1.176
Risks identified are reviewed and decisions taken on the same by a Risk Management committee.	100	3.78	.927
Valid N (listwise)	100		

The second goal of the study was to establish the effect of risk assessment on financial performance of hotels at the Kenyan Coast. The statement that the hotel has a well-documented policy on risk management had a mean score of 3.76 and a standard deviation of 1.512. The statement that hotels updates its risk register had a mean score of 3.17 and a standard deviation of 1.531. The statement that the hotel management encourage reporting of events in order to identify the risks had a mean score of 3.14 and a standard deviation of 1.831. The statement that there is adequate capacity to perform risk assessment in my hotel had a mean score of 3.48 and a standard deviation of 1.176. The statement that Risks identified are reviewed and decisions taken on the same by a Risk Management committee had a mean score of 3.78 and the standard deviation of 0.927. These results are consistent with Muio (2016) 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.

8.1.3 Information System

**Table 5 Information System
Descriptive Statistics**

	N	Mean	Std. Deviation
The audit department provides management with assurance that there are no major weaknesses and/or major internal control weakness are reported.	100	3.85	1.381
The internal audit department reports functionally to the audit committee of the Board.	100	3.55	1.250
The internal audit department conducts its work independent of the management.	100	4.33	1.295

The head of the Internal audit function is a member of the senior management team in the company and reports to the CEO	100	3.81	1.454
Valid N (listwise)	100		

The third objective was to investigate the effect of information system on financial performance of hotels at the Kenyan Coast. The statement that the audit department provides management with assurance that there are no major weaknesses and/or major internal control weaknesses are reported had a mean score of 3.85 and a standard deviation of 1.381. The statement that the internal audit department reports functionally to the audit committee of the Board had a mean score of 3.55 and a standard deviation of 1.250. The statement that the internal audit department conducts its work independent of the management had a mean score of 4.33 and a standard deviation of 1.295. The statement that the head of the Internal audit function is a member of the senior management team in the company and reports to the CEO had a mean score of 3.81 and a standard deviation of 1.454. These results are in agreement with Olumbe (2015) most of the corporations 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.

8.1.4 Control Activities

**Table 6 Control Activities
Descriptive Statistics**

	N	Mean	Std. Deviation
The hotel has developed effective policies and procedures on information and communication.	100	3.38	1.462
The hotel policies on information and communications provide well established techniques and mechanisms to address non-compliance in financial matters.	100	3.66	1.423
The hotel has clear segregation of duties for the various financial functions	100	3.93	1.273
Whistle blowing in the hotel has been and continues to be an effective way to obtain critical and sensitive information necessary for curbing cases of fraudulent activities	100	3.54	1.585
The company utilizes "suggestion boxes" for obtaining information that is sensitive and confidential for the effective management of the organization.	100	3.81	1.245
Valid N (listwise)	100		

The fourth objective was to examine the effect of control activities on financial performance of hotels at the Kenya Coast. The statement that the hotel has developed effective policies and procedures on information and communication had a mean score of 3.38 and a standard deviation of 1.462. The statement that the hotel policies on information and communications

provide well established techniques and mechanisms to address non-compliance in financial matters had a mean score of 3.66 and a standard deviation of 1.423. The statement that the hotel has clear segregation of duties for the various financial functions had a mean score of 3.93 and a standard deviation of 1.273. The statement that whistle blowing in the hotel has been and continues to be an effective way to obtain critical and sensitive information necessary for curbing cases of fraudulent activities had a mean score of 3.54 and a standard deviation of 1.585. The statement that the company utilizes “suggestion boxes” for obtaining information that is sensitive and confidential for the effective management of the organization had a mean score of 3.81 and a standard deviation of 1.254. These results agree with Mwakimasinde, *et al.*, (2014) that internal control system was characterized by control environment, risk assessment process, information system and control activities while financial performance was characterized by cost per unit, goal attainment and profitability or surplus. The regression results also show that internal control system helps increase financial performance of sugarcane out grower company’s percent. Based on the findings and conclusions of the study, the following recommendations were made; Internal control system has been found to have a statistically positive effect on performance of sugarcane out grower companies hence there is need for the sugarcane out grower companies to improve on their internal control system.

8.1.5 Financial Performance

Table 7 Financial Performance
Descriptive Statistics

	N	Mean	Std. Deviation
Profitability in company over the last 7 years has been increasing steadily.	100	4.11	1.428
Return on investment in company over the last 7 years has been growing steadily	100	4.12	1.225
Liquidity in company over the last 7 years has been increasing steadily	100	3.80	1.333
Earnings per share in my company over the last 7 years has been increasing steadily	100	4.08	1.308
Diversified Investments in my company have steadily increased over the last 7 years due to good performance	100	4.16	1.502
Valid N (listwise)	100		

The statement that profitability in company over the last 7 years has been increasing steadily had a mean score of 4.11 and a standard deviation of 1.428. The statement that return on investment in company over the last 7 years has been growing steadily had a mean score of 4.12 and a standard deviation of 1.225. The statement that liquidity in company over the last 7 years has been increasing steadily had a mean score of 3.80 and a standard deviation of 1.333. The statement that Earnings per share in my company over the last 7 years has been increasing steadily had a mean score of 4.08 and a standard deviation of 1.308. The statement that diversified Investments in my company have steadily increased over the last 7 years due to good performance had a mean score of 4.16 and a standard deviation of 1.502.

8.2 Correlation Analysis

To establish the relationship between the independent variables and the dependent variable the study conducted correlation analysis which involved coefficient of correlation and coefficient of determination.

8.2.1 Coefficient of Correlation

Pearson Bivariate correlation coefficient was used to compute the correlation between the dependent variable (Financial Performance) and the independent variables (Control Environment, Risk Assessment, Information Systems and Control Activities). According to Sekaran, (2015), this relationship is assumed to be linear and the correlation coefficient ranges from -1.0 (perfect negative correlation) to +1.0 (perfect positive relationship). The correlation coefficient was calculated to determine the strength of the relationship between dependent and independent variables (Kothari & Gang, 2014).

Table 8 Pearson Correlation

Correlations					
	Financial Performance	Control Environment	Risk Assessment	Information System	Control Activities
Financial Performance	1				
Control Environment	.288**	1			
Risk Assessment	.491**	.166	1		
Information System	.418**	.126	.492**	1	
Control Activities	.688**	.340**	.662**	.662**	1
	100	100	100	100	100

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

In trying to show the relationship between the study variables and their findings, the study used the Karl Pearson's coefficient of correlation. This is as shown in Table 8 above. According to the findings, it was clear that there was a positive correlation between the independent variables, control environment, risk assessment, information systems and control activities and the dependent variable financial performance. The analysis indicates the coefficient of correlation, r equal to 0.288, 0.491, 0.418 and 0.688 for control environment, risk assessment, information systems and control activities respectively. This indicates positive relationship between the independent variable namely control environment, risk assessment, information systems and control activities and the dependent variable financial performance with control activities having the highest contribution.

8.2.2 Coefficient of Determination (R^2)

To assess the research model, a confirmatory factors analysis was conducted. The four factors were then subjected to linear regression analysis in order to measure the success of the model and predict causal relationship between independent variables (Control Environment, Risk Assessment, Information System, Control Activities), and the dependent variable (Financial Performance).

**Table 9 Coefficient of Determination (R^2)
Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.787 ^a	.619	.600	2.12905

a. Predictors: (Constant), Control Activities, Control Environment, Risk Assessment, Information System

The model explains 61.9% of the variance (R Square = 0.619) on Financial Performance. Clearly, there are factors other than the four proposed in this model which can be used to predict financial sustainability. However, this is still a good model as Bryman and Bell, (2018) pointed out that as much as lower value R square 0.10-0.20 is acceptable in social science research. This means that 61.9% of the relationship is explained by the identified four factors namely control environment, risk assessment, information systems and control activities. The rest 38.1% is explained by other factors in the financial performance in hotels at the Kenyan Coast, Kenya not studied in this research. In summary the four factors studied namely, control environment, risk assessment, information systems and control activities or determines 61.9% of the relationship while the rest 38.1% is explained or determined by other factors.

8.3 Regression Results

8.3.1 Analysis of Variance (ANOVA)

The study used ANOVA to establish the significance of the regression model. In testing the significance level, the statistical significance was considered significant if the p-value was less or equal to 0.05. The significance of the regression model was as per Table 10 below with P-value of 0.00 which is less than 0.05. This indicates that the regression model is statistically significant in predicting factors of financial performance. Basing the confidence level at 95% the analysis indicates high reliability of the results obtained. The overall Anova results indicates that the model was significant at $F = 38.666$, $p = 0.000$

Table 10 ANOVA
ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	701.089	4	175.272	38.666	.000 ^b
	Residual	430.621	95	4.533		
	Total	1131.710	99			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Control Activities, Control Environment, Risk Assessment, Information System

8.3.2 Coefficients

The researcher conducted a multiple regression analysis as shown in Table 11 to determine the relationship between financial performance in star rated hotels at the Kenyan Coast Kenya and the four variables investigated in this study.

Table 11 Coefficients
Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	29.978	2.479		12.091	.000
	Control Environment	.363	.085	.059	4.271	.000
	Risk Assessment	.382	.108	.075	3.537	.001
	Information System	.600	.156	.064	3.846	.003
	Control Activities	.476	.088	.661	5.409	.000

a. Dependent Variable: Financial Performance

The regression equation was:

$$Y = 29.978 + 0.363 X_1 + 0.382 X_2 + 0.600X_3 + 0.476X_4$$

Where;

Y = the dependent variable (Financial Performance)

X₁ = Control Environment

X₂ = Risk Assessment

X₃ = Information System

X₄ = Control Activities

The regression equation above established that taking all factors into account (Financial Performance of hotels at the Kenyan Coast) constant at zero Financial performance in star rated hotels at the Kenyan Coast, Kenya will be 29.978. The findings presented also showed that taking all other independent variables at zero, a unit increase in control environment would lead to a 0.363 increase in the scores of financial performance in star rated hotels at the Kenyan Coast; a unit increase in risk assessment would lead to a negative 0.382 increase in the financial performance in star rated hotels at the Kenyan Coast; a unit increase in information system would lead to a 0.600 increase the scores offinancial performance in star rated hotels at the Kenyan Coast and a unit increase in control activities would lead to negative 0.476 increase the scores of financial performance in star rated hotels at the Kenyan Coast.

9.0 CONCLUSION AND RECOMMENDATIONS

9.1 Conclusions

9.1.1 Conclusion

The study concluded as follows:

9.1.1 Control Environment

Since there was a strong positive correlation between the independent variable control environment and the dependent variable financial performance in star rated hotels at the Kenyan Coast. From the study findings on coefficients, t- values of 4.271 and p-values of 0.000, this result rejected the null hypothesis that control environment has no significant effect on financial performance of star rated hotels at the Kenyan Coast. Therefore, the study concludes that control environment has a significant effect on financial performance of star rated hotels at the Kenyan Coast.

9.1.2 Risk Assessment

Since there was a strong positive correlation between the independent variable risk assessment and the dependent variable financial performance in star rated hotels at the Kenyan Coast. From the study findings on coefficients, t- values of 3.537 and p-values of 0.001, this result rejected the null hypothesis that risk assessment has no significant effect on financial performance of star rated hotels at the Kenyan Coast. Therefore, the study concludes that risk assessment has a significant effect on financial performance of star rated hotels at the Kenyan Coast.

9.1.3 Information Systems

Since there was a strong positive correlation between the independent variable information system and the dependent variable financial performance in star rated hotels at the Kenyan Coast. From the study findings on coefficients, t- values of 3.846 and p-values of 0.003, this result rejected the null hypothesis that information system has no significant effect on financial performance of star rated hotels at the Kenyan Coast. Therefore, the study concludes that information systems has a significant effect on financial performance of star rated hotels at the Kenyan Coast.

9.1.4 Control Activities

Since there was a strong positive correlation between the independent variable control activities and the dependent variable financial performance in star rated hotels at the Kenyan Coast. From the study findings on coefficients, t- values of 5.409 and p-values of 0.000, this result rejected the null hypothesis that control environment has no significant effect on financial performance of star rated hotels at the Kenyan Coast. Therefore, the study concludes that control environment has a significant effect on financial performance of star rated hotels at the Kenyan Coast.

9.2 Recommendations

From the study findings the following are the recommendations:

1. That hotels control environment should be enhanced,
2. The managers should embrace enterprise risk management and good corporate governance to maximize on the financial benefits of internal control systems
3. The management should also ensure that their organizations have strong internal control environment where internal control activities inform of policies and procedures are adequate.
4. The control environment and control activities should on a regular basis be evaluated by internal audit department to provide management with the assurance on the adequacy and effectiveness of mitigation controls that management has put in place.

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