

The Effect of Internal Controls on the Financial Performance of Non-Governmental Organizations in Rwanda - A Case Study of Africa Indoor Residual Spraying Project

Sibomana, J.P¹, Mulyungi, M. P²

^{1,2}Jomo Kenyatta University of Agriculture and Technology

Abstract: Reports by the Rwanda Governance Board (RGB) indicate that 53.3% of the NGOs have failed to be sustainable due to fraud, embezzlement and failure to account for the funds from funding countries or organizations overseas. The purpose of this study was to investigate the effect of internal controls on the financial performance of NGOs in Rwanda with reference to Africa Indoor Residual Spraying Project. A combination of both descriptive and correlative research design using a question to collect data was conducted on sixteen (16) employees of the Africa Indoor Residual Spraying Project. The data was processed and analyzed using SPSS for both descriptive and inferential statistics. Findings revealed that there was huge outcome of financial audit processes on the financial performance of AIRSP, this was supported by 76.9% of the respondents who strongly agreed on the objectivity of financial audit carried out by the project auditors. Secondly, the highly strongly agreed was about whether auditors at AIRSRP carry out reviews of individual systems which was at 92.3% and this revealed the positivity on this fact since each system is reviewed individually. Also, 84.6% of the study participants strongly agreed that better performance of the project depended on of internal controls processes. Further the coefficient for adjusted R squared was 0.787 implying that 78.7% of the variations in financial performance amongst the NGOs could be explained by internal controls. Moreover, the p-value for the ANOVA was 0.002 which is less than alpha of 0.05 (5%). Confirming that the internal control systems were significantly associated with financial performance. The study thus concluded that internal controls play a key role in the improvement and management of finances within amongst the NGOs in Rwanda. NGOs are thus advised to develop and adopt appropriate financial control structures for enhanced financial performance. Regular auditing and monitoring of the internal control systems by professionals to ensure consistency and accuracy is also recommended.

1. Background of the Study

World over, it is acknowledged that internal controls undoubtedly provide unparalleled administrations to management in the behavior of their duties and responsibilities. There has been advance in achieving accord on what audit standards, Non-Governmental Organizations (NGOs), governments and government offices ought to apply and to manage inspecting in the general population area. However, as of late, a mix of various forces has prompted a peaceful transformation of the process. Organizations need to exhibit responsibility in the utilization of funds to the beneficiaries and productivity in service delivery, funding, supervision and reporting (D'Aveni, 2014).

In the United States of America, one-third of management of the established Non-Governmental Organizations (NGOs) use internal controls to ensure effective financial performance and makes it available to many employees from the major departments to make the transactions and this makes it easy for auditors. While there are differences in the sophistication and functionality of the applications offered by the NGOs, beneficiaries are typically able to check their status, set up personalized alerts, send payments to another account using a mobile number, and locate the nearest NGO branches. Technological advancement makes it possible to track and analyze working environment with continually increasing speed thus making it essential for organizations to be well advised by the internal audit related department (McKenzi, 2016).

Internal controls carried out in the most European countries are intended to deliver functional yet not complete authorization to an organization administration and panel of administrators that the firm has well-arranged plans to be completed. To note is that the likelihood of achievement is successfully prejudiced by restrictions fundamental in all backgrounds of interior rheostat rehearses. NGOs in the UK advance some measures including internal controls to guarantee that their objectives and purposes are accomplished successfully and that do support themselves complete implementation and categorized purposes, circumvent damage of possessions, authorize formation of trustworthy information and agreement strong consistence along the regulations and instructions. In Germany, it is viewed as if internal control practices involve the entire system of frameworks built up in an organization to give sensible confirmation that hierarchical targets will be accomplished (Joseph et al, 2015).

Non-governmental organizations in most Asian countries put it that internal control roles are one of the greatest stranded strategies to curtain and progress association performance. Internal auditing practices are a crucial part of an organization performance in both Government and Non-governmental institutions. Internal control which is defines as the events or measures originated by an organization association such that to guarantee accomplishment of the element's marks, objectives and procedures. Many countries all over the world which may be affected economically, low productivity and high rate of dependency tend not to give much attention to internal audit which later lead to corruption injustices (Muga, 2012).

In South Africa, the impacts and execution of greatest of the time regarding effect of internal controls on NGO's efficiency and effectiveness have been clearly measured or the results reported. In addition, this is contributed by regulatory bodies providing enough guidance on how these evaluations should be performed internally. It is suggested that this process should be customized for individual companies and that it cannot be a case of one size fits all. It confirmed are making it a state of obligation to prepare, instruct, and sharpen their workers on the most proficient method to utilize these internal control frameworks since its adequacy relies on upon the competency and constancy of the general population utilizing it. All these internal control activities guarantee that any dangers that may influence the organization's capacity to accomplish its objectives are fittingly continued a premeditated detachment from and should to happen at all levels and in all elements of the association (Graham, 2015).

In Uganda, NGOs currently are all for their unbelievable capability and sophisticated approach from internal controls, and infrequent possessions out to be all sent the more proficiently to decrease and standardize hazards. Machine-driven development seriously does make it imaginable to pathway and scrutinize evidence with unswervingly well hiking speed hence making it fundamental for an institution to become super much encouraged by the interior audit section. Internal control is different from starting with one suggestion then onto the subsequent, and progressing out enhancement in contemporary setting can be a substantial responsibility. These internal audit assistances may come from former colonial monopole to strengthen bilateral ties between the former colonies and their colonial powers (Barahona and Elizondo, 2012).

Over the last decade, the Government of Rwanda has undertaken a number of reforms for better financial internal controls of organizations including effective business registration, public finance management and procurement reforms which have initiated changes to the law and regulations; it has also successfully developed financial management information system (FMIS) and has installed country wide fiber optic backbone both of these are huge developments and critical to the success of its vision. Rwandan government pushes hard so as internal controls and audits are in place across all the organizations to ensure safe custody of their assets; to avoid misuse or misappropriation of the assets and to detect and safeguard against probable frauds (MINECOFIN, 2014).

It's for this reason the researcher was interested in carrying out a study to analyse the effect of internal controls on the financial performance of Non-Governmental Organizations in Rwanda.

2. Statement of the Problem

It is worth noting that internal control of any organization be it government or non-governmental is reasonably important in enhancing performance, success and sustainability of projects that that particular organization runs. Most development projects fail at the sustainability level because of failure to have all-time internal controls by the

management and the audit departments in the entire process of project management right from the design up to evaluation of the project (Graham, 2015). In a study by Rwanda Governance Board (RGB) (2016), discovered that 53.3% of the NGOs have failed to be sustainable due to fraud, embezzlement and failure to account for the funds from funding countries or organizations overseas.

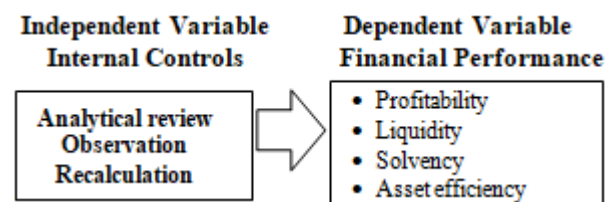
This research was therefore intended to demonstrate the effect of internal controls on the financial performance of NGOs in Rwanda with reference to Africa Indoor Residual Spraying Rwanda Project.

3. Conceptual Framework

According to McKenzi (2016), a conceptual framework is an analytical tool with several variations and contexts. It is used to make conceptual distinctions and organize ideas. Likewise, conceptual frameworks are abstract representations, connected to the research project's goal that guides the research data assortment and investigation.

Conceptual framework is a theoretical structure of assumptions, principles and rules that hold together the ideas comprising abroad concept. It breaks down the research variables into sub-variables of financial audit as an independent variable and performance as a dependent variable.

Thus, the below framework breaks down the variables of internal controls and financial performance into their respective sub variables. The independent sub variables include analytical review, observation and recalculation while dependent sub variables include: profitability, liquidity, solvency and asset efficiency.



Internal controls are intended to guarantee that suitable controls over systems and software are in place to ensure better performance and ensure that internal checks are functioning as designed. Controls can have features constructed into them to ensure that fraudulent truncations are identified or made challenging, if not intolerable, to perform. Internal controls provide reassurance that financial audits are operational, but they do not unavoidably distinguish fraud or exploitation. Internal controls intentions narrate to organization's plans, approaches, and measures used to meet the administration's undertaking, objectives, and purposes. Internal control contains planning, establishing, leading, and regulatory program operations and the systems put in place to degree, story, and display sequencer presentation (Garry et al, 2012).

Phannindra et al (2015) put it that the adoption of internal controls by NGOs has positively influenced their financial performance in terms of profitability and liquidity; and non-

financial performance such as project sustainability, strategy effectiveness, efficiency, accountability, readiness to audit, manager's perceptions and external factors by partners. The study suggested that the most important factors influencing the achievement of maximum benefits of internal controls were readiness and recalculation. According to Berger and Gregory (2009) management should ensure that procedures are implemented by making supervisor accountable for financial performance in their areas and by providing them with help, guidance and training they may need to carry out their responsibilities effectively. Due to the importance of effective fraud detection, any measures that can enhance the efficacy of auditors should be of value. While experience and ability are undeniably important in the detection process, certain individual characteristics may be predictive of the capacity to detect fraud.

Internal controls are such important at all levels of NGO development. In developing countries, it has been recognized as the need to retain their already scarce resources as an integral part of international efforts to combat illicit financial flows, and especially offshore tax evasion. The different ways through which domestic revenues contribute to reduction in Foreign aid reliance. Audit is central to achieving these interrelated objectives. Internal controls provide NGOs with the funds that are recovered and needed to invest in development and in the longer term, offers an antidote to aid dependence in the poorest countries and a predictable fiscal environment to promote growth. It helps the capacity to achieve sustainable growth in infrastructure, combat corruption, and attract foreign direct investments (FDI) and develop transparent financial systems (McKenzi, 2016).

Wolfgang (2014), in their effort to provide evidence on the effectiveness of particular audit techniques in detecting poor internal controls that affect the financial performance suggested that all intentional errors are concentrated in relatively few audits and these are fairly predictable by an NGO. The great majority of such errors affect income but the direction of effect may either be an understatement or over statement. Regarding the signaling of an error, they found that the large portion of human errors are initially signaled by less rigorous audit procedures such as analytical review and discussions with the client. Beneficiary personnel problems such as inexperience, incompetence and insufficient knowledge and inadequate control follow up or reviews were found instrumental in causing the errors.

Mukhopadhyay (2013) asserted that successful implementation of internal controls helped to establish self-evaluation systems and feedback mechanisms within the organization. Findings associated internal controls with improved financial performance in most NGOs. According to Jude et al, (2010) well established internal controls incredibly facilitate the increase of trust degree mostly from all stakeholders which in turn enhances transparency and accountancy especially in the entire organization. The research further revealed that internal controls are associated with improved efficiency and enhanced NGO's operations. Other asserted findings showed that internal controls include: increased profitability, solvency and transparency satisfaction.

4. Methodology

The researcher adopted both descriptive and correlative research designs. Descriptive research was adopted in order to provide information on characteristics of the selected study population whereas correlative research was adopted such that it could be used to investigate and analyse the data quantity collected on each variable and thereby determining the relationship between the study variables. In line with this, Statistical Package for Social Sciences (SPSS) SPSS was used to carry out regression analysis helped to determine Analysis of Variance (ANOVA) and Coefficients among the study variables.

The population of interest constituted employees working at AIRS Rwanda Project which operates from within the Rwandan community. Basing on this limelight, the research population included sixteen (16) employees of AIRS Rwanda Project working in finance and operations departments, in addition to management team. Since the population was less enough, the researcher therefore used universal sampling technique to cover entire target population altogether. Hence, with the help of questionnaire and guided interview, primary data was collected from 16 respondents.

5. Results and Findings

Table 1 presents study findings in regards to the model summary. As showed in the table, it was discovered that 78.8% changes in financial performance could be accredited on internal controls an organization puts in place. Thus, a strong positive effect between the study variables marked by $R=.816_a$ as asserted in the model summary table which was named table 1.

Model Summary

In the model summary table, it was indicated that an adjusted R squared is coefficient that administrates the inconsistency in the reliant variables due to the variations in the independent variable. As showed in table 1, the value of adjusted R squared was 0.787 which is actually a sign that there was variation of 78.7% on financial performance to changes in analytical review, observation and recalculation. Besides the above findings, while having an interview with the Chief of Party of AIRS Rwanda Project, it was learnt that sometimes some of the directors of this NGO tend to abandon a number of the advice, suggestions and recommendations that are always provided by internal auditors or other junior staff from internal audit department.

Table 1: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.816 _a	.788	.6809	.13154
a. Predictor: (Constant), Analytical review, Observation and Recalculation				

Analysis of Variance (ANOVA)

Findings presented in table 2 are about ANOVA test and they indicated that a p-value was 0.002 which is less than alpha (5%), significance level. This exhibits that the data which were collected fit well with the multiple regression

models hence an indication that internal controls have a positive effect on the financial performance of AIRS Rwanda Project. In addition, this manifests that the model adopted by the researcher was statistically significant.

Table 2: Analysis of Variance (ANOVA)

Model	Sum of Squares	Df	Mean Square	F	Sig.	
1	Regression	.991	5	.248	7.132	.002 ^b
	Residual	.369	18	.023		
	Total	1.360	23			
a. Dependent Variable: Financial Performance						
b. Predictors: (Constant), Analytical review, Observation and Recalculation						

Coefficients

Findings obtained and presented in table 3 were established as a regression equation as showed below:

$$Y = \beta_0 + \beta_1 X_1 + e$$

$$Y = 1.252 + 0.737 (\text{internal controls}).$$

Grounded on regression analysis equation presented above, it was discovered that by having internal controls to a constant zero, financial performance would have a value of 0.737. These study results in other words meant that an increase of a single unit in internal controls would lead to an increase of 73.7% of financial performance at AIRS Rwanda Project.

In addition to these findings, since earlier results of ANOVA also found out that the p-value was less than alpha (0.05) and this is an endorsement that all the variables were statistically significant in positively affecting the financial performance in AIRS Rwanda Project.

Table 3: Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	
	B	Std. Error	Beta			
1	(Constant)	1.252	.292		.292	.774
	Internal Controls	.737	.312	.203	1.345	.142
a. Dependent Variable: Financial Performance						

6. Discussion of Findings

This study's principal objective was intended to scrutinize the effect of internal controls on the financial performance of NGOs that operate in Rwandan community with reference to AIRS Rwanda Project. Based on the findings reached after the primary and secondary data, the study objective was achieved as indicated in previous section.

This study's findings are in line with findings of a study carried out in Jordan, Asia by Phannindra et al (2015). Their study found out that the adoption of internal controls by NGOs has positively influenced their financial performance in terms of profitability and liquidity; and non-financial performance such as project sustainability, strategy effectiveness, efficiency, accountability, readiness to audit, manager's perceptions and external factors by partners. The study suggested that the most important factors influencing the achievement of maximum benefits of internal controls were readiness and recalculation.

More so, the study's results were supported by a research conducted by Mukhopadhyay (2013) who discovered that successful implementation of internal controls helped to establish self-evaluation systems and feedback mechanisms within the organization. Findings associated internal controls with improved financial performance in most NGOs. Findings of a study conducted by Jude et al, (2010) on internal controls also revealed that internal controls facilitate the increase of trust degree mostly from all stakeholders which in turn enhances transparency and accountability especially in the entire organization. The research further revealed that internal controls are associated with improved efficiency and enhanced NGO's operations. Other asserted findings showed that internal controls include: increased profitability, solvency and transparency satisfaction.

7. Conclusion and Recommendation

The study concluded citing better financial performance at AIRS Rwanda Project which is majorly affected by competent staff that undertakes internal controls. They perfectly carry out analytical reviews, observations and recalculations. However, it was discovered that to some extent internal auditors lack independence and freedom since some of their recommendations are sometimes neglected by some top managers.

Finally, strong and positive effect of internal controls on the financial performance of AIRS Rwanda Project was revealed after the regression investigation. This was demonstrated by a p-value worth 0.002 which is less than the alpha of 0.05 thereby explaining that the study's variables are so much associated. Besides, it was revealed that there was variation of 78.8% on financial performance of AIRS Rwanda Project because of the changes in internal controls.

In response to lack of independence and freedom of the internal auditors, the researcher suggested that the Chief of Party ought to put in place stringent measures against the directors who sometimes neglect the advice from internal audit department.

The administration of the AIRS Rwanda project was suggested to continue considering conferences and workspaces in which auditors can be trained frequently and be given refresher courses about the subject of the study. Regarding safety measures, the top management should be look into the fact of using internal audit components to watch over safety measures and risk management.

On public awareness, some stakeholders such as the beneficiaries together with other responsible stakeholders in the government are recommended to sensitize the general public reporting issues to do with fraud. This will enable the NGOs to increase the transparency thereby ensuring better financial performance.

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