

**EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL
PERFORMANCE OF SEVENTH DAY ADVENTIST CHURCH,
KENYA**

BY

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**A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT
OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF
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DECLARATION

I declare that this research project report has not been presented anywhere for any award and that all sources of information have been acknowledged by means of references.

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MBA/BE/6001/2015

APPROVAL

This research project report has been presented for examination with my approval as the university supervisor.

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I wish to sincerely acknowledge the assistance I have got from colleagues and school of business staff more especially my supervisor, Dr. Mule. His encouragement, mentorship and support inspired me to complete this project on time.

DEDICATION

This project report is dedicated to my parents and my immediate family members.

ABSTRACT

Internal controls help prevent errors and irregularities from occurring. If errors or irregularities do occur, internal controls will help ensure they are detected in a timely manner. However, there are financial challenges in Seventh Day Adventist churches (SDA) evidenced by financial statements, there is poor budgetary controls, low liquidity and working capital levels. They are therefore faced with many financial challenges hindering their mission, vision and growth. Empirical evidence shows that, good internal controls may influence the financial performance of organizations. While past studies indicate contradicting evidence on the influence of internal controls on financial performance, studies on the link between review of control environment, review of existence of assets, conduct of annual audit to financial performance in the seventh Day Adventist church is missing. Therefore, the general objective of this study is to determine effect of internal control systems on financial performance of SDA churches in Kenya. Specific objectives of the study were to; determine the relationship between review of the control environments and financial performance; establish the association between the review of existence of assets and financial performance of SDA church and establish the relationship between conduct of annual audit and financial performance of SDA church. The study was anchored on the systems theory, and lending credibility theory. Correlation research design was employed. The study target population was all the 200 employees of the centre. Stratified random sampling was used to select 67 respondents for the study. Both primary data collected using questionnaires and secondary data collected using review. Inferential statistics using Pearson correlation analysis was used to analyze data. The findings were that indicate that review of control environment and financial performance had a positive and significant association ($r = .457, p = .000$) implying that review of control environment leads to improved financial performance; review of existence of assets had a positive and significant association with financial performance ($r = .441, p = .000$) meaning that review of assets leads to improved financial performance and conduct of annual audit and financial performance had a positive and significant association ($r = .256, p = .000$). The data is presented in tables and figures. The findings of the study may benefit policy makers in new policy formulation, investors on how to partner with the fund and future researchers in the area internal control systems in relation to financial performance.

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ABBREVIATIONS AND ACRONYMS

SDA	Seventh Day Adventist
WKUC	West Kenya Union Conference
KLC	Kenya Lake Conference
NWKC	North West Kenya Conference
GRVC	Greater Rift Valley Conference

OPERATIONAL DEFINITIONS OF TERMS

Local Conference - Group of churches put together under one local administration

Union Conference - Administrative unit overseeing Local Conferences of SDA churches

Internal control systems - A system of internal control refers to the process by which organizations maintain environments that encourage incorruptibility and deter fraudulent activities by management and employees

Financial performance - Financial performance is a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues. This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation

Verification of Existence, Custody and Safety of Assets - Assets verification involves physical verification of assets acquired through a budget and specifying the locations where they are held and the ones responsible for their possession and also confirmation that they are disclosed in financial statements.

Reviewing of Government process - This refers to reviewing of structures and processes that are designed to ensure accountability, transparency responsiveness, rule of law, stability, equity and inclusiveness, empowerment, and broad based participations are in place

Conducting value for money Audit - This is an independent evidence-based investigation which examines and reports on whether economy, effectiveness and efficiency has been achieved. Confirmation whether completed projects conform to budgetary allocations.

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CHAPTER ONE

INTRODUCTION

This chapter provides the background of the study, the problem statement, the research objectives and research questions. It also provides the scope and justification of the study and conceptual framework.

1.1 Background of the Study

In modern world spiritual nourishment is adequately required to nature citizens, a country where Christianity is fully practiced, is said to be free from wars and any other misconduct, and therefore ever peaceful. SDA church as a society is one the churches with responsibility of nourishing the world spiritually. However it faces some financial challenges to meet her obligations, it can not evangelise to other unentered areas of the world efficiently, from the financial records, there liquidity level, does not meet thresholds. The theory underpinning this study is systems theory. Theory propounded by Ludwig Von (1968) based on the premise that real systems are open to, and interact with, their environments, and that they can acquire qualitatively new properties through emergence, resulting in continual evolution.

These information asymmetries result is varying costs of internal control systems on financial performance. They proposed that firms seek to overcome problem of undervaluation arising from internal control systems in place. Internal control mechanisms affects financial performance. Miller and Midiliani however proposed that internal controls systems indeed is determining factor in financial performance. Internal control refers to systems employed in running the business, it is important in any business for it defines how the opertaions should be carried out in a clearer manner for better achievemnts of organizations goals.

There are various source of internal cotrols in an organizations, that includes, Working policy, Organogram, Budget, internal control documents, Procurements policy document. Achievement of good internal controls is realized when the organization achieves her goals from time to time and constant growth. However this can only be realized by management put in place, by so making important decesion for the betterment of organizations (James,2015)

Internal control as “Comprising the plan of an organization and all the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, prorate operational efficiency and adherence to prescribed managerial policies.” The definition of internal control is divided into financial internal control and non-financial (administrative) internal control. Financial internal control pertains to financial activities and may be exemplified by controls over company’s cash receipts and payments financing operations and company’s management of receipts and payments. Non-financial internal control on the other hand deals with activities that are indirectly financial in nature i.e. controls over company’s personnel section and its operations, fixed assets controls and even controls over laid down procedures Reid and (Ashelby 2012).

Performance is an evaluation judgment passed on a process or activity based on the benefits it has produced. Activities of accompany can be evaluated in terms of financial performance, quality of service and products satisfied customers, market performance, research and development. Cunningham (2013) states that internal control systems begin as internal processes with the positive goal of helping a corporation meet its set objectives. Management primarily provides oversight activity; it sets the entity's objectives and has overall responsibility over the ICS. Internal controls are an integral part of any organization’s financial and business policies and procedures. Internal controls consist of all the measures taken by the organization for the purpose of; protecting its resources against waste, fraud and inefficiency; ensuring accuracy and reliability of accounting and operating data; ensuring compliance with the policies of the organization; evaluating the level of performance in all organizational units of the organization. ICS are applicable to each organization in relation to key risks and are embedded within the operations and not treated as a separate exercise.

ICS should be able to respond to changing risks within and outside the company and they are a means to an end, not an end itself . Cunningham (2012), further states that Internal controls are effected by people not merely policy manuals and forms, but people functioning at every level of the institution. Internal control only provides reasonable assurance to the firm’s leaders regarding achievement of operational, financial reporting and compliance objectives; promoting orderly, economical, efficient and effective

operations; safeguarding resources against loss due to waste, abuse, mismanagement, errors and fraud.

Financial performance can be evaluated in terms of Return on equity (ROE), return on net asset (RONA), asset turn over (ATO) (James and John 2015) Seventh day adventist as church is an organizations that deals with spiritual nourishment of souls based to the believers of her doctrines as a church.The financial support is got from tithe oand offerings donated by local church members,and is administered by higher body called Conferences, Conferences are groups of churches put together under one administrations in regions. The concept is not new it started early enough in 1906 here in Kenya.Since the administration of church funds are different depending with people concerned, church operations and developemts are done differently,it implies that ,there are a time when some business are not doing well and are not reaching out for souls as need may be.Sunji, N and Ogollah, K. (2015) in their study,influence of unrelated diversification strategy componets on corporate performance:A case of Churches in Kenya found that when churches expand their membership, and activities to other sectors,where environmental uncertainties is reduced and soul reachment is high, the chance of spreading the gospel is greatly increased and cash flows become more reliable.

Mawanda (2012) conducted a research on effects of internal control systems on financial performance in SDA institution of higher learning, Baraton Kenya. In his study he investigated and sought to establish the relationship between internal control systems and financial performance in Baraton University. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls. The study established an insignificant relationship between internal control system and financial performance.The sole purpose of the study is to determine effect of internal control on financial performance of Seventh Day Adventist churches in Kenya.

1.2 Statement of the Problem

An appropriate internal control systems is the only way to deal with financial performance in an organization. SDA church play an important role in spiritual growth not only in Kenya but entire world. They are faced with financial challenges hindering them from discharging their roles as stipulated in their policies, because of internal control systems. Efforts to revive back financial challenged organizations have always focused on internal control monitoring. Different scholars have proposed that internal control measures have benefited organizations, and these organizations have always realized their goal. However the financial statement of December 2016 SDA church KLC shows budget variance, negative growth and low financial indicators levels, this depicts poor budgetary controls and financial management. Researchers have carried out studies on the interplay between internal controls and financial performance. However given variety of measures of liquidation and profitability, industrial differences, and contextual differences, the study has not been exhaustive. This study therefore seeks to determine the effects of internal controls on financial performance of SDA churches in Kenya.

1.3 Objective of the Study

The main objective of the study was to establish the effect of internal control systems on financial performance of SDA church, Kenya

Specific objectives of the study were to:

1. Determine the relationship between review of the control environment and financial of SDA church in Kenya.
2. Establish the association between the review of existence of assets and financial performance of SDA church in Kenya.
3. Determine the relationship between conduct of annual audit and financial performance of SDA church in Kenya.

1.4 Research Hypotheses

The study was guided by the following research hypotheses:

H₀₁: Review of control environment has no relationship with financial performance of SDA church in Kenya.

H₀₂: The review of existence of assets has no association with financial performance of SDA church in Kenya.

H₀₃: Conduct of annual audit has no relationship with financial performance of SDA church in Kenya.

1.5 Scope of the Study

Seventh Day Adventist is a world church with her highest administration office in United States of America. The study is focused on internal controls as one of the components financial performance and it affects performance of the church organizations. The study scope is limited to SDA church WKUC in Kenya as an administrative unit, which consists of five organizations that is Kenya Lake Conference, Ranen Conference, Greater Rift Valley Conference and North West Kenya Conference). Both secondary and primary data for the period ending December 2016 SDA church KLC financial statement was used.

1.6 Significance of the Study

This study is of interest to academicians and future researchers who will be undertaking other researches related to this. This is because it increases their knowledge on internal control and provides the necessary information to be incorporated into their work. This study will effectively strengthen God's work in Kenya. Knowledge of internal control on financial performance will enhance effectiveness of internal control. This will ensure a balanced liquidity position in the church organizations in Kenya. It may also control provision for doubtful debts, costs resulting from debtors. Furthermore the study helps to inculcate scientific and deductive thinking and promotes the development of logical habits and thinking by all staff in the organization and further form basis for further research in the field of finance.

1.7 Conceptual Framework

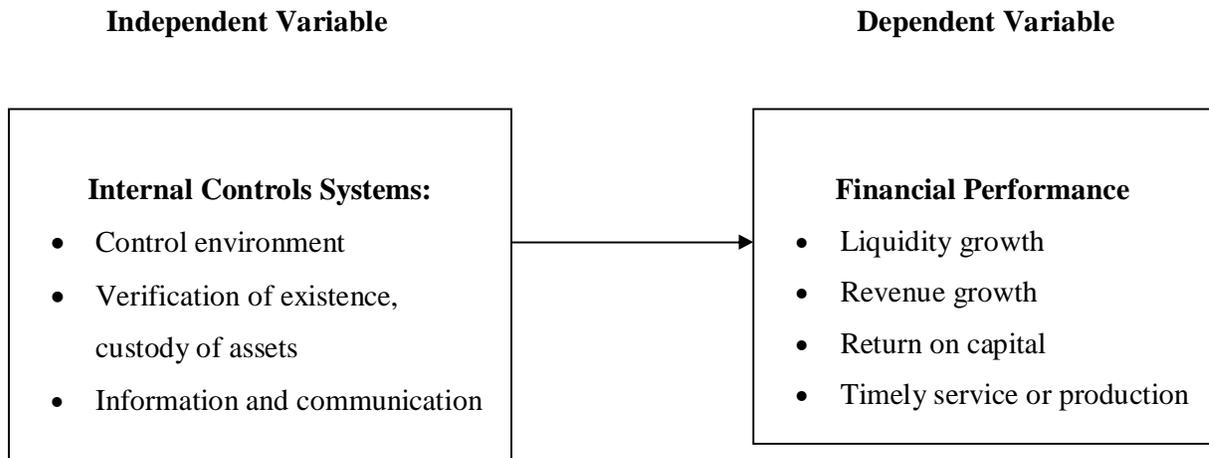


Figure 1.1: Internal Control System and Financial Performance Relationship

Source: Adopted from Glendinning (1932).

The conceptual frame work for the present study is adapted from a study by Glending (1932). This diagrammatic representation shows the effect of internal control systems on financial performance of SDA churches.

CHAPTER TWO

LITERATURE REVIEW

This chapter presents the theoretical, conceptual and contextual literature and empirical review of the related literature on the subject under study. The chapter is organized according to the specific objectives in order to address the research problem. The theory under review is systems theory and lending credibility theory. Finally, the section developed on the gaps that arose from this literature and then summary.

2.1 Theoretical Review

2.1.1 Systems Theory

The theory underpinning this study is systems theory. Theory propounded by Ludwig Von (1968) based on the premise that real systems are open to, and interact with, their environments, and that they can acquire qualitatively new properties through emergence, resulting in continual evolution.

They proposed that firms seek to overcome problem of performance arising from internal control systems in place. When Internal control systems is overridden by management, error or fraud cannot be easily detected and rectified, that in the long run results to poor financial performance. Systems theory is used to describe the relationships between the context and structure of internal control effectiveness and organizational performance, especially reliability of financial reporting as so in that respect systems theory is even more relevant.

Empirical study suggests that internal control systems with internal auditors who are specialized and higher in internal audit ability will achieve internal control effectiveness analysis and that the firm will benefit from the organizational effectiveness via internal control systems efficiency, Cadez and Guilding (2013). The systems theory is significant to the study in that SDA churches are in dire need of internal control systems so as to aid in not only growth, development, but also mission achievements.

2.1.2 The Lending Credibility Theory

Another theory based on public perception, is the lending credibility theory. The key issue of this theory is the addition of credibility to financial statements. Stakeholders need a guarantee for a fair representation of the economic value of the firm (Hayes et al., 2005).

The information hypothesis assigns an important role to the auditor in providing credibility to the financial statements. Given a situation of uncertainty, the demand for auditing has as one of the controlling mechanisms several possible explanations. The first one is the general belief that an audit enhances the reliability of financial statement data and provides assurance to users about their decisions

Another theory is the dependence of the directors on the audit to produce information helpful in estimating risk, even if the audit results do nothing more than confirm the directors' expectations and beliefs about their decisions (Soltani, 2007). The theory suggests that the primary function of the audit is to add credibility to the financial statements. This theory underpins this study's objective as it is based on the reliability of the credibility of financial statements of an entity that are confirmed

2.2 Internal Control Systems

2.2.1 Control Environments

Cadez and Guilding (2013) identified some factors, which impact management control systems; these are: external environment, technology, structure and size, strategy and national culture. It suggests that the demands imposed by technical tasks in the organization encourage the development of strategies to coordinate and control internal activities. The location of information in relation to technology and environment has an important influence on organization structure. In uncertain environments with non-routine technology, information is frequently internal. Where environments are certain, or where technology is routine, information is external. The dimensions of structure and control include authority structure and activities structure, i.e. rules and procedures that determine the discretion of individuals. Authority relates to social power. In the Systems model, decentralized authority is more appropriate where uncertain environments or non-routine technology exist. Centralized authority is more appropriate when environments are certain. Systems theory states that "the design and use of control systems is contingent upon the context of the organizational setting in which these controls operate," (Fisher,

2012). Therefore the idea of Systems theory is that the selection and use of a management control system is contingent on a variety of internal and external factors. It is therefore clear that, factors such as level of authority, reconciliation and approval, technology, structure and size, strategy and national culture impact management control systems. The theory suggests that the demands imposed by technical tasks in the organization encourage the development of strategies to coordinate and control internal activities.

Daft (2012) in his book writes: “Systems means: one thing depends on other things” and “Systems theory means: it depends.” Internal control functions are task-oriented and can be loosely structured. The functions also can vary considerably, depending on the area of a company under control and the type of business model, so managers must carefully manage their inspections and take variables into account to get the job done. The Systems theory also can be applied to an audit team’s structure within the organizations. Typically, audit team managers receive audit projects. They then create ad hoc audit teams for the projects, selecting auditors based on expertise and experience in the subject areas, and on auditor availability, all of which add up to contingencies for any given project.

2.2.2 The Concept of Existence and Safety of Assets

This concept includes verification of actual existence of securities and physical assets like buildings, property and land against financial reports like balance sheets (Robson et al., 2007). The ultimate goal of this step is to attain a high level of confidentiality that the transactions and portfolio positions reported to clients are fully and fairly reflect investments and transactions and made as shown in an advisers’s books and records and on custodial records.

A study on the value of financial statement verification in debt financing from private United states firms by Craig (2010) in michigan evidence that audited financial statement are more informative and that they significantly influences lenders’ decisions. This parameters enhances the internal control systems on financial performance.

2.2.3 The Concept of Budgetary Performance

Performance budget is a budget that reflects the input of resources and the output of services for each and every unit of organization. Fortunately this type of budget is commonly used by the church administration to show the link between the funds provided by

church members through donations in terms of tithes and offerings, for services of the gospel. For several years now there has been reported cases of non budget compliant, disparity, and poor implementation

Dixon (2012) said that appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. Kotey, Reid and Ashelby (2002) 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.

Whittington and Kurt (2013) 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 and Morris, 2012). This ranking is based on some traditional aspects of financial performance including: total returns, sales growth, profit growth, net margin, and return on equity. Dwivedi (2012) however, mentions other financial measures to include value of long-term investment, financial soundness, and use of corporate assets. John and Morris (2012) mentions accounting based performance using three indicators: return on assets (ROA), return on equity (ROE), and return on sales (ROS). Each measure is calculated by dividing net income by total assets, total common equity, and total net sales, respectively.

2.3 Empirical Review

2.3.1 Relationship between reviewing the Control environment and Financial Performance.

Academic research considers financial constraints as an important obstacle for any organization. Mawanda (2012) conducted a research in Kenya on effects of internal control systems on financial performance in SDA institution of higher learning, using quantitative techniques. In his study he investigated and sought to establish the relationship between internal control systems and financial performance. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas financial performance focused on Liquidity, Revenue growth as the

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

Case studies on internal controls in Belgium illustrate the importance of the control environment when studying internal auditing practices. Sarens and De Beelde (2006) in Belgium, using quantitative techniques, found that certain control environment characteristics like tone-at-the-top, level of risk and control awareness, extent to which responsibilities related to risk management and internal controls are clearly defined and communicated are significantly related to the role of the internal audit function and fraud detection within an organization.

Using the analytical approach and focusing on control activities and monitoring, Barra (2012) in Kisumu investigated the effect of penalties and other internal controls on employees' propensity to be fraudulent. Data was collected from both managerial and non-managerial employees. The results showed that the presence of the control activities, separation of duties, increases the cost of committing fraud. Thus, the benefit from committing fraud has to outweigh the cost in an environment of segregated duties for an employee to commit fraud. Further, it was established that segregation of duties is a "least-cost" fraud deterrent for non-managerial employees, but for managerial employees, maximum penalties are the "least-cost" fraud disincentives. The results suggest the effectiveness of preventive controls control activities such as segregation of duties is dependent on detective controls.

Prior studies (Mawanda, 2012) show that internal controls contribute to performance of firms including church organizations. While, some studies use descriptive research or quantitative approach to study internal control environment and auditing standards (De Beelde, 2006), Others (Barra, 2012) employ analytical approach but focus on effect of penalties and other internal controls on employee propensity to be fraudulent using

correlation research design. Therefore, the relationship between reviewing control environment and financial performance of SDA church has not been explored.

2.3.2 Relationship between the Reviewing of Existence of Assets and Financial Performance

Ewa and Udoayang (2012) carried out a study to establish the impact of internal control design on banks' ability to investigate staff fraud and staff life style and fraud detection in Nigeria. Data were collected from 13 Nigerian banks using a four point likert Scale questionnaire and analyzed using percentages and ratios. The study found that Internal control design influences staff attitude towards fraud such that a strong internal control mechanism is deterrence to staff fraud while a weak one exposes the system to fraud and creates opportunity for staff to commit fraud.

Kakucha (2013) evaluated the level of effectiveness of internal controls of enterprises operating in Nairobi. The study was quantitative and was conducted between September 2007 and June 2009 using a sample of 30 small businesses as listed in the National Social Security Fund (NSSF) Register of Kenya. Primary data was collected from the managers of the small business using interviews and examination of documents pertaining to internal controls. The study established that there are deficiencies in the systems of internal controls, with the degree of deficiencies varying from one enterprise to another. The components of internal control that were missing in most businesses surveyed were: firstly, risk analysis, and secondly lack of proper flow of information. In addition, the study established that the sample population had limited awareness of what constituted an effective system of internal control. The study also found that there is a negative relationship between the age of an enterprise and the effectiveness of its system of internal control while a negative correlation between the resources held by an enterprise and its internal control system weaknesses exists. They recommended that there was need to enlighten the operators of small business of what constitutes an efficient and effective system of internal control through forums and seminars.

Empirical evidence (Ewa and Udoayang, 2012; Kakucha, 2013) examine fraud detection and effectiveness of internal controls. While Ewa and Udoayang, 2012 use descriptive research design to investigate fraud, staff life style and fraud detection, on the contrary Kakucha, 2013 explored the level of effectiveness of internal controls among enterprises

in Nairobi, Kenya but fail to focus on church organizations. Hence, the relationship between review of existence of assets and financial performance of SDA church in Kenya has not been investigated.

2.3.3 Relationship between Conduct of Annual Audit and Financial Performance

Amudo and Inanga (2012) also carried out a study in Uganda to evaluate the internal control systems that the regional member countries of the African Development Bank Group institute for the management of the Public Sector Projects that the Bank finances. There are 14 projects of the bank's public sector portfolio in Uganda. The data received and analyzed is for eleven projects. Three projects were omitted because they were not fully operational to install effective internal control systems. The study identified the following six essential components of an effective internal control system: control environment, risk assessment, control activities, information and communications, monitoring and information technology. The outcome of the evaluation process was that some control components of effective internal control systems were lacking in those projects. These rendered the control structures ineffective.

Wee Goh (2012) studied 208 firms on audit committees, boards of directors, and remediation of material weaknesses in internal control. He measured the effectiveness of the audit committee by its independence, financial expertise, size, and meeting frequency, and the effectiveness of the board by its independence, size, and meeting frequency, and by the duality of the chief executive officer (CEO) and chair positions (CEO duality). He also examined other factors that can affect firms' timeliness in the remediation of material weaknesses, such as the severity of material weaknesses, firms' profitability, the complexity of firms' operations, and so on. He found out that the proportion of audit committee members with financial expertise is positively associated with firms' timeliness in the remediation of material weaknesses. Second, firms with larger audit committees are more likely to remediate material weaknesses in a timely manner. Third, that a more independent board is less susceptible to the undue influence of management and more likely to exert pressure on management to remediate material weaknesses.

Jones (2013) compared internal control, accountability and corporate governance in medieval and modern Britain. He used a modern referential framework (control environment, risk assessment, information and communication, monitoring and control

activities) as a lens to investigate medieval internal controls used in the twelfth century royal exchequer and other medieval institutions. He demonstrated that most of the internal controls found today were present in medieval England. Stewardship and personal accountability were found to be the core elements of medieval internal control. The recent recognition of the need for the enhanced personal accountability of individuals is reminiscent of medieval thinking.

Romar and Moberg (2013) conducted a case study that showed the following could have contributed to WorldCom scandal in 2002: unrealistic growth targets when expectations were low, management philosophy was aggressive; inadequate assessment of internal and external factors, and objectives before setting aggressive targets; poor segregation of duties; access to data entry and manipulation was not properly segregated and there was a lack of stringent monitoring of the internal control system and therefore quality of the controls around the posting of journal entries to the general ledger was not identified as weak.

Olumbe (2012) conducted a study to establish the relationship between internal controls and corporate governance in commercial banks in Kenya. The researcher conducted a survey of all the 45 commercial banks in Kenya. It was concluded that most of the banks had incorporated the various parameters which are used for gauging internal controls and corporate governance. This 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 that there is a relationship between internal control and corporate overnance.A study conducted by Wainaina (2012), in Wajir,using qualitative approach, examined the internal control function. He established that, other than the prevention and detection of fraud, internal controls should reflect the strength of the overall accounting environment in an organization as well as the accuracy of its financial and operational records.

Previous studies (Amudo and Inanga, 2012) show that evaluation and auditing of internal controls lead to improved performance of firms. While, some studies use qualitative approach to study internal auditing committees and weaknesses of internal controls (Wee Goh, 2012, Jones, 2013). Others (Olumbe, 2012) employ comparative analysis and analytical approach to study the dynamics of internal control systems and corporate

governance of commercial banks in Kenya. On the contrary, other studies notably Wainaina, 2012 use qualitative approach to explore internal control systems functions. Thus, the relationship between conduct of annual audit and financial performance of SDA church has not been studied.

CHAPTER THREE

METHODOLOGY

This chapter describes the research design, the study population and the sampling procedure that are to be used. Data collection method is also highlighted together with the instruments used in data collection and those used in testing the validity and the reliability of the research instruments. This chapter finally discusses the data analysis procedure used in order to establish the relationship between the variables of the study.

3.1 Research Design

The study employed a correlation research design which involves relating two or more variables and allows predictions of outcomes based on causative relationships between the variables (Cooper and Schindler, 2003). According to Mugenda and Mugenda (2003), correlational research explores the relationship between variables, that is, the effect of one thing on another and more specifically, the effect of one variable on another. Mugenda and Mugenda (2003) contend that correlational research has the advantage of being relatively cheap and it is used for the current study so as to assess the relationships between study variables.

3.2 Study Area

This research was conducted in SDA church WKUC, Kenya Lake Conference as an Organization within it. KLC is located along Kendu Bay -Oyugis road just 2 km from Kendu Bay town.

3.3 Research Population

The study covered Adventist church organization. That is Kenya Lake Conference. The population of this organization is 200 according to by product payroll of May, 2017, hence the study targeted 200 respondents.

Table 3.1: Target Population

Target Population	Number
Kenya Lake Conference	200
Total	200

Source: SDA Church Record, 2017

3.4 Sample Size and Sampling Method

Stratified random sampling will be used to sample 30% of the respondents from the stratum in the population as shown below:

Table 3.2: Study Sample

Target population	Number	Sample Size
Kenya Lake Conference	200	60
Total	200	60

Source: SDA Church Record, 2017

According to Gall,(2012) a sample size of 30% of the target population is deemed appropriate and representative of the population. Therefore a sample of 60 respondents was selected for the study through a simple random sampling.

3.5 Data Sources and Collection Methods

The researcher was both primary and secondary data. The primary data was collected using open ended and closed ended questionnaires sent to different categories of the respondents

The secondary data was collected from the existing records, financial statements and the internal control documents

3.5.1 Data Collection Procedures

A set of questionnaires were sent to seventy four (74) respondents. This is about 18% higher than the targeted sample size in order to take care of those respondents that would fail to return their questionnaires. These questionnaires were then be collected for analysis after they have been filed by the respondents. Questionnaires has been chosen because it enabled respondents to have enough time to give a well thought out answer, it is low cost and will be able to reach out staff that are far and not accessible due to transport logistics. The possible limitations of this method are that the respondents may take long time before filling the questionnaire. Some questionnaire may not be returned after being filled. However this is anticipated to be very small and negligible percentage.

This data collection method all the same was most preferred because its advantages outweigh all the perceived disadvantages.

3.5.2 Reliability of the Instruments

Reliability is the degree to which results obtained from the analysis of the data actually represent the phenomenon under study. Kothari (2004) explains that a measuring instrument is reliable if it provides consistent results. As proposed by Mugenda and Mugenda (1999), the pilot was administered on 4 respondents leaving an effective sample to be 70 respondents. These 4 respondents who participate in the pilot will not be included in the final study.

Table 3.3: Pilot test results using Cronbach’s Alpha Reliability Test

Variables	No. of Items	Cronbach’s Alpha
Internal controls	3	0.786
Financial performance	3	0.871

Source: Field Data, 2017

All the variables had alpha values of above 0.701, indicating strong internal consistency among measures of variable items.

3.5.3 Validity of Research Instrument

Validity refers to the degree to which an instrument measures what it is supposed to measure. The researcher confirmed the validity of the instruments by giving them to the lecturers particularly the supervisors to go through them in order to assess their validity. The researcher also confirmed the validity of the instruments by giving them to his colleagues to go through them before using them. The validity was also be confirmed through a pilot survey to check on the language and the vocabulary used.

3.6 Data Analysis

Data was analysed using inferential statistics namely Pearson correlation coefficient. The analysed data was presented in tables and charts.

CHAPTER FOUR

RESULTS AND DISCUSSIONS

This chapter entails results presentation and discussion. The first part presents demographic characteristics and descriptive statistics and the rest presents results as per each objective.

4.1 Response Return Rate

The administered questionnaires were done in person to the respondents by the research assistants. Some respondents filled the questionnaires in the researcher's presence and returned them immediately. Others opted to fill them at their own free time. Out of the 70 questionnaires administered to the respondents, 67 of them were returned constituting a response rate of 96.0 % of the administered questionnaires.

4.2 Demographic Characteristics of the Sample

The study sought to establish the background of the respondents in the study in terms of gender, age and respondent's location in relation to place of work. The results were as shown in the following sections.

Table 4.1 Respondent's Gender

Gender	Frequency	Percent	Valid Percent	Cumulative Percent
Female	23	34.33	34.33	34.33
Male	44	65.67	65.67	100.0
Total	67	100.0	100.0	

Source: Field data, 2017

Table 4.2 indicates that 65.67 % of the respondents are males while 34.33 % of them were females. This implies that majority of employees in KLC are males, hence the data obtained was gender biased.

Table 4.2 Respondent's Age

Respondent's age bracket	Frequency	Percent	Valid Percent	Cumulative Percent
Below 25 years	8	11.94	11.94	11.94
25-30 years	12	17.91	17.91	29.85
36-40 years	23	34.32	34.32	64.17
40-45 years	13	19.40	19.40	83.57
Above 45 years	11	16.42	16.42	100.0
Total	67	100.0	100.0	

Source: Conference Data, 2017

Most of the respondents were aged above 36 years which is a very active and productive age bracket.

4.3: Relationship between review of the Control Environment and Financial of SDA Church in Kenya

In order to assess this relationship, Pearson's correlation analysis was performed and the results are summarized in the Table 4.3 as shown below.

Table 4.3: Correlations of Review of Control Environment and Financial Performance

Variables	Review of Financial control Performance environemnt
1. Review of control environment	1
2. Financial Performance	.457** (.000) 1

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

Source: Field data, 2017

Table 4.3 indicates that review of control environment and financial performance had a positive and significant association ($r = .457, p = .000$). This implies that review of control environment leads to improved financial performance. These findings are in tandem with previous studies (Ewa and Udoayang, 2012) who report a positive relationship between

review of control environment and financial performance. However, the results are at variance with the findings of Kakucha, 2013 who found no association between review of control environment and financial performance.

4.4: Association between the Review of Existence of Assets and Financial Performance of SDA Church in Kenya

To assess this association, Pearson’s correlation analysis was performed and the results are summarized in the Table 4.4

Table 4.4: Correlations of Review of Existence of Assets and Financial Performance

Variables	Review of Existence Assets	of Financial Performance
1. Review of existence of Assets	1	
2. Financial Performance	.441** (.000)	1

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

Source: Field data, 2017

Table 4.4 shows that review of existence of assets had a positive and significant association with financial performance ($r = .441, p = .000$). This implies that review of assets leads to improved financial performance. These findings are in tandem with previous studies (Mawanda, 2012) who report a positive association between review of existence of assets and financial performance. However, the results are at variance with the findings of Kakucha, 2013 and De Beelde, 2006 who found no association between review of existence of assets and financial performance.

4.3: Relationship between Conduct of Annual Audit and Financial Performance of SDA Church in Kenya

In order to assess this relationship, Pearson’s correlation analysis was performed and the results are summarized in the Table 4.5 as shown below.

Table 4.5: Correlations of Conduct of Annual Audit and Financial Performance

Variables	Conduct of annual audit	Financial Performance
1. Conduct of annual audit	1	
2. Financial Performance	.256** (.000)	1

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

Source: Field data, 2017

Table 4.5 indicates that conduct of annual audit and financial performance had a positive and significant association ($r = .256$, $p = .000$). This implies that conduct of annual audit leads to improved financial performance. These findings are in tandem with previous studies (Barra, 2012) who report a positive relationship between conduct of annual audit and financial performance. However, the results are at variance with the findings of Ewa and Udoayang, 2012 who found no relationship between conduct of annual audit and financial performance.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

This chapter presents a summary of study findings, conclusions and recommendations based on the major findings.

5.1 Summary of Findings

Based on correlation analysis, objective one found that review of control environment and financial performance had a positive and significant relationship. Based on correlation analysis, objective two found that review of existence of assets had a positive and significant association with financial performance. Lastly, based on objective three, the study found that conduct of annual audit and financial performance had a positive and significant association.

5.2 Conclusions of the Study

From the findings of objective one, it is concluded that review of control environment leads to improved financial performance. Based on the findings of objectives, the study concludes that review of existence, of assets leads to improved financial performance and from the findings of objective three, the study concludes that conduct of annual audit leads to better financial performance.

5.3 Recommendations of the Study

Based on conclusion of objective one, SDA church should intensify review of control environment . From the conclusion of objective two, treasury department should continue review of existence of assets as this was found to improve financial performance. Similarly, from conclusion of objective three ,SDA office should continue reviewing existence, custody and safety of assets in the conference.conducting annual audit as this leads to improved performance.

5.4 Limitations of the Study

The outcome of the study cannot be generalized to all Churches in Kenya since the study was limited to KLC and did not incorporate all church organization in Kenya. The study adopted a correlational research design. The use of predetermined questions may have forced respondents to respond to questions even without properly understanding them.

5.5 Suggestions for Further Research

In order to improve this study, the researcher would like to suggest the following for further investigation. An exclusive study on the financial performance constraints facing KLC in Kenya should be carried out. Future research should be conducted on determinants of internal control system requirements in Kenya and compare their performance over a period of time using secondary data. Future studies could also explore the relative importance of internal control practices. Lastly, future research efforts could dwell on comparative analysis of internal control practices and financial performance in church across the country and use more robust research designs such as time series.

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APPENDICES

Appendix I: Introductory Letter

Department of Accounting and Finance
School of Business and Economics
Maseno University
P.O.BOX 333-10100,
Maseno/Kenya

Dear Sir/Madam,

RE:REQUEST FOR RESEARCH DATA

I am a master's student at Maseno University –Homa Bay Campus pursuing a course leading to award of master's in Business Administration in Partial fulfillment of the requirements of this course;I am conducting a study on the effect of internal control systems on financial performance of SDA churches in West Kenya Union Conference,Kenya.I therefore kindly request you to assist by completing the attached questionairs to the best of your knowledge.

The information required is purely of academic purposes and will be treated with a lot of confidentiality.Acoply of the findings of this study will be made to you upon your request.

Thanks for your cooperation.

Yours faithfully

Name Nicodemus Oyugi Okoth

Signature.....

Date.....

Appendix II: Letter to the Respondents

Dear Respondent,

RE: REQUEST TO FILL THE ATTACHED QUESTIONNAIRE.

I am Nicodemus Oyugi Okoth a student of Maseno University, pursuing a master's degree in Business Administration[Finance option]undertaking this research project' "EFFECTS OF INTERNAL CONTROLS ON FINACIAL PERFORMANCE OF SDA CHURCHES IN KENYA"

All information given in this questionnaire will be treated with utmost confidentiality and will be used for academic purpose only.

Any help is fully appreciated, thank you in advance.

Yours faithfully,

Nicodemus oyugi okoth

MBA/BE/6001/2015

c/o Maseno University

Instruction: Tick or Write in the space provided

Section A

2. Gender:

a) Female ___ b) Male _____

3. Age in years:

a) below 25 years_ (b) 25-30 Years _ © 36-40 years__ (d) 40-45 Years____ (e) 46 Years and above-----

- When was the organization established ?-----
- Location of the Organization -----
- The number of the employees in the organization-----

SECTION B

INSTRUCTIONS: Tick the summated scale column in the way you feel the internal control systems has influence on financial performance

1. Has the review of governance process influenced the financial performance in anyway?

- Reviewing of the tone at the top 1 2 3 4 5
- Reviewing of flow of information 1 2 3 4 5
- Review of documentation of policies and procedure 1 2 3 4 5

On the scale: 1-very little; 2-little; 3 moderately; 4 large; 5 Very large

2. Has the asset verification, existence, and custody affected financial performance?

- The process of acquisition passes through the tendering committee 1 2 3 4 5
- The cost effectiveness is looked at before acquisition 1 2 3 4 5
- Assets are in good custody and accounted for 1 2 3 4 5
- Does the organization has asset register 1 2 3 4 5

On the scale: 1-very little; 2-little; 3 moderately; 4 large; 5 Very large

3. Has the budgetary controls put in place influenced the financial performance?

- Do you review your expenditure in line with budget 1 2 3 4 5
- Do you operate within your budgeted line 1 2 3 4 5
- Do management seek solutions on how to cut down overexpenditures 1 2 3 4 5

On the scale: 1-very little; 2-little; 3 moderately; 4 large; 5 Very large 1 2 3 4 5

Appendix IV: Interview Schedule

NO	INTERVIEWEE	DATE	REMARK
1	EXECUTIVE DIRECTOR		
2	SENIOR ACCOUNTANT		
3	CONFERENCE INTERNAL AUDITOR		
4	HUMAN-RESOURCE PERSONNEL		
5	ACCOUNTANT-IN CHARGE OF ASSETS		

Appendix V: Research Plan

Activity						
Searching and review of research topic						
Understanding the pilot study						
Field work						
Data collection						
Analysis of data collected						
Report writing and submission						

Appendix VI: Research Budget

ITEMS DESCRIPTION	COST (Kshs)
Internet Expenses	3,000.00
Printing of Research instruments	11,000.00
Printing of Proposals and binding	4,000.00
Printing and Binding Project books	5,000.00
Miscellaneous expenses	6,000.00
TOTAL	29,000.00