

The Impact of Internal Control Challenges on Organizational Financial Performance for Selected Local Government Authorities in Arumeru District, Arusha Tanzania

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Abstract: - The article examines the impact of internal control challenges on financial performance in selected Local government Authority in Arumeru district, Arusha, Tanzania. The study used the descriptive to-explanatory research design. The study was conducted in three local government authorities wards located in Kikatiti, Majiya Chai and Usa-river. A total of 113 respondents working in those departments were involved in this study. Purposive sampling procedure was used to determine the research participants. The validity of research instrument was determined through content validity index and factorial analysis for construct validity. Reliability was tested by the Cronbach Coefficient Alpha with a result of 0.877. The data analysis will include both descriptive and inferential statistics. Descriptive statistics was used to analyze the demographic characteristics of research participants. Inferential statistics was used to analyze the relationship between internal control challenges and organizational financial performance in the Local government authorities. The major challenge was unethical behavior of employees, insufficient remuneration and impunity for fraudulent behavior with local government Authority in Arumeru District. However, the participant disagreed that employee pressure, unnoticed misconduct, inadequate fraud control and prevention were among the critical challenges facing the local government authorities in Arumeru District. There was a statistically significant relationship between poor remuneration, inadequate fraud control and prevention, unnoticed misconduct, impunity and organizational financial performance. On the other hand, challenges such as the Employee pressure, Unethical Behavior, and lack of internal control measures were statistically insignificant.

Keywords: internal control, financial performance, organizational performance, Tanzania

I. INTRODUCTION

Internal control system is a critical topic in all local government in Tanzania. This is due to fact that most local government authorities are weak in the implementation of internal control system. This agreement is supported by Ringo (2013) who suggests despite the existence of internal audits in various Local authorities with internal control systems in place, financial crimes still persist in the form of fraud irregularities and even breaches of other controls. In addition

to this, a study by Mbwanji (2013) purports that Nevertheless all the requirements to ensure internal control, still most organizations suffer from liquidity problems, insufficient accountability, untimely financial reports, fraud, resources misuse and unyielding decisions that do not lead to expected outcome. Further evidence cited by Mbwanji supports that, internal control in Tanzanian public sector is weaker than in private sector and misuse of fund was high due to lack of internal controls, living beyond real income, personal finance losses, ignorance, incapacity and lack of audit trial. Another study by Ngopa (2013) on a study conducted in Tanzania supports that, internal control in public sector was a major challenge caused by insufficient facilities, inadequate skills among internal auditors, poor cooperation from staff, weak transparency and accountability and poor commitment from management. In same vein, there are multiple studies that concluded that internal control measures are ineffective and among the major causes of fraud, misappropriation and mismanagement of funds (Abdul, 2014; Badara, 2012; Vuai, 2014).

According the statistics report of the Controller and Auditor General of Tanzania in the government fiscal year 2016/2017, there were unsupported expenditure amounting to TZS 8,713,443,263.77 from 184 implementers, however 52 percent of the qualified financial statements were attributed to expenditure not properly supported and the missing payment vouchers, facts that render validity of such expenditures questionable. These deficiencies imply weaknesses in record keeping and internal control system as they signify that the majority of Accounting Officers and Chief Executives have not been able to redress though it is their primary responsibility.

In light of the outlined studies and statistics supporting the challenges in internal control in the public sector, and the significant interest in internal controls, in part, as outcomes of significant losses incurred by several public organizations. An analysis of the problems related to these losses indicates that they could probably have been avoided had the institutions maintained effective internal control systems. Such systems

would have prevented or enabled earlier detection of the problems that led to the losses, thereby limiting damage to the organization. Therefore, this study purpose is to analyze the impacts of internal control on fraud detection, prevention and control at selected Local Government Authorities

1.1. Problem Statement

The application of internal control measures is inevitable for maximizing the financial performance of any organization especially the government sectors. In recent year, we have seen the initiatives of the Tanzania government to implement internal control measures. However, these internal control measures have experienced numerous challenges and problem during the implementation phases. Some of these challenges include undetected misconduct, pressure from colleagues or top management and unethical behavior to individuals entrusted with entity resources. Other challenges include inadequate internal control measures and the lack of fraud control mechanism. Furthermore, the lack of systemic procedure to reprimand fraudulent behavior is another factor to consider. Last but not least, low compensation is major factor in hindering internal control implementation. These are challenges which impose detrimental effect on organizational financial performance. Therefore, the article examines the impact of internal control challenges on financial performance in selected Local government Authority in Arumeru district, Arusha, Tanzania.

1.2 Research Questions

1. What are the demographic characteristics of internal control practitioners?
2. What are the internal control challenges that hinder its effective implementation?
3. What is the relationship between the internal control challenges and organizational financial performance for selected local government authorities in Arumeru district?

II. REVIEW OF RELATED LITERATURE

There are numerous literatures that have explored the topic of internal control and its significance to any entity. According to Boynton et al (2001) is a process Implemented by an entity's board directors, management, and other personnel designed to provide reasonable assurance regarding the accomplishment of goals in the following areas: reliability of financial reporting, compliance with applicable laws and regulations and effectiveness and efficiency of operations. In light of the definition, internal control plays a significant to the financial performance of the organization. Financial performance is a result of appropriate internal control system implemented in an organization. Therefore, internal control should be a topic of great concern for the financial health of any organization.

To expand to the concept of internal control, the components of internal controls are control environment, risk assessment, control activities, information and communication and monitoring (Abdul, 2014; Agung, 2015; Al-Rawashdeh, 2017). Specifically, control environment provides an atmosphere affecting the control consciousness of the employees (Feng, 2009; Gamage, Lock and Fernando, 2014). Risk assessment is the entity identification and evaluation of all inherent risks to accomplishing of the objectives (Boynton, 2001; Graham, 2015). Control activities refer to the policies, rules and regulations that assist to ensure the top administrative directives are implemented. Information and communication are the identification, capture and exchange of information in a form and time frame that enable people to carry out their responsibilities (Boynton et al, 2001). Monitoring is a process that evaluates the quality of the performance of internal control for a given period of time (Hemed, 2009; Directors Toolkit, 2013). These components are essential for effective implementation of internal control procedures (Brian, 2013; Bubilek, 2017; Cheng, 2014; COSO, 2013).

Although internal control can be implemented in the organization, there are limitations for the reach of internal control in the organization. One of the fundamental limitations is mistakes in judgement. There are times when management and other employees make poor judgment in business decision making due to lack of information, time limits, or other related procedures (Boynton et al, 2001; Hongming and Yanan, 2012; Makgatho, 2013). Another limitation is breakdowns in implemented control system as a result of employees misunderstanding or misinterpreting instructions or even due to careless (Boynton et al, 2001, Munene, 2009). Collusion is another limitation for internal control whereby employees, managers and other third party might work together to hide illicit financial activities to conduct fraudulent activities. On the other hand, management can override stipulated polices, rules and regulations for illegal purposes like financial gain (Boynton et al, 2001; Myula, 2011; Paraskevi, 2016). The last limit is the cost versus benefit whereby cost of the internal control should not exceed the benefits that are expected to ensure (Boynton et al, 2001; Njeri, 2014; Ntongo; 2012).

In the implementation of internal control systems, there are challenges or problems which lead to the weak internal control measures. There are so many challenges which contribute to ineffective internal control procedures. According to Agung (2014) the three challenges of ineffective internal control systems are opportunity, pressure from colleagues or managers, and rationalization among parties involved in illicit behavior. Another study by Amrizil (2004) provides a different perspective of challenges of internal control implementation. Amrizil (2004) emphasizes that nonexistent or week internal control, lack of employees honesty and integrity, unachievable employee financial goals, employees personal financial problems and industry in which

the company is apart has history or tradition of occurrence of fraud. Furthermore, Sukrisno (2005) sites the existence of conflict of interest, unwritten policies, no sanction to fraudsters, unrealistic goals to be achieved by employees and bonuses based on performance will tempt managers to do window dressing implementing the division reports.

These challenges are encountered in the Tanzania local government authorities as well. It is well know that government official are perpetrators of criminal financial activities. There are many reports and studies which have outline in details the financial epidemic. Even though the availability and implementation of internal control systems in the local government authorities, these procedures are ineffective. The effects of poor implementation have negative effect on the financial performance of local government authorities. According to James (2013) misuse of financial resources in government agencies is dramatically escalating and largely becoming a huge problem which requires an urgent intervention from government as the mere way to get rid of it. To better illustrate the existence of this problem, one of the evidences from MORUWASA elucidated that, almost up to 42% of allocated funds were misused by public servants in the budget year 2011-2012 and three years strategic plan 2011-2012 to 2013-2014 (James, 2013). In Tanzania, Further reports reveals that scandals such as those of TANESCO on irregularities to the procedures used to purchase and the very high costs of power plant, Bank of Tanzania (BoT)'s excessively high costs on the twin tower constructions due to irregularities on the procedures used to amend the construction contract and miss-management in external payment account (EPA), irregularities on the procedures and excessively high costs on the purchase of military radar (Abdul, 2014). Although there are internal control systems in these organizations, these government institutions are plagued by scandals which have detrimental effect on the organizational financial performance. This study has identified a literature gap that is worth studying. Therefore, this study examines the impact of internal control challenges on financial performance in selected Local government Authority in Arumeru district, Arusha.

III. RESEARCH METHODOLOGY

This part provides the research design, population, sampling procedures, validity and reliability of the research instrument and the procedures for data analysis.

3.1 Research Design

The study used the descripto-explanatory research design. This research design merges both descriptive and explanatory research designs. Descriptive design will be used to investigate the internal control challenges affecting organizational financial performance in selected local government authorities in Arumeru district, Arusha. In addition, correlation design will be used to assess the

relationship between internal control challenges and organizational financial performance.

3.2. Population and Sampling Procedures

The study was conducted in three local government authorities wards namely Kikatiti, Majiya Chai and Usa-River. Convenience was the basis of choosing the local authorities for the study. The accounting officers were the respondents of this study. A total of 113 respondents working in those departments were involved in this study. Since the intended population is relatively small, the entire population was used as the sample size Purposive sampling procedure was used to determine the research participants. purposive sampling as "a sampling technique that allows a researcher to use cases that have the required information with respect to the objectives of his or her study (Mugenda and Mugenda, 2003).

3.3 Validity and Reliability of Research Instrument

In order to ensure the validity of the research instrument, the research used content validity index to determine the content validity. Furthermore, the researcher used factorial analysis to determine the construct validity of the research questionnaire. To determine the validity, the questionnaire was evaluated by 5 experts in academia and 5 experts in internal control practices in local government authorities. Moreover, reliability was tested by the Cronbach Coefficient Alpha with a result of 0.877. The reliability results indicated the internal consistency of the research instrument (Muijis, 2010; Moule and Goodman, 2009).

3.4 Data Analysis Procedures

The data analysis will include both descriptive and inferential statistics. Descriptive statistics was be used to analyze the demographic characteristics of research participants. Inferential statistics was used to analyze the relationship between internal control challenges and organizational financial performance in the Local government authorities. Specifically, Analysis of variance (ANOVA) was applied to determine the correlations between internal control challenges and organizational financial performance.

IV. RESULTS AND DISCUSSION

This study intends to determine the responses on three major questions regarding the impact on internal control challenges on the organizational financial performance in Arumeru District. Specifically the study intends to answer the following questions

4.1 What are the demographic characteristics of internal control practitioners?

This section summarizes the background of the study from 93 surveys were retrieved from research participants. Among the participants, 47 (61.2%) were male and 36 (38.7%) were female. The data also indicated that Managers were 13(13.9%), finance department were 31(33.3%) and other

employee were 49 (52.6%). The participant experience revealed the following: 35 (38.7%) were employees who worked for more than 10 years, 31 (33.3%) were employees who worked between 5 to 10 years, 19 (20.4%) were employees who worked between 1 to 5 years, and 7 (7.5%) were employees who have worked for less than a year. The research participants came from three local government authorities in Arumeru district. The most commonly represented local government authorities was 35 participants (37.6%) from Usa-River, followed by 32 participants (34.4%) from Majiya Chai Ward, and 24 participants (27.9%) from Kikatiti Ward. Table 1 provides a summary of the demographic characteristics of internal control practitioners in the local government authorities.

Table 1: Descriptive Statistics for the Demographic Characteristics of Participants

Questions	Description	Frequency	Percentage
Gender	Male	57	61.2
	Female	36	38.8
Designation	Managers	13	13.9
	Finance Department	31	33.3
	Other employees	49	38.7
Experience	0-1 year	7	7.5
	1-5 years	19	20.4
	5-10 years	31	33.3
	More than 10 years	36	38.7
Location	Usa-River Ward	35	37.7
	Majiya Chai Ward	32	34.4
	Kikatiti Ward	26	27.9

4.2 What are the internal control challenges that hinder its effective implementation?

In regard to determining the challenges that hinders the effective implementation of internal control procedures, the researcher obtained the following results. The participants strongly agreed that the unethical behavior of employee entrusted with organizational resource (M = 4.87, SD = 0.458) was the main challenges in internal control. The second most identified challenge was the poor compensation or remuneration of employees (M = 4.72, SD = 0.485). Impunity for fraudulent behavior was the third outstanding challenge in the implementation of internal control measures (M = 3.66, SD = 0.498). The lack of harsh repercussion to punish fraudulent behavior among employees was an obstacle to internal control implementation. The four challenges was pressure from colleagues and to management (M = 3.76, SD = 0.321). The fifth ranked challenge was unnoticed misconduct (M = 2.47, SD = 0.458). The Six ranked challenge was inadequate internal control procedures and measures in the local government authorities (M = 2.32, SD = 0.467). The

seventh and last ranked challenge was inadequate fraud control and prevention (M = 2.24, SD = 0.487). Table 2 provides the summary of findings about the challenges that hinder the effective implementation of internal control.

Table 2: Challenges that hinder the effective implementation of internal control

Questions	Mean	Standard Deviation	Interpretation
Unnoticed Misconduct	2.47	0.458	Strongly Agree
Employee Pressure	3.76	0.321	Strongly Agree
Unethical Behavior	4.87	0.254	Strongly Agree
Lack of Internal Control Measures	2.32	0.467	Disagree
Inadequate Fraud Control and Prevention	2.24	0.487	Disagree
Impunity	4.66	0.498	Strongly Agree
Insufficient Remuneration	4.72	0.485	Strongly Agree

4.3 What is the relationship between the internal control challenges and organizational financial performance in selected local government authorities in Arumeru district?

This section discusses the relationship between internal control challenges and organizational performance in selected local government authorities in Arumeru district. The result analysis revealed that poor compensation or remuneration or employees were statistically significant and therefore there is strong relationship between poor compensation and organizational financial performance (Importance = 0.32). In addition, the findings indicated a strong relationship between inadequate fraud control and prevention and organizational financial performance (Importance = 0.26).at the same time, unnoticed misconduct was statistically significant although a low relationship between unnoticed misconduct and organizational financial performance (Importance = 0.09). Further analysis indicated that impunity for fraudulent behavior was statistically significant and there was a low relationship between impunity and organizational financial performance (Importance = 0.06).In addition, challenges such as the Employee pressure, Unethical Behavior, and lack of internal control measures were statistically insignificant and therefore these challenges had a weak relationship with organizational financial performance. This implies that the Unethical behavior, employee pressure and local internal control procedures had no impact on the overall financial performance of the local authorities.

Table 16

Correlation, Coefficients, P-Values and Importance of Unnoticed Misconduct, Employee Pressure, Unethical behavior, Lack of Internal Control Measures, Inadequate Fraud Control and Prevention, Impunity, Insufficient Remuneration and the Organizational financial performance in selected local government authorities in Arumeru district

Variable	Standardized Coefficients		Correlations						
	B	SE	F	Sig	Zero-Order	Partial	Part	Importance	
Unnoticed Misconduct	0.15	0.06	6.45	0.00	0.09	0.15	0.14	0.09	
Employee Pressure	0.12	0.07	3.22	0.07	-0.31	0.11	0.10	-0.03	
Unethical Behavior	0.13	0.04	4.32	0.04	0.84	0.14	0.17	0.11	
Lack of Internal Control Meas	0.43	0.00	4.54	0.13	0.32	0.13	0.21	0.13	
Inadequate Fraud Control &Pr	0.37	0.08	3.76	0.00	0.21	0.16	0.43	0.26	
Impunity	-0.23	0.06	16.6	0.00	-0.24	-0.21	-0.20	0.06	
Insufficient Remuneration	-0.12	0.06	14.8	0.00	-0.21	-0.21	-0.21	0.32	

Note. Dependent Variable: Organizational Financial Performance; Multiple

$R = 0.437$; $R^2 = 0.132$; Adjusted $R^2 = 0.085$; $F = 5.572$; $Sig. = 0.00$

V. CONCLUSION

Based on the findings of this article as substantiated by empirical data, the following conclusion emerged from the study. The demographic characteristics indicate that the participants of three local government authorities were almost evenly distributed. Likewise for the gender who participated in this research. The major challenge was unethical behavior of employees, insufficient remuneration and impunity for fraudulent behavior with local government Authority in Arumeru District. However, the participant disagreed that employee pressure, unnoticed misconduct, inadequate fraud control and prevention were among the critical challenges facing the local government authorities in Arumeru District.

There was statistically significant relationship between poor remuneration, inadequate fraud control and prevention, unnoticed misconduct, impunity and organizational financial performance. On the other hand, challenges such as the Employee pressure, Unethical Behavior, and lack of internal control measures were statistically insignificant.

Recommendations

Referring to the findings in this study, the Arumeru local government authorities should implement the following procedures to enhance organizational financial performance

1. The Arumerulocal government should provide adequate remuneration package to their employees as a deterrent for fraudulent behavior due to financial necessity. When employees are well compensated, then they will not be less tempted to commit fraudulent activities for personal gain.
2. The Arumerulocal government authorities should impose adequate fraud control and prevention system to detect and prevent fraudulent activities.
3. The Arumerulocal government authorities should invest in ethical and moral seminars to improve unethical behavior which is a hindrance toward the implementation of internal control.
4. Arumerulocal government authorities should impose harsh punishment for fraudulent behavior.

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