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INTERNAL CONTROLS AND FINANCIAL PERFORMANCE OF COMMERCIAL STATE CORPORATIONS IN KENYA

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ABSTRACT

The purpose of the study was to determine the internal controls and financial performance of commercial state corporations in Kenya. The study adopted cross-sectional descriptive survey research design. Primary data was collected by use of structured questionnaires while Secondary data was collected from performance reports and relevant documents using secondary data collection sheet. The study conducted pilot test before data collection to test reliability and validity of data collection instruments. The collected data was analysed, summarized and tabulated by use of SPSS software version 29. Descriptive analysis and inferential analysis was used to summarize the results for each of the study objectives. The results revealed that all four internal control variables; internal auditing, documents and records, communication systems, and transaction authorization have a statistically significant positive effect on the financial performance of commercial state corporations in Kenya, with communication systems showing the strongest influence per unit change. The results revealed that all four internal control variables—internal auditing, documents and records, communication systems, and transaction authorization—have a statistically significant positive effect on the financial performance of commercial state corporations in Kenya, with communication systems showing the strongest influence per unit change. The study concludes that internal controls play a critical role in enhancing financial performance in commercial state corporations. Strengthening internal auditing practices, improving record management, enhancing communication systems, and reinforcing transaction authorization frameworks are essential for improving financial outcomes. The study recommended that commercial state corporations invest in capacity building for audit teams, adopt modern accounting systems, improve information system integrity and communication clarity, and enforce robust transaction authorization policies. Further research is recommended to explore additional internal control variables and extend the scope to other public sector and private entities in Kenya.

Key Words: *Internal Auditing, Documents & Records, Communication Systems, Transactional Authorization*

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INTRODUCTION

In the 21st century, organizations have found themselves working in a rapidly changing environment characterized by vicious competition, globalization, competition between competitors, diversification, the rising expectations and demands of various customers, and performance-related issues (Pakurar, Haddad, Nagy, Popp, & Olla, 2019). The public demand for radical improvement of the state corporations' management has resulted in a wave of organizational, managerial, financial and accounting reforms in the state corporations worldwide, both in service and production sectors (Ntim & Soobaroyen, 2018). The Internal Control serves as a form of assurance for confirming accurate reporting and the attainment of a firm's objectives, particularly in light of the increasing demand for information from internal and external stakeholders (Chowdhury, 2019).

Public internal control is increasingly recognised as an integral part of modern governance systems and an essential tool for preventing, detecting and responding to corruption. Internal controls are basic organizational elements that assist management in providing efficient services to customers, ensuring the accuracy of financial statements, and ensuring compliance with laws and regulations (Committee of Sponsoring Organizations of the Treadway Commission [COSO], 2013). Internal control, according to Hayes et al. (2017), has five components: the control climate, the entity's risk assessment mechanism, information and statement systems, control behavior, and control monitoring. This study will focus on control environment, risk assessment, control activities, communication systems and monitoring.

In the United States, for example, investors lost $180 billion in the World Com Scandal in 2002, $150 million in the Tyco Scandal in 2002, $1.4 billion in the Heath South Scandal in 2003 (the largest publicly traded company), and $3.9 billion in the America International Group (AIG) scandal in 2005, among other financial fraudulent activities affecting publicly traded companies. A number of high-profile corporate accounting scandals in the early 2000s resulted in significant losses for some investors, company personnel, and other stakeholders. As a result of these scandals, there has been a push for a greater emphasis on internal control systems (Musah, Padi, Okyere, Adenutsi, & Ayariga, 2022).

Regionally, in Ghana, Kidido (2021) discovered that the internal control systems in place at the Lands Commission are inadequate, and that there is even a lack of supervision for those that do exist. There are not well-designed, formal control systems in place to guide the Commission's operations. Ndifon and Patrick (2018) discovered a negative relationship between internal control activities and financial performance in their study on the Impact of Internal Control Activities on the Financial Performance of Tertiary Institutions in Nigeria.

In Kenya corporate failures include those witnessed in New Kenya Corporative creameries, CMC Holdings and recently the Chase and Imperial bank (Ombaba & Kosgei, 2017). According to Gakeri (2016) these scandals are attributed to weak legal and regulatory framework. Contextually, Kenyan State Corporations are established and governed by the State Corporations Act of Kenyan law (Tonui & Olweny, 2018).

With the exception of financing investments for public policy goals, commercial SCs are entities that typically operate on commercial principles to perform a strategic function profitably. They are also generally self-sustaining and accountable to all stakeholders and the general public through the appropriate departmental and oversight committees of Parliament (Fiebelkorn, Owuor, & Nzioki, 2021). As of December 31, 2021, Kenya had 33 commercial and manufacturing state corporations, according to the State Corporation Advisory Committee. State corporations have grown to be a powerful institution in Kenya and highly helpful engines for fostering growth, playing a significant part in the development of the nation through the provision of public services.

Despite their important socioeconomic roles, several state corporations in Kenya are marked by inefficiency, losses, poor and unreliable products and services, and a lack of accountability, transparency, and financial probity. Kenya Meat Commission (KMC), Kenya Cooperative Creameries (KCC) and more recently, Kenya Airways which nearly collapsed due to poor profitability are some of the examples of the state corporations which have not been performing expected (Ogoro & Simiyu, 2015). The poor performance has been attributed to perceived inefficiency and ineffectiveness, as well as resource mismanagement due to a lack of good internal control systems; perceived bad corporate governance, and political patronage by managers and board members appointed for political reasons. State corporations have come to be seen as more important for political patronage than for industrial development over time (Tonui & Olweny, 2018).

Statement of the Problem

Pakurar et al (2019) stated that in order to enhance the reliability of financial performance, there must be an internal control system including direct or indirect internal audits, in order to increase the transparency and accountability among information providers in the organization. Werner and Gehrke (2018) mentioned that an effective internal control system is linked with organizational success in terms of achieving revenue targets. Contextually, in Kenya, most state corporations have underperformed, and large sums of money have been added by the government to meet operating and capital expenditures.

According to National Planning and Economic Planning report of 2022, 32 State Corporations that had Pre-tax Profit as a Performance Indicator, showed a total loss of KSh. 9, 444, 118, 212.47 against a targeted loss of KSh.7,597,996,202.12 (RoK, 2022). Five (5) State Corporations representing 15.6% targeted to reduce their loss to KSh. 33,900,079,394.00. Further, the report shows that a total of 31 State Corporations had Return on Investment as a Performance Indicator and 10 of these State Corporations, representing 32.3% achieved 100% and above of their annual target. Overall, the financial performance of commercial state corporations has been dipping thus necessitating a study to find out the cause for this performance.

Despite numerous empirical studies on internal controls and financial performance, it is still unclear how the internal controls affects financial performance in public institutions. Haddad (2016) partially study the integral impact of the supply chain and ICS on the FP. They employed different methodologies and proxies to measure the internal controls. Moreover, several studies have examined the relationship between internal controls and financial performance of different sectors and regions. For instance, Abu Hamour, Massadeh, and Bshayreh, (2023) found a positive relationship between COSO's components and FP (ROI, ROE) of Jordanian banks. Similarly, Chowdhury (2021) found that monitoring and information and communication components positively impacted the financial performance of Bangladeshi banks. Hanoon, Khalid, Rapani, Aljajawy, and Al-Waeli (2021) investigated the ICSs' relationship with the FP of Iraqi banks using the ROE metric only and found a positive impact of most of the ICS components on FP. Emmy and Gladys (2018) researched on internal control systems and financial performance of Jomo Kenyatta Foundation. However, the reviewed studies have given a wide berth on ICS in the context of commercial state corporations financial performance. Thus the study sought to fill the research gaps by establishing the effect of internal controls on financial performance of commercial state corporations in Kenya.

Objectives of the Study

The general objective was to investigate the internal controls and financial performance of commercial state corporations in Kenya. The specific objectives were;

- To establish the effect of internal auditing on financial performance of commercial state corporations in Kenya.
- To determine the effect of documents & records on financial performance of commercial state corporations in Kenya.
- To determine the effect of communication systems on financial performance of commercial state corporations in Kenya.
- To find out the effect of transactional authorization on financial performance of commercial state corporations in Kenya.

The hypotheses of the study were;

- **H_{01}:** There is no significant effect of internal auditing on financial performance of commercial state corporations in Kenya.
- **H_{02}:** There is no significant effect of documents & records on financial performance of commercial state corporations in Kenya.
- **H_{03}:** There is no significant effect of communication systems on financial performance of commercial state corporations in Kenya.
- **H_{04}:** There is no significant effect of transactional authorization on financial performance of commercial state corporations in Kenya.

LITERATURE REVIEW

Theoretical Review

Systems Theory

Systems theory was propounded in the 1940s by a biologist Ludwig von Bertalanffy and advanced by Ross Ashby in his study "Introduction to Cybernetics" in 1956. Bertalanffy (1968) emphasized that real systems were open to, and interact with, their environments, and that they can acquire qualitatively new properties through emergence, resulting in continual evolution. He argued that rather than reducing an entity or organization to the properties of its parts or elements, systems theory focused on the arrangement of and the inter-relations between the parts which connect them into a whole. Such an organization determined a system that is independent of the concrete substance of the elements (for example, the various departments such as finance, accounting, human resources, research and development). Thus, the same concepts and principles of organization underlie the different disciplines, providing a basis for their unification.

Hartman (2010) observed that the systems theory provides a leader with a tool for analysing organizational dynamics without providing a specific theory about how an organization should be managed. He also observed that with the recognition of systems theory, all organizations consist of processing inputs and outputs with internal and external systems and sub-systems helpful in providing a functional overview of any organization. Smit and Cronje (2014) observed that a system is a collection of parts unified to accomplish an overall goal. If one part of the system is removed, the nature of the system is changed as well.

Institutional Theory

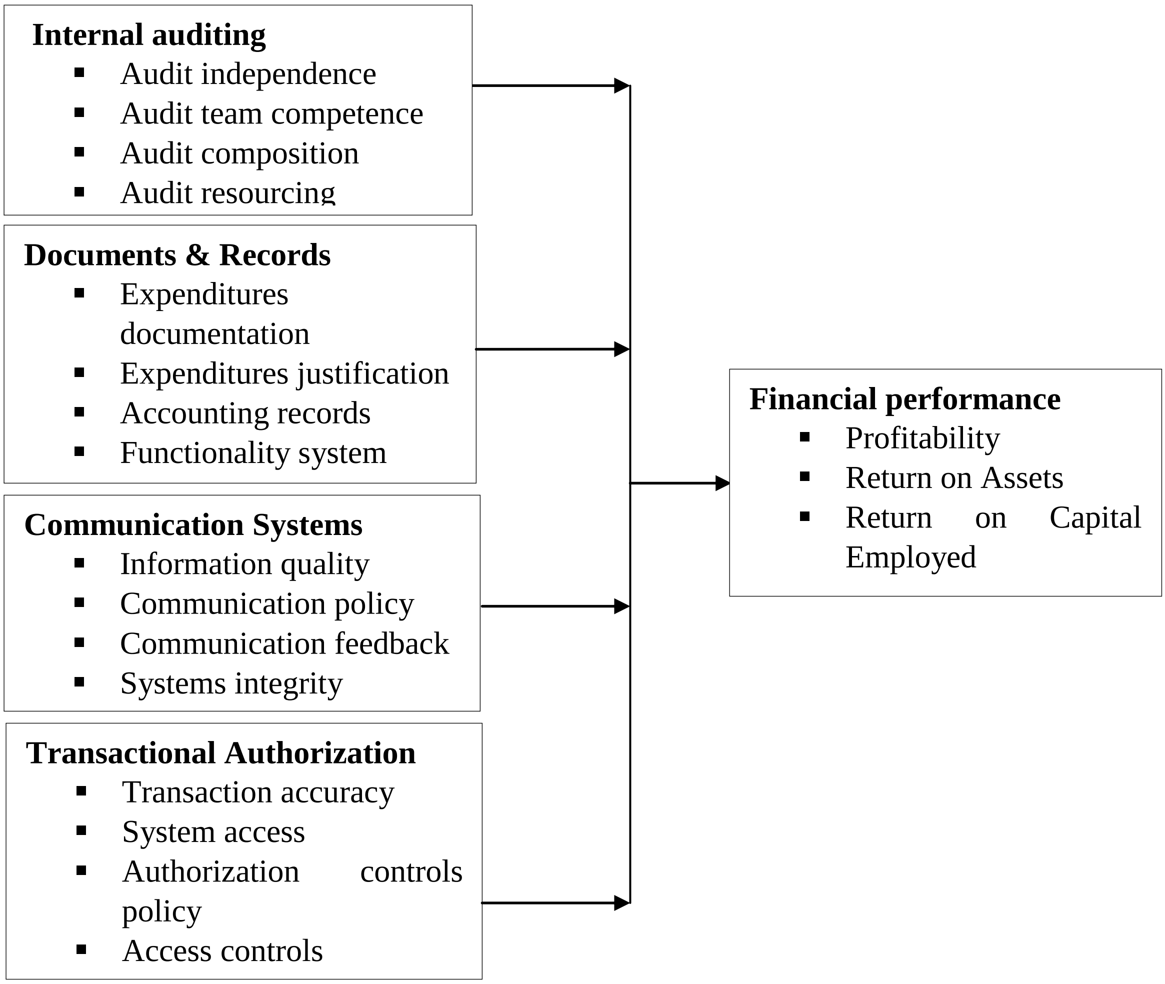
This theory was advanced by Meyer and Rowan in 1977 and DiMaggio and Powell in 1983, who considered the institutional processes including the systems and structures that are established within the functioning aspect of the organization and guides its daily operations and workings. The organization is comprised of the social structures, cognitive aspects and technical aspect. This study concentrates on the technical aspect of the institution as it discovers the systems and applications that once adopted into the institutional structure will improve its performance in terms of quality service delivery (Powell & Colyvas, 2008).

The study looks at institutional theory as a framework that enhances the adoption of innovative and inventive measures through the use of advanced technological systems and applications in an organization. The state corporations have adopted the use of control systems. As the study tries to link the aspects of internal controls to its performance, the institutional theory exposes the value and benefits accrued to the organization through adoption of usage of internal control systems. The study supports documents and records variable in the study.

Agency Theory

The theory of agency which was proposed by Stephen Ross and Barry Mitnick is about the relationship between agents or principals and the control of delegation (Mitnick, 2013). The theory has been used as the theoretical foundation for internal audit and management audit investigations. For instance, Tetteh et al. (2022) used the agency theory to evaluate the success of internal control systems on the financial performance of listed entities on the Ghana stock exchange using information technology as a moderating variable. Guo and Eschenbrenner (2018) used agency theory to clarify how management control systems are implemented in an organization. El-Mahdy and Park (2014) and Agyei-Mensah (2016b) stated that an internal control system helps eliminate information asymmetry, increase the quality and reliability of the information, and assist agents to align their interests with those of the principal. According to Adegboyegun, Ben-Caleb, Ademola, Oladutire, and Sodeinde (2020), a system of control must be put in place to balance management interest with that of shareholders to minimise agency loss.

Conceptual Framework



Independent variables **Dependent variable**

Figure 1: Conceptual framework

Empirical Review

Hamed (2023) investigates the influence of internal control systems (ICS) compliance on banks' financial performance sustainability (FPS) in the Amman Stock Market. Using a questionnaire survey of sixteen listed banks, the extent of ICS compliance and its impact on various indicators of financial performance is examined, such as profitability, earnings, and returns on sustainability initiatives. It is found that the banks comply with ICS requirements and that ICS compliance positively and significantly affects their financial sustainability. In particular, this study shows that the control activities, information and communication, and monitoring components of ICSs are key drivers of bank performance.

Zheng, Liu, and Sial (2018) researched on the effectiveness of internal control and Corporate Social Responsibility in Chinese Capital Market. The paper analyzed comparatively the influences of internal control on the assumption of corporate social responsibility (SCPS) from the accrual basis, and the fulfillment of corporate social responsibility (CSRF) from the cash flow system respectively. Using a sample of 1767 firms listed in China between 2011 and 2016, we find that effective internal control has significantly promoted enterprises to assume social responsibilities. Meanwhile, effective internal control substantially improves the fulfillment of corporate social responsibility.

Bett and Memba (2017) investigated the impact of internal control systems on the financial performance of Kenya's Menengai Oil Company. The study's specific objectives were to determine the effect of control environment on Menengai Company's financial performance, to determine the influence of risk assessment on Menengai Company's financial performance, and to establish the influence of information systems on Menengai Company's financial performance. A survey research design was used for the study. The study relied on a survey of 189 people. The collected data were tabulated first, then analyzed using descriptive and inferential statistics. The findings were presented in the form of charts, tables, and graphs. Control environment, risk assessment, and information all have a significant impact on financial performance, according to ANOVA tests.

Mariam and Onyiego (2018) investigated the impact of risk assessment on the financial performance of Kenyan commercial banks: A Case Study of Commercial Banks in Mombasa County. The study concluded that operational risk management was the most important factor influencing commercial bank performance in Kenya. The study also concluded that credit risk management has a significant impact on commercial banks' financial performance as a result of counterparties' failure to meet their obligations. The study's findings also established that liquidity risk management has a significant impact on commercial banks' financial performance.

Mardiana and Dianata (2018) investigated the impact of risk assessment on financial performance using good corporate governance as a moderating variable. The data used comes from the Financial Statements of Sharia Banking Companies Listed on the Indonesia Stock Exchange from 2011 to 2016. Following the stage of purposive sampling, the worthy of used sample is 5 Companies. The findings revealed that Capital Adequacy Ratio (CAR) and Non-Performing Loan (NPL) had a negative and insignificant effect on Return on Asset (ROA), while operating efficiency had a negative and significant effect on Return on Assets (ROA).

Asiligwa and Rennox (2017) conducted research to determine the Effect of Internal Controls on Financial Performance of Kenyan Commercial Banks. Internal controls were measured using the five elements of internal control specified by the Committee of Sponsoring Organizations of the Treadway Commission framework of internal controls, whereas financial performance was measured using the historical average of Return on Equity. Because of its ability to describe the relationship between elements of Internal Controls and Financial Performance, a descriptive research design was chosen. The 43 Kenyan commercial banks were used in the study. A structured questionnaire was used to collect primary data. Frequency tables were used to present descriptive statistics derived from data analysis, while correlation and regression tables were used to present inferential data findings. The study's findings revealed that the banking sector has strong financial performance, which is due in part to the implementation and maintenance of effective internal controls.

METHODOLOGY

Research Design

The cross-sectional research design was used in this investigation. This method helps to illustrate how a study's variables interact over a brief period of time (Kothari, 2014). The instrument's ability to capture a lot of data is what led to the selection of this research design. This design's main goal is to truthfully and accurately explain a scenario or area of interest in a methodical manner. It is helpful for answering questions about what, why, who, and how much can be done to calculate a phenomenon's incidence (Cooper & Schindler, 2016).

Target Population
The entire set of participants or objects of interest that the researcher hopes to study is referred to as a population (Kothari, 2014). Kenya has 33 commercial and manufacturing state corporations, according to the State Corporation Advisory Committee website (2023). The 33 entities formed the study's unit of analysis. The departmental heads drawn from finance, accounting, risk, and ICT departments served as the unit of observation.

Sampling Frame
The sampling frame comprises of a comprehensive list of all the sampling units from which a sample could be selected. A sampling frame is required to define the universe (population). The frame (data sources) could be a list from households, establishments, and industries with detailed addresses, products produced and/or consumption, expenditure, revenue data, and so on (Kothari, 2014). In Kenya there are 33 commercial and manufacturing state corporations and they formed the sampling frame for the study.

Data Collection Methods
The study collected primary data using a structured questionnaire which comprised of two sections. The first part collected information on demographic characteristics of the respondent, while the second part consisted of questions where the variables of the study was the focus. The structured questions were used in an effort to conserve time and money as well as to facilitate easier analysis of data. Secondary data was obtained from the analysis of company's audited annual reports. This secondary data collected, was used to support the findings on the primary data and provide more information that may have not been captured by the respondents.

Data Analysis and Presentation
The data collected was coded and analyzed using descriptive statistics and inferential statistics as data analysis techniques. The study generated both descriptive statistics and inferential statistics. Descriptive analysis on collected primary data was done to give mean and standard deviation to be adopted as central tendency measures and measures of dispersions respectively. Inferential statistics involved regression analysis and correlation analysis (Creswell, 2014). Analyzed data was presented in frequency distribution tables so as to make it easy for research results description and explanation. The data analysis tool used in the study was Statistical Package for Social Sciences (SPSS version 29).

A multiple linear regression was used to analyse the relationship between internal controls and financial performance of commercial state corporations.

$$\mathbf{Y= \beta_\theta +\beta_1X_11+\beta_2X_2+\beta_3X_3+ \beta_4X_4+\varepsilon}$$

Where:

Y is financial performance
$\boldsymbol{\beta_\theta}$ is regression constant
$\boldsymbol{\beta}$ is regression coefficients
$\mathbf{X_1}$ is internal auditing
$\mathbf{X_2}$ is documents & records
$\mathbf{X_3}$ is communication systems
$\mathbf{X_4}$ is transactional authorization
$\boldsymbol{\varepsilon}$ is error term

RESULTS

Response Rate
The researcher distributed 132 to the respondents. 50 questionnaires were duly filled and returned representing 96.2%. This indicated high level of respondents' cooperation during the exercise. For an effective

representative, this response rate was sufficient. According to Mugenda & Mugenda (2013), a response rate of 50% is sufficient for analysis and reporting, 60% is good, and 70% and more is exceptional. According to the comments, the study was excellent.

Descriptive Analysis of Study Variables

Descriptive analysis was conducted on the study variables to check the mean and standard deviation. The results are presented in the following tables.

Internal Auditing

The researcher asked respondents to rate their agreement or disagreement on the various aspects of internal auditing. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 4.5.

Table 1: Internal Auditing

	Mean	Std. Deviation
The state corporation has an internal audit team	4.76	.511
The internal audit team in the corporation is independent and autonomous	4.02	.953
The internal audit team is competent in its function	4.88	.266
The audit function is adequately resourced	4.21	.314
The audit team in the state corporation divergently composed	4.16	.650

The results in Table 1 have shown that respondents agreed to a large extent that the state corporation has an internal audit team, as indicated by a mean of 4.76 and a standard deviation of 0.511. Additionally, respondents agreed that the internal audit team in the corporation is independent and autonomous (mean = 4.02, std. dev = .953) and that the audit function is adequately resourced (mean = 4.21, std. dev = .314). Furthermore, the results revealed that respondents agreed to a large extent that the audit team in the state corporation is divergently composed, as shown by a mean of 4.16 and a standard deviation of 0.650. These findings are supported by Hazaea et al. (2024) whose on internal audit practices in commercial banks across five Arab countries found that independence and objectivity of the internal audit team significantly enhance organizational performance.

Documents & Records

The study were asked to rate their agreement or disagreement on the various aspects of documents & records. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 2.

Table 2: Documents & Records

	Mean	Std. Deviation
The state corporation documents all its expenditures	4.81	.337
Records are well monitored through in the corporations by the incharge department	4.96	.158
The corporation have implemented the use of electronic modern accounting software	4.99	.107
Usage of a variety of records is implemented for cross checking the records	3.98	.836
There is reliability of records and documents is guaranteed in the system under use in the corporation	4.56	1.124

The results in Table 2 have shown that respondents agreed to a large extent that the state corporation documents all its expenditures, as evidenced by a mean of 4.81 and a standard deviation of 0.337. Similarly, respondents agreed to a large extent that records are well monitored within the corporation by the in-charge department (mean = 4.96, std. dev = .158). The corporation's implementation of electronic modern accounting software also received strong agreement, with a mean of 4.99 and a standard deviation of 0.107. Furthermore, respondents agreed that the reliability of records and documents is guaranteed in the system under use, though this item showed a lower mean of 4.56 and a notably higher standard deviation of 1.124. The findings are supported by a study by Amissah and Justice (2020) on financial record-keeping in small and medium enterprises in Ghana found that the adoption of modern accounting software significantly improved documentation accuracy and reliability.

Communication Systems

The study respondents were asked to rate their agreement or disagreement on the various saspects of communication systems. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 3.

Table 3: Communication Systems

	Mean	Std. Deviation
Information system ensures information is kept confidential and stored securely.	5.01	.115
Information about tasks, requests from supervisors are clearly communicated, to the right people and at the right time	4.77	.356
The entity obtains relevant quality information to support functioning on internal control	4.54	.461
The authority communicates with external stakeholders on the functioning of internal control	4.27	.441
The information systems in the corporation have integrity	4.23	.894

The results in Table 3 have shown that respondents agreed to a large extent that the information system ensures information is kept confidential and stored securely, as demonstrated by a mean of 5.01 and a standard deviation of 0.115. Respondents also agreed that information about tasks and requests from supervisors is clearly communicated to the right people at the right time (mean = 4.77, std. dev = .356). Additionally, the entity's ability to obtain relevant quality information to support the functioning of internal control received agreement, with a mean of 4.54 and a standard deviation of 0.461. The integrity of the information systems in the corporation was also agreed upon with a mean of 4.23 and a notably higher standard deviation of .894. Also respondents agreed that there is communication with external stakeholders on the functioning of internal control (mean = 4.27, std. dev = .441). A study by Al-Qudah et al. (2022) in Jordanian banks found that secure and confidential information systems were critical to operational success. However, a study by Al-Dmour et al. (2019) in public sector organizations indicated that while confidentiality was often strong, clarity and timeliness of task-related communication frequently suffered from delays or misdirection.

Transactions Authorization

The study respondents were asked to rate their agreement or disagreement on the various aspects of transactions authorization. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 4.

Table 4: Transactions Authorization

	Mean	Std. Deviation
Transactional authorization have a well outlined authority flow	4.81	.252
The transactions accuracy is ensured in the state corporation	4.19	.706
The state corporation systems access is restricted to authorized users only	4.88	.516
There is authorization controls policy in the state corporation	3.44	.928
The state corporations has stringent access controls of physical and system installations	4.56	.879

The results in Table 4 have shown that respondents agreed to a large extent that transactional authorization has a well-outlined authority flow, as indicated by a mean of 4.81 and a standard deviation of 0.252. Respondents also agreed that the accuracy of transactions is ensured in the state corporation (mean = 4.19, std. dev = .706). Additionally, the state corporation's stringent access controls for physical and system installations received strong agreement, with a mean of 4.56 and a standard deviation of 0.879. However, the existence of an authorization controls policy in the state corporation showed a lower level of agreement, with a mean of 3.44 and a high standard deviation of 0.928, pointing to significant differences in respondent opinions. Regarding restricted system access to authorized users, respondents agreed to the statement (mean = 4.88, std. dev = .516). The findings are supported by a study by Al-Sartawi (2020) in Middle Eastern financial institutions found that a well-defined authority flow for transactions significantly improved operational efficiency. Similarly, research by Osei et al. (2019) in Ghanaian public sector organizations supported the notion that stringent access controls and transaction accuracy were critical for reducing fraud

Financial Performance

The study respondents were asked to rate their agreement or disagreement on the various aspects of financial performance. They were required to do this on a 5 point Likert scale where 1 represented Strongly disagree while 5 represented Strongly agree. The results are presented in Table 5.

Table 5: Financial Performance

	Mean	Std. Deviation
The profitability of the authority has increased over the last five years	4.69	.321
The return on assets has improved over the last five years	4.17	.632
The authority has expanded its market share over the last five years	4.61	.525
The return on capital employed has increased	4.99	.667

The results in Table 5 have shown that respondents expressed a relatively high level of agreement that the profitability of the authority has increased over the last five years, as indicated by a mean of 4.69 and a standard deviation of 0.321. Similarly, respondents showed high level of agreement that the return on assets has improved over the same period (mean = 4.17, std. dev = .632). The expansion of the authority's market share over the last five years also received a high level of agreement, with a mean of 4.61 and a standard deviation of 0.525. Respondents strongly agreed that the return on capital employed has increased, as evidenced by a mean of 4.99 and a standard deviation of 0.667.

Correlation Analysis Results

Correlation analysis was done to determine the correlation between the internal controls and financial performance using the Pearson's product moment correlation analysis. The results are shown in Table 6.

Table 6: Correlation Results

		Internal auditing	Documents & records	Communication systems	Transaction authorization	Financial performance
Internal auditing	Pearson Correlation	1				
	Sig. (1-tailed)					
	N	119				
Documents & records	Pearson Correlation	.064	1			
	Sig. (1-tailed)	.008				
	N	119	119			
Communication systems	Pearson Correlation	.374*	.441	1		
	Sig. (1-tailed)	.053	.026			
	N	119	119	119		
Transactions authorization	Pearson Correlation	.382*	.508	.075	1	
	Sig. (1-tailed)	.016	.047	.003		
	N	119	119	119	119	
Financial performance	Pearson Correlation	.412	.233*	.468	.241	1
	Sig. (1-tailed)	.000	.031	.005	.000	
	N	119	119	119	119	119

*. Correlation is significant at the 0.05 level (1-tailed).

From the bivariate correlation results in Table 6, it was established that transaction authorization had the highest correlation with documents and records, as shown by a correlation coefficient of 0.508 and a p-value of 0.047 ($p < 0.05$), indicating a significant positive relationship within the context of internal controls and financial performance of commercial state corporations in Kenya. This was followed by the correlation between communication systems and financial performance, with a correlation coefficient of 0.468 and a p-value of 0.005 ($p < 0.05$). The correlation between internal auditing and financial performance was significant at $r = 0.412$ and a p-value of 0.000 ($p < 0.05$), while the correlation between communication systems and documents and records ($r = 0.441$, $p = 0.026$) also demonstrated a meaningful association.

The least significant correlation among the variables considered was between communication systems and transaction authorization ($r = 0.075$, $p = 0.003$), though it remained statistically significant at the 0.05 level. A study by Mwangi and Oluoch (2021) on Kenyan state corporations found a strong positive correlation between transaction authorization and documentation practices. They argued that stringent authorization enhances the reliability of financial records, a critical factor in state corporations where accountability is paramount, thus supporting the significant relationship observed in this study.

Multiple Regression Analysis Results

The data was used to regress project completion on material resource management constructs. The results of regression analysis are presented as follows.

Table 7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.752[a]	.565	.514	.27417

a. Predictors: (Constant), Documents & records, internal auditing, Communication systems, Transactional authorization

The results in Table 7 indicated that the regression model has a moderate to strong predictive capacity. The correlation coefficient (R) of 0.752 suggests a substantial positive relationship between the predictors (documents and records, internal auditing, communication systems, and transaction authorization) and the dependent variable, financial performance. The R Square value of 0.565 indicates that approximately 56.5% of the variability in financial performance can be explained by these internal control variables, which is a considerable proportion. The Adjusted R Square of 0.514, accounting for the number of predictors and sample size, slightly tempers this to 51.4%, still reflecting a robust model fit.

Table 8: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	21.448	4	5.362	36.979	.000[b]
	Residual	16.513	114	.145		
	Total	37.961	118			

a. Dependent Variable: Financial performance completion

b. Predictors: (Constant), Documents & records, internal auditing, Communication systems, Transactional authorization

From the Analysis of Variance results in Table 8, it was established that the significance value in testing the validity of the model was obtained as 0.000 which is less than 0.05, the critical value at 99% significance level. Therefore, the model is statistically significant in predicting the relationship between the study variables.

Table 9: Regression Coefficients

		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	2.106	.637		3.306	.000
	Internal auditing	.406	.184	.311	2.207	.003
	Documents & records	.214	.106	.193	2.019	.021
	Communication systems	.437	.211	.385	2.071	.011
	Transactional authorization	.229	.112	.127	2.045	.019

a. Dependent Variable: Financial performance

The optimal regression model is:

$$y = 2.106 + .406X_1 + .214X_2 + .437X_3 + .229X_4$$

The regression results showed that independent variables had significant value less than 0.05 implying that they are all significant. From the results, it showed that holding all factors constant at zero, the change in financial performance would be 2.106. Further, the regression results showed that a unit change in internal auditing, on average, would lead to 0.406 unit change in financial performance. Further, regression results showed that a unit change in documents & records, on average, would lead to 0.214 unit change in financial performance. A unit change in communication systems, on average, would lead to 0.437 unit change in financial performance and a unit change in transactions, on average, would lead to 0.229 unit change in financial performance.

Discussion of Key Findings

The first objective of the study sought to determine the effect of internal auditing on the financial performance of commercial state corporations in Kenya. Regression analysis conducted proved that there was a positively significant effect of internal auditing on financial performance, as indicated by the values $\beta 1 = 0.406$, $p = 0.003$ ($p < 0.05$). The study concludes that a unit change in internal auditing, on average, would lead to a 0.406 unit change in financial performance. On hypothesis testing, since the p-value is less than 0.05, the null hypothesis that there is no significant effect of internal auditing on financial performance is rejected. These results align with a study by Kibet et al. (2020), which found that internal auditing significantly enhances financial performance in Kenyan state corporations by improving accountability and control mechanisms.

The second objective of the study sought to establish the effect of documents and records on the financial performance of commercial state corporations in Kenya. Regression analysis conducted proved that there was a positively significant effect of documents and records on financial performance, as indicated by the values $\beta 2 = 0.214$, $p = 0.021$ ($p < 0.05$). The study concludes that a unit change in documents and records, on average, would lead to a 0.214 unit change in financial performance. On hypothesis testing, since the p-value is less than 0.05, the null hypothesis that there is no significant effect of documents and records on financial performance is rejected. This finding is consistent with Mwangi and Oluoch (2021), who demonstrated that effective record-keeping positively impacts financial outcomes in Kenyan parastatals by ensuring transparency and accuracy.

The third objective of the study sought to examine the effect of communication systems on the financial performance of commercial state corporations in Kenya. Regression analysis conducted proved that there was a positively significant effect of communication systems on financial performance, as indicated by the values $\beta 3 = 0.437$, $p = 0.011$ ($p < 0.05$). The study concludes that a unit change in communication systems, on average, would lead to a 0.437 unit change in financial performance. On hypothesis testing, since the p-value is less than 0.05, the null hypothesis that there is no significant effect of communication systems on financial performance is rejected. These results agree with Kinyua et al. (2015), whose study in Kenyan public entities revealed that robust communication systems significantly boost financial performance by facilitating timely and accurate decision-making.

The fourth objective of the study sought to determine the effect of transaction authorization on the financial performance of commercial state corporations in Kenya. Regression analysis conducted proved that there was a positively significant effect of transaction authorization on financial performance, as indicated by the values $\beta 4 = 0.229$, $p = 0.019$ ($p < 0.05$). The study concludes that a unit change in transaction authorization, on average, would lead to a 0.229 unit change in financial performance. On hypothesis testing, since the p-value is less than 0.05, the null hypothesis that there is no significant effect of transaction authorization on financial performance is rejected. This finding is supported by Njeru et al. (2019), who found that stringent transaction authorization processes in Kenyan parastatals significantly enhance financial performance by reducing fraud and ensuring resource efficiency.

CONCLUSION AND RECOMMENDATIONS

Descriptive statistics findings revealed that respondents agreed to a large extent that the state corporations have an internal audit team that is competent, independent, and adequately resourced. Further, results showed that the internal audit function is well-established, with a divergently composed team that supports oversight and accountability within the organizations. These findings suggest strong internal auditing structures that enhance financial performance.

Descriptive statistics findings revealed that respondents agreed to a large extent that state corporations effectively document all expenditures, monitor records diligently, and utilize modern electronic accounting systems. Further, results showed that respondents agreed that a variety of records are used for cross-checking, and that the reliability of records and documents is guaranteed in the systems in use. These findings indicate a strong documentation culture that supports accuracy and accountability in financial processes.

Descriptive statistics findings revealed that respondents agreed to a large extent that the information systems ensure confidentiality and secure storage of data. Further, results showed that communication of tasks and supervisory requests is clear, timely, and directed to the appropriate individuals. Additionally, respondents agreed that relevant quality information is obtained to support internal control functions, and that the systems in place uphold data integrity and facilitate communication with external stakeholders.

Descriptive statistics findings revealed that respondents agreed to a large extent that transactional authorization processes in state corporations are well-outlined with a clear flow of authority. Further, results showed that access to systems is restricted to authorized users only, and that physical and system installations are under stringent access control. Additionally, respondents agreed that transaction accuracy is maintained, although there was moderate agreement on the existence of formal authorization control policies, indicating some inconsistency in their implementation across corporations.

The study concluded that internal auditing has a significant effect on the financial performance of commercial state corporations in Kenya. It is concluded that state corporations have established internal audit teams that are competent, independent, and adequately resourced. The presence of a divergently composed audit team enhances oversight and accountability, positively influencing financial outcomes. The findings confirm that effective internal auditing strengthens internal control mechanisms and improves financial performance.

The study concludes that documents and records management has a significant effect on the financial performance of commercial state corporations in Kenya. It is concluded that expenditures are well documented and records are reliably monitored through in-charge departments. The adoption of modern electronic accounting systems and use of various records for cross-checking ensures the accuracy and reliability of financial data. These practices collectively enhance transparency and contribute positively to financial performance.

The study concludes that communication systems have a significant effect on the financial performance of commercial state corporations in Kenya. It is concluded that the information systems in use ensure secure storage and confidentiality of data, while communication of tasks is clear, timely, and appropriately targeted. The ability to access quality information for internal controls and the integrity of communication systems support decision-making and enhance overall financial efficiency.

The study concludes that transactional authorization has a significant effect on the financial performance of commercial state corporations in Kenya. It is concluded that corporations have well-defined authority flows, restricted system access to authorized users, and stringent access controls for both physical and digital infrastructure. The enforcement of transaction accuracy and authorization protocols helps minimize fraud and errors, thereby supporting improved financial performance.

The study recommended that commercial state corporations should continue to strengthen the independence and autonomy of their internal audit teams. Adequate resources should be allocated consistently to ensure the audit function operates efficiently. Additionally, there is a need to promote continuous professional development for audit staff and maintain diverse team compositions to enhance oversight and effectiveness.

The study recommended that state corporations should invest further in advanced electronic accounting and documentation systems to enhance accuracy, efficiency, and data integrity. Regular system audits and staff training should be conducted to ensure that record-keeping standards are upheld. Additionally, policies should be developed or reinforced to promote the consistent use of diverse records for validation and cross-checking of financial data.

The study recommended that corporations should strengthen internal communication frameworks to ensure clarity, timeliness, and accuracy of information flow. Investment in secure, user-friendly information systems should be prioritized to safeguard confidentiality and support effective internal control functions. Further, communication with external stakeholders regarding internal control processes should be enhanced to promote transparency and accountability.

The study recommended that state corporations should implement and regularly review comprehensive authorization control policies to guide financial transactions. Access to physical and digital systems should remain restricted to authorized personnel, with regular audits to detect potential vulnerabilities. Moreover, clear documentation of the transaction approval process should be maintained to ensure compliance and reduce the risk of fraud.

Recommendation for Further Research

The scope of this study was limited to internal controls in the context of commercial state corporations in Kenya. However, the coefficient of determination (R^2) revealed that internal control variables—internal auditing, documents & records, communication systems, and transactional authorization—explained only 56.5% of the variation in financial performance. Therefore, further studies should be conducted to examine other internal control constructs not included in the current study and explore their effect on financial performance, not only in commercial state corporations but also in other public sector institutions and private enterprises.

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