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A CRITICAL REVIEW OF LITERTURE ON INTERNAL CONTROL SYSTEMS AND PUBLIC FINANCIAL MANAGEMENT AMONG GOVERNMENT MINISTRIES IN KENYA

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Abstract: **The globalization process, the complexity of government transactions and the increase in fraudulent activities have recently prompted scholars and experts, and authorities to divert their attention to internal control systems and adoption of technology in the public sector. Public financial management professionals are focused on having improvements in the management and budgeting, in line with changes in financial reporting. However, despite the internal control systems put in place, the public sector of Kenya has been characterized by misuse of resources and funds and poor service delivery. There has been in issues public financial management among various government institutions which cut across ministries and state corporations which has brought about poor performances, corporate failures, depletion of wealth, corruption and fraud. Studies on internal controls systems are characterized by various research gaps. The study sought to carry pout a critical review of literature on internal control systems and public financial management among Government Ministries in Kenya.**

Keywords: **Internal Control Systems, Public Financial Management, Information and Communication, Control Environment, Risk Assessment and Control Activities.**

1. INTRODUCTION AND BACKGROUND

Financial management is globally regarded as a fundamental segment of governments and as well as their establishments (Vitayanti & Nini, 2017). Institutions in the public sector manage a lot of open subsidizes while work in a political environment. In the context of both developing and developed nations, public financial management professionals are focused on having improvements in the management and budgeting, in line with changes in financial reporting (Rizaldi & Yurniwati, 2015). They seek to strengthen institutions through improvement in auditing and governance. Proper financial management ensures that financial priorities put in line with the goals and objectives of institutions. It is a general recognition that majority of developing countries are characterized by inefficient internal control system. These deficiencies in the control systems are viewed to be facilitate public resources misuse, therefore having adverse implications for developing countries.

Economic crimes remain an area of concern to many Countries as it keeps them on guard. Kenya as a country with its fast rate of growth and development especially in technology is not left behind. Due to increased access to information the country has been experiencing mismanagement of funds and bribery in public sector (Economic & Survey, 2016). Hardly do a day passes without issues of public fund mismanagement through corruption mentioned in media. (Lkpesu, 2019). Governments can make an important contribution to public well-being through the execution of government policies and the delivery of public services that are important to the deliver desired services. Their fiscal advantage lies in the closeness of the public to the decision makers and administrators of the programs that provide services to ensure effective and efficient utilization of resources allocated. Government has the potential to be the most transparent and accountable in providing services.

Internal control systems are process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance (COSO, 2013). For purposes of the study, the definition by COSO definition of internal control systems was adopted. The Public Finance Management (PFM) has significantly changed with the Constitution 2010 and devolved systems of governance coming into place (Wabwire & Bogonko, 2019). The Constitution sets the pace for creating a PFM system that is more efficient, effective, transparent and participatory for improved service delivery to its citizen. PFM refers to the set of laws, rules, systems and processes used by sovereign nations (and sub-national governments), to mobilise revenue, allocate public funds, undertake public spending, account for funds and audit results.

1.1 Statement of Problem

Since the promulgation of the Constitution 2010, Kenya has made significant stride in the enacting public finance management legal frameworks and formulation of policies for enhancing transparency, accountability and other constitutional values, ethics and principles for effective public financial management performance (Ndegwa & Mungai, 2019). Despite putting in place all these, there are concern of lack of transparency and accountability in the application of public resources. The government is spending a lot of money every financial year but the effectiveness of this superior expenditure is not evident in the quality of the delivery of services to its citizen (The et al., n.d.). The first quarter of FY 2019/2020 budget implementation faced the following challenges; late release of exchequer, the MDAs failed to submit quarterly report in time, there was delay in uploading of procurement plans and budget in IFMIS, low levels of expenditure and discrepancies between IPPD and IFMIS data (*FIRST QUARTER FY 2019 / 20*, 2019). Despite the existing legislations to curb fraud in public sector, there have been concerns of lack of transparency and accountability in public financial management due rising cases of corruption.

Sound internal control system are of importance of institutions as it prevents the incidence of poor financing through helping institutions to work efficiently and in harmony while detecting irregularities and errors in their operations (Wardwiyono, 2012). Institutions over the years have recognise the roles of internal control systems which has been regarded as vital tools for safeguarding an institutions' overall achievements of objectives (Wabwire & Bogonko, 2019). Failure to establish a reliable and dependable system could harm the organization in many ways and expose the risks to the efforts of nurturing accountability in the public sector (Mohamad, Jamaliah & Mahmudul, 2015). The role of internal control systems in the public sector organization notably is supporting the system for purposes of establishing and fostering the accountability of decision makers. However, despite the internal control systems put in place, the public sector of Kenya has been characterized by misuse of resources and funds and poor service delivery. The study sought to carry out a critical review of literature on internal control systems and public financial management in Kenya.

1.2 Objective of the Study

The study sought to carry out a critical review of literature on internal control systems and public financial management in Kenya.

2. THEORETICAL REVIEW

Systems Theory was coined by Bertalanffy (1940) and further advanced by Ashby in 1956. The proponents argue that real systems were open to, and interact with immediate environment, where qualitatively new properties can be acquired via the emergence of continual evolution. The assert that instead of reducing an organization or entity into properties of its elements or parts, the arrangement of and the inter-linkages among the parts which makes them whole is the focus of systems theory. Systems Theory presents a leader with the basic tool analysing the various dynamics with an entity as observed by Hartman (2010). It was further observed that in line with systems theory, institutions consist of inputs and outputs processing with functional overview. A system is viewed to be a collection of unified parts geared towards accomplishing a stipulated goal and objective. Therefore, the removal of one part of the system, changes the nature of the system as well. The underlying influence of systems theory in the management of institutions is that assess situations in a wider view (Abdi, 2015). Systems theory therefore provides a new angle for managers to assess, interpret events and patterns in the work environment. Various parts of the institutions and the interrelations of the parts are synchronized spanning from coordination of central administration with its programs, works as well as supervisors among other key components.

Agency Theory was coined by Jensen and Meckling (1976). The simplicity of the theory of narrowing down institutions into two key parts being the agent and principal has been the reason behind its prominence. Agency theory views institutions as necessary structures required in maintaining contracts and through this control can be exercised so as to minimize opportunistic acts or behaviors of agents (Mwangi, 2012). In line with this theory, comprehensive contract is put down so as to have the interests of both parties (agents and principals) harmonized. This relationship is strengthened through the engagement of expert and systems (auditors and control systems) by principals for purposes of monitoring agents (Jussi & Petri, 2004). The theory further acknowledges that any incomplete information arising from the agents' interests, relationship or work performances described can be adverse and as well as moral hazard. Adverse selection and moral hazard influences agents' output in two forms; not getting things done exactly how the agents were appointed to and not having the requisite knowledge on what should be done.

Contingency Theory was brought forth by Fielder (1960). The theory is based on the proposition that majority of organizations or institutions are not well structured and coordinated. The theory is based on the behavior of institutions as regards contingent factors which include such as technology and external environment which influence the function and design of organizations. The underlying assumption of contingency theory is that structures vary from institution to institution and no single structure is equally applicable to all institutions. Rather, the effectiveness of an institution is dependent on a match or fit between the underlying technology in place, institutional size, environmental factors institutional structure and their information system.

Stakeholder Theory is based on the idea of redefinition of a corporation. Friedman (2006) asserted that the organization is in itself a community of stakeholders and as such the goal should be towards addressing its needs, priorities and as well as viewpoints. Stakeholder management is therefore vested on managers or those at the helm of affairs of institutions. Managers therefore run the affairs of institutions on behalf of stakeholders and as such are expected to ensure that their rights are observed as well as input considered in decision-making (Abdi, 2015). Stakeholders are concerned about the active management of relationships, environment and also the promotion of shared interests for purposes of developing and building organizational strategies towards success. Stakeholder management also includes a variety of issues which span from social responsibilities, environmental issues and labor conditions which however may be conflicting with the institutions' interests (Friedman & Miles, 2006).

2.1 Empirical Review

2.1.1 Control Environment and Public Financial Management

Control environment is regarded as a key mechanism in the management of institutions due to it being a reflection of the policies and attitudes of managers regarding the importance of internal controls. It provides structure and serves as the foundation for the other internal control mechanisms. Kinyua, Gakure, Gekara and Orwa (2015) researched on internal control environment and financial performance with focus on Nairobi Stock Exchange, Kenya. Based on regression analyses, it was documented that a significant underlying linkages between internal control environment and financial performances. The study however centred on listed firms which are profit making in nature.

Sanusi, Johari, Said and Iskandar (2015) studied the effect of internal control environment, financial management and accountability in Malaysian mosques. The outcome show that internal control environment is significant in ensuring sound financial management. The study notably had a low response rate of 42.2%. Rizaldi and Yurniwati (2015) did a research on control environment at Internal Control Systems Government Indonesia. The study was descriptive and the study respondents chosen through purposive sampling. Based on descriptive analyses, the study found that internal control environment impacted on Indonesia local government's ability to implement sound financial management. The study notably applied descriptive analysis focusing on Indonesia local government.

Vitayanti and Nini (2017) did a research on risk assessment, control environment, information and communication, monitoring and control activities' effect on fraud prevention while focusing on local government of Palu in Indonesia. Multiple regression outcome indicates that control environment has insignificant influences on fraud prevention in the local government of Palu. Nuswantara, Maulidi and Pujiono (2017) investigated the efficacy of control environment and how it affects fraud deterrence in local government, Indonesia. Control environment was found to be key in fraud deterrence. The study however focused on local government, Indonesia where other key components of internal control systems were isolated. Wabwire and Bogonko (2019) assessed internal Controls and their influences on public finance management while focusing on the County Government of Busia, Kenya. Control environment was found to have a significant positive effect on Public Finance Management.

2.1.2 Risk Assessment and Public Financial Management

Etengu and Amony (2016) studied internal control system and how they affect the financial performance with focus on non-governmental organisations situated in Uganda. Findings of the study reveal that risk assessment had significant influences on financial performances of NGOs. Vitayanti and Nini (2017) did a research on internal controls systems and on fraud prevention while focusing on local government of Palu in Indonesia. The study centred on local government of Palu in Indonesia. Countries are characterized by different economic and regulatory conditions, as such, the findings of a study in the context of one country may be applied directly to another country.

Kipchumba (2018) undertook a research on internal controls and County Government financial management with focus on Uasin Gishu, Kenya. The study applied regression and correlation analyses and documented that risk assessment has negative and insignificant influences on financial management at County Government of Uasin Gishu. Muhunyo (2018) analyzed the effect of internal control systems on performances of public institutions, the case of higher learning in Nairobi City County, Kenya. Multiple regression and descriptive analyses were used and it was documented that risk assessment had significant influences on financial performances of the institutions of higher learning in Nairobi City County, Kenya. The study focused on financial performances of higher institutions.

2.1.3 Control Activities and Public Financial Management

Abdi (2015) assessed internal control systems' impact on financial performances for Mogadishu private banks. It was found that control activities highly influenced the achievement of improved financial performances. Etengu and Amony (2016) studied internal control system and how they affect the financial performance with focus on non-governmental organizations situated in Uganda. International Union for Conservation of Nature was the focus of the study. Findings of the study reveal that risk assessment had significant influences on financial performances of NGOs. The study notably was on NGOs.

Lerno (2016) analyzed the associations between internal controls and performances of County Governments in Kenya. Control activities were key in influencing the performances of County governments. The study however did not consider other key internal controls components such as risk assessment and control environment. A study was done by Vitayanti and Nini (2017) on control environment, risk assessment, information and communication, monitoring and control activities and their effect on fraud prevention while focusing on local government of Palu in Indonesia. Based on regression analyses, control activities were found to strongly enhance fraud prevention in the local government of Palu.

Muhunyo (2018) did a research which sought to evaluate internal control systems influences on performances of public institutions with focus on higher learning in Nairobi City County, Kenya. The study found that control activities had significant influences on financial performances of the institutions of higher learning in Nairobi City County, Kenya. Ndegwa and Mungai (2019) found that control activities systems strongly influenced the financial management in Ministry of Finance, Kenya. The research focus was however a single ministry.

2.1.4 Information and Communication and Public Financial Management

Uwaoma and Ordu (2015) assessed the influence of internal controls on financial management in the context of Nigeria. The findings from the multiple regressions show that information and communication is key in influencing production firms' financial management. Lerno (2016) assess the underlying relationship between internal controls and County Governments performances in Kenya. Information and technology reportedly had key influences on the performances of County governments. The study however did not considered other key internal controls components such as risk assessment and control environment.

Vitayanti and Nini (2017) studied the effect of internal controls on fraud prevention while focusing on local government of Palu in Indonesia. The analysis of data was done using multiple regression and the study found that information and communication facilitate fraud prevention in the local government of Palu. Countries are notably charaerterized by varying economic and cultural factors and as such the findings of the research which was done on local government of Palu in Indonesia may not be directly applicable to other countries.

Kipchumba (2018) undertook a research on internal controls and County Government financial management with focus on Uasin Gishu, Kenya. Based on regression analyses, the study found that information communication had strong influences on financial management at County Government of Uasin Gishu. The study however was based on County Government of Uasin Gishu. The study also isolated other key components of internal control such as control environments. Ndegwa and Mungai (2019) did a study on internal controls influences on financial management, the case of ministry of finance in Kenya. The inferential analyses reveal that information communication influences financial management in Ministry of Finance. The study focus was a single ministry which may not be reliably generalized for all the government ministries in Kenya.

2.2 Conceptual Framework

Conceptual framework embodies a diagrammatic expression of the relationship among research variables (Mugenda & Mugenda, 2013). The proposed conceptual framework is contained in The figure below.

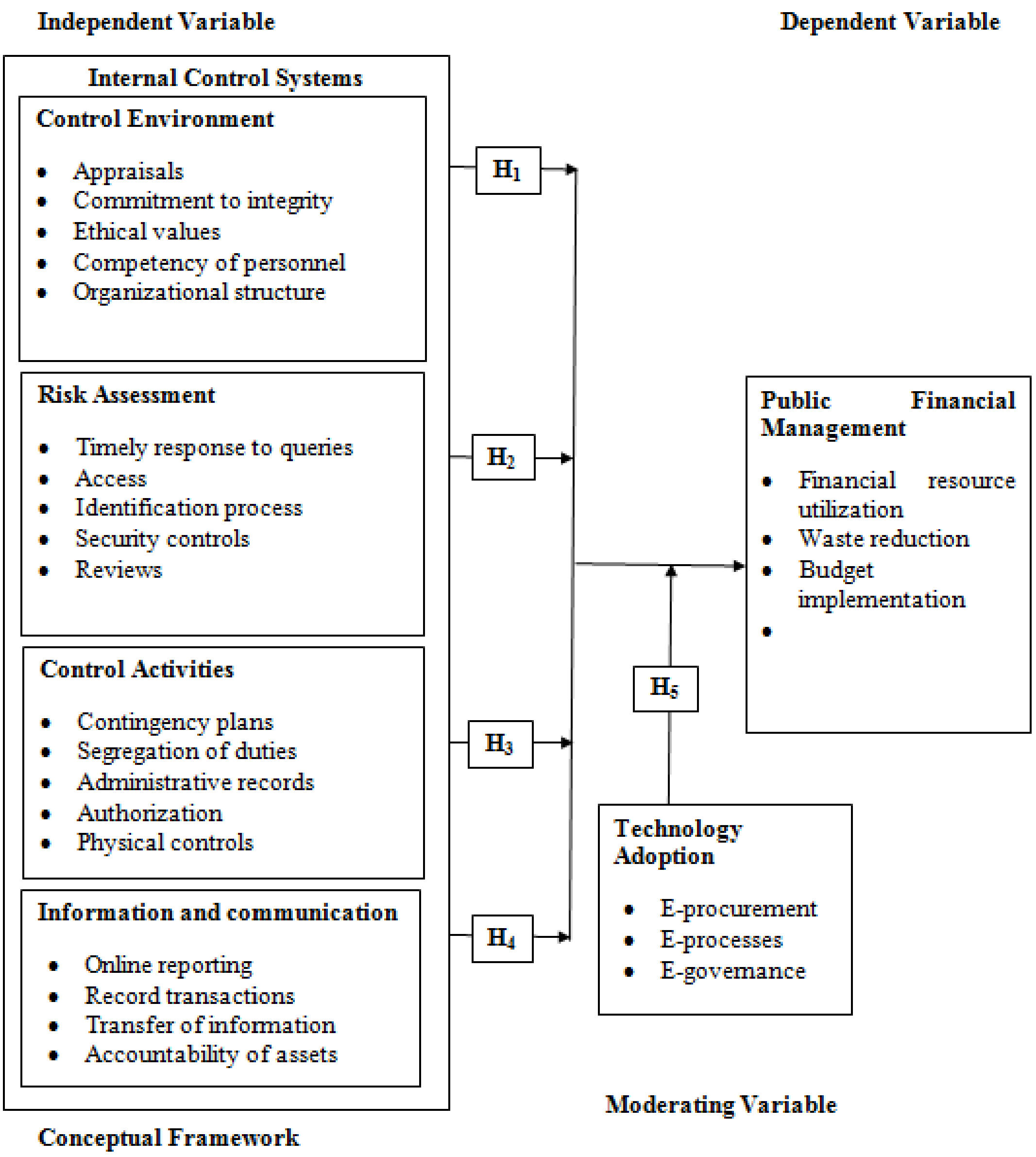

Figure 1

Source: Researcher (2020)

3. CONCLUSION

The study concludes that various research gaps exist as evidenced by the review of literature on internal control systems and public financial management in Kenya. As such, establishing the statistical significance of these relationships will enhance the formulation and implementation of policies by government.

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