FINANCIAL MANAGEMENT SYSTEMS AND PERFORMANCE OF KENYA STATE CORPORATIONS: CASE OF KENYA RURAL ROADS AUTHORITY

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ABSTRACT

There is a rise on demand for better transparency; coherence and answerability in the administration of public's funds. Therefore, transformation in Government's financial management systems and techniques is becoming wanting. As it is extensively accorded in the Government of Kenya, there are basic problems that hinder efficiency and effectiveness of its financial and accounting roles, this is due to weak performance of key financial duties; inadequate financial information to support decisions; insufficient or inadequate supervision of the employees involved in ensuring success of the financial management system; poor or inadequate financial reports, mismanagement of assets, lack of adherence to the set laws and regulations as well as negative attitude to accounting and accountability leading to slow progress of KeRRA. The general Objective of this study was to determine the effect of financial management system on the performance of Kenya State Corporations. The specific objectives were to establish how laws and regulations; internal controls; cash management and accounting system affect performance of Kenya Rural Roads Authority. Three theories were used in this study for the theoretical review; Agency Theory, Contingency Theory and Resource Based Theory. A descriptive research design was utilized where a questionnaire was used to collect primary data. Secondary data was used to validate the realistic and communicative validity of primary data. The study target population was 102 employees at Finance Department at Kenya Rural Roads Authority. Purposive sampling method was utilized to come up with a sample of 53 respondents. The data gathered from the respondents was analysed by use of SPSS. Multiple regression analysis was utilized to analyse data to establish the effect that financial management system has on the performance of Kenya State Corporations case study being KeRRA. Cronbach's Alpha was used in reliability. Findings revealed that Financial Reporting quality of KeRRA was reliable, efficient and effective. It was further noted that Laws and Regulations are verified and monitored thus indicating systematic stability is maintained. The Internal Control Variable findings indicated that positive effect on performance at KeRRA is achieved where problems are predicted before they occur, errors adjusted and malicious acts prevented and cambered. It was further noted that mismanagement of funds is well prevented since a favourable cash management system is maintained. The findings of KeRRA Accounting System indicated that sufficient management reporting is supported as well as policy decisions. Based on these findings, it can be summarized that financial reporting, internal controls, cash management as well as Laws and Regulations all affect the performance of Kenya State Corporations positively. Adoption of a more advanced technology is however recommended for Kenya State Corporations to ensure efficiency and effectiveness of financial management system. Since only 64.2 percent of the findings were defined by the independent variables, suggestions for further research should be undertaken on more elements that may affect performance of Kenya State Corporations.

Key Words: *financial management, financial management system, performance, public finance, financial reporting, internal control, cash management, accounting system*

INTRODUCTION

In Brazil, USA, India, UK and Canada, the clear effect of financial management system on the performance of organizations has been pinned out in studies done (Partra, 2009). Key financial management system in the mentioned countries has aided in enhancing profitability level of organizations through strong economical control instruments like; liquidity methods as well as capital design (Partra, 2009). The upgrading of fast growing organizations together with globalization mechanism are exhibited to be affected by the finance procedure selections as well as finance administration skills; the higher efficient management system the more profitableness an organization is.

Scholars like (Abuzayed, 2012) had the view that efficient financial management systems enabled Organizations to be beneficial in Ghana. (Rehman, 2010) shared the same view that inefficient financial management system were the major causes of downfall for business firms in Ghana. However, amendments in Governments Financial Management systems have been dictated by an increase in demand for transparency and answerability in the management of the public funds. Higher pressure to compete globally and efficiently is being witnessed in all spheres of life. Stakeholders are becoming more demanding therefore needing increased focus on quality of service offered. In response to these external demanding pressures, organizations and corporations' resort to different strategic responses like adoption of new financial systems, reorganizing, downscaling, business process re-designing, Benchmarking, Total Quality Management, Management by Objectives etc.

Recently, the use of financial management systems by Kenyan state corporations has been advocated as one of the best means of preventing the proceeding effects of funds embezzlement that have persistent in the public sectors (GOK, 2011). Moreover; financial management systems enable a state corporation to increase its ability to control and monitor its expenditure as well as funds received; it will also increase accessibility to key information and enhance the operational performance; Financial management system will also assist in improving management practices in general by availing prompt financial information that top management use to administer and run programs effectively; budget formulation and efficient resource management. A good reliable financial management system can also aid governments in developing countries to have effective funds control; increase transparency and enhance accountability therefore minimising political interference and also preventing frauds and corruption.

STATEMENT OF THE PROBLEM

A full functioning and efficient Financial Management System improves governance by its provision of real-time, reliable, representative financial information which management can rely on to make concrete decisions." According to (Gurusamy, 2009), Financial management System should boost effective appropriation of financial resources for socially desirable goals as well as economically productive goals. However, there are several factors that can affect the financial management system hence affecting the performance. These factors are Internal Control, Laws and Regulations, Cash Management (Asset Management), Accounting System, Financial Reporting requirements among others. Effectiveness of financial management systems on performance should be deemed of most significance in every Organization. For this purpose, entities give much importance to the above-named factors that influence the financial management system. These factors are functions performed and practised by employees of an entity to assist the management in accomplishing the organizations goals. The law of corporate governance features the need for the organizations to maintain a good, effective and efficient financial management system with the aim of achieving efficiency and effectiveness of operations in attaining business objectives; preparation of reliable financial reports; adherence to applicable laws, rules and regulations; maintenance of reliable cash management systems and also ensuring that the internal controls are effective and reliable. In their report; (OECD, 2013) noted that Kenya State entities have been fighting performance challenges. As per (Lien, Piesse, Strange, & Filatotchev, 2009) inadequate transparency, integrity and accountability affects State entities performance. In addition, (Adams, Renee, Benjamin, Hermalin, & Michael, 2010) stated that poor financial management system is enhanced by lack of accountability in administration of public activities which ended up to poor delivery of services to the people. In his study (Wamalwa, 2009) sought to investigate the bond between performance contracts and financial performance of Kenya Airport Authority and Kenya Railways and in this study he concluded that performance contracts are huge successful kits in enhancing the financial performance of Kenya Airports Authority and Kenya railways. Another study done by Business Daily Africa (2013) shows that government Accountants fail to maintain proper books of accounts leading to a circumstance where the government has no reliable records of its debts or assets. A study done by (Shitakwa, 2008) revealed that there is a link between Performance Contracting and Performance of State-Owned Corporations. Another study of corporate governance and financial performance of State Corporations was done by (Murithi, 2008). A study by (Musyoki, 2008) was done on relationship between quality improvement and financial performance for commercial banks. Among these studies done few to none have explained or examined the impact that financial management systems have on financial performance of State Corporations in Kenya. Therefore, this study desired to fill that gap by looking at what impact does financial management system have on the financial performance of State Corporations through a case of Kenya Rural Roads Authority.

OBJECTIVE OF THE STUDY

This study's general goal was to investigate the effect of financial management system on the Performance of Kenya State Corporations; Case of Kenya Rural Roads Authority.

THEORETICAL REVIEW

Agency Theory

It was developed by (Berle & Means, 1932) and became majorly recognized when (Jensen & Meckling, 1976) articulated the agency shortcomings in the governance of Organizations. As per the theory; management acts sometimes in their own-interests instead of the Stakeholders of the firm's interests. This theory has been utilized extensively in various fields like, Accounting, Marketing, Economics, Organizational Behaviour, Political Science, Sociology . Adam Smith alerted against plenitude and laxity of managers administering money other than what they possess (Smith, 1776). Agency theory supports use of rules and rewards to line up the behaviour of management to those of the stakeholders of an Organization. In regards to the Accounting and Management literature, states that one of the major responsibilities and duties of management is applying control over Organizations resources and undertakings. The definitive explanation of administration guide posits control as "the strategy by which managers guarantee that resources are attained and utilized efficiently and adequately in the achievement of the Organizations goals".

Agency theory in 1980's was also used broadly in the managerial accounting field to ascertain the best-incentive contracting in various individuals and initiating satisfactory accounting control strategies to supervise their performance and operations. An Organization can be featured as a centre of Contractual Agreements in various parties given the agency theory paradigm and following the recommendations of (Jensen & Meckling,1976) among others. Thus, contracts are deemed as suitable methods for resource administration and disclosing the range of the Organization's undertakings. Moreover, they can be viewed as a strong framework for effective and efficient management responsibility supervision criteria. In this case, suitable control variables; performance measures; endogenous and exogenous variables influencing the control procedure can be represented and defined numerically by accommodating the "Agency theory."

In conclusion, the Agency theory is important for this study due to it outlining how management influences the achieving of the organization performance through prioritization of either their needs or the stakeholders needs.

Contingency Theory

The nature of the contingency theory model is that Organizational efficiency develops from fitting attributes of the Organizations like structure to contingencies that reflect the condition of the Organization. There are several crucial presumptions in the contingency approach as stated

by (Donaldson, 2001), they include; the superior the fit among contingency variables the fitter the performance of the Organization; Organization key players perform in means that are ever in concert with the super ordinate goals of organizational efficiency; therefore, there is always objective harmony among decision makers in an entity; linear model of contingency variables.

The contingency model is exceptionally deterministic and rational (Shields, 2007). The dependent variable is either performance of the financial system or the performance of the entity (Shields, 2007); the performance of the financial system is taken to pointedly affect the performance of an entity. The ground of the model is "fit" among the contingency variables and the condition of the financial system being scrutinized; In this model, the contingency variables are primarily events of the financial system functions where the degree of fit is assumed to determine the level of performance.

Contingency theory offers a meaningful way of visualizing the link between contingency variables and Organization structure for a higher positive performance. Moreover, use of the different contingency variables that are fit for the Organization led to higher performance; he outlined these variables to be, Organizational Characteristics; environmental uncertainty; assumption of administratively-oriented capital budgeting control strategy. Therefore, this theory is applicable to this study for Organizational performance of an entity relies on the financial management system that is adhered to by an entity.

Resource Based Theory

Basics of this theory runs back to the application of (Chandler, 1962). The researcher pointed out that the most crucial origin of Organizational Performance as well as competitive advantage is the Organizational internal resources. The theory further asserts that the board is a crucial link between the organization and the crucial resources that it requires in order to maximize performance. Entities attain positive performance by developing, achieving and effectively distributing resources that are already available to them. Through the resources owned internally, an Organization attains good performance.

The theory focuses on how stakeholders within the business environment affect a focal organization and how an organization can respond to these stakeholders (Gunay, 2008); the aim of resource-based theory is to encourage competitive supremacy for corporations through static as well as rare organizational capabilities; these features of resource-based theory are; empowering the organizational employees; allowing social interaction among the organizational employees; creating firm-specific investments in the employees according to their unique know how and skills; forming on-going and strong relationships with the employees; developing business outcomes aimed at allowing stakeholders to boost their supplies of resources to the organization; form active communication among the top management and employees with the help of Human Resource Managers; reinforcing creativity, innovation, long-term orientation and co-operation.

Resource based theory has been extensively utilized by researchers to support research on an entity's performance. In his study, (Gikonyo, 2018) used the theory to establish the link between employee engagement and performance and training of State corporations in Kenya. In addition, (Fondo, 2016) utilized the resource-based theory in his study to explore the effect that corporate governance has on performance of State-Owned Corporations in the service industry in Kenya. Therefore, resource-based theory is crucial in this study since successful key implementation needs resource provision.

EMPIRICAL REVIEW

Government entities have the responsibility of ensuring that all the citizens are provided with services that satisfies their basic needs. It is the duty of these Government entities, including State Corporations to provide services to the citizens by using their own resources. i.e. finances, employees and equipment. In order to carry out these duties, the entities are required to use reliable, relevant supportive information to make the decisions necessary. Among this information is the financial information. For several years, numerous studies have revealed the gains of financial information. Each Organization has set objectives that it aims at achieving. In order for it to achieve these goals, appropriate performance measures are utilized. (Pany & Whittington, 2001) talks of the extensiveness of controls used in supporting the accomplishment of goals internally in areas of financial reporting; operations; along with adherence to the laws and regulations. Undertakings of internal controls usually involve use of two elements; Policies establishing what should be done and procedures to practice these policies. (Owizy, 2011) evaluated the adequacy of internal control in Government entities by using a case study of Benue State Ministry of finance in Nigeria. His findings in the study do not confirmed whether Benue Ministry of finance prepared yearly budget on time as well as whether they had a sufficient expenditure tracking procedure that prevented misappropriation of funds.

When researching about the functions of public sector audit and financial control management systems in Sudan (El-Nafabi, 2009) established that control and audit systems are meaningful in guaranteeing answerability for public resources utilization as well as protecting constrained public funds from misuse; misappropriation and lawless practices. (El-Nafabi, 2009) did a study and observed that poor and inefficient financial administration systems as well as inadequacy in financial systems are part of the promoting elements of economic corruption in Sudan leading to poor financial performance and Organizational Performance in general. However, solutions on how to overcome inefficiency in financial management system and poor performance were not availed in the aforementioned studies.

In Zambia, a research to determine and evaluate the performance of Public Funds management was conducted with the goal of checking the efficiency and reliability of the financial management system. In the research, it was concluded that the system was efficient in budget production and also the internal controls were found to be effective. The Government of Zambia in recent years, since the introduction of a financial management system, has been meeting the

requirement of on timely submission of the necessary and key financial reports. This study focused on Zambia only and excluded other African countries including Kenya; therefore, the study that will be carried out will focus on Kenya State Corporations and try to fill part of the gap missed by the Zambia study.

Othman (2001) outlined that the greater financial and managerial autonomy is found in statutory bodies compared to departments and ministries. Limited resources and demand increase upon public funds expenditure in the early 90's prompted reforms (Malaysian-Government, 2001). These reforms were introduced through Accounting Systems, Internal Auditing Systems and modified budgeting systems. These changes represented themes of National Public Financial Management reforms in Countries that are developed. In the developed world, the reforms adhered to are; substituting traditional bureaucratic ways with decision making decentralization (Romzek, 2000); Private Organization Accounting; Budgeting Techniques and Management methods (Pollit & Bouckaert, 2000) and lastly use of information technique systematically (Pollit & Bouckaert, 2000). These reforms assisted in improving and enhancing processes followed in decision making and also enriched the level of accountability. Though the studies done outlined introduction of accounting systems in Public funds management; they fail to conclude whether the accounting systems are efficient, reliable and effective; this gap will try to be covered by this study.

The empirical review uses data to explore the connection between the performance and financial reporting, laws and regulations, Internal Control, Cash Management and Accounting system. However, management practices that entails quality financial management system varies depending on the method used to measure financial performance. Generally, Organizations that achieve good performance outcomes are characterised by; efficient management practices; effective budget planning processes and good practices while implementing systems. Strikingly, little research inspired to break the differences in the acts of financial management in State Corporations inside different settings and methods the lead of these practices from an administrative view taking the effect of the practices on the State Corporations performance as a base.

RESEARCH METHODOLOGY

A descriptive research design was adapted by use of a case study of Kenya Rural Roads Authority in order to aid in acquiring information which describes existing events by cross-examining individuals concerning their attitude, behaviour, perceptions or values. This study was carried out at Kenya Rural Roads Authority finance department. The targeted population was 102 respondents. Purposive sampling was used in selecting Finance Manager; General Manager and Senior Accountants and in selecting a sample from the accountants and their deputies; in Kenya Rural Roads Authority accountants and the deputy accountants are based at the regional level. the sample size of the study was 49 respondents. Questionnaires were adapted as data acquiring tool for primary data. Secondary data was gathered from reports from KERRA, magazines,

newspapers and other periodical information. Data was studied using descriptive statistics and correlations.

RESEARCH RESULTS

The R value of 0.367 revealed that there was a significant positive linear relationship between Financial Reporting and Performance of Kenya Rural Roads Authority. This meant that 13.4% of the variation in Performance was outlined by the model $Y= \beta_0 + \beta_1 X_1 + \mathcal{E}$. From the findings, the results to the model $Y = 2.172+0.342X_1$ estimates were both significant at the 0.05 level of significance. This indicated that there was a significant relationship between Financial Reporting and Performance of Kenya State Corporations a case of Kenya Rural Roads Authority. The constant term implied that at zero Financial Reporting, the performance of Kenya State Corporations a case of Kenya Rural Roads Authority was at 2.172 units. From the findings, the coefficient 0.342 implied that improvement in Financial Reporting by one unit, increases performance by 0.342 units.

The R value of 0.573 revealed that there was a significant positive linear relationship between Laws and regulations and Performance of Kenya Rural Roads Authority. This meant that 32.8% of the variation in Performance was outlined by the model $Y= \beta_0 + \beta_2 X_2 + \mathcal{E}$. From the findings, the results to the model $Y = 1.784+0.474X_1$ estimates were both significant at the 0.05 level of significance. This indicated that there was a significant relationship between laws and regulations and Performance of Kenya State Corporations a case of Kenya Rural Roads Authority. The constant term implied that at zero Laws and Regulations, the performance of Kenya State Corporations a case of Kenya Rural Roads Authority was at 1.784 units. From the findings, the coefficient 0.474 implied that improvement in Laws and Regulations by one unit, increases performance by 0.474 units.

The value of R and R^2 were 0.520 and 0.271 respectively. The R value of 0.520 revealed that there was a significant positive linear relationship between Internal Control and Performance of Kenya Rural Roads Authority. This meant that 27.1% of the variation in Performance was outlined by the model $Y= \beta_0 + \beta_3 X_3 + \mathcal{E}$. From the findings, the results to the model $Y = 1.322+0.584X_1$ estimates were both significant at the 0.05 level of significance. This indicated that there was a significant relationship between Internal Control and Performance of Kenya State Corporations a case of Kenya Rural Roads Authority. The constant term implied that at zero Internal Control, the performance of Kenya State Corporations a case of Kenya Rural Roads Authority was at 1.322 units. From the findings, the coefficient 0.584 implied that improvement in Internal Control by one unit, increases performance by 0.584 units.

The R value of 0.321 revealed that there was a significant positive linear relationship between Cash management and Performance of Kenya Rural Roads Authority. This meant that 32.1% of the variation in Performance was outlined by the model $Y= \beta_0 + \beta_4 X_4 + \mathcal{E}$. From the findings, the results to the model $Y = 2.108+0.193X_1$ estimates were both significant at the 0.05 level of

significance. This indicated that there was a significant relationship between Cash management and Performance of Kenya State Corporations a case of Kenya Rural Roads Authority. The constant term implied that at zero Cash management, the performance of Kenya State Corporations a case of Kenya Rural Roads Authority was at 2.108 units. From the findings, the coefficient 0.193 implied that improvement in Cash management by one unit, increases performance by 0.193 units.

The value of R and R^2 were 0.456 and 0.207 respectively. The R value of 0.456 revealed that there was a significant positive linear relationship between Accounting System and Performance of Kenya Rural Roads Authority. This meant that 45.6% of the variation in Performance was outlined by the model $Y= \beta_0 + \beta_5 X_5 + \mathcal{E}$. From the findings, the results to the model $Y = 1.572+0.421X_1$ estimates were both significant at the 0.05 level of significance. This indicated that there was a significant relationship between Accounting System and Performance of Kenya State Corporations a case of Kenya Rural Roads Authority. The constant term implied that at zero Accounting System, the performance of Kenya State Corporations a case of Kenya Rural Roads Authority was at 1.572 units. From the findings, the coefficient 0.421 implied that improvement in Accounting System by one unit, increases performance by 0.421 units.

CONCLUSIONS

The study’s research conclusions therefore established that all the independent variables (laws and regulations, cash management procedures, internal controls and accounting systems) evaluated have weighty effect on performance at KeRRA as revealed by the strong coefficient of correlation and p-value which is less than (5 percent) 0.05. Analyzed factors total effect was very high as revealed by the coefficient of determination. Relevance of the studied variables is proved by the absolute P-value of 0.00 which is less than 5 percent (0.05), significantly calculated at a significance level of 95 percent. Therefore, the studied independent variables namely, financial reporting; laws and regulations; internal controls; cash management and accounting system have significant effect on performance at KeRRA.

RECOMMENDATIONS

KeRRA management should invest more in technology and especially a more efficient accounting system that is integrated with other relevant departments to ensure efficiency and effectiveness of the financial management system, this will assist in detection and prevention of any misappropriation as well as reduce and cumber corruption. The KeRRA management and other stakeholders should embrace on both internal and external auditing systems to control misappropriation of public resources; safeguard public assets and prevent loss or embezzlement of public funds by malicious employees. KeRRA management authority should implement policies, rules and regulations that will assist in effectiveness management and smooth running of financial management system, they should also ensure that the existing rules, regulations and laws guiding Government Organizations are strictly adhered to by every employee in KeRRA,

this can be achieved by regularly training their employees and other stakeholders through seminars, workshops. KeRRA as well as other State Corporations management should invest more in training of the staff on the usage and importance of the financial management systems.

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