THE NEXUS OF INTERNAL FINANCIAL CONTROLS AND OPERATIONAL PERFORMANCE AT GRAIN MOTOR SERVICES

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ABSTRACT

The Research investigates the relationship between internal financial controls and operational performance at Grain Motor Services. Data collected was presented qualitatively and quantitatively using tables, and graphs and also descriptive presentations. The target population for the study was mainly comprised of management (10), operational staff (30) and clients (55), the number of customers was drawn from firm's database. The sample comprised clients (55), management (10), and Operational staff (30). In determining the sample size, the researcher used the census method. This approach is to use the entire population as the sample. The interviews and questionnaires were used as data collection tools. The findings also suggested that employee participation on internal financial controls issues is a strong determinant to improved internal controls. This research managed to establish that there is strong correlation between internal controls and organisational financial performance at Grain Motor Services. It is possible for an organization especially business organizations to control its actual performance through the use of well-crafted internal controls. The successful implementation of internal controls is dependent on good enforcement, management support, improved internal policy guidelines and employee participation**.** Communication methods in most operations at Grain Motor Services should be improved. Many organizations do not have well defined channels of communication and this makes it difficult for employees not to fully understand the rationale of internal financial controls. The research also recommended that the outsourcing strategy on some of Grain Motor Services non-core activities can be a sound strategy to revise the high cost structure of the organisation. Although this is a non-profit making organisation entity, it is critical to have a clear separation of powers such that political creed does not creep into the professional running of the entity. This calls for the need to appoint even the management based on merit

Keywords: Relationship, internal financial controls, operational performance.

1.0 INTRODUCTION

Grain Motor Service has been failing to meet operational targets for the past three consecutive years and in the year 2016 and 2017, the firm has witnessed significant financial losses. Operational revenue has dropped drastically by 22 percent in first quarter of 2018 compared to the previous period, and the outlook for 2020 also look not quite impressive. The net effect of a decline in productivity revenue was a heavy knock on company bottom line and as such the firm has failed to declare dividends to its major shareholders. In the context of such financial dire straits, the firm's viability has been shaken to the core. The firm continue to operate with significant financial loopholes that requires urgent redress if the company is to recover from the current demise of poor vehicle maintenance, high workshop staff turnover as well as prolonged non-payment of staff salaries. However, the prevalence of financial literacy to fully support sound operational performance at Grain Motor Service has come under heavy scrutiny. Fears are that if viable options are not solicited timorously the business performance will continue to shrink and affecting revenue growth and operational performance at Grain Motor Service.

Various definitions regarding internal financial controls have been put forth by various authors but the most notable ones are given by Drucker (1964) cited by Drury (2009) gives the distinction between "controls" and "control", further clarifying that controls are measurement and information whereas "control" means direction. According to Drury, (2009) internal controls include all methods and procedures that direct employees towards achieving the organisation's objectives. According to Millichamp & Taylor (2008:87), the system of accounting and record keeping is unlikely to yield any meaningful results and succeed completely in the absence of a solid foundation of internal controls. Such sentiments are also stated by Abudullahi (2015) commenting on the role of budgetary controls and organisational performance.

There are many justifiable factors leading to the increasing relevance of internal controls across many organisations belonging to a multiplicity of sectors, whether public or private, profit making or non-profit making organisations. Millichamp& Taylor, (2008) underscored the indispensable nature of internal controls as being helpful through a number of ways. Recognising internal control as a process, effected by management, designed to provide reasonable assurance regarding the achievement of organisational objectives, Colbert (2004),

Drogan (2002) and Adams (2014) classified the contribution of internal controls in three broad categories namely; Effectiveness and efficiency of operations, Reliability of financial reporting, Compliance with applicable laws and regulations

Meigs and Meigs (1981**)** in their book, Accounting: The Basis for Business Decision wrote "even the best designed system of internal control will not work satisfactorily unless people assigned to operate it are competent". Each person involved must have a level of competence since the reliability of accounting records are affected by an organization's personnel policies**"**Nwoko(1988**)** in summarizing the feature of a good internal control system stated that the internal control system should not revolve around a person, no matter how highly placed otherwise in his absence, or when indisposed, there would be obvious flows. A good internal control system should revolve around procedures, processes and techniques. Training programmes should be carefully planned to familiarise new employees with their responsibilities. Polices with respect to working conditions, salary increment, and promotion are very important and can be a powerful force in encouraging efficiency and loyal service.

Internal control system and documentation quality

An important practice with respect to the design of any document used for control purposes is the sequential numbering of documents.(Abudullahi, 2015). Any missing document would create a missing number in the sequence. This practice reduces the likelihood of fraudulent use of documents by dishonest employees Carefully defined and effectively used, documents can contribute greatly to both the safeguarding of assets and accuracy of records.(Drury, 2000). No framework for internal control is perfect in the sense that it can prevent some shrewd individual from "beating the system" either by outright embezzlement or by producing inaccurate records. The task is not total prevention of fraud, nor is it implementation of operating perfection, rather the task is designing a cost–effective tool that will help achieve efficient operation and reduce temptation (Abogun, 2012).

Organisational culture and skills orientation

The plan of organisation of internal control underscores the importance of sound organisational practices. Of particular importance is the separation of assigned duties and responsibilities in such a way that no single employee can both perpetrate and cancel errors or irregularities. Helmes (1964) outlined the cardinal principles of internal control as follows:

- Responsibility for the performance of each duty must be fixed. Without the proper charge of responsibility, the quality of the control will be inefficient.
- Accounting and financial operations must be separated. An employee should not be in a position which he has control of both the records and operations giving rise to entries in the records. For example, the person in charge of general ledger should have no access to the cash or records of cash sales.
- All available proofs of accuracy should be utilized in order to assure correctness of operation.
- No one person should be in complete charge of a business transaction. Any person purposely or inadvertently will commit errors, but the probability is that an error will be discovered if the handling of a transaction is separated between persons.
- Employees must be carefully selected and trained for better performance, cost reduction and more alert employees.
- Employees should be bonded as it serves as a psychological deterrent to a tempted employee.
- Employees should be rotated on a job, and valuation for those in position of trust should be enforced.

Internal control systems including internal audits are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organisation. Jensen (2003) and Fadzil et al (2005) said that an effective internal control system unequivocally correlates with organisational success in meeting its revenue target level. Effective internal control for revenue generation involves; regular review of the reliability and integrity of financial and operating information, a review of the controls employed to safeguard assets, an assessment of employees' compliance with management policies, procedures and applicable laws and regulations, an evaluation of the efficiency and effectiveness with which management achieves its organisational objectives (Ittner, 2003).

2.0 Materials and Methods

The approach used in this research is non positivist (phenomenological), the researcher opted for this approach over positivist (hypothesis). Phenomenalism(non-positivist) stresses the significance of looking at variables in a natural setting in which they are found, thus studying variables as they are in their natural setting rather than the later that operates with pre-assumptions. This approach is more holistic and more suitable for research where the purpose is to gain more insight and understanding of an area (Kothari, 2004).

The researcher opted for a descriptive case study owing to a number of reasons. A case study allows the exploration and understanding of complex issues (Saunders et al,2015). It can be considered a robust research method particularly when a holistic, in-depth investigation is required. A case study research highlights the embeddedness of a phenomenon in its real-life context (Blumberg et al., 2005).Some of the advantages of using case studies are: an entity can be investigated in depth; more attention is given to details; the data is strong in reality due to being based on people’s experiences; generalisations are allowed; and data can be achieved for further research work, (Yin,2014). However, the challenges of the case study design lie in the difficulty in generalising the finding to other situations.

The sample comprised clients (55), management (10), and Operational staff (30). In determining the sample size, the researcher used the census method. This approach is to use the entire population as the sample. Although cost considerations make this impossible for large populations, census is attractive for small populations (e.g., 200 or less) (Saunders et al ,2015) A census eliminates sampling error and provides data on all the individuals in the population. In addition, some costs such as questionnaire design and developing the sampling frame are "fixed," that is, they will be the same for samples of 50 or 200.
Primary data sources are those sources used to get first-hand information. It also provides much more reliable information since the data is new and direct from the targeted population. Primary data sources for this research included questionnaires and interviews.
Secondary data used included published information from journals, texts and various business publications.

3.0 Results and Discussion

Relationship between internal financial controls and financial risk profile at Grain Motor Service

The main purpose of this question was to establish the relationship between internal financial controls and the organisational risk profile from the respondents. This was critical in determining possible areas of internal control reforms.Table 4.4 shows the responses given by the respondents.

Table 1: Internal financial controls& risk profile at Grain Motor Service

n=93

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Agree	17	18.28	18.3	18.3
	Strongly Agree	35	37.63	37.6	55.9
	Strongly Disagree	22	23.66	23.7	79.6
	Disagree	14	15.05	15.1	94.6
	Undecided	5	5.38	5.4	100.0
	Total	93	100.0	100.0	

Results in Table 4.5above showthat the majority of the respondents, 37.63%(Strongly agree) and 18.28% (agree) indicated that there was a very close relationship between internal financial controls and the organisational risk profile. Only 15.05%(Disagree) and 23.66% (Strongly disagree) concluded that there was no significant relationship between the two variables. 5.38%respondents were not sure. The above results find support in Christopher (2011) and Kaplan & Norton (2006) who both acknowledged the significant role of internal controls in mitigating business risk. It was Armstrong (2007) who argued that internal financial controls despite their integral role cannot entirely mitigate risk butis dependent on other factors such as strategic planning

Areas of internal financial control reforms at Grain Motor Service

The respondents (employees) were given an opportunity to identify key areas serving as major cost centres that were likely to threaten operations performance at Grain Motor Service.

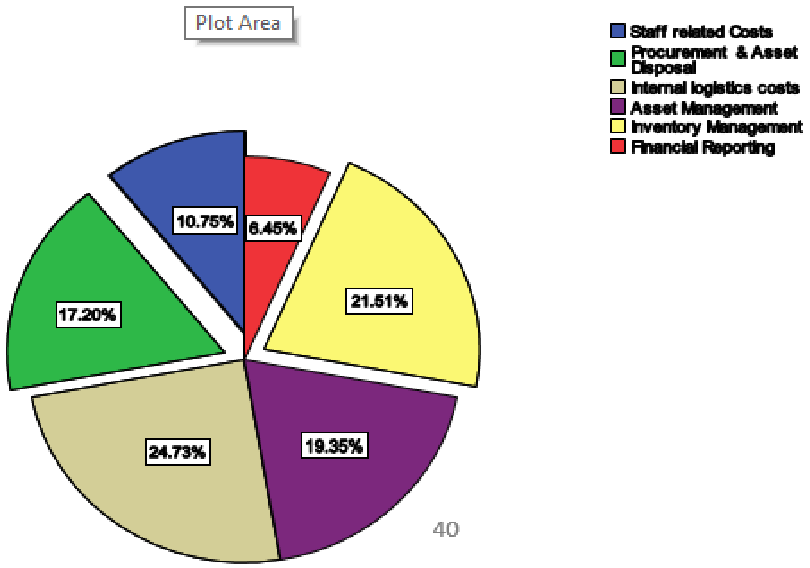

Figure 1 Potential areas of internal financial control reforms

From information obtained, respondents were able to identify main areas of internal financial controls at Grain Motor Service, which if utilised, will present immense opportunities for the institution. The majority of the respondents (24.73%) identified staff related costs as too high, the major drivers being hefty management travel allowances that are unbearably high. Inventory management (21.51%) attributed to stock theft and fraud issues. Procurement costs and asset disposal remained on the high side; mostly the spare parts used are imported.Lysons and Farrington (2006) posts that careful decisions must be made in make or buy decisions, if organisations are to remain competitive.

Factors affecting effective internal financial controls at Grain Motor Service

This question was important in establishing the major setbacks to the effective implementation of internal financial controls at Grain Motor Service. The study classified these factors as both external and internal to the organisation. Table 2 below shows response rate on the negative factors to the effective implementation at Grain Motor Service. This is critical in explaining the possible causes as to why the internal financial controls are performing sub optimally at Grain Motor Service.

Key 1 = strongly agree, 2= agree, 3= moderately agree, 4 disagree and 5= strongly disagree

Reasons for Internal Control sub-optimal performance,

	1	**2**	**3**	**4**	**5**
Manager's responsibilities in budgeting and financial control are well clearly defined	2%	5%	11%	37%	45%
Effective accounting records and procedures in budgeting and financial control are clearly understood and applied	3%	2%	9%	39%	47%
Support and commitment of top management for the system of internal controls is in place	5%	1%	13%	51%	30%
	3%	4%	13%	31%	49%

Revision of procedures where amendments are needed to make them appropriate and useful					
This organization recognises that financial controls is a management activity and not an accounting exercise	11%	5%	18%	36%	30%
This organization ensures that there is equal employee participation in internal controlsformulation and implementation	29%	43%	21%	2%	5%
There is an information system that provides data for managers so that they can make realistic predictions	6%	12%	15%	56%	11%
This organization sets internal financial control that are reasonable and achievable	14%	8%	13%	28%	37%

Identifying barriers to internal financial control reforms at Grain Motor Service

The respondents were also asked the key barriers to successful implementation of internal controls atGrain Motor Service. This was logical in the prevailing business environment where organisations are in constant look for areas of cost savings and strategic alignment. The economy in Zimbabwe has been undergoing macro-destabilization that companies need to adopt various austerity measures, and one way is revising their expenditure and cost profiles (Gono, 2005).

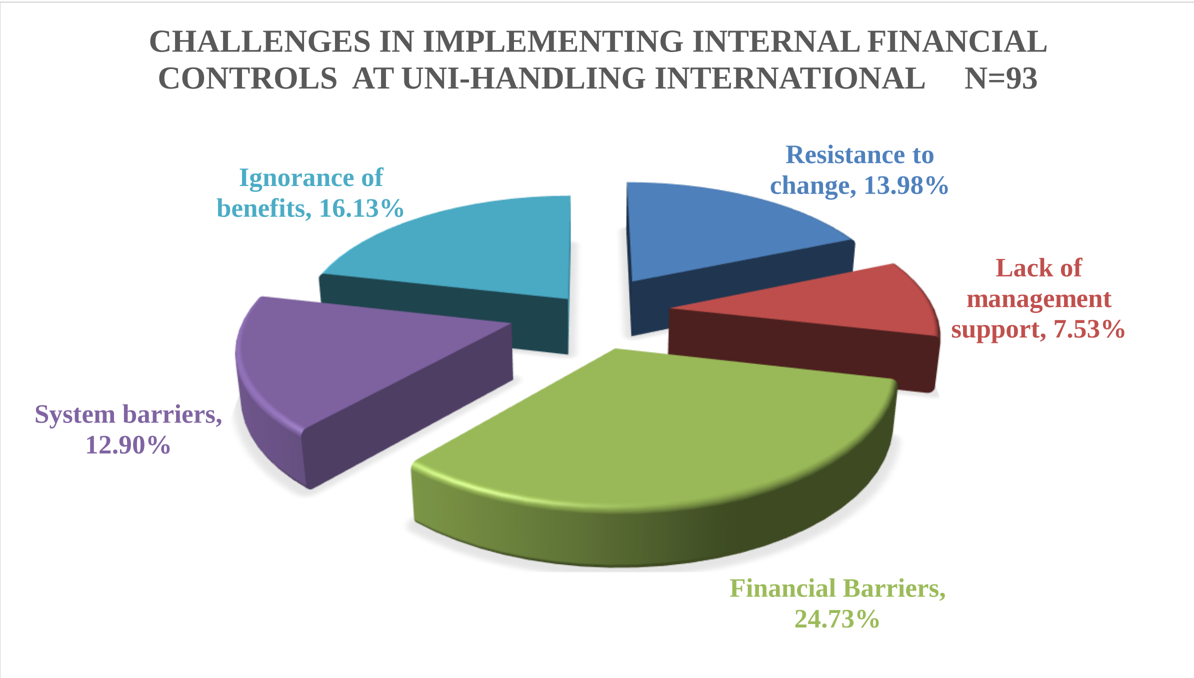

Figure 2 Barriers of Internal Financial Control Reforms

Figure 2 indicates that the key barriers to internal financial control reforms is ignorance of benefits constituting 16,13% of the respondents, structural& system barriers (12.90%), resistance to change (13.98%), financial barriers and lack of skills (24.73%) and lack of management support (7.63). The above findings find credence in Stoner, (2003), who argued the need fora resource capability as key to change management in most organisations. Lucey

(2009) regards financial barriers as major constraints to budgetary reforms in many organisations.

Internal Financial Controls & Organisational Future
Below is a list of responses gathered by the researcher from interviews conducted on management and employees pertaining to internal financial controls and the future of the organisation (Grain Motor Service). The majority of them were optimistic about the future of the organisation. Suggestions are classified below:

Key: 1 strongly agree 2agree3 Undecided 4 disagree, 5 strongly disagree

Table 3: Internal Financial Controls and Organisational Future

	1	**2**	**3**	**4**	**5**
Internal financial control reforms will improve the operations and service delivery at Grain Motor Service	74%	13%	2%	3%	8%
The internal financial control challenges at Grain Motor Servicerequire inclusive participation of stakeholders	64%	24%	0%	8%	4%
Employee training is key to internal financial control reforms at Grain Motor Service	68%	22%	1%	3%	6%
If internal financial controls control measures and reforms are fully implemented, the future for the organisation will be bright.	78%	12%	1%	5%	4%

From a combination of theoretical and empirical evidence gathered in this study, the success and effectiveness of internal financial controls in the organisation is an interaction of a number of interrelated factors. It was gathered that employee participation on internal financial controls issues is a strong determinant to improved internal controls. This research managed to establish that there is strong correlation between internal controls and organisational financial performance at Grain Motor Service. A high cost structure at the back of weak transaction recording systems was found to be having detrimental results on the organisation. The study managed to unravel among other things, a close relationship between internal financial control and the organisation risk profile. Some key antecedents to effective internal control systems were found to be equally in bad shape; these include faltering policies and guidelines, unfavourable control environment and management laxity.

Results in Table 3 above show that the majority of the respondents, 37.63% (Strongly agree) and 18.28% (agree) indicated that there was a very close relationship between internal financial controls and the organisational risk profile. Only 15.05% (Disagree) and 23.66% (Strongly disagree) concluded that there was no significant relationship between the two variables. 5.38%respondents were not sure. The above results find support in Christopher (2011) and Kaplan & Norton (2006) who both acknowledged the significant role of internal controls in mitigating business risk. It was Armstrong (2007) who argued that internal financial controls despite their integral role cannot entirely mitigate risk but is dependent on other factors such as strategic planning

Potential areas of internal financial control reforms at Grain Motor Service

From information obtained, respondents were able to identify main areas of internal financial controls at Grain Motor Service, which if utilised, will present immense opportunities for the institution. The majority of the respondents (24.73%) identified staff related costs as too high, the major drivers being hefty management travel allowances that are unbearably high. Inventory management (21.51%) attributed to stock theft and fraud issues. Procurement costs and asset disposal remained on the high side; mostly the spare parts used are imported. Lysons and Farrington (2006) posts that careful decisions must be made in make or buy decisions, if organisations are to remain competitive

4.0 CONCLUSIONS

The absence of sound information systems to aid decision making along with lack of skills, resistance to change and ignorance of the benefits and lack of management support are some of the key barriers to internal financial reforms at Grain Motor Service. Therefore, the following summary of conclusions can be made concerning internal financial control and overall financial performance of business organizations:

- Internal control increases the profitability of business organizations.
- Internal financial control helps to achieve a profit plan and the revenue targets.
- Internal financial control impacts business performances positively
- It is possible for an organization especially business organizations to control its actual performance through the use of well-crafted internal controls.
- The successful implementation of internal controls is dependent on good enforcement, management support, improved internal policy guidelines and employee participation.

5.0 RECOMMENDATIONS

- The internal control system should also be realistic by not only putting much concentration on past performance but also reflect how the future is likely to be, given the current conditions.
- Also, Grain Motor Service should look at other factors that directly affect performance. These include availability of qualified personnel to implement the internal controls, the level of technology applied and the effect of changes in demand.
- Communication methods in most operations at Grain Motor Service should be improved. Many organizations do not have well defined channels of communication and this makes it difficult for employees not to fully understand the rationale of internal financial controls.
- The outsourcing strategy on some of Grain Motor Service non-core activities can be a sound strategy to revise the high cost structure of the organisation.
- Although this is a non-profit making organisation entity, it is critical to have a clear separation of powers such that political creed does not creep into the professional running of the entity. This calls for the need to appoint even the management based on merit

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