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Effect of Internal Control on Private Higher Learning Institutions' Financial Performance in Arusha City, Tanzania

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Abstract*:* This study was about the effect of internal control on private higher learning institutions' financial performance in Arusha City, Tanzania. It was guided by the correlational study design, using a questionnaire as source of data with 40 respondents. Data was analyzed through descriptive statistics and regression analysis. The study concluded that internal control functions very well in the private higher learning institutions since there are policies and procedures for authorization, there is segregation of duties, member know their responsibilities and boundaries, accounts are reconciled on monthly basis, financial transactions are properly recorded, payments are authorized and the universities provide training opportunities for improved performance. Risk management functions well since the universities follow established policies and procedures to avoid risks, there is compensation when risks emerge, workers and students are trained on what to do when danger comes and there are clear channels of communication. Regarding monitoring, each production unity understands the limits of their performance, project units provide reports on time and verification and authorization are ensured before transactions take place. The institutions perform well financially since they gain profits in their projects, there is enough liquid cash to cater for immediate expenses and there are adequate financial resources to run the institutions. Monitoring and risk management are significant predictors of financial performance as revealed by the multiple correlation coefficient results. The study recommends that monitoring and risk management have to be taken seriously as the two out of four independent variables enhanced financial performance.

Keywords: Internal control; financial performance; environment; activities; risk management; monitoring.

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Introduction

Internal control is defined by Libby et al (2009, p. 344) as "methods an organization can uses to protect against theft of assets, to enhance the reliability of accounting information, to promote efficient and effective operations and to ensure compliance with applicable laws, regulations and codes of ethical conduct." Phillips et al. (2008) considered internal control as a process by which a company provides reasonable assurance regarding the reliability of the company's financial reporting, the effectiveness and efficiency of its operations and its compliance with applicable laws and regulations."

Internal control is one of key determinants for organizational effectiveness. Significance of internal control is brought to view by Libby et al. (2009) who argued that to be successful, every business has to make control of their daily operations. This can be accomplished by hiring the right employees, paying them the right amount of wages, ordering and receiving the right products, paying suppliers the right amounts and at the right time, setting the right price and collecting and depositing the right amount of cash. The authors advised that in order to achieve this goal, each company or organization has to establish and follow specific procedures and policies that describe how the business should be run.

Masanja and Masimba (2020) who examined the effect of internal control system on the efficiency of financial management in Arusha, Tanzania argued that internal control systems are an important aspect of financial management in any organization since organizations with weak internal control systems are bound to stagnate in the financial operations while those with strong internal control systems are destined to thrive.

Adetoso and Akinselure (2016) argued that despite the fact that internal audit and internal control system have been in existence for many years, companies still experience fraud issues which hinder the development and performance of organizations. They cited the experience of Nigerian higher education institutions where financial crimes are on the increase trends in terms of fraud supported by employees, financial irregularities, collusion among senior and highly-trusted employees to creatively defraud the universities, financial misstatement and breaches of control. The study recommended that management of the institutions need to ensure regular review of the internal audit activities to strengthen controls and avoid internal control issues that hinder the progress of the institutions. Ayedh et al. (2021) studied about the relations between internal control measures and accountability practices in Waqf institutions and revealed that internal control systems through various mechanisms cause regulatory compliance. Zhang (2017) argued that effective internal control can reduce the risk of enterprise and it can enable enterprises to enhance their value.

In Ghana, the study of Ashigbor et al. (2020) contended that the importance of internal control system in relation to achieving organizational goals cannot be overemphasized. The findings showed that internal control mechanisms have a positive and unique contribution to the performance of organizations. Due to such findings, the study recommended that the life insurance firms need to improve the various components of internal control frameworks.

Masanja (2018) argued that internal control system is a critical topic in all local government authorities in Tanzania due to the fact that most local government authorities are weak in the implementation of the internal control systems. The study revealed several challenges including unethical behavior of employees and impunity for fraudulent behaviors. The study further revealed a significant relationship between poor remuneration, inadequate fraud control and prevention, unnoticed misconduct, impunity and organizational financial performance. The study concluded that while effective internal control may cause organizations to perform optimally, poor control systems may bring about poor performance. These findings are supported by Bilegeya and Mrindoko (2023) who carried out a similar study with Commercial Banks in Tanzania and revealed that the banks' implementation of internal control had a positive relationship with financial performance; information and communication had a positive and highly significant impact on the profitability of commercial banks and monitoring had a positive and highly significant impact on the financial performance of the commercial banks. Furthermore, the study of Eugene (2019) in Moshi Tanzania, revealed that despite the identified shortfalls, internal control system in Moshi District was exceptionally effective in ensuring accountability.

This study was conducted in private universities in Arusha City. The study sought to address the financial crisis the private Universities in Tanzania are currently experiencing. The main source of funding for the universities is students' tuition fees. This does not only threaten their sustainability but also it restricts students from disadvantaged groups, including those from low income families to be admitted into such universities as their fees are relatively higher than those charged by public universities. While the government pays salaries to staff working in public universities, the situation is not the same in private universities which face a great challenge of remunerating their staff. As a result, private universities fail to expand their physical infrastructures and attract skilled and competent lecturers. This threaten not only the quality of higher education but also their survival in the global market (Komba, 2017).

The study of Mkulu and Paschal (2020) involved a sample of 100 Lecturers, 40 university students and 10 private university managers in Tanzania to establish growth and Challenges experienced by the universities. One of identified challenges is limited funding that makes it difficult for the universities to continue existing while maintaining quality. The study recommended that private learning institutions should address the problem of funding through students' loan schemes.

While some studies revealed that private learning institutions depend on tuition fee to run daily operations (Ishengoma, 2023; Komba, 2017; Mkulu & Paschal 2020), other studies indicate that management of funds in private educational institutions is a challenge. A recent study by Johnson and Pastory (2023), for instance, revealed inefficiency in implementing cash management, particularly cash planning, cash budgeting, cash collection as well as cash control in private schools. Unless something is done to ensure proper management of limited funds in the private education sector in Tanzania, their sustainability is in danger. This study therefore sought to establish the effect of internal control on financial performance in private learning institutions in Arusha City, Tanzania.

Literature Review

This part presents the review of literature. The section covers both the theoretical framework and empirical literature.

Theoretical Framework

This study was guided by two theories: Agency Theory and Stewardship Theory.

Agency Theory

Agency theory was founded by Jensen and Meckling in 1976. The theory involves a contract under which one or more persons (the principal) engage another person (the agent) to perform service on their behalf, which involves delegating some decision-making authority to the agent. According to Eisenhardt (1988), Agency Theory attempts to describe the relationship between the principal and the agent the use of contract. The theory sets out to establish if the contractual agreement is followed.

Stewardship Theory

Stewardship Theory is rooted in psychology and sociology and was developed by Muhunyo (2018). The theory presents managers as ethical persons who have to maximize the returns of a firm in good faith and without self-seeking ambitions. The theory considers managers as stewards who must act to the best of the interests of the firm and should align their interests with those of the firm (Block, 1996). Stewardship Theory brings to view the fact that managers must possess entrepreneurial skills to manage funds since the principals do not have expertise nor time to effectively run their enterprises. As a result, they hand over the operations for managers to control day-to-day operations for the benefit of the organization.

Studies on Financial Performance

Various studies have investigated on financial performance. For instance, Kipesha (2013) evaluated the performance of Microfinance institutions in Tanzania by integrating financial and nonfinancial performance metrics. The findings revealed low average financial performance among the reviewed microfinance institutions. Akhtar et al. (2012) studied on the relationship between Financial Leverage and Financial Performance. The results confirmed that the firms having higher profitability can improve their financial performance by having high levels of financial leverage. Hairuzzaman (2019 investigated about the impact of service quality and customer satisfaction on financial performance. The study revealed that service quality has a positive and significant effect on financial performance and customer satisfaction.

Methodology

Research Design

This study was guided by the correlational study design. In this study, internal control is an independent variable while financial performance is the dependent variable. The two were correlated through regression analysis tools to establish how the independent variables affects the dependent variable.

Population and Sampling

The population of the study involved accountants and administrators in higher learning institutions. Each of the two selected universities had six accountants and 15 administrators. Therefore the sample size was 40 respondents who participated in the study through filling a questionnaire.

Instruments

The study used a questionnaire as data collection instrument. The questionnaire had three major sections. The first section dealt with demographic information of the respondents. The second had items for internal control and the third had items for financial performance.

Validity and Reliability

Validity was determined by checking the clarity of statements by using data from the pilot study. Furthermore, the researchers consulted two expert in accounting to go through the questionnaire against research questions. Their comments were incorporated to improve the validity of the questionnaire.

On the other hand, reliability was established through Cronbach's Alpha calculation through the SPSS. Each variable was tested separately and those items with low reliability (below 0.6 Cronbach's Alpha were to be omitted from the questionnaire. The findings of the reliability test appear in table 1 where the Cronbach's Alpha ranged from 0.646 to .782. While the cutoff point was 0.6, all the items were included.

Table 1: Reliability Results

SN	Item	Cronbach's Alpha
1	Environment	.646
2	Activities	.743
3	Risk Management	.815
4	Monitoring	782
5	Performance	.727

Table 2: Gender of Respondents

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	25	56.8	56.8	56.8
	Female	19	43.2	43.2	100.0
	Total	44	100.0	100.0	

Statistical Treatment of Data

Demographic factors were analyzed through frequencies and percentages. Internal control and financial performance section was analyzed through mean scores and standard deviations, where mean scores were interpreted as follows: 1.00-1.49= strongly disagree, 1.50-2.49= disagree, 2.50-3.49=agree and 3.50-4.00=strongly agree. The hypothesis was tested through regression analysis.

Ethical Considerations

The researchers made sure that every concept from other authors are properly cited and referenced to avoid similarity issues. Permission to conduct the study was sought from government authorities; respondents were treated with dignity and their names were not indicated in the results.

Results and Discussions

The results section presents demographic characteristics of respondents, descriptive results and hypothesis testing as follows:

Demographics of Respondents

The analysis of data starts with presentation of demographic characteristics of respondents in terms of gender as seen in table 2. The table shows that male respondents were 25 (56.8%) while female respondents were 19 (43.2%). Therefore, the majority of respondents were males.

The mean score was in four point scale with the following options to which respondents indicated their perceptions: strongly disagree (1), disagree (2), agree (3) and strongly agree (4). The mean score interpretation was as follows: 1.00-1.49=strongly disagree, 1.50-2.49=disagree, 2.50-3.49=agree and 3.50-4.00=strongly agree as appears in table 3 to 7.

Research Question 1: What are the internal control measures that take place in selected higher learning institutions in Arusha City?

This research question sought to establish internal control measures that took place in selected higher learning institutions in Arusha City. To answer this research question, there were four possible internal control measures (control environment, control activities, risk management and monitoring) to which respondents had to agree or disagree to indicate what actually takes place in their particular institutions of higher learning.

Control Environment

To establish the existence of control environment, there were seven items in the questionnaire as reflected in table 3.

In table 3, the overall mean score for control environment is 3.2532 which is in the range of agreement. This implies that respondents generally agreed with the seven statements about control.

Table 3: Control Environment

SN	Item in the Questionnaire	Mean	Std. Dev	Interpretation
1	There are policies and procedures for authorization	3.4545	.50369	Agree
2	Stakeholders understand the importance of internal control	3.3864	.49254	Agree
3	Policies and procedures for authorization are known by key stakeholders	3.2727	.49947	Agree
4	The management makes appropriate decisions concerning fund utilization	3.2500	.53374	Agree
5	In each unity there is segregation of duties for each person	3.205	.5532	Agree
6	Each member knows his responsibilities and boundaries	3.1364	.40868	Agree
7	The University has a code of conduct policy known to key stakeholders	3.0465	.53245	Agree
	OVERALL SCORE	**3.2532**	**.31247**	**AGREE**

Table 4: Control Activities

SN	Item in the Questionnaire	Mean	Std. Dev	Interpretation
1	Accounts are reconciled on monthly basis to detect errors and fraud	3.2955	.55320	Agree
2	Financial transactions are recorded in vouchers for future references	3.2727	.45051	Agree
3	Payments are authorized by concerned officers	3.2727	.49947	Agree
4	The university provides training opportunities for control measures	3.2727	.45051	Agree
5	Payment procedures are followed	3.2500	.43802	Agree
6	There is internal check which takes place from time to time	3.1818	.49522	Agree
7	There is proper documentation in all financial issues	3.1818	.44579	Agree
8	University assets are recorded and marked	3.1591	.42826	Agree
	OVERALL SCORE	**3.2358**	**.29187**	**AGREE**

Table 5: Risk Management

SN	Item in the Questionnaire	Mean	Std. Dev	Interpretation
1	The university follows established policies and procedures to avoid risks	3.2500	.48823	Agree
2	There is compensation when risks emerge in the institutional property	3.2500	.48823	Agree
3	Workers and students are trained on what to do when danger comes	3.1591	.42826	Agree
4	The management ensures payment of insurance on time	3.1364	.40868	Agree
5	There are mechanism to identify and react to changes	3.1364	.46209	Agree
6	There is clear channels of communication with regards to risk	3.1136	.38675	Agree
7	All fixed assets have been insured	3.0682	.39753	Agree
8	Risks are assessed in a regular basis	3.0682	.39753	Agree
	OVERALL SCORE	**3.1477**	**.31354**	**AGREE**

The score of specific items in the table were also in the same range. Therefore, respondents agreed that there are policies and procedures for authorization, that stakeholders understand the importance of internal control, that policies and procedures for authorization are known by key stakeholders and that the management makes appropriate decisions concerning fund utilization. They also agreed that in each unity there is segregation of duties, that each member knows his responsibilities and boundaries and that the University has a code of conduct known to key stakeholders.

Control Activities

The overall mean score of control activities in table 4 is 3.2358 which is in the range of agreement. This implies that respondents generally agreed with eight statements about control activities in the organizations. The score of specific items in the table were also in the same range. Therefore, respondents agreed about the existence of control activities in their organizations.

In particular, they agreed that accounts are reconciled on monthly basis to detect errors and fraud, that financial transactions are recorded in vouchers for future reference, that payments are authorized by concerned officers and that the universities provide training opportunities for effective control. While training opportunities are very important for practitioners to undertake their roles in an effective way, the universities are commended for providing opportunities for professional growth. Finally, respondents agreed that payment procedures are followed, that there is internal check which takes place from time to time, that there is proper documentation in all financial issues and that university assets are recorded and marked.

Risk Management

Risk management is one of powerful ways to ensure control measures in organizations. Therefore, it was important for the study to establish the extent to which risk management takes place in the organizations under investigation. As seen in table 5, the overall mean score for risk management was 3.1477 which is in the range of agreement. This implies that the respondents generally agreed with the eight statements about risk management.

Respondents agreed that the universities follow established policies and procedures to avoid risks, that there is compensation when risks emerge in the institutional property, that workers and students are trained on what to do when danger comes and that the management ensures payment of insurance on time. Furthermore, they agreed that there are mechanism to identify and react to changes that may affect the institutions, that there is clear channels of communication with regards to risk, all fixed assets have been insured and that risks are assessed on regular basis.

Monitoring

To determine the extent to which monitoring takes place in the organizations under investigation, the overall mean score for monitoring in table 6 is 3.1851 which is in the range of agreement. This implies that respondents generally agreed with seven statements about monitoring. The score of specific items in the table were in the same range, denoting agreement. Therefore, respondents agreed about the existence of monitoring in their organizations.

Table 6: Monitoring

SN	Item in the Questionnaire	Mean	Std. Dev	Interpretation
1	Segregation of duties is available	3.3182	.60127	Agree
2	Each production unity understands the limits of their performance	3.2273	.42392	Agree
3	Project units provide reports on timely basis	3.2273	.42392	Agree
4	Verification and authorization are ensured before transactions are done	3.1591	.36999	Agree
5	Security issues are very important	3.1364	.34714	Agree
6	The university follows up issues that threaten maximized profit	3.1364	.34714	Agree
7	University projects are closely monitored	3.0909	.29080	Agree
	OVERALL SCORE	**3.1851**	**.26607**	**AGREE**

Table 7: Financial Performance

SN	Item in the Questionnaire	Mean	Std. Dev	Interpretation
1	The organization gains profits in tis projects	3.1818	.49522	Agree
2	There is enough liquid cash to cater for immediate expenses	3.1591	.36999	Agree
3	There are adequate financial resources to run the institution	3.1364	.34714	Agree
4	The organization affords to cover it operating cost	3.0909	.42141	Agree
5	The working capital is above 100%	3.0455	.48005	Agree
6	The organization does not need to request for loans for its sustainability	3.0227	.45692	Agree
7	Salaries are paid on time	3.0000	.52827	Agree
	OVERALL SCORE	**3.0909**	**.30977**	**AGREE**

In table 6, respondents agreed that segregation of duties is available. They also agreed that each production unity understands the limits of their performance, that project units provide reports on timely basis, that verification and authorization are ensured before transactions are done and that security issues are very important in the organizations. Finally, they agreed that the universities follow up issues that threaten maximized profit and the University projects are closely monitored.

The established control effectiveness in terms of Control environment, control activities, risk management and monitoring is commendable as previous findings by Zhang (2018) concluded that effective internal control enables enterprises to perform financially. However, the findings are contrary to previous study findings by Monisola and Rekiat (2016) who revealed grossly inadequacy in internal control initiatives among small business organizations in Nigeria.

Research Question 2: What is the view of respondents on financial performance in higher learning institutions in Arusha City?

This research question sought to establish the financial performance in higher learning institutions in Arusha City. The financial performance was measured by seven items in the questionnaire to which respondents had to agree or disagree.

As indicated in table 7, the overall mean score for respondents' view on the financial performance was 3.0909 which suggests that respondents generally agreed with the items. The score for specific items in the table further ranged between 2.50 and 3.49 which means that respondents agreed with all specific items in the questionnaire regarding financial performance.

The respondents agreed that the organizations gain profits in their projects, that there is enough liquid cash to cater for immediate expenses, that there are adequate financial resources to run the institutions and that the organizations afford to cover the operating cost. They also agreed that the working capital is above 100%, that the organizations do not need to request for loans for its sustainability and that salaries are paid on time. Therefore, the financial performance in the organizations under investigation was promising. These findings are contrary to those by Kipesha (2013) who evaluated the performance of Microfinance institutions in Tanzania by integrating financial and nonfinancial performance metrics and revealed low average financial performance among Microfinance institutions reviewed. The institutions reviewed were not sustainable with low relative productivity and low profitability.

Research Question 3: Is there a significant relationship between internal control measures and financial performance among selected higher learning institutions in Arusha City?

This research question sought to link the independent and the dependent variables to establish the possible existing relationships. To accomplish this task, it was necessary to test the following null hypothesis: there is no significant relationship between internal control measures and financial performance among selected higher learning institutions in Arusha City. Since there were multiple independent variables (control environment, control activities, risk management and monitoring) against one dependent variable (financial performance), the researchers used linear regression to test the hypothesis as reflected in table 8 to 12.

As seen in table 8, monitoring and risk management are the only independent variables that entered in the model. The rest of the independent variables (control environment and control activities) did not enter in the model.

Table 8: Variables Entered/Removed[a]

Model	Variables Entered	Variables Removed	Method
1	Monitoring	.	Stepwise (Criteria: Probability-of-F-to-enter <= .050, Probability-of-F-to-remove >= .100).
2	Risk Management.		Stepwise (Criteria: Probability-of-F-to-enter <= .050, Probability-of-F-to-remove >= .100).

a. Dependent Variable: Performance

Table 9: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.522[a]	.273	.256	.26726
2	.590[b]	.348	.316	.25619

a. Predictors: (Constant), Monitoring

b. Predictors: (Constant), Monitoring, Management

As seen in table 9, monitoring and risk management were found to be significant predictors of the financial performance. The multiple correlation coefficient, which is the relationship between internal control and the financial performance is .590.

The coefficient of multiple determination is .316, which is interpreted as 31.6% of the variance in the internal control is accounted for by monitoring and management. While monitoring accounts for 25.6, risk management accounts for 6% of internal control. Therefore, internal control influences financial performance of the organizations. This finding matches with Zhang (2018) who argued that internal control plays an important role in corporate governance, and it has an important impact toward financial performance.

Table 10: ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.126	1	1.126	15.768	.000[b]
	Residual	3.000	42	.071		
	Total	4.126	43			
2	Regression	1.435	2	.718	10.933	.000[c]
	Residual	2.691	41	.066		
	Total	4.126	43			

a. Dependent Variable: Performance

b. Predictors: (Constant), Monitoring

c. Predictors: (Constant), Monitoring, Management

Table 11: Coefficients[a]

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	1.154	.490		2.356	.023
	Monitoring	.608	.153	.522	3.971	.000
2	(Constant)	.794	.498		1.596	.118
	Monitoring	.403	.175	.347	2.311	.026
	Management	.321	.148	.325	2.170	.036

a. Dependent Variable: Performance

Table 12: Excluded Variables[a]

Model		Beta In	t	Sig.	Partial Correlation	Collinearity Statistics Tolerance
1	Environment	.283[b]	2.037	.048	.303	.836
	Activities	.241[b]	1.581	.122	.240	.717
	Management	.325[b]	2.170	.036	.321	.708
2	Environment	.173[c]	1.063	.294	.166	.601
	Activities	.033[c]	.158	.875	.025	.372

a. Dependent Variable: Performance

b. Predictors in the Model: (Constant), Monitoring

c. Predictors in the Model: (Constant), Monitoring, Management

The study maintains that there is a significant relationship between internal control measures in terms of monitoring and risk management and financial performance among selected higher learning institutions in Arusha City. Therefore, the null hypothesis is rejected.

Conclusions and Recommendations

Conclusions

It is concluded that internal control functions very well in the private higher learning institutions since there are policies and procedures for authorization, there is segregation of duties, member know their responsibilities and boundaries, accounts are reconciled on monthly basis, financial transactions are properly recorded, payments are authorized and the universities provide training opportunities for improved performance.

Risk management functions well since the universities follow established policies and procedures to avoid risks, there is compensation when risks emerge, workers and students are trained on what to do when danger comes and there are clear channels of communication. Regarding monitoring, each production unity understands the limits of their performance, project units provide reports on time and verification and authorization are ensured before transactions take place.

The institutions perform well financially since they gain profits in their projects, there is enough liquid cash to cater for immediate expenses and there are adequate financial resources to run the institutions. Monitoring and risk management are significant predictors of financial performance as revealed by the multiple correlation coefficient results. Therefore, selected internal control measures influence financial performance.

Recommendations

Based on the conclusions, the study recommends that monitoring and risk management have to be taken seriously as the two out of four independent variables functioned very well toward enhancing financial performance. Risk management can be improved by ensuring availability and actual utilization of policies training stakeholders on what to do when danger comes and ensuring mechanism to identify and react to changes that may affect the institutions. On the other hand, monitoring can be improved by making sure that each production unity understands the limits of their performance, project units provide reports on time and verification and authorization are ensured before transactions take place.

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