CASH RECONCILIATIONS AND THE FINANCIAL PERFORMANCE OF MEDIUM ENTERPRISES IN MANUFACTURING SECTOR IN NAIROBI COUNTY

Charity Wairimu Maina
School of Business and Economics, Kenya Methodist University, Kenya.
Wilson Muema
School of Business and Economics, Kenya Methodist University, Kenya
Doreen Mutegi
School of Business and Economics, Kenya Methodist University, Kenya

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ABSTRACT

The majority of challenges faced by medium enterprises (MEs) are fraud-related and could be avoided if in place there is a strong internal control system. The purpose of this study was to establish the influence of internal controls on the financial performance of MEs in the manufacturing sector in Nairobi County. The study was descriptive, the population for the study included 95 MEs in the areas of the food processing sector: flour milling, milk processing, and cooking oil manufacturing. The sample for the population was 77 MEs obtained through the Yamane formula at a margin error of 5%. Data for the study was collected using a questionnaire through the in-person drop and pick method. The study also collected secondary data from the financial statements of the companies on sales as well as net profit earned. Collected data was analyzed through descriptive analysis (frequency, percentages, mean and standard deviation) and inferential analysis through simple linear regression using SPSS. The study found that food manufacturing companies in Nairobi County utilize cash reconciliation, segregation of duties, inventory audit, cost management, and risk assessment as the internal controls. The study further revealed on cash reconciliation and financial performance $\beta = 0.759$, t=2.770 with associated p- value= 0.0079 which was less than 0.05). The study concluded that cash reconciliations had a positive and significant influence on the financial performance of MEs in Nairobi county. The study recommended for the manufacturing MEs in Nairobi County to keep petty cash records for reconciliation, have a real-time cash reconciliation register, reconcile payment receipts and invoice records, conduct ad-hock cash checks, have alert messages on bank transactions.

Key Words: **Internal Controls, Cash Reconciliation, Financial Performance**

INTRODUCTION

Internal controls of an organization refer to the practices, policies, and behaviors that an organization instills to respond to the operational, business, compliance, and other forms of risks that an organization needs to take care of to effectively and efficiently carry on its business and remaining a performing business. For the ultimate purpose of safeguarding a company's assets, an organization needs to instill discipline through policies and a regulatory framework that safeguards loss through loss or frauds (Ewert & Wagenhofer, 2016). The efforts include maintaining proper books of accounts and creating accountability for any particular transaction including incurring liability, these efforts ensure compliance with the standard internal control policies set up by the firm's management. Internal control is part of management that ensures that an organization is always steered towards achieving its goals and objectives. However, there are chances always that there is the risk of the company staff not adhering to the policies resulting in financial loss or a company failing to undertake some projects as a result of financial misappropriation (Ghafoor et al., 2019).

The ultimate decision of internal controls rests on the management department. The management decisions come up with financial plans to achieve the goals and objectives of the organization. Controls assists in ensuring that the goals are smoothly achieved in the organizations by instilling checks and monitoring the progress of the plans. Controls in institutions are carried out through the introduction of ad-hock checks, carrying out appraisals to check on performances. Controls are mainly carried out to ensure that the employees do not conduct unethical practices that can result in an organization losing its money or causing reputational issues (Ntayi, 2017).

Treadway Commission Report of 2017 in the United States of America (USA) noted that the presence of a weak internal control system or the absence of the internal control system is the major cause for fraudulent financial reporting in both the private and public sectors. Processing fraudulent expenditure and lack of an internal control system on the procurement practices result in the loss of public fiancé or acquisition of projects that do not give value for the money I the public sector mainly referred to as corruption (Gee et al., 2019).

According to Ahmed et al. (2018) who studied the role of entrepreneurship orientation on the financial performance of small and medium enterprises in South Africa noted that SMEs in South Africa were at the front in the provision of decent jobs among the citizen, they noted that out of 10 jobs created in the country 8 came from the private sector, therefore calling for the best entrepreneurial qualities including risk alertness in ensuring that the company was safe from both internal and external risk and aggression. 57% of the surveyed entrepreneurs revealed they had experienced some sort of fraud being commitment at some point in time by their employees including shoplifting or cooked financial statements.

In Kenya major companies have reported high financial losses and declining profits as a result of fraud, corruption and other financial irregularities among these companies are Kenya airways, Uchumi supermarkets, Mumias sugar companies, and others that have losses in billions and millions, on the other hand, banks including Eco bank, Dubai bank and imperial banks have completely collapsed as a result of fraudulent activities resulting from the presence of weak internal controls or complete absence of it (Koech, 2018).

Julie (2019) studied the influence of internal controls on the financial performance of small and medium enterprises in Kisumu County. It was revealed that the majority of the companies lacked an internal control department and if available they lacked personnel with adequate skills and competencies to prevent or respond to fraudulent activities, the departments also lacked financial resources to effectively respond to the challenges. The effect of the weak internal control department was possible collusion between employees to commit fraud, loss of collected revenues, and petty cash. Kamau (2016) noted that strong internal controls had a positive significant effect on the financial performance of companies listed with Nairobi stock exchange through strong internal control the company were able to observe high levels of integrity, ethical values, risk assessment, monitoring, and evaluation, appraisal of projects, therefore, the improvement in financial performance.

Many businesses across the world are faced with failure challenges with a majority of them not surviving their third anniversary despite their great roles in creating employment and being a major contributor to the countries' gross domestic product. The majority of these challenges are fraud-related and could be avoided if in place there is a strong internal control system (Business, 2018).

Manufacturing companies in Kenya have faced poor performance both financially and ultimately their collapse as a result of fraudulent activities committed by their employees which have resulted in adverse impacts on the economy through job losses. According to an economic survey of 2017, only 20% of manufacturing firms make it to their third anniversary Kenya National Bureau of Statistics, 2017). Due to the nature of manufacturing companies outsourcing raw materials for production, purchase orders are manipulated or stock is lost at go-downs and warehouses without a proper tracking record of at which stage it disappeared. On the other hand, petty cash on small transactions relating to the purchase of stationery and running of errands is another cash- cow for people handling cash (Odhiambo, 2016).

Past studies have indicated that companies that do not maintain proper books of accounts and mitigate losses through risk management practices have registered low performance. However, there is little knowledge of how weak or strong internal control influences the financial performance of manufacturing companies in Nairobi County. Available scholarly work points out that non-governmental organizations and multinational corporations with strong internal controls have noted increased project success and financial performance respectively (Koech, 2018; Julie, 2019). While the previous studies concentrate on detective internal controls and financial performance the intended study was an all-inclusive one seeking to know how preventive, detective and corrective internal controls influence financial performance. The purpose of the study was to establish the influence of internal controls on the financial performance of medium enterprises in the manufacturing sector in Nairobi County. Specifically, the study sought to answer the question: what is the influence of cash reconciliations on the financial performance of medium enterprises in the manufacturing sector in Nairobi County.

THEORY AND HYPOTHESIS

Amponsah et al. (2017) carried out a study on the influence of internal controls on the financial performance of Insurance companies in Ghana. The study was conducted among 97 companies obtained through stratified and random sampling. The questionnaire for the study included structured questions on the existence of Petty cash records, countersigning of daily cash collections by more than one officer, surprise cash checks during the daily weekly as well as monthly, availability of cash management software to check available bank balances in real-time. The study also included profitability and liquidity as measures for financial performance. The study established through inferential statistics that there was a strong positive relationship between cash management practices of reconciliation and profitability of the companies.

Akimana (2019) studied the influence of internal cash management policies as internal controls on the financial performance of agribusiness enterprises in Nairobi County. The study comprised 161 firms in the daily sector, value addition in fruits, and food processing. The study used a questionnaire as the major tool of data collection where adoption of ICT in real-time conciliation and segregation of duties in reconciliation was considered as cash management practices. The study considered profitability and liquidity as major measures of financial performance in the companies. The study established through correlation and regression analysis that there was no significant relationship between cash reconciliation as management practices and financial performance in these studies.

Alzeban and Sawan (2015) carried out a study on the influence of investing in routine cash checks on the financial performance of hospitals in the United Kingdom offering only outpatient services. The study was conducted among 152 stratified sampled health centers. The data for the study was emailed to the companies where the financial managers were targeted for the study. Regression analysis conducted among the costs of routine cash checks and profitability revealed a significant negative relationship between reconciliation costs and profitability of these hospitals. The study, however, recommended only standard surprise checks on cash reconciliation to avoid the higher financial implication of budget that in turn leads to a negative effect on the profitability of the health centers.

Hθ: Cash reconciliations do not significantly influence the financial performance of medium enterprises in the manufacturing sector in Nairobi County

The study adopted a descriptive research design to unearth the situation on the influence of internal controls on the financial performance of medium enterprises in Nairobi County. The research design was adopted due to its nature of reporting situation as it is in the field with no interference on the findings, also the descriptive research design allowed for the building of hypothesis, and therefore, inferences on the data was done easily. In the current study, all the medium enterprises in Nairobi County were considered as the population targeted in the study. According to the Nairobi county government, there are 95 medium enterprises in the food industry in Nairobi County: flour millers, milk processing, and cooking oil. The study considered all the 95 accountants to provide data for the study because the study is in the financial area.

The sample size for the study was 59 respondents.
The study used the Yamane formula to determine the sample size.

Yamane Formula, $n = \frac{N}{1+N(e^2)}$ ……………………………………..….. Equation (i)

Where n is the correct sample size, N is the target population, e is the margin of error. Therefore, the sample size was determined as follows.
Within a margin error of 5%, the formula gave a sample size of 59 respondents. A random sampling procedure was also done to ensure an equal chance of respondents being selected (Fowler Jr, 2018).
n=95/ [1+95(0.05*0.05)] = 95/1.2375=76.76 which is 77 to nearest figure.

Data Instrument

Data for the study was collected using a questionnaire as the main instrument. Data for the study was collected through the drop and pick method of the questionnaire through the assistant of two research assistants. Data for the study was quantitative. On the quantitative data coming from the closed end, questions were analyzed through descriptive research design and inferential statistics using a statistical package for social analysis (SPSS). Descriptive statistics carried out included frequency distribution, percentages, mean and standard deviation. After analysis data was presented on tables and interpreted narratively. Inferential statistics were carried through simple linear regression analysis:

$Y = \alpha+\beta_1 X_{1+}\varepsilon$...Equation (ii)

Where Y is the performance of the medium-size enterprises, **ε** is the error term

RESULTS AND DISCUSSION

Response Rate

The study targeted to collect data from 77 respondents who include financial managers or accountants in food manufacturing medium enterprises in Nairobi County. The study managed to collect both primary and secondary data from 54 companies. This response represents a 70.12 % response rate.

Demographic Characteristics

The majority of the respondents are between the age of 41 and 50 years as shown by 42.6%, the majority of the respondents were graduates as shown by 51.9% (28) and the majority of the respondents had worked in the organization for a period between 6 and 10 years as shown by 42.6% (23).

Petty cash records

Table 1 shown that the majority of the respondents as shown by 94.4% (51) already kept petty cash records for reconciliation only 5.6% (3) of the respondents did not keep petty records for their companies. Petty cash is very sensitive and requires special records because many firms lose money in small bits which in summation results in huge financial loss. Similar findings were revealed by Amponsah et al. (2017) who carried out a study on the influence of internal controls on the financial performance of Insurance companies in Ghana. The practices of internal controls included the existence of Petty cash records, countersigning of daily cash collections by more than one officer, surprise cash checks during the daily weekly as well as monthly, availability of cash management software to check available bank balances in real-time. The study also included profitability and liquidity as measures for financial performance. The study established through inferential statistics that there was a strong positive relationship between cash management practices of reconciliation and profitability of the companies.

Table 1: Petty Cash Records

Response	Frequency	Percent
yes	51	94.4
No	3	5.6
Total	**54**	**100.0**

Reconcile Payment Receipts and Invoice Records

Table 2 revealed that the majority of the manufacturing companies reconciled payment receipts and invoice records as shown by 96.3% (52) whereas only 3.7% (2) did not conduct a reconciliation of payment receipts against invoice records. Ramamoorti et al. *(*2017) concurred that reconciliations done on cash involve verification of amount to be paid for purchases by an appointed authority to avoid fraud through payment for non-existence goods or services, in this case, local purchase orders and invoices are verified before payments are done.

Table 2: Reconciliation of Payment Receipts and Invoice Records

Response	Frequency	Percent
yes	52	96.3
no	2	3.7
Total	**54**	**100.0**

Number of times cash is reconciled weekly

Table 3 revealed that most of the manufacturing companies carried out about 6-time cash reconciliation as shown by a mean of 5.58. The company that had carried out the highest number of cash reconciliation weekly did 8 times whereas the company that did the least number of cash reconciliation weekly did 3 times. Similar findings by Amponsah et al. (2017) on the influence of internal controls on the financial performance of Insurance companies in Ghana revealed that routine cash checks during the daily weekly as well as monthly impacted positively on the financial performance of insurance companies.

Table 1: Number of Times Cash Is Reconciled Weekly

Cash reconciliation	N	Minimum	Maximum	Mean	Std. Deviation

times on average in a week is cash reconciled	54	3	8	5.58	1.252

Financial Performance

Table 4 shown that the majority of the manufacturing companies had an average profit of kshs 90.94 Million; the majority of the manufacturing companies in Nairobi county made annual average sales of kshs 271.64 million whereas the majority of the manufacturing companies in Nairobi County had a profit margin of 33.97% as shown by a mean of 33.976. A similar study by Gee et al. (2019) revealed that in manufacturing organizations, financial performance can be improved through the reduction of wastage in the production process to improve on profit margin and operation efficiency margin. The critical success factors in a manufacturing organization fall within the ability to be economical and efficient in the whole production line. Financial statements and reports prepared by the organization provide crucial information relating to performance, such information including sales revenues and profits levels are important in communicating key information that guides decision making among investors.

Table 4: Descriptive Statistics on Financial Performance

Financial Measure	N	Minimum	Maximum	Mean	Std. Deviation
Average profit (M)	54	33.90	149.32	90.9412	33.87956
Average sales(M)	54	109.0	534.0	271.648	105.9343
Profit margin (%)	54	19.595	48.424	33.97582	5.055909

Hypothesis Testing

Hypothesis tests were conducted to ascertain whether cash reconciliation had a significant influence on the financial performance of medium enterprises in Nairobi County, which was conducted through regression analysis.

Model Summary

Table 5 shown a Rsquare of 0.169 which revealed that cash reconciliation could explain 16.9% of the changes in the financial performance of the medium enterprises in Nairobi County.

Table 5: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.412	0.169	0.126	.985

ANOVA

Table 6 revealed an F-ration of 51.040 which was associated with a p-value of 0.001 showing that the model was fit, therefore reject the null hypothesis that the variables in the model had no significant relationship.

Table 6: ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1089.8	5	217.960	51.040	0.000
	Residual	204.98	48	4.270		
	Total	1294.78	53			

a. Predictors: (Constant), Cash reconciliation
b. Dependent Variable: Financial Performance

Regression Coefficients

Table 7 above shown that cash reconciliation had a positive and significant influence on financial performance (β = 0.759, t=2.770, p- value= 0.0079 which is less than 0.05). Amponsah et al. (2017) concurred the relevance of internal controls on the financial performance of Insurance companies in Ghana. The study established through inferential statistics that there was a strong positive relationship between cash management practices of reconciliation and profitability of the companies.

Table 7: Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.739	0.226		3.270	.0019
	Cash reconciliation	0.759	0.274	0.691	2.770	.0079

a. Dependent Variable: Financial Performance

CONCLUSIONS AND RECOMMENDATIONS

The study concluded that cash reconciliations have a positive and significant influence on the financial performance of food manufacturing medium enterprises in Nairobi County. The study recommended for the manufacturing medium enterprises in Nairobi County to keep petty cash records for reconciliation, have a real-time cash reconciliation register, reconcile payment receipts and invoice records, conduct ad-hock cash checks, have alert messages on bank transactions, introduce a real-time cash control system and ensure many times as possible on cash reconciliation on weekly basis to enhance internal control which will in effect enhance financial performance.

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