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Effect Of Risk Management On The Financial Performance Of Companies Quoted In The Nairobi Securities Exchange

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ABSTRACT
Internal Controls are processes designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Internal Control Systems play an important role in every organization as it assist in realization of their financial performance goals. The study sought to determine the effect of internal control systems on financial performance of companies quoted in the Nairobi Securities Exchange (NSE). To achieve the objective of this study, the research specifically looked at the following objectives, control environment, internal audit, risk management, internal control activities and role of corporate governance controls on the financial performance of quoted companies in Kenya. The study adopted survey research design. The population chosen for this study was all 62 companies quoted in NSE. The study used a sample of 38 companies from a target population of 62 companies quoted in NSE. The sample was drawn using stratified random sampling technique. The study relied on both primary and secondary data. Primary data was collected using structured questionnaires while the Secondary data was extracted from audited annual reports, publications and document analysis. Data analysis used both descriptive and inferential statistics. Frequency tables were prepared, averages determined and tests of hypothesis like ANOVA, chi-square, correlation analysis were done. The data was analyzed using statistical package for social scientists (SPSS) computer software version 21.0. The results and findings concluded that there was significant association between risk management and financial performance and that the focus should now move from a compliance and financial control function to facilitating organizations to proactively identify, assess and control risks. The study recommends that companies quoted in Nairobi securities exchange should have risk management function adequately entrenched in all their day to day operations to ensure continuous improvement in their financial performance.
Key Words: Internal Controls, Control Environment, Information and Communication, Monitoring Activities, Profitability, Efficiency

INTRODUCTION

The paper focuses on the background to the study in which the concept of internal control system is put into perspective. It also clearly brings out the general perception that; institution of internal control systems will always lead to improved financial performance. The paper handles the purpose of the study which is to determine the effect of internal control systems on the financial performance of quoted companies in Nairobi Securities Exchange. The chapter also brings into focus the scope of the study as covering companies quoted in Nairobi Securities Exchange

The companies listed at the NSE are classified into the following segments: Agricultural seven companies, Automobiles and Accessories three companies, Banking eleven companies, Commercial and Services nine companies, Construction and Allied five companies, Energy and Petroleum five companies, Growth Enterprise Market Segment two companies, Insurance six companies, Investment four companies, Manufacturing and Allied nine companies, Telecommunication and Technology one company. Suspended companies were excluded from the study, as their current trading performance is nonexistent. The sampling method used was stratified sampling technique as the companies are heterogeneous and falls into different segments. This sampling method ensured that the sample obtained was representative of the population. The findings were then projected to the whole segments represented at NSE.

Internal Controls are processes designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Mwindi, 2008). Tunji (2013) and Dhillon (2001) argue that internal controls encompass a set of rules, policies, and procedures an organization implements to provide reasonable assurance that: (a) its financial reports are reliable, (b) its operations are effective and efficient, and (c) its activities comply with applicable laws and regulations. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework look at internal control as a process, affected by an entity's board of directors, management and other personnel, designed to provide "reasonable assurance" regarding the achievement of objectives in the following categories: Effectiveness and efficiency of operations, reliability of financial reporting, compliance with applicable laws and regulations.

The COSO framework (2013) identifies five main elements of internal control systems against which the review should take place. These include Control environment, Risk assessment, control activities, information and communication and monitoring. There is a general expectation that institution and enforcement of proper internal control systems will always lead to improved financial performance. The COSO framework also found out that properly instituted systems of internal control improve the reporting process and also give rise to reliable reports which enhances the accountability function of management of an entity. Internal controls are put in place to ensure safe custody of all companies' assets; to avoid misuse or misappropriation of assets and to detect and safeguard company's resources against probable frauds.

Recently a number of financial scandals have been witnessed in quoted companies both in local and international scene. For example in America, investors lost $180 billion in World Com Scandal of 2002, $150 million in Tyco Scandal of 2002, $1.4 billion in Heath South Scandal of 2003 (the largest publicly traded company) and $3.9 billion in America international Group (AIG) scandal of 2005, among several financial fraudulent activities affecting publicly quoted companies. In the early 2000s, a number of high-profile corporate accounting scandals resulted in some investors, company personnel and other stakeholders suffering significant losses. These scandals resulted in demands for a greater emphasis on corporate governance. In July 2002, the United States Congress passed the Sarbanes-Oxley Act (SOX) in an effort to reduce public concern over a number of high profile corporate failures in the US. Ashbaugh-Skaife et al., (2008) documented that firms reporting internal control weaknesses have more complex operations; have experienced recent changes in organizational structure; are at increased exposure to accounting risks; and have fewer resources to invest in internal control. Furthermore, Doyle et al., (2005) indicated that firms with material weaknesses have a lower earnings quality than those that do not report material weaknesses. Additionally, Hamersley et al., (2007) showed a negative market reaction to firms that had reported material weaknesses in internal control per the requirement of Sarbanes-Oxley Act, Section 302.

In South Africa, cases of accounting scandals have been recorded in Randgold and Exploration companies. In Nigeria, the managing director and chief financial officer of Cadbury Nigeria were dismissed in 2006 for inflating the profits of the company for some years before the company's foreign partner acquired controlling interest. These scandals emphasize the need to evaluate, scrutinize, and formulate systems of checks and balances to guide corporate executives in decision-making. These executives are legally and morally obliged to produce honest, reliable, accurate and informative corporate financial reports periodically (Hayes et al., 2009).

In Kenya, Statistics available from CMA 2014 have shown most firms especially quoted companies have registered declining financial performance in the recent years. Examples include Kenya Airways which reported a loss Ksh 10 billion, Mumias Sugar company Ksh 3.4 billion loss, Uchumi super markets Ksh

226million loss, Eveready East Africa limited Ksh 248million loss, CMC holding suspended from NSE and so on. Rezaee (2012) revealed that financial reporting is ineffective due to corruption, frauds, and ineffective regulations that have led to poor financial performance in publicly quoted companies. According to World Economic Forum (WEF), Kenya was ranked position 106 out of 144 due to mega corporation scandals. Some of the companies cited by the report for poor corporate governance were CMC and centum Ltd.

Companies listed in Nairobi stock exchange are expected to have effective and efficient internal controls to provide reasonable assurance about the achievement of the entity's objective with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. According to Capital Market Authority Act (cap.485, gazette Notice no. 3362), the board of public listed company is required to maintain a sound system of internal controls to safe guard the shareholders investments and assets. Despite existence of elaborate system of internal controls in quoted companies, a number of quoted companies continue to experience financial distress which has threatened their survival in the business.

Internal Control Systems

The 2013 COSO Framework defines Internal Control system as "a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance'. The control environment sets the tone of an organization, influencing the control consciousness of its employees. The Committee of Sponsoring Organizations (COSO), a voluntary organization offering guidance on monitoring internal controls, report indicates that this component is the foundation for all other components of internal control, providing both discipline and structure to the organization. The COSO framework identifies five main elements of a control system against which the review should take place. These include Control environment, Risk assessment, control activities, information and communication and monitoring. Internal control systems operate at different levels of effectiveness. Determining whether a particular internal control system is effective is a judgment resulting from an assessment of whether the five components - Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring - are present and functioning. Effective controls provide reasonable assurance regarding the accomplishment of established objectives.

According to Feng, Li and McKay (2009), the quality of an organization internal control system has significant impact on the accuracy of management guidance, likewise firms that disclose ineffective internal controls system have larger tendency of experiencing management errors in their operation than those firms that report effective internal controls system. Schneider and Church (2008) in their study stated that 'effective internal controls systems are fundamental drivers toward earnings quality. In the same vein, effective internal control system has an essential role to play in a firm's success (Jokipii, 2010).

Other scholars have defined Internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of a firm's objectives in the effectiveness and efficiency of operations, reliability of financial and management reporting, compliance with applicable laws and regulations and protect the organization's reputation. Effective internal control system operates when some specific procedures are adopted by the management. International Accounting Standards (IAS) categorizes internal control types as a plan of organization, segregation of duties, control of documents, safeguarding of assets, competence of staff, arithmetic and accounting controls, recording and record keeping , supervision, authorization and approvals, vocation and rotation of duties, cost feasibility , routine and automatic checks (Kaplan, 2008). The above studies greatly support that effective internal controls significantly contribute to financial performance of companies.

Financial Performance

Financial performance is a measure of company's policies and operations in monetary terms. It is a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation. There are many different ways to Measure Company's financial performance. This may be reflected in the firm's return on investment (ROI), return on assets (ROA), value added, among others and is a subjective measure of how a firm can use assets from its primary mode of business and generate revenues (Mishkin, 2007) .

Positive financial performance in a firm can be achieved by eradicating waste in benefits services processes and systems. The "critical success factor" for a firm is the degree to which it fulfils its set objectives and mission in terms of being efficient, effective and economical. The information obtained from a sound internal control system as reflected from financial statements will provide a report on a firm's financial performance and position that is useful to a wide range of users for assessing the stewardship and making economic decisions (Doyle et al., 2007).

Internal Control Systems are very instrumental in achieving the firm's set mission and objectives; hence Value for Money. The main approach to VFM is the firm's control over the use of resources in order to achieve its set objectives. Heads of departments should establish sound arrangements for planning, appraising, authorizing and controlling operations in order to achieve positive Financial Performance. Financial Performance and Value for Money are used to assess whether or not a firm has obtained the maximum benefit from the goods and services it acquires and / or provides, within the resources available to it (COSO, 2013).

Value for Money is not paying more for a good or service than its quality or availability, justifies. A well public spending implies a concern with economy (cost minimization), efficiency (output maximization) and effectiveness (full attainment of the intended results). The most effective way to improve Financial Performance is by reducing the level of irregularity and fraud through improvements in the firm's systems of internal financial control. Shareholders need to be assured that their resources are being used efficiently and effectively in providing the right service at the least cost. Financial Performance analysis needs to pay attention to total risks and is related to concepts of efficiency and effectiveness (CPA Australia, 2008).

Internal Controls and Financial Performance

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 organization (Jensen, 2003). Internal control therefore has a much broader purpose such that the organization level of control problems associated with lower revenues, which explore links between disclosure of material weakness and fraud, earnings management or restatements internal controls provide an independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better revenue generation (Beeler et al., 1999). Fadzil et al., (2005) said that an effective internal control system unequivocally correlates with organizational 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 organizational objectives (Ittner, 2003).

There are three major classifications of internal controls; preventive, detective, and corrective. Preventive controls predict potential problems before they occur, make adjustments, and prevent an error, omission or malicious act from occurring. The detective controls are used to detect and report the occurrence of an omission, an error or a malicious act. Finally, the corrective controls help in ensuring that the impact of a threat is minimized, identify the cause of a problem as well as the correct errors arising from the problem. Corrective controls correct problems discovered by detective controls and modify the processing system to minimize future occurrence of the problem (Singleton et al., 2006).

According to CPA Australia (2008) each internal control procedure is designed to fulfil at least one of these eight criteria discussed below.

Completeness: that all records and transactions are included in the reports of business. Accuracy: the right amounts are recorded in the correct accounts. Authorization; the correct levels of authorization are in place to cover such things as approval, payments, data entry and computer access. Validity; that the invoice is for work performed or products received and the business has incurred the liability properly.

Existence of assets and liabilities: Has a purchase been recorded for goods or services that have not yet been received? Do all assets on the books actually exist? Is there correct documentation to support the item? Handling errors; that errors in the system have been identified and processed. Segregation of duties; to ensure certain functions are kept separate. For example, the person taking cash receipts does not also do the banking. Presentation and disclosure; timely preparation of financial reports in conformity with generally accepted accounting principles. All internal controls, whether administrative or accounting, are linked to a financial consequence. For example, keeping records for long service leave entitlements is an administrative control but it does ultimately have a financial consequence.

Nairobi Securities Exchange

The Nairobi Securities Exchange (NSE), was formed in 1954 as a voluntary organization of brokers, is now one of the most active markets in Africa. The NSE has played a role in increasing investor confidence by modernizing its infrastructure. At the dawn of independence, stock market activity slumped due to uncertainty about the future of independence in Kenya. However, after three years of calm and economic growth, confidence in the market was rekindled and the exchange handled a number of highly over-subscribed public issues (Moyes et.,2006).

In 1980s the Kenyan government realized the need to design and implement policy reforms to foster sustainable economic development with an efficient and stable financial system. In particular, it set out to enhance the role of the private sector in the economy, reduce the demands of public enterprise on the exchequer, rationalize the operations of the public enterprise sector to broaden the base of ownership and enhance capital markets in the formation of a regulatory body “the capital markets authority” in 1989, to assist in the creation of an environment conclusive to the growth and development of the country’s capital markets as detailed in the Statistical Abstract of 1990. The NSE is poised to play an increasing role in the Kenyan economy, especially in the privatization of state owned enterprises. In 2006 the NSE installed the automated trading system (ATS), which has resulted in high trading volumes with the daily market turnovers exceeding Ksh110 billion in some days. The implementation of the ATS provided for longer trading hours, increased trading efficiency and price discovery Economic Survey of 2007.

The boom experienced at the NSE in the recent past has resulted to an increase in the volume traded, with the stock market registering increased activity especially with initial public offers. The rapid growth of the NSE has been subject to debate among scholars, Politicians and the general public. Statements have been reported in the media questioning the phenomenal growth of the NSE in the past three years and more specifically the appreciation of stock prices of quoted companies. The growth has been attributed to the high growth rate registered by the Kenyan economy in the last three years and the changing international perception of Kenya as a secure investment destination as reported in the Statistical Abstract of 2008.

NSE introduced the NSE All-share Index (NASI), which is complementary to NSE 20 share index in an effort to provide investors with a comprehensive measure of the performance of the stock market. The Nairobi Stock Exchange is one of the leading developing markets in the world and investing in stocks has been hyped so much that the mention of the IPO reflexively elicits a pat on the pocket. Starting with KenGen offer in May 2006, the NSE has seen tremendous growth in the number of retail investors. However, the majority of investing public is still in the dark on the operations of the stock market. Many still do not bother to follow up on their investments, preferring to once in a while to keep the tab through media reports.

The Nairobi Securities Exchange facilitates good management of companies by asking them to give periodic reports of their performance. Providing a daily market reports and price list to ensure that investors know the worth of their assets at all times. In July 2011, the Nairobi Stock Exchange Limited changed its name to the Nairobi Securities Exchange Limited. The change of name reflected the strategic plan to evolve into a full service securities exchange which supports trading, clearing and settlement of equities, debt, derivatives and other associated instruments.

Corporate Governance guidelines of 2002 issued by the NSE actually recognizes the important role played by the Internal Audit function and actually gives the various best practices companies can adopt in regards to setting up an audit function. In Kenya, the internal audit function is becoming increasingly important and it's very crucial in the public sector. All listed companies are required to have an internal audit department. The board should establish an internal audit function which should be independent of the activities they audit and should be carried out with impartiality (Capital Markets Authority Act Cap. 485A).

Most of the companies quoted at the Nairobi Stock Exchange (NSE) have not adopted corporate governance guidelines and those who have, do not enforce them. The confused application of the state corporations Act, Companies act, capital market regulatory Authority Act and various circulars and directives from government authorities often create conflict structures and procedures, (Macharia, 2012).

Statement of the Problem

Globally, financial scandals have been witnessed triggering reaction for tighter regulation and enhanced standards for accounting and corporate governance (Sarbanes and Oxley, 2002). In America, scandals such World.com and Enron in year 2002 where investors lost over $180 billion led to enactment of Corporate and Auditing Accountability and Responsibility Act (Sarbanes and Oxley, 2002). These major financial scandals were caused by poor internal control systems including weak corporate governance which the Sarbanes Oxley Act of 2002, tried to address.

In Kenya, Statistics available from CMA report of 2014 have shown most firms especially quoted companies have registered declining financial performance in the recent years. Examples include Kenya Airways which reported a loss ksh 10 billion, Mumias Sugar company Ksh 3.4 billion loss, Uchumi super markets ksh226million loss, Eveready East Africa limited Ksh 248million loss, CMC holding suspended from NSE.

Data available from a World Bank report of 2014 show that declining financial performance of quoted companies adversely affects the economic growth of the Kenyan economy. Most quoted companies have functional internal audit departments charged with responsibility of providing management with re-assurance that internal control systems are adequate and quality of services is in place. There is however, continued poor financial performance, where budgets are not followed, rules and regulations on the use of finances are not adhered to and there is massive unaccounted for funds. This has put companies at risk of financial inadequacy, employee dissatisfaction and poor financial performance (Kaplan, 2008).

In the aftermath of corporate scandals and the global financial crisis, corporate governance has received significant attention from regulators and the public. Regulatory responses have focused on increasing disclosure requirements relating to corporate governance and this has, in turn, driven increased awareness and demand for internal assurance on corporate governance processes, including internal control and risk management. Thornton (2004) observes that in recent years, stakeholder's expectations from internal audit functions have changed significantly. The focus has now moved from a compliance and financial control function to facilitating organizations to proactively identify, assess and control risks. Previous studies have focused on the contribution of internal control systems on financial performance of small and medium scale business enterprises (Nyakundi, Nyamita and Tinega, 2014). Mawanda (2008) researched on effects of internal control systems on financial performance in an institution of higher learning. Khamis (2013) researched on contribution of internal control systems to financial performance of financial institution. Majority of the studies involving internal controls have focused on investigating the characteristics of firms that disclose material weaknesses in internal control. Al-Matari et al., (2012) noted that there was lack of research in developed as well developing nations regarding the direct association of internal control systems and firm performance.

In the Kenyan, researches done relating to internal control systems and financial performance do not show directly the effect of corporate governance and government policy on financial performance of companies. For example case study researches done by Wanjara (2014) and Kamau, (2013).

This study therefore focused on wider scope of companies quoted in the Nairobi securities exchange and sought to fill existing research gaps in determining the effect of internal control systems on financial performance of the companies quoted at NSE.

Research Objective and Hypothesis

The objective of the study was to establish the effect of risk management on financial performance of companies quoted in Nairobi Securities Exchange. The research hypothesis of the study was: There is no relationship between risk management and the financial performance of companies quoted in the Nairobi Securities Exchange.

LITERATURE REVIEW

Measurement of Financial Performance of Companies

Dixon et al., (1990) said that appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. Reid and Ashelby (2002) contends that performance is measured by either subjective or objective criteria, arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms.

In order to survive and succeed in a competitive market, firms must focus on maximizing profit or they will eventually be driven out of business (Dutta and Radner, 1999). John (2011) supports this claim by saying that only efficient firms stay in the market, and that less productive firms will eventually exit many markets. Performance measures provide a mechanism for the organization to manage its financial and non-financial performance. Accountability is increased and enhanced, ensuring that projects support the organizational strategy and that better services and greater satisfaction are provided to a customer.

Wilks and imblelman (2004) found out that objective performance measures include indicators such as profit growth, revenue growth, return on capital employed. Financial consultants Stern Stewart and Co. created Market Value Added (MVA), a measure of the excess value a company has provided to its shareholders over the total amount of their investments (John, 2011). This ranking is based on some traditional aspects of financial performance including: total returns, sales growth, profit growth, net margin, and return on equity.

Dwivedi (2002) argues that other financial measures should include value of long-term investment, financial soundness, and use of corporate assets. John (2011) discussed accounting based performance using three indicators: return on assets (ROA), return on equity (ROE), and return on sales (ROS). Each measure is calculated by dividing net income by total assets, total common equity, and total net sales, respectively. The current study proposes to assess company financial performance using the following indicators as used by the various scholars discussed in previous studies above, Profitability, Return on asset and earnings per share.

Risk Management and Financial Performance

Enterprise Risk Management (ERM) was developed by COSO in 2004 to address risk management issues related to an organization. The frame encompasses all component of internal control frame work, but adds also the components of objective setting, event identification and risk response (Rittenberg, 2005). COSO (2011) emphasizes the importance of objective setting in the entity and relates it to risk assessment as a precondition. However it should be emphasized that the company internal control framework should be established in order to have reasonable assurance to achieve established objective, risk identification and analysis are the critical components. In evaluating the effectiveness of internal control activities, it is essential to assess them against entity’s objectives and related risks.

Internal control should provide for an assessment of the risks the agency faces from both internal and external sources. Once risks have been identified, they should be analysed for their possible effect. Management then has to formulate an approach for risk management and decide upon the internal control activities required to mitigate those risks and achieve the internal control objectives of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations. The objective of financial reporting and performance in the entity, the production of accurate, complete, relevant, timely and reliable financial information to demonstrate and maintain accountability, to meet statutory reporting requirements, to account for an organization’s stake holders for the its financial performance (CIPFA 2002:24). Cebenoyan and Strahan (2004) find evidence that banks which have advanced in risk management have greater credit availability, rather than reduced risk in the banking system. The greater credit availability leads to the opportunity to increase the productive assets and bank’s profit.

Schroeck (2002) and Nocco and Stulz (2006) stress the importance of good risks management practices to maximize firms’ value. In particular, Nocco and Stulz (2006) suggests that effective enterprise risk management (ERM) have a long-run competitive advantage to the firm (or banks) compared to those that manage and monitor risks individually. Schroeck (2002) proposes that ensuring best practices through prudent risk management result in increased earnings.

The survival and success of a financial organization depends critically on the efficiency of managing these risks (Khan and Ahmed, 2001). More importantly, good risk management is highly relevant in providing better returns to the shareholders (Akkizidis and Khandelwal, 2007; Al-Tamimi and Al-Mazrooei, 2007). In addition, prudent risk management by financial institutions is the hallmark to avoid financial distress that could lead to a full blown financial crisis.

RESEARCH METHODOLOGY

This study adopted a survey research design. The population of this study focused on the state-owned corporations in Kenya. Stratified random sampling technique was used to determine the sample size. The number of respondents involved in this study was 144. Data was collected using questionnaires. Data was analysed through the use of descriptive statistics and multiple linear regression analysis.

Data Analysis

The study adopted different statistical approaches to examine the effect of internal control systems on financial performance of companies quoted in the Nairobi Securities Exchange. All constructs were adopted from pre-existing scales found in the literatures. In addition to descriptive statistics, the reliability among the multiple measures of the variables that comprise this study was measured using Cronbach's alpha coefficient generated by statistical packages for social sciences (SPSS). Cronbach's alpha is a measure of consistency and checks if the questions of the questionnaire were understood and if the data are minimally reliable (Babbie, 2002);

RESULTS AND DISCUSSION

Response Rate

The data was collected from the companies listed in Nairobi securities Exchange which are registered and regulated by Capital Market Authority. The sample of the study consisted of 38 companies out of 62 listed companies.The target population was 144 Senior Managers out of which 115 responses were received,translating into 79.8% response rate. The response was considered appropriate since Sekaran, (2008) argues that any response above 75% is classified as best.

Gender Distribution

The gender of the respondents was sought. Majority (59.5%) of the respondents were male while the rest (40.5%) of the respondents were female as shown in Table 1. The statistics show that majority of employees incharged of internal control systems in companies quoted in Nairobi Securities Exchange are Male. The distribution however represents a fair gender balancing , an indication of successful efforts of various gender mainstreaming compaigns.

Table 1: Distribution of Respondents by Gender

Gender	**Percentage**
Male	59.5
Female	40.5
Total	**100.0**

Sector Distribution of The Respondents

The Distribution of respondent per sector as shown in the Table 2 below shows that there is proper representation of all the sectors represented by various companies quoted in Nairobi securities Exchange, an indication that proper stratification of the sector was done.

Table 2: Distribution of Respondents by Sector

Sector	Target	Response	%
Automobiles	8	5	4.34
Banking	26	22	19.13
Commercial/Services	23	19	16.52
Construction And Allied	11	9	7.83
Energy/Petroleum	11	10	8.69
Growth Enterprises	4	2	1.74
Insurance	11	10	8.69
Investment	8	4	3.49
Manufacturing	23	18	15.65
Telecommunication	4	4	3.49
Total	**144**	**115**	**100**

Job Position of Respondents

Although the unit of observation for this study was the Senior Managers in the quoted companies as already indicated in the methodology, this question sought to establish the job position of the respondents in the organization. An overwhelming 94% of the respondents were Senior executive management with 6% indicating Middle level managers as indicated in Table 3. This was very important profile distribution for this study since the respondents were the right people with adequate information relevant to this study hence best placed.

Table 3: Job position of Respondents

Designation	Percentage
Senior Executive Managers	96%
Middle Level Manager	4%
Total	**100**

Level of Education of Respondents

Respondent's level of education was sought and majority (57%) of the respondents indicated that they have at least a degree level of education while sizeable (43%) posses a higher degree at postgraduate level (Table 4). This is highly expected since the respondents are at a senior management level where the skills knowledge and Competencies is supposed to be high. This depicts that the respondents were well educated and informed and therefore furnished this study with better information which added value.

Table 4: Level of Education of Respondents

Education Level	Percentage
Bachelors Degree	57
Post graduate	43
Total	**100**

Working Experience of Respondents

This question sought to investigate the number of years each respondent have worked with the company. Majority (39.1%) of the respondents have a working experience between 6 to 10 years, 25.2% have 11 to 15 years, 25.2% have 11 to 15 years 17.4% have below 5years, 11.3% have 16 to 20years and 7% have over 20 years of experience as shown in Table 5. This means that the respondents have adequate working experience with the companies and therefore possess the necessary knowledge and information which was considered useful for this study.

Table 5: Working Experience of Respondents

Experience in years	**Percentage**
Less than 5 years	17.4
6 to 10 years	39.1
11 to 15 years	25.2
16 to 20 years	11.3
Over 20 years	7.0
Total	**100.0**

Test for Normality

The test for normality of financial performance (dependent variable) was done by use of Kolmogorov-Smirnov test. Given that H0 and H1, set α=0.05, the rule is that reject H0 if P-value is less than α else fail to reject H0, where:

H0: The data is normal
H1: The data is not normal

Table 6 indicates that using the Kolmogorov-Smirnov Test of normality, employee engagement data is normal since the P-value, 0.240 is above 0.05 and thus we fail to reject the null hypothesis (H0).The study therefore concluded that financial performance variable is normal in distribution and hence subsequent analysis could be carried out.
Table 6 further shows that financial performance is approximately normally distributed with a mean of 17.9347, standard deviation of 5.69643and the number of respondent were 115 represented by N=115. The dependent variable should be normally distributed because the study was using multiple linear regression model, where the condition of normality must be satisfied.

Table 6: Test for Normality

One-Sample Kolmogorov-Smirnov Test

		FINANCIAL PERFORMANCE
N		115
Normal Parameters[a]	Mean	17.9347
	Std. Deviation	5.69643
Most Extreme Differences	Absolute	.096
	Positive	.061
	Negative	-.096
Kolmogorov-Smirnov Z		1.030
Asymp. Sig. (2-tailed)		.240

One way to make it very likely to have normal residuals is to have a dependent variable that is normally distributed (Cooper and Schindler, 2011). Figure 1 shows the normal QQ plot which indicates that the condition of normality for employee engagement is satisfied. The quantile-quantile (QQ) plot is an excellent way to see whether the data deviate from other distributions but only interested in the normal distribution. The scatter plot shows the relationship between the actual observed values and what those values would be expected when the data is normally distributed.

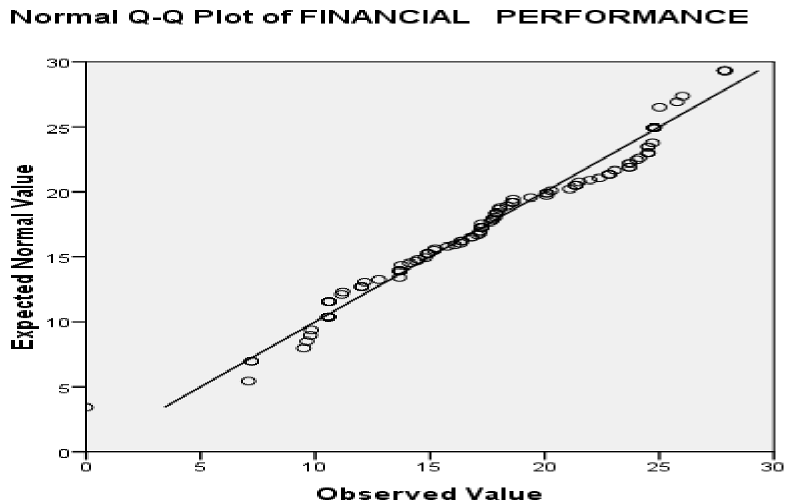

Figure 1: Normal QQ Plot of Financial performance.

According to Cooper and Schindler (2011), for a variable to be normally distributed most of the points should lie on the theoretical quantile line. The theoretical quantile line of the data is fitted and from the normal QQ plot it indicates that the observed values versus the expected normal values are randomly distributed along the line of best fit indicating that the dependent variable is normally distributed.

Descriptive Analysis

Risk Management Control and Financial Performance of Companies

In relation to risk identification the study sought to investigate if the companies had well documented policy on risk management, if the company regularly updates risk registers and whether the management encourage reporting of events in order to identify risks. The study also sought to establish if the company had a monitoring system that identifies potential risks. The results as shown in Table 7 below indicates that majority(46.1%) of the respondents strongly agreed that their companies had well documented policy on risk management,27.8% agreed, 18.30% were neutral while 2.6% and 5.2% disagreed and strongly disagreed respectively. Further opinion on whether the company regularly updates the risk register, majority(33%) of the respondent agreed that their companies regularly updates risk register,25% strongly agreed,30.4% were neutral, 7% disagreed and 4.3% strongly disagreed.Opinion on whether the company management encourage reporting of events in order to identify the risks,most (44.3%) of the respondent agreed that management encourage reporting of events in order to identify the risks, 32.2% strongly agreed,while 16.5% were neutral.A few 2.6% and 4.3% disagreed and strongly disagreed respectivel. As to whether the company has a monitoring system that identifies potential risks,most (36.5%) of the respondent agreed that the company has a monitoring system that identifies potential risks,28.7% strongly agreed while 22.6% were neutral. The balance 8.7% and 3.5% of the respondent disagreed and strongly disagreed respectively. The result agree with the findings of (Deakin,1998) that financial performance analysis needs to pay attention to total risks and is related to concepts of efficiency and effectiveness (Deakin, 1998).

Risk Evaluation

Under risk evaluation the study sought to investigate if the companies had adequate capacity to risk assessment ,if there was a risk review process and if the management adequately evaluates and records the risks when making important decisions.Also the study sought to establish if the company management effectively communicated risks to employees and other stake holders.The results as shown in Table 7 below indicates that majority (38%) of the respondents agreed that their companies had adequate capacity to perform risk assessment ,20% strongly agreed, 33% were neutral while 5.2% disagreed and 3.5% strongly disagreed. Further opinion on whether the company has a risk review process after implementation of the mitigation measures/control for identification of risks, majority (44.3%) of the respondent agreed that their company had a risk review process after implementation of the mitigation with 22.6% strongly agreeing while 25.2 % were neutral. The rest 4.3% disagreed and 3.5% strongly disagreed. On the opinion whether company management effectively communicate risks to the employees and the stakeholders, most (36.5%) of the respondents agreed that company management effectively communicated risks to employees and stake holders, 19.1% strongly agreed, 33.9% were neutral while 8.7% disagreed and 3.5% strongly disagreed. Finally opinion on whether the management adequately evaluates and records the risk when making important decisions (launch of projects or new products, development of strategic plans, investment plans), most (37%) of the respondent agreed that the management adequately evaluates and records the risk when making important decisions, 19% strongly agreed, 33% were neutral and 4.3% disagreed while 5.2% strongly disagreed.

Risk Mitigation

Respondents' opinion on whether the company has adequately implemented any inspection plans to reduce the inherent risks and if those plans which are periodically revised,45.2% of respondent agreed while 15.7% strongly agreed.33% of the respondent were neutral while 6.1% disagreed. As to whether there exists a Risk Management committee in the organization,35.7% of the respondent strongly agreed ,29.6% agreed,20.9% were neutral while 11.3% disagreed and 2.6% strongly disagreed.Further opinion on whether risks identified are reviewed and decisions taken on the same by a Risk Management committee,37.4% of the respondents agreed ,29.6% disagreed,20.9 were neutral while 7.8% disagreed and 4.3% strongly disagreed. Opinion on whether recommendations by the Risk Management committee are reported directly to top management and the audit and risk sub-committee of the board,40% of the respondents agreed,30.4% strongly agreed ,19.1% were neutral while an equal response 5.2% disagreed and strongly disagreed. Finally opinion on whether management uses instruments for risk transfer or sharing with other organizations (e.g. insurance companies), an equal response of 34.4% agreed and strongly agreed while 23.5% were neutral and an equal response 3.5% strongly disagreed and agreed respectively.

The result supports the findings by Thornton (2004) who observed that in recent years, stakeholder"s expectations from internal audit functions have changed significantly.The focus has now moved from a compliance and financial control function to facilitating organizations to proactively identify, assess and control risks.

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Table 7: Respondents' Risk Management

Respondents Opinion	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Documented policy on risk management	5.2%	2.6%	18.3%	27.8%	46.1%
The company regularly updates the risk register	4.3%	7.0%	30.4%	33.0%	25.2%
Reporting of events to identify the risks	4.3%	2.6%	16.5%	44.3%	32.2%
Monitoring system to identify potential risks	3.5%	8.7%	22.6%	36.5%	28.7%
Capacity to perform risk assessment	3.5%	5.2%	33.0%	38.3%	20.0%
Risk review process	3.5%	4.3%	25.2%	44.3%	22.6%
Communication of risks	3.5%	8.7%	33.9%	36.5%	17.4%
Evaluation and recording of risks	5.2%	4.3%	33.9%	37.4%	19.1%
Inspection plans for reducing inherent	.0%	6.1%	33.0%	45.2%	15.7%
Risk Management committee	2.6%	11.3%	20.9%	29.6%	35.7%
Risks identification and review	4.3%	7.8%	20.9%	37.4%	29.6%
Reporting of identified Risk	5.2%	5.2%	19.1%	40.0%	30.4%
Instruments for risk transfer or sharing	3.5%	3.5%	23.5%	34.8%	34.8%

Regression Analysis

The study carried out regression analysis to establish the statistical significance relationship between the independent variables notably, internal control environment , internal audit funtion, risk management, control activities and corporate governance on the dependent variable which was financial performance. According to Marshall and Rossman (2006) regression analysis is a statistics process of estimating the relationship between variables. Regression analysis helps in generating equation that describes the statistics relationship between one or more predictor variables and the response variable. The regression analysis results were presented using a scatter plot diagram, regression model summary tables, Analysis of Variance (ANOVA) table and beta coefficients tables.

Regression Analysis on Risk management versus Financial performance

H_0: There is no significant relationship between risk management control and financial performance.

Regression analysis was conducted to determine the significance relationship of risk management against Financial performance. Figure 2 illustrates scatter plot diagram of regression analysis results of significance of risk management versus financial performance. The scatter diagram (Figure 2) indictaes a positive linear relationship between risk management and financial performance.

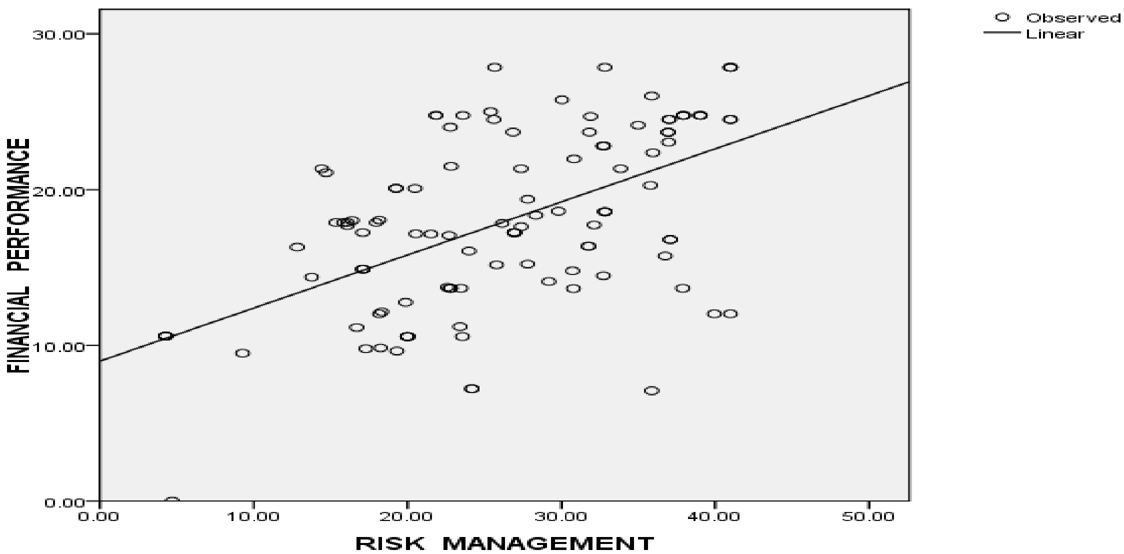

Figure 2: Regression Model on risk management versus financial performance

Table 8 presents the regression model on risk management versus financial performance. As presented in the table, the coefficient of determination R square is 0.308 and R is 0.555 at 0.05 significance level. The coefficient of determination indicates that 30.2% of the variation on financial performance is influenced by risk management. This implies that there exists a positive significant relationship between risk management and financial performance.

Table 8: Correlations of risk management and financial performance

Correlation

		FINANCIAL PERFORMANCE	RISK MANAGEMENT
FINANCIAL PERFORMANCE	Pearson Correlation	1	.555**
	Sig. (2-tailed)		.000
	N	115	115
RISK MANAGEMENT	Pearson Correlation	.555**	1
	Sig. (2-tailed)	.000	
	N	115	115

**. Correlation is significant at the 0.01 level (2-tailed).

R	.555[a]
R Square	.308
Adjusted R Square	.302
Std. Error of the Estimate	4.75792

The Analysis of variance (ANOVA) results as shown in Table 9 confirms that the model fit is appropriate for this data since p-value of 0.000 which is less than 0.05. This implies that there is a significant positive relationship between risk management and financial performance

Table 9: Analysis of variance (ANOVA) for Risk management

ANOVA						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1141.151	1	1141.151	50.409	.000[a]
	Residual	2558.077	113	22.638		
	Total	3699.228	114			

The results further indicate that risk management control has a positive and significant effects on financial performance (Table 10). The fitted model FP = 8.992 +0.341*X3. This implies that a unit change in risk management will increase financial performance by the rate of 0.341.
Even when risk management function is non-existence, financial performance is still positive at 8.992 indicating that there are other drivers of financial performance including internal control environment, internal audit function, control activities and corporate governance.

Table 10: Risk management and financial performance

Coefficients						
		Unstandardized Coefficients		Standardized Coefficients		
Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	8.992	1.335		6.733	.000
	RISK MANAGEMENT	.341	.048	.555	7.100	.000

SUMMARY AND CONCLUSIONS

Factor analysis was done filter the risk management items to manageable and meaningful size of 0.4 and above. All the 13 questions were retained for further analysis. The results indicated that Risk management exist in companies quoted in Nairobi securities exchange where, 65% of respondents indicated that there is satisfactory risk management embedded in the running of companies quoted in NSE. However, 25% were indifferent and 10% indicated that Risk management was not entrenched.
The correlation analysis also indicated that there is a positive significant relationship between Risk management and financial performance. The positive relationship was represented by 0.555 and the number of respondents was 115. The results corroborated findings of earlier studies which observed that in recent years, stakeholder's expectations from internal audit functions have changed significantly. The focus has now moved from a compliance and financial control function to facilitating organizations to proactively identify, assess and control risks. Regression analysis was done where the results indicated that risk management had a goodness of fit of 30.2% indicating that risk management explained 30.2% of the variation in the financial performance of companies quoted in Nairobi securities Exchange in Kenya. The results and findings therefore conclude that there was significant association between risk management and financial performance. The study, therefore, recommends that companies quoted in

Nairobi securities exchange should have risk management adequately entrenched in all their day to day operations to ensure continuous improvement in their financial performance.

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