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Financial Accountability and Financial Performance of County Governments in Kenya

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Abstract:
The annual amount of funds in the counties are not well utilized in the past years, and even the money that is returned to the treasury at the end of each financial year has always been less than what has remained after the total expenditure for the year. Worse still, there has been lack of accountability for the discrepancies and the gap between the allocated funds and the money spent. The study sought to understand the relationship between financial accountability and financial performance of county governments in Kenya. The study was based on elements of agency theory and employed the descriptive explanatory cross sectional survey design that was applied across the 47 targeted counties in Kenya and the finance managers. The researcher applied census sampling of all the 47 counties and collected primary data using questionnaires and secondary data for a five year period of 2016-2002. The data was entered into SPSS analysis tool where descriptive statistics and inferential statistics were conducted to link the variables. The study established that financial accountability had a moderate effect on financial performance based on the r values. The adjusted coefficient of determination was found to be 0.632 meaning that financial accountability accounted for 63.2% of financial performance in the county. It was concluded that financial accountability elements like transparency, timely responses, equitability, inclusivity and adherence to constitution requirements led to improved financial performance. The study then recommends that the counties adopt financial accountability measures when seeking to improve their financial performance.

Keywords: *Financial accountability, transparency, timely responses, inclusivity, financial performance*

1. Introduction

The local authorities in most developing nations are said to continue playing a minor role in public service delivery, whereby some notable nations such as Brazil and China are dominating in the list. Despite the increasing expectation of the role of local authorities, the minor role played by these local authorities in developing nations is explained by the heavy regulation of the local authority activities coupled with scarcity of financial resources (Gomes, Alfinito& Albuquerque, 2013). A report by International Federation of Accountants (IFAC) documents that in most countries across the globe, there is a surging need for channeling more efforts towards supporting management of finances and accountancy in the public sector.

Public financial management (PFM) is about the governments coming up with strong systems and structures for managing of their finances collected from revenues and income from investments. PFM includes four key dimensions of fiscal management, operational management, fiduciary risk management and governance (Bashir, 2016).Dandago (2018) stated that under fiscal management the accounting model considers the expenses and revenues and places emphasis on maximizing resource utilization to avoid instances of wastages and losses. On governance and governing models, when there is need for sound management of public resources and more so through structures, transparency and accountability measures put in place. The local county government can also adopt the governance model that utilizes financial accountability to create transparency and account for all finances under its mandate (Alkaraan, 2018).

Financial performance, according to Wang'ombe and Kibati (2016) covers an entity's financial performance is an outcome of: liquidity (the availability of cash to facilitate payment of bills); net income (the amount of surplus revenues vs expenses) and solvency (comparison of assets vs liabilities and debts). Measurement of financial performance in the county governments is differently done compared to other business enterprises (Lubale, 2017); since the process is affected by politics, communities, interested parties influence and lengthy bureaucracy in release of finances for different projects. Gomes, *et al.* (2013) define financial performance as a county's capacity to finance all its services on a continuous basis coupled with the capability to meet various fiscal obligations.While Mogaka, Atambo and Mogwambo (2016) view it as the ability to adopt financial, budgetary and economic information and Mugambi and Theuri (2014) stated the financial condition of a county government can be measured in terms of: budgetary solvency, cash solvency, and long-run solvency.

In this study, financial performance of the county governments is a measure of surplus or deficits generated.

According to Aramide and Bashir (2015), PFM covers all the financial processes under legislation for purposes of financial control and this view looks at making budget estimates, allocation of funds, setting limits on the expenditures, development of reports, audits and accounting for all the monies. In the context of this study, public financial management will constitute financial practices of financial accountability aspects. Financial accountability is about the processes and structures that are needed to make financial decisions and for the government and public entities it is about making the financial records available and accessible to the public view. The annual reports are accessible to shareholders and interested stakeholders and putting measures to safeguard accountability, transparency and improved service delivery.Lotiaka and Namusonge (2017)established that there is no evidence of adequate follow-up done to verify the accountability reports submitted to the Office of the Auditor General by most County Governments and there was no follow up activities reported.This heightens the need why financial accountability should be entrenched to be part of public financial management in aiding financial performance in county governments across Kenya.

A survey done by CoG (2017) revealed that financial performance of Kenyan counties is featured by certain common characteristics, namely poor system design, lack of systems documentation, lack of audit trails and lack of automated bank reconciliation. The findings further tabled that there existed a lack of system data checks and balances, lack of remote access, restricted capacity to produce reports and poor response time. Resultantly, the aforementioned problems have triggered extravagant and wastage in spending seen mostly in loss of resources via improper spending, irregularity and possible fraud (Simon &Muhamed, 2017). According to the Office of the Auditor General (OAG) report (2016), a huge gap exists between the finances received by County Governments and the utilization of the same.

The decline in financial performance in the counties is such that the aggregate revenue collected for FY2016/17 was at ksh.32.52 billion and its target was set at ksh.57.66 billion as the annual budget declined by 7.1% as compared to the FY2015/16 at ksh.35.02 billion. These low revenues generated lead to delayed projects, insufficient funds to run the counties and poor service delivery. The report by Africog (2015) on public procurement in Kenya revealed that Machakos, Mombasa and Wajir had extensively abused and violated the procurement rules and legislation. The FY 2013/14 revealed excessive hemorrhage of resources meant for public which made these three countries have poor performance and low service quality. The OAG report for Kirinyaga County, for the FY 2018/19 showed a deficit of kshs.304, 761,511 since the expenditure was 5,241,797, 280 while the revenue for that year was kshs.4, 937,035,769.00.Since the counties adversely suffers from financial performance problems, it is apparently clear to integrate core PFM practices and specifically that of financial accountability to rectify the problem.

2. Literature Review

2.1.Agency Theory

It was formulated by Jensen and Meckling in 1976 and is based on the relationship between the agent and that of the principle. An agency relationship refers to a contract whereby the principle engages the agent to carry out some services or activities and delegates the decision making powers. It also explains the multi-faceted relationships between government and the other agencies. In the background of government organizations, such as the National Government and County government, the agency theory explains the principal-agency relationship whereby the citizens being the principle give the authority and power to the governments to carry out the mandate on their behalf.

The agency theory's major assumption is that, there is always a potential conflict exiting between stakeholders and the management, which are driven by various interests thus necessitating the need for monitoring and control of initiatives. Secondly, Hendriks (2017) criticizes agency theory by arguing that the peripheral costs incurred in monitoring the agents tend to be higher as compared to the marginal cost incurred in the franchise's contractual agreement. The third criticism is that, during the formulation of the possession, there are problems with the controlling functions whereby the management shadows their own interests instead of their shareholders.

In the agency theory, the agents are expected by the shareholders to make informed and corrective decisions that are in tandem with those of the principal. Where the challenge arises is when the agent unavoidably makes decisions that capture the principal's interests. The theory fits well with the variables under study since it holds that employees working for a public entity ought to account for their tasks and responsibilities. Contextually, agency theory is very crucial. Financial accountability, as one of the study variables and the study was anchored on this theory since the implementation of public budgets is usually based on the varying interests of the people, who in turn, are mandated with the task of providing the government with the planning and implementation structure.

2.2. Empirical Literature Review

Chemakai, Ondiek and Tibbs (2018) studied the effect of board accountability on SACCO performance in Kakamega County. Using survey research design, the study focused on sizeable population of five selected SACCOs within the area comprising of a 50,000 membership. The study adopted stratified random sampling to arrive at 890 respondents who were five financial managers, branch managers, forty-five board members and 800 shareholders. At 99% confidence level, the study found that board accountability had impacted positively on the SACCO performance. Contextually, the study looks at financial sector where SACCOs are part of and methodologically, the sample size is too big and the research exercise might bring about errors and inaccuracies that might affect the quality of the study results. There is need to cover the government agencies since they operate and have different mandates and consider a smaller and more manageable sample size to use, for accuracy of data.

Ndikwe and Owino (2016) study was on the role of school board's accountability on the school's financial performance. The study employed stratified to draw 153 respondents. The study managed to use a descriptive review of 49 Kenyan public schools, and the resultant data was further subjected to a multivariate regression analysis. The study findings indicated that accountability of the school board led to significant effects on financial performance of the schools that were investigated. The contextual gap in the study is that it focused on schools while the present study covered the county governments; that imply that some of the outcomes from the study cannot be applicable to the current study which expands on literature. Conceptual financial performance is linked to accountability of the school's boards and there is need to explore how financial accountability affects the performance.

2.3. Conceptual Framework

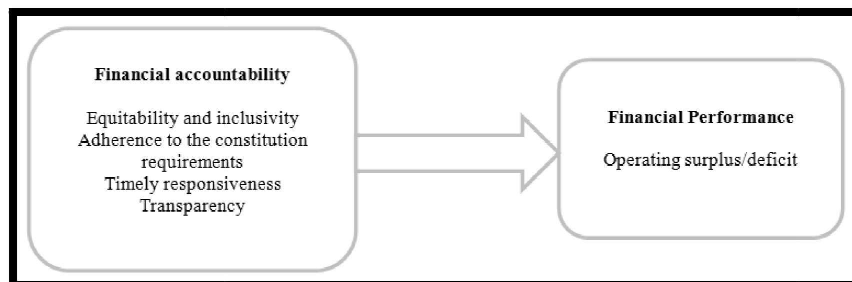

Figure 1: Conceptual Framework
Source: Researcher (2021)

On the basis of the conceptual framework, the research hypotheses for this study were;

- H_o: Financial Accountability has no effect on financial performance of County Governments in Kenya
- H_1: Financial Accountability has an effect on financial performance of County Governments in Kenya

3. Research Methodology

The study adopted descriptive, explanatory cross sectional survey design. The rationale behind the selection of this explanatory design is because the study explores the effect that financial accountability has on financial performance and cross sectional design to cover all the 47 counties. The respondents were 47 finance managers one from each of the counties in Kenya hence census sampling. The primary data was gathered via structured questionnaires that employed the five-point likert scale and secondary data was collected on the dependent variable being financial performance covering a 5-year period (2016-2020).

A pilot test was undertook using 4 National government staff from the finance department in four different ministries to check for validity and reliability and the results showed the instrument was a good fit. The researcher then collected the primary and secondary data and thereafter conducted descriptive analysis (standard deviation, mode and mean) and inferential statistics (analysis of variance and regression analysis).

4. Research Findings and Discussions

The 47 questionnaire that were administered to the respondents, 43 of them were filled and returned. This represented a response rate of 91.5% and as per the stipulation of Mugenda and Mugenda (2003) stipulation that 70% and above of a response rate is ideal to use in research and for drawing conclusions and recommendations of the study.

4.1. Descriptive Analysisfor Financial Accountability

Financial Accountability	Mean	Std. Dev
The senior finance personnel take responsibility for timely delivery of accurate financial statements	4.3721	.65550
To ensure transparency, all the reports made public /accessible by the public	4.5349	.63053
All the reports adhere to constitutional requirements and/or financial standards	4.3023	.67383
To control misappropriation of funds, any officer suspected to be involved is supposed to be brought to book, provided there is available and sufficient evidence	4.2558	.65803
The County Government has set accounting standards	4.5116	.55085
The county has recruited knowledgeable staff who are responsible for the implementation of the accounting standards	4.5349	.63053
The senior finance personnel take responsibility for timely delivery of operating metrics	4.5116	.50578
The county government has instituted equitability when making financial decisions	4.4186	.62612
There is transparency when making the financial decision-making	4.2791	.45385
Overall Score	4.4134	.5983

Table 1: Financial Accountability

The findings in Table 1 show that statements on financial accountability had an overall mean of 4.4134 and standard deviation of .45385. The findings also reveal that all statements had means of 4.0 and above and the highest was means of 4.5 and the lowest mean score at 4.2. This findings show that financial accountability plays a big part in financial performance of the counties.

4.2. Trend Analysis for Financial Performance

The dependent variable covered in the study was financial performance, and it was represented by surplus/deficit. For standardization purpose, the values of natural logarithm of surplus/deficit were determined and the trend analysis generated as indicated in Figure 4.1.

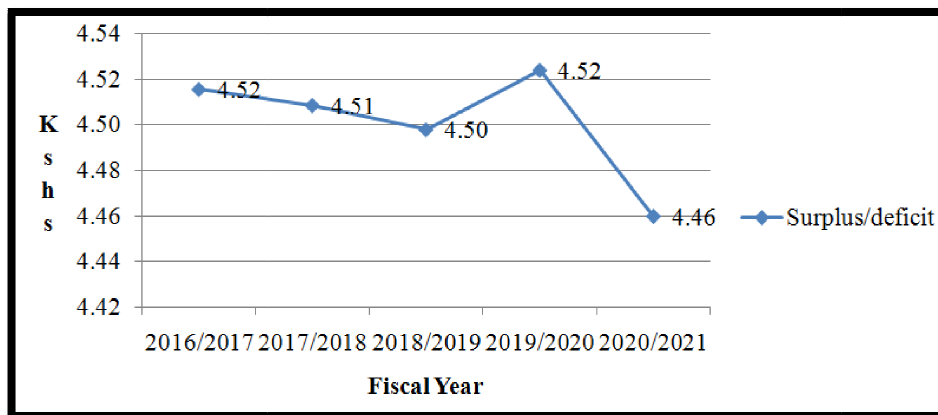

Figure 2: Natural Logarithm of Surplus/Deficit as a Proxy of Financial Performance

Figure 2 indicates instabilities in financial performance of the Counties in Kenya, represented by the value of surplus/deficit generated. This instability could be attributed to challenges in financial accountability in these counties as based on the OAG's report for 2017 showing that most counties in Kenya have issues when it comes to their financial management practices.

4.3. Correlation Analysis

		Financial Performance	Financial Accountability
Financial Performance	Pearson Correlation	1	
	Sig. (2-tailed)		
	N	43	
Financial Accountability	Pearson Correlation	.403	1
	Sig. (2-tailed)	.000	
	N	43	43

Table 2: Correlation Analysis
***. Correlation is significant at the 0.01 level (2-tailed)*
**. Correlation is significant at the 0.05 level (2-tailed)*

Table 2 shows that the correlation analysis results are such that financial accountability had r values of 0.403 and p-values of 0.000 thus the correlation was positive but moderate to financial performance.

4.4. Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.817[a]	.667	.632	.08014
a. Predictors: (Constant), FinancialAccountability				

Table 3: Model Summary

Table 3 shows that the coefficient of correlation is 0.817, meaning that the correlation is moderate and positive, the adjusted coefficient of determination is 0.632 or 63.2% of variations on the financial performance can be traced back to financial accountability and the residual effect of 36.8% can be explained by other elements that are excluded by the scope of this current study.

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	.490	1	.122	19.052	.000[b]
	Residual	.244	41	.006		
	Total	.734	42			
a. Dependent Variable: FinancialPerformance						
b. Predictors: (Constant), FinancialAccountability						

Table 4: ANOVA

The ANOVA results obtained and shown in table 3 indicate that the model is a good fit since the F calculated is 19.052 and it is greater than F critical at 4.079. The p-values are 0.000 and it is less than the set standard of 0.05 and show that financial accountability has a significant effect on financial performance.

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.155	.262		12.027	.000
Financial Accountability	.039	.016	.732	2.534	.016

Table 5: Regression Coefficient
A. Dependent Variable: Financial Performance

The Resultant Equation takes the form of:
Y = 3.155 + .039X Financial Accountability ……………………………… (i)

The hypothesis was H_0 financial accountability has no significant effect onfinancial performanceofCounty Governments in Kenya. The study established the p-value of financial accountability as 0.001 ($p<0.05$), thus it was significant. Hence, the study reject hypothesis H_0. These findings are echoed by Chemakai,*et al.* (2018) who found that board accountability had impacted positively on the SACCO performance.Ndikwe and Owino (2016) indicated that accountability measures and practise led to high financial performance of the schools under study.

5. Conclusions

The established that financial accountability was positively but moderately influenced the financial performance in the counties in Kenya based on the p-values and r values showing moderate strength in the relationship. It then concluded that financial accountability positively affected county performances. The respondents agreed that elements of financial accountability had a moderate effect on financial performance. Some of these elements included transparent and equal financial decision making, setting financial standards in the county, accurately recording financial statements and putting to book all people who misappropriate county funds. From the conclusions, it is recommended that the counties adopt financial accountability aspects as a means of enhancing financial performance.

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