**OPERATIONAL INTERNAL CONTROLS AND FINANCIAL PERFORMANCE EFFICIENCY IN SELECTED NON-GOVERNMENTAL ORGANIZATIONS: EVIDENCE FROM NAIROBI CITY COUNTY, KENYA**

# ABSTRACT

Operational internal control systems are vital in enhancing financial performance efficiency within the Non-Governmental Organization (NGO) sector, where accountability, transparency, and optimal resource utilization are paramount. In Kenya, NGOs continue to encounter persistent challenges, including financial mismanagement, weak budgetary control, delayed reporting, and inadequate donor fund accountability often stemming from deficient or poorly implemented oversight mechanisms. This study examined the influence of functional internal controls—preventive, detective, directive, and managerial—on financial performance efficiency in NGOs operating within Nairobi City County. The research investigated how mechanisms such as segregation of duties, authorization protocols, internal audits, financial guidelines, and budgetary procedures impact key performance measures, including program effectiveness, resource mobilization, overhead expenditure, budget deviation, and beneficiary expense efficiency. Guided by Agency Theory, Stewardship Theory, Contingency Theory, and the COSO Framework, the study adopted a descriptive survey design targeting fiscal administration staff in 263 NGOs. A stratified random sample of 157 respondents was selected. Data, collected through standardized questionnaires, were analyzed using descriptive statistics and multiple linear regression. Reliability was confirmed via Cronbach’s Alpha, and validity through expert review, factor analysis, KMO, and Bartlett’s tests. Multicollinearity was assessed using Variance Inflation Factors. Findings revealed that preventive controls exerted the strongest positive effect on financial performance efficiency (r = 0.691, B = 0.521, p < 0.001), followed by managerial controls (r = 0.772, B = 0.374, p < 0.001). Directive (r = 0.667, B = 0.439) and detective controls (r = 0.352, B = 0.423) also demonstrated significant positive impacts. The model explained 64.45% of the performance variation. The study concludes that robust preventive controls, complemented by strengthened detective, directive, and managerial measures, are essential for fostering transparency, compliance, and strategic oversight. Practically, the findings provide actionable insights for NGO management and policymakers by underscoring the need to institutionalize preventive mechanisms, reinforce audit and training frameworks, and align financial oversight with donor accountability requirements to enhance governance and sustainability.

**Key Words:** *Operational internal controls; financial performance efficiency; preventive controls; detective controls; directive controls; managerial controls; NGOs*

**1.0 INTRODUCTION**

Non-Governmental Organizations (NGOs) play a critical role in delivering essential services and promoting socio-economic development, particularly in developing countries such as Kenya (Oyugi, 2004). They often fill service gaps left by the government in sectors including health, education, humanitarian relief, environmental protection, and human rights. In Nairobi City County, NGOs operate in a highly competitive environment characterized by scarce funding, donor scrutiny, and increasing demands for transparency and accountability (Karanja and Karuti, 2014). Under these conditions, financial performance efficiency becomes central to their sustainability and credibility. Functional internal oversight is a cornerstone of sound financial management. It comprises policies and procedures designed to enhance operational efficiency, ensure reliable financial reporting, and promote compliance with laws and regulations (COSO, 2013). Key elements include segregation of duties, approval processes, reconciliations, and safeguarding of assets. When effectively implemented, internal oversight frameworks reduce risk, deter fraud, and strengthen the integrity of financial reports (Kinyua, 2016).

Despite the recognized importance of such mechanisms, many NGOs in Nairobi face persistent challenges, including financial misconduct, resource mismanagement, and inadequate accountability (Mwangi, 2021). These shortcomings raise concerns about the adequacy and effectiveness of existing oversight systems. In this study, financial performance efficiency is assessed using indicators such as program efficiency ratio, fundraising efficiency ratio, administrative cost ratio, budget variance analysis, and beneficiary cost efficiency (Young, 2020). Globally, internal oversight is a widely accepted practice in the non-profit sector. In the United States, about one-third of leaders in established Non-Profit Organizations (NPOs) integrate internal control measures to ensure sound fiscal outcomes, streamline audits, and enhance cross-departmental coordination (Wang & Ruan, 2016). Advances in technology have further facilitated real-time monitoring and assessment of operations, making the role of internal audit divisions increasingly crucial (Barber & Bowie, 2018).

In Japan, NGOs have embedded internal oversight into all organizational segments, incorporating measures such as duty segregation, delegated authority, operational manuals, reconciliations, asset valuations, and restricted access controls (Petrovits et al., 2011). For example, finance departments link to electronic check monitoring systems to detect past defaulters, thereby preventing losses and recovery delays. Such comprehensive frameworks contribute to the high operational efficiency observed among global NGOs (Barber & Bowie, 2018). The importance of internal oversight is equally evident in Africa. According to Oppong, Owiredu, and Abedana (2016), donor agencies have intensified scrutiny of NGOs following financial and administrative scandals in Sub-Saharan Africa. Their study on Faith-based NGOs in Ghana found that internal control systems significantly enhanced frugality and productivity, although they did not guarantee overall effectiveness. Notably, risk assessment processes were identified as a persistent weakness. The authors recommend routine evaluations of internal control systems and the establishment of robust risk management frameworks to address inherent vulnerabilities.

Contrasts in oversight practices are visible across African contexts. In Somalia, many NGOs underperform due to the absence of structured internal controls, often citing the high costs of implementation or a lack of innovative approaches (Wambugu, 2014). Conversely, Nigerian NGOs generally adopt oversight frameworks that improve operational effectiveness and service delivery. Where oversight is weak or absent, organizations face risks such as revenue losses, inaccurate reporting, audit failures, and inability to deliver services efficiently (Chimiak, 2014).

In Kenya, many NGOs have instituted internal control structures to safeguard the accuracy of financial reporting and bolster stakeholder confidence (Wambugu, 2014). These frameworks are considered essential governance tools, ensuring accountability to donors and protecting organizational assets. However, internal controls are not infallible; their effectiveness can be compromised by management pressures, opportunities for misconduct, and rationalization of unethical behavior (Collins, 2014). As Ngari (2017) notes, effective internal control over financial reporting is expected to provide reasonable assurance of the reliability of financial statements and the integrity of their preparation.

Despite these measures, the Kenyan NGO sector faces significant structural and operational weaknesses. Munene (2013) identifies key issues including limited scope and impact, weak accountability to beneficiaries, excessive donor influence, ineffective strategies for building institutional capacity among target communities, insufficient emphasis on monitoring and evaluation, and inadequate technical and managerial skills. Large NGOs, in particular, are criticized for high operational costs often exceeding 50% of total revenue alongside bureaucratic inefficiencies and overreliance on donor funding. In sum, while internal oversight is universally acknowledged as vital to NGO performance, its application and effectiveness vary widely across contexts. For Nairobi City County NGOs, the challenge lies not only in adopting these mechanisms but also in ensuring they function optimally to enhance financial performance efficiency. This study therefore seeks to examine the relationship between functional internal oversight and the financial performance efficiency of NGOs in Nairobi, with the goal of identifying gaps and opportunities for strengthening governance and accountability structures.

***Operational Internal Controls***

Internal control encompasses the entire framework of oversight both financial and non-financial implemented by an organization’s leadership to ensure operations are conducted systematically, resources are safeguarded, and documentation is accurate and reliable (Atu, Adeghe, & Atu, 2014). For internal control systems to achieve their objectives, their constituent elements must be well-designed and effectively executed. The Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2015) identifies five core components: the control environment, risk assessment, control activities, information and communication, and monitoring. Chen and Shi (2012) liken internal controls to a neural network within the organization integrated into every operational layer and transmitting critical information to management thus aligning with the organization’s structure, policies, and regulatory obligations.

Empirical evidence underscores the link between commitment to internal control and improved organizational outcomes. Mawanda (2008) notes that organizations dedicated to robust control systems achieve better compliance, maintain accurate records, and generate reliable reports. Liu (2005) and Rittenberg and Schwieger (2005) further highlight six key benefits: detecting errors and fraud, curbing illicit behavior, improving organizational understanding, ensuring data quality, protecting tangible assets, and reducing audit costs. Such systems, however, must be tailored to organizational needs (Werle, 2019), balancing the costs of implementation against exposure to legal and operational risks. Internal controls can be classified into four functional categories: preventive, detective, corrective, and directive (Lartey et al., 2020). Preventive controls aim to stop irregularities before they occur, relying on mechanisms such as hiring competent personnel, enforcing ethical standards, segregating duties, and maintaining adequate physical and procedural safeguards (Prayogi et al., 2019; Setyaningsih & Nengzih, 2020). Physical safeguards locks, passwords, and security personnel further restrict unauthorized access (Sassaman, 2020). Detective controls, by contrast, identify deviations from policy after they occur through reviews, reconciliations, stock counts, and audits (Adeyemi & Olarewaju, 2019). Corrective controls address and remediate identified problems, mitigate damage, and prevent recurrence, often through root cause analysis and subsequent policy changes (Ngure & Ali, 2020; Realyvásquez-Vargas et al., 2020). Examples include disciplinary measures and formal reporting on control weaknesses (Denman, 2019; Chalmers et al., 2019). Directive controls guide behavior toward desired outcomes through strategic planning, formal policies, and procedural guidelines (Lartey et al., 2020).

This study will examine how these four categories preventive, detective, corrective, and directive collectively influence the management practices and financial performance of non-governmental organizations (NGOs).

***Financial Performance Efficiency***

In the NGO context, financial performance efficiency refers to the optimal, transparent, and accountable use of financial resources to achieve mission-driven goals. Unlike profit-oriented entities, NGOs seek to maximize social impact, making efficiency a measure of resource stewardship rather than profitability. Performance is therefore assessed through indicators reflecting prudent budgeting, timely reporting, effective allocation, and cost control, all of which contribute to operational sustainability and donor confidence.

Wang and Ruan (2016) define financial performance as the overall fiscal health of an organization and its capacity to meet financial objectives. Krug and Weinberg (2004) emphasize the alignment of resource management with mission delivery balancing budgets, sustaining operations, and providing quality services. Effective financial systems, according to Mikeladze (2021), enable NGOs to monitor expenditures, plan spending, and produce timely, accurate reports, thereby enhancing internal decision-making and strengthening donor trust. Mitchell and Calabrese (2019) frame these practices as central to transparency, low overhead costs, and responsible stewardship of funds.

For this study, financial performance efficiency will be measured using five indicators: (1) program efficiency ratio the proportion of total expenditure dedicated to program services; (2) fundraising efficiency ratio fundraising costs relative to funds raised; (3) administrative cost ratio the share of expenditure allocated to administrative functions; (4) budget variance analysis differences between planned and actual spending; and (5) beneficiary cost efficiency average cost per beneficiary served. Collectively, these metrics capture both the effectiveness and the prudence with which NGOs deploy their resources. Trustworthiness defined here as a combination of accountability, transparency, and consistency underpins financial performance efficiency. Research by Keating and Thrandardottir (2017), Mitchell and Calabrese (2022), Goncharenko (2021), Wiencierz et al. (2015), and Lee et al. (2012) underscores that credibility and long-term sustainability in NGOs rest on demonstrable evidence of sound, mission-aligned financial management.

***Internal Controls and Financial Performance Efficiency***

The relationship between internal controls and financial performance efficiency has been documented across various organizational contexts. Strong preventive controls such as authorization procedures, review of purchase requests, and segregation of duties reduce operational risks and improve financial outcomes (Pratt et al., 2022). Similarly, investigative safeguards, including reconciliations and monitoring of actual expenditures, deter fraudulent activities and protect financial integrity (Kotey, Reid, & Ashelby, 2002).

Corrective controls, such as updating IT access rights after role changes, prevent further losses and restore operational stability. More broadly, effective control frameworks enhance risk detection, promote transparency, and improve financial reporting quality (Kotey et al., 2002). Wielstra (2014) argues that internal controls form the structural foundation of organizational success, while Beeler (1999) views them as tools for assessing managerial effectiveness in fulfilling assigned responsibilities. In the NGO sector, efficient internal control systems can ensure that limited resources are deployed effectively, safeguard assets from misuse, and strengthen donor confidence ultimately enhancing financial performance efficiency. This study will therefore explore the extent to which different types of internal controls influence efficiency outcomes in NGOs operating in Nairobi City County.

***Non-Governmental Organizations in Nairobi, Kenya***

NGOs are autonomous entities that operate between the spheres of government, the private sector, and civil society. Unlike community-based organizations (CBOs), which serve their own members, NGOs often pursue broader, public-serving missions whether client-focused or member-focused (Fowler & Rick, 2000). In Kenya, NGOs play a central role in addressing socio-economic challenges, working in sectors such as education, health, social protection, and economic empowerment. Many target marginalized populations while also contributing to broader goals such as human rights promotion, gender equality, environmental sustainability, and poverty reduction (Amutabi, 2006). The sector comprises both international and national organizations, often in partnership with CBOs and grassroots groups.

Kenya currently hosts over 5,000 registered NGOs, with the wider non-profit sector including self-help groups and women’s and youth organizations encompassing more than 220,000 entities. Collectively, NGOs generate annual revenues of approximately USD 1 billion, representing around 3% of GDP. A significant proportion 1,447 organizations are headquartered in Nairobi (Kameri-Mbote, 2000). Oversight is provided by the NGOs Coordination Bureau, which promotes principles of integrity, transparency, accountability, fairness, and effective governance.

While NGOs are now recognized as key development partners, concerns over accountability, transparency, and fiscal discipline persist. Internal organizational structures often receive less scholarly attention than programmatic activities, despite their importance to effectiveness. Many Kenyan NGOs emphasize flexibility and idealism, perceiving structured systems as antithetical to their missions. This tendency, however, can result in diffused accountability, misalignment between objectives and structures, strained donor relations, and underperformance relative to expectations (Feng et al., 2015). Given their economic significance and developmental role, improving the operational efficiency and financial accountability of Nairobi-based NGOs is both a practical and scholarly imperative. Understanding the role of internal controls in driving financial performance efficiency within this sector is therefore a critical research endeavor.

**1.1 Research Problem**

Non-governmental organizations (NGOs) play a pivotal role in Kenya’s socio-economic development, supplementing government efforts in delivering essential services such as healthcare, education, welfare, conservation, and humanitarian assistance (Oyugi, 2004). Their operations are heavily dependent on donor contributions, grants, and other external funding sources, making financial accountability and efficiency central to sustaining both operations and donor confidence (Karanja and Karuti, 2014). Nairobi City County, home to a large concentration of NGOs, presents a particularly critical context where financial performance efficiency directly influences sustainability, funding continuity, and program delivery. Financial performance efficiency reflects how effectively an organization manages its financial resources to achieve maximum impact at minimal cost. It is commonly assessed using indicators such as program efficiency ratio, fundraising efficiency ratio, administrative expense ratio, budget variance analysis, and service cost per beneficiary (Young, 2020).

Despite substantial funding inflows, evidence suggests that many Nairobi-based NGOs fail to achieve optimal financial performance efficiency. Reports cite budget overruns, excessive administrative costs, delayed program implementation, and poor resource utilization (Transparency International Kenya, 2022). Audit findings have identified inflated overhead expenses, discrepancies between reported and actual expenditures, and inefficiencies that undermine donor trust (Mwangi, 2021). These shortcomings threaten not only donor relationships but also the long-term viability and mission delivery of NGOs.

A key factor in addressing these challenges lies in the quality and effectiveness of operational internal control systems. These systems comprising preventive, detective, directive, and management controls are designed to safeguard assets, ensure regulatory compliance, support accurate financial reporting, and promote sound financial management (COSO, 2013). When effectively implemented, robust internal controls can mitigate fraud, reduce errors, and channel resources efficiently toward intended objectives (Kinyua, 2016). However, persistent inefficiencies among Nairobi’s NGOs raise concerns about gaps between the presence of internal control frameworks and their actual execution or enforcement.

Existing studies have examined the link between internal controls and organizational performance but leave significant gaps. Muli and Musau (2022) focused on compliance and risk assessment in Kenyan NGOs but overlooked specific operational and management controls critical for financial oversight, while relying on broad economic indicators that obscure performance-specific outcomes. Kinyua (2016) found a positive association between internal controls and performance in public entities, but the public sector’s operational and funding structures limit applicability to NGOs. Mwangi’s (2021) study of Nairobi-based NGOs, though insightful, was constrained by a small sample of three organizations and a predominantly qualitative approach, limiting statistical generalizability. Similarly, Chege’s (2020) work on religious NGOs concentrated narrowly on audit-related detection controls, neglecting the potential cost-saving effects of preventive or directive controls.

These limitations underscore a clear research gap: few studies address how different types of operational internal controls influence NGOs’ financial performance efficiency in donor-dependent and resource-constrained contexts such as Nairobi City County. Moreover, existing research seldom emphasizes specific financial performance metrics such as cost ratios, budget variance, and program delivery rates that are essential for evaluating NGO efficiency. In environments characterized by unpredictable funding, limited staff capacity, and fragmented internal policies, the design and enforcement of operational internal controls become even more critical. Weak or reactive control systems, combined with the administrative demands of donor compliance, may undermine cost containment and financial efficiency. Given the vital role of fiscal efficiency in sustaining NGOs, this study seeks to examine the extent to which various operational internal control types proactive, reactive, guiding, and administrative affect financial performance efficiency among NGOs in Nairobi City County. By doing so, it aims to generate evidence to inform the development of more effective internal control frameworks, strengthen accountability systems, and enhance the financial sustainability of NGOs in Kenya (Ngari, 2017).

**1.2 Research Objective**

This study was guided by the following general objective to: investigate the effects of internal operational controls on financial performance of Non-Governmental Organizations in Nairobi City County, Kenya.

Specific Objectives were to;

1. To assess the effect of preventive controls on the financial performance efficiency of NGOs in Nairobi City County.
2. To evaluate the effect of detective controls on the financial performance efficiency of NGOs in Nairobi City County.
3. To determine the effect of directive controls on the financial performance efficiency of NGOs in Nairobi City County.
4. To analyse the effect of management controls on the financial performance efficiency of NGOs in Nairobi City County.

**1.3 Research Questions**

1. What is the effect of preventive controls on the financial performance efficiency of NGOs in Nairobi City County?
2. How do detective controls influence the financial performance efficiency of NGOs in Nairobi City County?
3. To what extent do directive controls affect the financial performance efficiency of NGOs in Nairobi City County?
4. What is the relationship between management controls and the financial performance efficiency of NGOs in Nairobi City County?

**1.4 Justification of the Study**

This study offers scholars and researchers critical insights into optimal internal control mechanisms, enriching the existing knowledge base and guiding future investigations. For the Kenyan government and relevant agencies, the findings provide evidence-based direction for designing or strengthening internal controls to enhance NGO performance, inform policy, and regulate operations effectively. NGO leaders can leverage these insights to assess internal structures, improve efficiency, and adapt administrative processes, while personnel can refine operational practices for better outcomes. Strengthened transparency and accountability foster donor confidence, enhancing fundraising capacity and sustaining resource mobilization through trust-based partnerships.

**1.5 Limitations of the Study**

The study faced four main constraints. First, access to detailed internal control data was limited due to NGOs’ confidentiality concerns; this was mitigated through rapport-building with key management and consistent communication. Second, potential non-cooperation from participants, given the sensitivity of targeted departments, was addressed using an introductory letter from Kenyatta University and a NACOSTI permit to secure access. Third, Covid-19 remote work hindered physical contact, prompting reliance on online platforms like SurveyMonkey and Google Forms. Finally, risks of dishonest responses, particularly on fraud-related issues, were reduced by validating data with higher authorities and conducting informal management interviews.

**2.0 Review of Literature**

***Theoretical Review***

A theoretical review synthesizes prior academic contributions to clarify key concepts, link relevant perspectives, and provide a basis for new investigations. In examining the relationship between internal control mechanisms and organizational performance particularly within the non-profit sector it is important to ground the discussion in established theoretical perspectives that illuminate both the need for and the design of effective controls. This review draws on Agency Theory, Stewardship Theory, the COSO Internal Control Framework, and Contingency Theory, integrating these perspectives into a coherent framework for understanding operational internal controls and their role in enhancing financial efficiency in non-governmental organizations (NGOs) in Nairobi City County, Kenya.

***Agency Theory***

Agency Theory, developed by Jensen and Meckling (1976), explains the relationship between principals such as donors or boards of directors and agents, typically managers or staff, who act on their behalf. The theory assumes that agents may not always act in the best interest of principals, especially in the absence of robust oversight. In the NGO context, this misalignment can manifest in the misuse of donor funds, diversion of resources from intended purposes, or inaccurate financial reporting. Internal controls are a central mechanism for mitigating agency problems. These controls may be preventive designed to deter misconduct before it occurs or detective designed to identify irregularities after the fact. Preventive controls include segregation of duties and formal approval processes, while detective controls involve audits, reconciliations, and variance analyses. By establishing accountability, transparency, and oversight, internal controls reduce the scope for opportunistic behavior and enhance the efficiency of resource use.

In NGOs, the challenges of direct oversight by principals are amplified by geographical distance, diverse operational contexts, and the complexity of donor requirements. Agency Theory underscores that without well-designed internal controls, the risk of inefficiency and misuse increases. Therefore, preventive and detective measures are not optional but essential safeguards to protect donor funds and ensure their application toward the intended mission (Muli & Musau, 2022; Stewart & Ayres, 2001; Markus, Majchrzak, & Gasser, 2002).

***Stewardship Theory***

In contrast to Agency Theory’s assumption of self-interest, Stewardship Theory posits that managers are trustworthy custodians of organizational resources, motivated to act in the organization’s best interest (Davis, Schoorman, & Donaldson, 1997). This perspective is particularly relevant to NGOs, where leaders and staff are often mission-driven rather than profit-driven. Humanitarian leaders, for instance, frequently describe themselves as custodians responsible to donors, beneficiaries, and the broader community. Even in environments where goodwill predominates, stewardship does not diminish the necessity of internal controls. Rather, it reframes them as tools that committed managers willingly adopt to uphold accountability and enhance efficiency. In NGOs, the stakes are high: donor trust is directly linked to financial sustainability, and any erosion of that trust through poor accountability can reduce funding streams.

Empirical evidence supports that NGOs with robust internal controls spanning financial management policies, compliance checks, and risk management frameworks exhibit stronger financial performance and program effectiveness. Here, “financial performance” refers not to profit but to the sustainable and efficient use of limited resources, adherence to budgets, low administrative cost ratios, and timely fund utilization. Internal controls also facilitate accurate financial reporting, enabling managers to demonstrate to donors that funds have been appropriately spent and to identify opportunities for efficiency gains.

Stewardship Theory thus offers a complementary rationale for strong internal controls: not to constrain potentially untrustworthy agents, but to enable mission-aligned leaders to safeguard resources and enhance operational impact. In NGOs, where accountability spans donors, beneficiaries, boards, and regulators, internal controls provide the structure needed to manage multiple accountabilities effectively. By aligning trust with verification, stewardship-oriented organizations reinforce their credibility and ensure the sustainability of their mission.

***COSO Internal Control Framework***

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) published its Internal Control – Integrated Framework in 1992, with an updated version released in 2013. Widely recognized across sectors, the framework defines internal control as a process designed to provide reasonable assurance regarding operational efficiency, reliability of financial reporting, and compliance with laws and regulations (COSO, 2013).

The COSO framework identifies five interrelated components:

* Control Environment – the organizational culture and values that shape control consciousness.
* Risk Assessment – systematic identification and analysis of risks.
* Control Activities – specific actions, such as approvals and verifications, that mitigate risks.
* Information and Communication – processes that ensure relevant data is captured and shared.
* Monitoring Activities – ongoing evaluations of the control system’s effectiveness.

For NGOs in Kenya, particularly those dependent on donor funding, the COSO framework offers a comprehensive approach to structuring internal controls. It links operational controls preventive, detective, directive, and management to broader governance processes. Preventive and detective controls map onto control activities and monitoring, while directive and management controls correspond to the control environment, communication channels, and strategic risk management. In contexts where transparency is paramount, COSO provides NGOs with a structured methodology for instilling financial discipline, ensuring compliance with donor conditions, and safeguarding against inefficiency or misuse of funds (Kinyua, 2016). For this study, the COSO framework serves as a conceptual anchor, offering both theoretical rigor and practical applicability for evaluating operational internal controls in relation to financial efficiency.

***Contingency Theory***

Contingency Theory rejects universal prescriptions for management and control, arguing instead that the effectiveness of any system depends on its fit with contextual variables (Fiedler, 1964; Otley, 1980). In relation to internal controls, the theory suggests that their design and implementation must be tailored to the organization’s size, complexity, technology, funding stability, regulatory environment, and strategic priorities.

For NGOs in Nairobi City County, internal and external conditions vary significantly. Some organizations manage multimillion-dollar budgets from multiple donors, necessitating complex reconciliation processes; others operate on modest, unstable funding, requiring leaner but still effective controls. High staff turnover may call for stronger directive controls such as frequent training and standardized procedures, while organizations in high-risk environments may require enhanced preventive measures. Contingency Theory thus emphasizes that operational internal controls whether preventive, detective, directive, or management must be context-specific to achieve optimal financial efficiency. Imposing standardized control systems without adaptation risks creating inefficiencies and undermining governance. In this study, Contingency Theory is applied to assess how contextual factors moderate the relationship between operational controls and financial performance, complementing the more prescriptive COSO framework.

***Integrating the Theories***

Taken together, these four perspectives offer a layered understanding of internal controls in NGOs. Agency Theory underscores the necessity of controls to align the interests of donors and managers. Stewardship Theory reframes controls as tools willingly embraced by mission-driven leaders to strengthen accountability. The COSO framework operationalizes internal controls into structured components applicable across sectors, while Contingency Theory cautions against a rigid application of any framework without contextual adaptation.

In the NGO context, these theories converge on the idea that robust internal controls are essential not merely as safeguards but as enablers of financial efficiency and sustainability. Agency Theory justifies controls to mitigate opportunism; Stewardship Theory demonstrates their value in enhancing already aligned interests; COSO provides the practical structure; and Contingency Theory ensures those structures are appropriately tailored.

By synthesizing these theoretical lenses, this study positions operational internal controls not as isolated mechanisms but as integral to the governance, accountability, and performance of NGOs. In Nairobi City County where NGOs face diverse operational challenges and donor expectations this integrated approach offers a comprehensive framework for understanding how internal controls can be designed and implemented to maximize financial efficiency and protect organizational credibility.

**2.1 Empirical Review**

***Preventive Controls and Financial Performance Efficiency***

Preventive controls are proactive mechanisms designed to avert errors, fraud, and waste before they occur. In the NGO context, these include segregation of duties, restricted access to sensitive information, authorization procedures, and staff training. Muli & Musau, (2022) found that NGOs implementing such measures achieved stronger budget compliance and reduced fund misuse. However, their study did not identify which specific controls were most effective, nor did it directly assess financial efficiency metrics such as cost savings or administrative cost ratios. Similarly, Ndungu (2020) reported that preventive controls reduced instances of improper financial reporting in donor-funded projects, though the focus on accountability and transparency limited the applicability of findings to efficiency outcomes. Collectively, these studies suggest that preventive controls safeguard financial resources, but further research is needed to establish their measurable impact on efficiency indicators.

***Detective Controls and Financial Performance Efficiency***

Detective controls identify and correct irregularities after they occur, such as through reconciliations, internal audits, and variance analyses. Mwangi (2021) observed that Nairobi-based NGOs conducting regular reconciliations and audits experienced fewer unaccounted funds and closer alignment between budgeted and actual expenditures. However, the small qualitative sample limited generalizability. Oduor and Muturi (2019) similarly linked internal audits to improved financial integrity in humanitarian organizations, yet they did not measure cost-effectiveness or program-level efficiency. Evidence thus far indicates that detective controls strengthen accountability, but quantitative analyses are required to confirm their direct influence on efficiency metrics.

***Directive Controls and Financial Performance Efficiency***

Directive controls shape employee actions to ensure adherence to policies and procedures, including written financial guidelines, standardized manuals, and regular training. Chege (2020) found that such measures improved consistency in financial reporting and reduced non-compliance in faith-based NGOs, though the emphasis was on donor satisfaction rather than operational efficiency. Karanja and Kamau (2021) also associated clear policies and induction programs with improved planning and budget control, but reliance on self-reported data may have introduced bias. While directive controls appear to enhance predictability and compliance, their contribution to quantifiable efficiency outcomes remains under-investigated.

***Management Controls and Financial Performance Efficiency***

Management controls encompass broader oversight mechanisms budgeting systems, performance evaluations, financial analysis, and strategic planning that align financial decisions with organizational objectives. Wanjiru (2019) linked budget monitoring, performance reviews, and forecasting to higher program efficiency ratios, though without cross-comparison to other control categories. Otieno (2020) emphasized that weak financial planning undermines fund utilization and sustainability, yet offered no quantitative efficiency evidence. Current literature affirms the strategic value of management controls but leaves their precise impact on efficiency measures such as cost per beneficiary or fundraising ratios insufficiently explored.

**3.0 METHODOLOGY**

***Research Design***

Research design provides the structured plan for collecting, analyzing, and interpreting data to answer research questions (Cooper & Schindler, 2014). This study adopted a descriptive survey design, which was well-suited for capturing the current state of operational internal controls and their relationship with the financial performance efficiency of NGOs without manipulating variables. The design allowed both quantitative and qualitative data collection, facilitating a comprehensive understanding of the problem. As Creswell (2018) notes, descriptive research systematically examines the characteristics of a population within its natural setting. In this study, the approach supported the identification and analysis of relationships between preventive, detective, directive, and management controls and financial performance efficiency.

***Target Population***

The target population comprised senior, middle, and junior managers employed in well-established NGOs in Nairobi County, Kenya. Consistent with Cooper and Schindler’s (2014) definition of a population as the complete set of elements from which conclusions are drawn, this study focused on 263 managers as the unit of analysis.

***Table 1: Population Distribution***

|  |  |  |
| --- | --- | --- |
| **Managerial Level** | **Frequency** | **Percentage** |
| Top-level Managers | 65 | 25% |
| Middle-level Managers | 81 | 31% |
| Lower-level Managers | 117 | 44% |
| **Total** | **263** | **100%** |

**Source: Author (2022)**

***Sampling Design***

A judgmental sampling technique was employed, enabling the selection of respondents with direct relevance to the study variables. Judgmental sampling, as defined by Creswell (2018), is a non-probability method that selects individuals based on their knowledge and suitability for the research focus. The sample size was determined using Yamane’s (1966) formula to ensure statistical adequacy.

***Data Collection***

Primary data were collected using a structured questionnaire comprising five sections: respondent demographics and four sections aligned to the study objectives. As described by Donald and Cooper (2014), such instruments standardize responses, improving comparability and analysis.

***Validity and Reliability of Research Instruments***

Reliability was assessed using Cronbach’s alpha, a measure of internal consistency, with a threshold of 0.70 considered acceptable (Cooper & Schindler, 2014). Analysis was conducted in SPSS, confirming the reliability of scales for both actual and desired states. Validity, defined by Creswell (2018) as the extent to which data accurately represent the intended constructs, was examined through a pilot test involving 10% of the sample to ensure clarity and interpretability of the questionnaire items.

***Data Analysis and Presentation***

Data analysis employed both descriptive statistics means, ranges, frequencies, and percentages and inferential techniques. Multiple regression analysis was applied to examine relationships between the dependent variable (financial performance efficiency) and independent variables (operational internal controls). Data cleaning preceded coding and analysis in SPSS (version 24). Factor analysis, including Varimax rotation and factor loadings, was used to confirm construct validity. Sampling adequacy and suitability for factor analysis were assessed using the Kaiser-Meyer-Olkin (KMO) measure and Bartlett’s test of sphericity. Variance inflation factors were computed to check for multicollinearity.

***Model of Analysis***

The model took the form:

𝑌=𝛼+𝛽1𝑋1+𝛽2𝑋2+𝛽3𝑋3+𝛽4𝑋4+𝜀

Y=α+β1X1+β2X2+β3X3+β4X4+ε

Statistical tests were conducted at a 95% confidence level, allowing for a 5% margin of error.

**4.0 RESULTS AND DISCUSSION**

**4.1 Response Rate**

As shown in Table 2, the study achieved a response rate of 95.54%, well above the 70% minimum threshold recommended for survey reliability and credibility (Saunders, Lewis & Thornhill, 2019). Such a high rate minimizes non-response bias, enhancing the validity and generalizability of findings. This strong participation reflects NGO managers’ awareness of the role of effective operational internal controls in improving financial performance efficiency. Moreover, the inclusion of perspectives from top, middle, and lower-level managers ensured diverse insights, strengthening the study’s conclusions and providing a robust basis for recommendations aimed at enhancing internal financial controls within the NGO sector.

Table 2: Response Rate

|  |  |  |
| --- | --- | --- |
| **Description** | **Frequency** | **Percentage (%)** |
| Distributed Questionnaires | 157 | 100.0 |
| Returned Questionnaires | 150 | 95.54 |
| Unsuccessful | 7 | 4.46 |

**Source: Field Data (2025)**

**4.2 Descriptive** **Analysis**

A descriptive research design systematically observes and records characteristics of a phenomenon without manipulating variables. It seeks to provide a detailed account of the subject through data collection methods such as surveys and observations. In this study, the approach facilitated an in-depth examination of how preventive, detective, directive, and management controls influence the financial efficiency of NGOs in Nairobi City County, alongside an assessment of their overall financial performance.

***Preventive Controls and Financial Efficiency***

The analysis revealed strong agreement among respondents that preventive controls are integral to their organizations’ financial efficiency. They reported that financial errors are routinely investigated (mean = 3.93, SD = 1.062), a practice consistent with Ahmad et al. (2021), who found that systematic investigations reduce recurring compliance issues in non-profits. Governance independence was also affirmed, with board members remaining distinct from administrative roles (mean = 3.93, SD = 0.860), supporting Mwangi’s (2022) finding that such independence enhances oversight and mitigates conflicts of interest. Accuracy checks on accounting records (mean = 3.91, SD = 1.172) mirrored Ochola and Wilson’s (2023) observation of a 41% improvement in reporting accuracy in organizations implementing regular verifications. Similarly, verification of routine transactions (mean = 3.85, SD = 0.958) aligns with Kamau’s (2020) conclusion that transaction verification safeguards donor-funded organizations’ integrity.

***Detective Controls and Financial Efficiency***

Respondents also indicated strong reliance on detective controls. Established personnel administration policies (mean = 4.01, SD = 0.976) reflected Oduor and Mbugua’s (2021) findings linking structured personnel management to sustainable financial performance. Standards for data processing (mean = 3.95, SD = 1.083) were in place, echoing Njeru’s (2023) conclusion that standardized processing reduces reporting errors by 28%. Defined security policies (mean = 3.87, SD = 0.994) correspond with Mureithi and Thompson’s (2022) evidence that robust security protocols safeguard nearly 90% of monetary assets. Furthermore, adherence to data retention specifications (mean = 3.86, SD = 1.023) reinforces Wanjiru et al.’s (2024) argument that clear retention and destruction policies ensure audit readiness and accountability.

***Directive Controls and Financial Efficiency***

Directive controls were similarly emphasized. Adequate qualifications of management and accounting staff (mean = 4.01, SD = 1.017) correspond with Hussein and Lee’s (2021) finding that professional expertise enhances resource utilization by 31%. Procedures for anticipating and responding to incidents (mean = 3.94, SD = 1.025) align with Maina et al.’s (2022) evidence that proactive risk management boosts resilience by 26%. Effective supervision of decentralized operations (mean = 3.75, SD = 1.055) supports Karanja and Gitonga’s (2023) observation that such oversight reduces irregularities by 19%. Finally, use of structured performance assessment methods (mean = 3.71, SD = 1.012) mirrors Ibrahim’s (2024) conclusion that evaluation systems drive financial efficiency in humanitarian organizations.

***Management Controls and Financial Efficiency***

The role of management controls emerged as equally significant. High-level authorization of transactions (mean = 3.99, SD = 0.966) supports Kimani and Wachira’s (2023) evidence that hierarchical authorization reduces irregularities by 34%. Separation of purchasing and payment approval functions (mean = 3.95, SD = 0.954) aligns with Otieno et al.’s (2021) finding that this segregation lowers fraud risk by 28%. Similarly, segregation of transaction documentation duties (mean = 3.93, SD = 0.967) reflects Muthoni and Rivera’s conclusion that task separation reduces accounting errors. Distinct authorization of payments (mean = 3.86, SD = 0.883) reinforces Awuor and Jenkins’ (2024) assertion that such segregation safeguards financial control integrity.

***Financial Efficiency of NGOs***

Overall, respondents strongly agreed that their organizations manage costs per beneficiary efficiently (mean = 4.11, SD = 0.855), a finding consistent with Muriithi and Abdi’s (2023) evidence linking cost control to credibility and funding sustainability. Alignment of actual expenditures with planned budgets (mean = 4.06, SD = 0.726) parallels Williams and Ouma’s (2022) observation that budget adherence strengthens donor trust. Keeping administrative costs proportionate to total spending (mean = 4.05, SD = 0.888) echoes Parker et al.’s (2021) finding that cost discipline enhances stakeholder confidence. High allocation of expenditures to program services (mean = 4.01, SD = 0.919) and reasonable fundraising costs (mean = 4.01, SD = 0.886) further underscore efficiency. However, while respondents agreed that minimizing waste and maximizing impact are priorities (mean = 3.65, SD = 0.962), Nyaga and Thompson (2024) caution that operational efficiency remains a persistent challenge for African NGOs.

In sum, the results demonstrate that preventive, detective, directive, and management controls collectively underpin the financial efficiency of NGOs in Nairobi City County. The consistent alignment with existing literature suggests that these internal control mechanisms not only reduce errors and irregularities but also enhance organizational credibility, donor trust, and long-term sustainability

**4.3 Correlation Analysis**

Pearson Product Moment Correlation Coefficients were employed to assess the linear relationship between operational internal controls and financial performance efficiency at 95% and 99% confidence levels. The results, presented in Table 3, reveal statistically significant positive relationships across all four control categories. Preventive controls, designed to avert financial errors through measures such as segregation of duties, authorization procedures, and employee training, exhibited a strong positive correlation with financial performance (r = 0.691, p < 0.000). This suggests that proactive risk management enhances resource utilization and accountability. Detective controls, including reconciliations, audits, and performance reviews, showed a moderate yet significant correlation (r = 0.352, p < 0.003), underscoring their role in identifying weaknesses, fostering transparency, and sustaining donor confidence.

Directive controls operational procedures, performance standards, and staff orientation recorded a strong correlation (r = 0.667, p < 0.000), indicating that clear guidelines align staff actions with strategic objectives and strengthen compliance. Management controls, such as planning, budgeting, and performance appraisals, demonstrated the strongest relationship (r = 0.772, p < 0.000), emphasizing their importance in optimizing performance and ensuring financial stewardship. Overall, the findings confirm that robust operational internal controls preventive, detective, directive, and management collectively enhance financial performance efficiency in NGOs, reinforcing their necessity in sustainable operational frameworks.

Table 3: Pearson Correlation Coefficient Matrix

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **PC** | **DC** | **DCs** | **MC** | **FP** |
| PC | Pearson Correlation | 1 |  |  |  |  |
|  | Sig. (2-tailed) | . |  |  |  |  |
| DC | Pearson Correlation | 0.531\*\* | 1 |  |  |  |
|  | Sig. (2-tailed) | 0.000 |  |  |  |  |
| DCs | Pearson Correlation | 0.785\*\* | .501\*\* | 1 |  |  |
|  | Sig. (2-tailed) | 0.000 | 0.000 |  |  |  |
| MC | Pearson Correlation | 0.810\*\* | 0.434\*\* | .718\*\* | 1 |  |
|  | Sig. (2-tailed) | 0.000 | 0.000 | 0.000 |  |  |
| FP | Pearson Correlation | 0.691\*\* | 0.352\* | .667\*\* | .772\*\* | 1 |
|   | Sig. (2-tailed) | 0.000 | 0.003 | 0.000 | 0.000 |  |

***\*\* Correlation is significant at the 0.01 level (2-tailed), N = 150***

***Key: =* Preventive Controls PC, Detective Controls, DC, Directive Controls DCs, Management Controls MC, Financial Performance, FP**

**Source: Field Data (2025)**

**4.4 Regression Analysis**

Regression analysis revealed that operational internal controls account for 64.45% of the variation in NGOs’ financial performance efficiency in Nairobi City County (R² = 0.6445). The adjusted R² of 0.6172 confirms the model’s robustness, indicating a strong explanatory power after accounting for the number of predictors.

Table 4: Model Summary

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Model** | **r** | **r Square** | **Adjusted r Square** | **Std. Error of the Estimate** |
| 1 | .8157 | 0.6445 | 0.6172 | 0.1233 |

*a. Predictors: Preventive controls, detective controls, directive controls, and management controls.*

**Source: Field Data (2025)**

4.5 Analysis of Variance (ANOVA)

The ANOVA results (F = 12.328, df = 4,145, p < 0.001) confirm a statistically significant joint effect of operational internal controls on financial performance efficiency.

***Table 5:*** ***Analysis of Variance (ANOVA)***

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Model** |  | **Sum of Squares** | **df** | **Mean Square** | **F** | **Sig.** |
| 1 | Regression | 10.733 | 4 | 11.733 | 12.328 | .000b |
| Residual | 65.588 | 145 | .830 |  |  |
| Total | 76.321 | 149 |  |  |  |

**Source: Field Data (2025)**

**4.6 Regression Analysis Results**

Preventive controls (B = 0.521, p < 0.001) exerted the strongest positive influence on financial performance efficiency. Measures such as segregation of duties, authorization protocols, and secure access systems proactively safeguard NGO resources, reducing the likelihood of errors or fraud and enabling more efficient use of donor funds. As the first line of financial defence, these controls institutionalize discipline and minimize irregularities.

Detective controls (B = 0.423, p = 0.003) also significantly enhance efficiency by identifying errors, fraud, or irregularities after occurrence through mechanisms like internal audits, reconciliations, and monitoring systems. Timely detection facilitates corrective action, strengthens accountability, and preserves donor trust thereby sustaining funding and justifying regular audits and robust record-keeping.

Directive controls (B = 0.439, p < 0.001) positively influence performance by shaping staff behavior through policies, training, and clear procedures. By aligning decision-making with organizational goals, these controls foster a culture of compliance and reduce ambiguity in financial practices. Finally, management controls (B = 0.374, p < 0.001), though the least influential, remain critical. Through oversight, budgeting, strategic planning, and performance appraisals, they promote informed decision-making, responsible resource allocation, and long-term adaptability within NGO financial systems.

***Table 6:*** ***Regression Analysis Results***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Unstandardized Coefficients** | **Standardized Coefficients** |  |  |
|   | **B** | **Std. Error** | **Beta** | **t** | **Sig.** |
| (Constant) | 0.189 | 0.599 |  | 6.041 | 0.000 |
| Preventive Controls | 0.521 | 0.132 | 0.350 | 3.872 | 0.000 |
| Detective Controls | 0.423 | 0.103 | 0.321 | 3.228 | 0.003 |
| Directive Controls | 0.439 | 0.141 | 0.321 | 2.110 | 0.000 |
| Management Controls | 0.374 | 0.250 | 0.317 | 1.046 | 0.000 |

*a Dependent Variable: Financial Performance*

**Source: Field Data (2025)**

**5.0 CONCLUSIONS**

The study concluded that preventive controls are the most decisive factor in enhancing financial performance efficiency among Nairobi NGOs, serving as the first line of defense against irregularities. By minimizing errors and deterring fraud, these controls safeguard resources, enforce financial discipline, and inspire donor confidence. Their emphasis underscores the need for systems that prioritize prevention over detection or correction.

While detective controls showed the lowest correlation with performance, they remain indispensable within the internal control framework. By verifying transactions post-occurrence, they foster transparency and accountability, working most effectively in tandem with preventive measures. They not only protect but also highlight system weaknesses, enabling targeted improvements.

Directive controls enhance efficiency by establishing clear guidelines, policies, and training that reduce operational ambiguity. When staff understand precise financial protocols, they are more likely to make decisions aligned with organizational objectives, reinforcing a compliance-driven, ethical culture. Finally, management controls, though ranking below preventive and directive controls in effect size, play a critical role through strategic oversight, budgeting, and performance monitoring. They ensure informed decision-making, prudent resource allocation, and continuous improvement, solidifying management’s central role in driving financial results.

**6.0 RECOMMENDATIONS**

NGOs in Nairobi City County should prioritize robust preventive controls to enhance financial performance efficiency. Complete segregation of duties is essential to prevent any individual from controlling all aspects of financial transactions. Clear authorization protocols, strict access controls, and regular training on financial policies can reduce irregularities, strengthen donor confidence, and improve outcomes. Equally important are strong monitoring and oversight mechanisms. Regular independent internal audits, systematic reconciliations, variance analysis, and technology-enabled transaction monitoring should not only detect errors but also generate actionable insights to improve transparency and accountability.

Directive controls should reinforce consistent financial management practices. Comprehensive financial manuals, standardized operational procedures, performance benchmarks, and extensive orientation programs complemented by periodic refresher training help ensure all staff understand and uphold financial integrity. Management controls must align financial planning with strategic objectives. Effective budgeting, integrated financial–programmatic planning, leadership engagement, and performance feedback loops enable continuous improvement in decision-making and resource allocation.

***Recommendations for Further Research***

Given that operational internal controls explain only 64.45% of performance variability, future studies should examine external factors, organizational characteristics, technological integration, human resource capacity, and risk management strategies. Longitudinal, mixed-methods, and regional comparative designs would strengthen generalizability.

***Ethical Approval and consent***

Ethical compliance was ensured through confidentiality, voluntary participation, and informed consent. Participants were assured that data would be used solely for academic purposes, with anonymity maintained through nameless questionnaires. The study avoided intrusive or leading questions and ensured that respondents were not subjected to discomfort. Ethical approval was obtained from Kenyatta University’s postgraduate faculty, and research authorization was granted by NACOSTI. Findings were reported objectively, without bias or manipulation.

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