EFFECT OF FINANCIAL MANAGEMENT PRACTICES ON EFFECTIVENESS OF PERFORMANCE CONTRACTING IN SERVICE DELIVERY OF LOCAL AUTHORITIES IN KENYA

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ABSTRACT

This study was an assessment of factors influencing the effectiveness Performance Contracting from in Service Delivery in Local Authorities of Kenya. Public outcry on quality of services is not uncommon in public sector more so in Local Authorities. Despite Government's inputs and concern and introduction of performance contracting, performance of Local Authorities on service delivery is far below expectation. It is for this reason that the current study sought to assess the factors influencing Performance Contracting in Service Delivery in Local Authorities in Kenya. Specifically, the study wished to address whether Financial Management has an influence in performance contracting. Corelational research design was used to conduct the study in 175 Local Authorities in Kenya. A sample of 18 Local Authorities was selected using a stratified sampling technique. The respondents from the Local Authorities included officers from all cadres of staff who wre randomly chosen from the sampled Local Authorities. The study findings indicated that financial management practices influenced performance contracting. Specifically, the study showed that the budget variances were not investigated and rectified, revenue collection and usage was not free from political interferences and all debtors were not followed in time. The study concludes that the financial management practices of Local Authorities are poor and ineffective. It can be concluded from this study that there exists a positive significant relationship between financial management practices and performance contracting of Local Authorities. The results reveal that financial management practices are statistically significant in explaining effectiveness of performance contracting of local authorities in Kenya. The study recommends that the council should put in place measures to safeguard the

independence and effectiveness of internal audit departments as such department is crucial in the implementation of internal controls.

Key Words: *Financial Management Practices, Performance Contracting, Local Authority*

Introduction and Research Gap

According to England (2000) a performance contract addresses economic, social or other tasks that an agency has to discharge for economic performance or for other desired results. It organizes and defines tasks so that management can perform them systematically, purposefully, and with reasonable probability of accomplishment. It also assists in developing points of view, concepts and approaches for determining what should be done and how to go about it. Performance contracts comprise determination of mutually agreed performance targets and review and evaluation of periodic and terminal performance.

As Selden (2003) has argued, all public sector reform initiatives, whether they be aimed at enhancing financial management, or promoting greater accountability, or enhancing policy development and capacity building within government, or driving forward ethics reform, or ensuring greater service delivery to citizens, are contingent upon a government possessing skilled and talented public servants. These public servants, both employees and managers, need to be well-educated and well-motivated, capable not only of administering public policies fairly and appropriately but also capable of assessing the effectiveness of their own program delivery, thinking through problems, devising solutions to emerging tensions, and providing good advice to their superiors on ways and means by which policies and programmes can be improved upon for greater implementation effect (CAPAM, 2005).

Traditionally, the shortcomings of the public sector were seen as organizational problems capable of solution by appropriate application of political will, powerful ideas and managerial will (Obongo,2009). The overriding concern with economic growth has led to a refocusing. Over the years, poor performance of the public sector, especially in the management of public resources has hindered the realization of sustainable economic growth. Some of the factors adversely affecting performance include: excessive regulations and controls, frequent political interference, poor management, outright mismanagement and bloated staff establishment. To improve performance, the Government has been undertaking a number of reform measures (Trivedi, 2009).

Miring'uh and Mwakio (2006) assert that there is overwhelming evidence that recent reform measures, including RRI have failed to stop immense hemorrhage of revenue at the City Hall. A recent damning forensic report by the Kenya Anti-Corruption Commission, states that City Hall continues to lose a huge portion of parking fees, land rates or rent to corrupt officials exploiting weak financial management systems (KACC, 2007). According to KACC (2007), perpetrators of the rip-off at the Council had devised a complex system to block evidence of unremitted money estimated to be worth millions of shillings. Key to the racket is concealment of the paper work involving such money, including bouncing cheques, tampering with the numbering of parking fees receipts and the filing of fraudulent expenditure claims at the council's cash office. The haemmorhage of revenue from Local Authorities may have led to low operating revenue to fulfill their service delivery targets which are outlined in the performance contracts.

Bouckaert et al (1999) assert that there is also a need to enhance the performance orientedness of the different financial management instruments (budgets, accounts and audits) and the coherency and consistency of these instruments. More coherence and consistency would mean that budget; accounts and audits are based on the same output and cost categories. Most organisations with contracts develop accrual and cost accounting but fail to use the resulting cost information in their budget estimates. Compliance audits remain more important than performance audits. The theory of contracting suggests that to improve performance, performance contracts must not only reduce the information advantage that managers enjoy over owners but also must be motivated through rewards or penalties to achieve the contract's targets.

Opiyo, (2006) researched on financial sources of finance in Local Authorities and observed that many of them were suffering financially and needed assistance. This resulted from unclear and conflicting objectives, poor management and lack of accountability. Though this responded to addressing financial status in local enterprises, it did show over reliance on exchequer. However, the researcher did not bring out how public enterprises can control and avoid over reliance on exchequer.

Public outcry on quality of services is not uncommon in public sector more so in Local Authorities. Despite Government's inputs and concern and introduction of performance contracting, performance of Local Authorities on service delivery is far below expectation (Afro Barometer Briefing Paper, 2010).

Based on the lower performance ranking of Local Authorities in Kenya and the continued drop in rank for Local Authorities, there is a justifiable need for a study to establish factors hindering performance contracting in improving service delivery in Kenyan Local Authorities. Mitullah (2004) brings out the deteriorating performance of Kenyan Local Authorities while the Afrobarometer survey of 2004 decries the poor service delivery of Local Authorities.

A critical review of past literature showed that several conceptual and contextual research gaps existed in the discourse of factors hindering performance contracting from improving service delivery in Local Authorities. For instance, the studies by Grapinet (1999), Bouckaert, Verhoest and De Corte (1999), Gao(2010) Shirley and Xu(2001) Fernandez (2010) Spivey (2005) Fernandez (2010), Spivey (2005) were carried out in developed and emerging countries such as USA, France and China. It is therefore possible to argue that the socio economic conditions of developed and emerging economies are somewhat different from that of a developing economy like Kenya. In addition, the reviewed literature indicates that there is a paucity of studies on factors influencing performance contracting in service delivery of Local Authorities in developing economies in general and Kenya in particular.

The reviewed local studies Akaranga (2010), Kobia and Muhamed (2006), Muganda-Ochara and Van Belle (2008) and Mittullah and Waema(2007) did not critically address the factors hindering performance contracting from improving service delivery of Local Authorities. For instance, studies by Mitullah and Waema (2007) and Muganda-Ochara and Van Belle (2008) were narrow and suffered from conceptual gaps since they only addressed the role of ICT in Local Authorities service delivery. The study by Kobia and Mohamed (2006) suffered from a contextual gap since it concentrated on the Kenya Institute of Administration while the focus of the current study is on Local Authorities. The study by Akaranga (2010) also faced methodological issues since it was a desk based study in addition to exploring a different contextual area (the general public sector). It is due to these conceptual and contextual gaps that the current study wishes to establish whether Financial Management has an influence in performance contracting in service delivery of Local Authorities in Kenya.

Research Objective

To establish whether financial management has an influence in performance contracting in service delivery of Local Authorities in Kenya.

Research Methodology

The study used a correlation survey research wich involves collecting data in order to determine whether and to what degree a relationship exists between two or more quantifiable variables. Survey research is the most common type of research design which involves determining the views or practices of a group through interviews all by administering a questionnaire (Jackson, 2002). The choice of correlational survey research design was because it is used to explore relationships between variables and to predict a subject score on one variable given his or her score on another variable. This method permits one to analyze interrelationships among a large number of variables in a single study. It also allows one to analyze how several variables either singly or in combination might affect a particular phenomenon being studied. The method also provides information concerning the degree of relationships between the variables being studied (Jackson, 2002; Kothari 2004; Mugenda and Mugenda, 1999). The target population for this study was the 175 Local Authorities in Kenya. A sample of 18 Local Authorities was selected using a stratified systematic sampling technique. The respondents from the Local Authorities included nine officers per Local Authorities (three from senior management, three from middle level management, and three from non management category).

Primary data was collected by using the questionnaire as the main research instrument. Since this study involved relationships between variables, the study utilized correlation and regression analysis to determine the relationship between financial management practices and performance contracting. To address the research question, the study checked whether the regression coefficient of service quality (β_1) was positive (+) and significant (p value of < .05) in line with theory and study expectations.

The data collected was analyzed using descriptive statistics such as mode, median, mean, standard deviation. Inferential statistics such as multiple regression modeling were employed to study the causal relationships among all the variables in the model. In order to identify whether significant differences in responses to factors exist among the four performance categories for Local Authorities, Analysis of Variance (ANOVA) was used. These measures were calculated using statistical package for social sciences (SPSS 17.0) software. Qualitative responses from customer were analyzed using content analysis. The findings were presented in form of bar graphs, pie charts, and tabulated reports.

The Statistical Package for the Social Sciences (SPSS) was used to effectively process the data collected. The relationship in the research questions was determined using the following regression model.

$Y = \beta_0 + \beta_2 X_2 + \mu$

Where

Y = Performance contracting

X_2 = financial management practices

In the model, β_0 = the constant term while the coefficient $\beta_i i = 1 \ldots .5$ was used to measure the sensitivity of the dependent variables (Y) to unit change in the predictor variables. μ is the error term which captures the unexplained variations in the model.

Research Findings and Discussion

The study sought to establish whether Financial Management had an influence on performance contracting in Local Authorities in Kenya. Results show that 93% of the respondents agreed that financial procedures and reporting systems are in place, 71% agreed that the council had internal capacity to prepare all financial reports and accounts and 56% agreed that latest accounting information systems are used for generating reports for stakeholders. Seventy nine percent of the respondents disagreed that budget variances are investigated and rectified, 90% disagreed that revenue collection and usage is free from political interference, 89% disagreed that all debtors are followed in time and 92% disagreed that the council has favourably reduced outstanding figures of rent and rates. Furthermore, 67% disagreed that revenue potential assessment studies are regularly done, 68% agreed that there is an elaborate and effective internal control framework for detection and prevention of frauds, 95% agreed that internal Audit department exists and 64% disagreed that the recommendations from both internal and external auditors are addressed immediately. Finally, 77% of the respondents disagreed that internal Audit is free from any interference and 80% disagreed that the Council collects adequate revenue to sustain itself. The mean score of the responses for this section was 2.77 indicating that more employees disagreed that financial management practices influenced performance contracting.

Table 1: Financial Management Practices

Statement	Likert Mean	Std. Deviation
Financial procedures and reporting system are in place	4.45	0.775
The council has internal capacity to prepare all financial reports and accounts	3.84	1.138
Latest accounting information systems are used are used for generating reports for stakeholders	3.49	0.992
Budget variances are investigated and rectified	2.15	0.986
Revenue collection and usage is free from political interference	1.82	0.871
All debtors are followed in time	1.69	0.836
The council has favourably reduced outstanding figures of rent and rate	1.57	0.835
Revenue potential assessment studies are regularly done	2.2	1.017
There is an elaborate and effective internal control framework for detection and prevention of frauds	3.62	1.184
Internal audit department exists	4.45	0.721
The recommendations from both internal and external auditors are rectified immediately	2.5	1.066
Internal audit free from any interference	2.15	1.185
The council collects adequate revenue to sustain itself	2.06	1.161
Average Likert Mean	**2.77**	**0.982**

The findings are in tandem with those in Opiyo (2006) who researched on financial sources of finance in Local Authorities and observed that many of them were suffering financially and needed assistance. This resulted from unclear and conflicting objectives, poor management and lack of accountability. Though this responded to addressing financial status in local enterprises, it did show over reliance on exchequer. However, the scholar or researcher did not bring out how public enterprises can control and avoid over reliance on exchequer.

The findings also concur with those of Bouckaert, Verhoest and De Corte (1999) opinions in which they attempted to analyze the public sector performance contracting in Belgium and Flanders. The paper analyzed the effects of contract management on several organizational dimensions such as human resources management, financial management and cost consciousness, internal organizations and external relations. In the field of human resource management, the paper opined that performance contracting had improved the performance orientedness of human resources management and increased the flexibility of allocating the right person to the right job. In the area of finance management, the paper claimed that the use of performance-based contracts has induced an increased cost consciousness. In addition, the use of contracts and the accompanying increase of operational autonomy have also induced some developments in the internal structure.

The findings imply that there were poor financial management practices at local authority. This showed that the budget variances were not investigated and rectified, revenue collection and usage was not free from political interferences and all debtors were not followed in time. The findings also implied that the council had not favourably reduced outstanding figures of rent and rate and the revenue potential assessment studies were not regularly done.

Regression analysis was conducted to empirically determine whether financial management practices was a significant determinant of performance contracting. Regression results indicated that the goodness of fit for the regression between financial management practices and performance contracting was satisfactory. An R squared of 0.533 indicates that 53.3% of the variances in the effectiveness of performance contracting in the local authorities are explained by the variances in the financial management practices. The correlation coefficient of 73% indicates that the combined effect of the predictor variables have a strong and positive correlation with performance contracting. Regression results indicated that the relationship between performance contracting and financial management practices was positive and significant (b1=-0.527, p value, 0.000). This implies that an increase in the effectiveness of financial management practices by 1 unit leads to an increase in effectiveness of performance contracting by 0.527 units.

Table 2: Model Summary for Financial Management Practices

Indicator	Coefficient
R	0.73
R Square	0.533
Std. Error of the Estimate	3.71234

Table 3: ANOVA for Financial Management Practices

Indicator	Sum of Squares	df	Mean Square	F	Sig.
Regression	3114.705	1	3114.705	226.006	0.000
Residual	2728.735	198	13.781		
Total	5843.44	199			

Table 4: Regression Coefficient for Financial Management Practices

Variable	Beta	Std. Error	t	Sig.
Constant	3.362	0.67	5.021	0.000
Financial management practices	0.903	0.06	15.034	0.000

Conclusions and Recommendations

The study concludes that the financial management practices of Local Authorities are poor and ineffective. It can be concluded from this study that there exists a positive significant relationship between financial management practices and performance contracting of Local Authorities. The results reveal that financial management practices are statistically significant in explaining effectiveness of performance contracting of local authorities in Kenya.

Financial management practices were found to be determinant of effective performance contracting. The study recommends that the council should put in place measures to safeguard the independence and effectiveness of internal audit departments as such department is crucial in the implementation of internal controls. The finance and revenue collection departments should also uphold tenets of professionalism, integrity and should be regularly trained and join professional bodies.

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