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## Strategic Contributions of Internal and Budget Controls to Church Financial Performance

<sup>1</sup>Ahenkora, K., <sup>2</sup>Boadu-Ayebofo, B. and <sup>1</sup>Adiwokor, E.

<sup>1</sup>*Christian Service University College, Kumasi*

<sup>2</sup>*The Methodist Church, Kumasi*

### Abstract

This exploratory empirical study adopted an integrative agency-stewardship perspective to assess the contributions of internal control activities and budget control to the qualitative financial performance of churches. Ten people who had practical working knowledge of the churches' finances were purposely selected from each of the 12 churches (societies) of the Amakom District of the Methodist Church. The results of the study, based on data from eighty respondents, showed that the tithe contributed the most to church income and overall members found the internal control activities, budget control and financial performance to be satisfactory. Internal control activities contributed significantly to financial performance but budget control made significant contributions only when the size of the church was introduced into the regression model. The strategic implication is that internal control is a prerequisite for handling church funds and church size determines adherence to budget control. The study contributes to the agency-stewardship theoretical perspective by affirming the notion that agency control solutions support the stewardship role of managers to maximize organizational performance.

**Keywords:** financial control, internal control, budget control, churches, financial performance, stewardship

### Introduction

The Church, as organised religion, is both a spiritual organism and a human organisation. From a legal perspective, the church is a non-profit voluntary organisation that belongs to the third sector. Most local churches are financially supported through the voluntary contributions of members. While financial goals are incidental to the church's overarching purpose of

delivering spiritual and social values (Ahenkora, 2011), they are nonetheless important for the church must raise and manage funds to sustain its programmes and activities. In today's competitive landscape, efficient management of financial resources is vital for any organisation in the private, public or voluntary sector to succeed. A local church loses the moral right and justification to collect and use monies without a proper system of accounting, auditing and reporting on the finances of the church. Sound financial management reflects good stewardship. A balanced theology of Christian financial stewardship demands accountability from members for their stewardship of financial blessings through giving and from the church leadership for stewardship of 'stakeholders and God's money' through sound financial management (Malphurs and Stroope, 2007). Financial impropriety in the church, as is the case for financial scandals in business and public organisations, is largely attributable to inadequate satisfaction of the performance-accountability requirement of effective corporate governance (Rosen, 2014).

Establishing effective control measures is central to the function of the church and the management of reputational risks. For an organisation to accomplish its strategies and guide people towards the achievement of its objectives, it is necessary to establish financial controls that continuously measure the firm's performance at all levels (Kuye and Sulaimon, 2012). The presence of a strong financial system contributes to achieving organizational goals through the provision of reliable financial data, safeguarding assets and records, evaluating operational efficiency through a budget, organizational control and encouraging adherence to prescribed policies and regulations (Hayles et al., 2014). Empirically, very little is known about the contributions of internal control mechanisms to stewardship behaviour and performance, especially in church charities. This study fills the gap.

### **Theoretical consideration: Integrating Agency and Stewardship Theories**

This study takes an integrative approach by using stewardship theory that focuses upon firm performance maximization through stewardship as well as agency loss mitigation through control. The rationale is that the contrasting views of the two theories provide a more holistic approach to describing

managerial behavior. While control is at the heart of the management and risk orientations of agency theory, involvement orientation, trust, and performance enhancement are at the core of stewardship theory (Davids, Schoorman and Donaldson, 1997). The agent manager's primary motivation is to meet personal economic needs but the steward manager's primary need of achievement and success are satisfied when the firm is performing well (Donaldson and Davis, 1991; Davis, Schoorman and Donaldson, 1997; Muth and Donaldson, 1998). Stewardship theory addresses the lack of trust and inclination to unethical behaviour inherent in the agency theory (Kyereboah-Coleman, 2007). An agency relationship exists when one party delegates responsibility to a second party for compensation. The principal and agent have divergent interests that may lead to managerial opportunism and moral hazard and, therefore, the principal establishes governance and control mechanisms to prevent agents from acting opportunistically. On the contrary managerial opportunism is not an issue of concern with agency theory (Donaldson and Davis, 1991; Davis, Schoorman and Donaldson, 1997; Muth and Donaldson, 1998). Confratto (2014) used perspectives from the management, organization and accounting literature to propose a map of current theorizing on stewardship and argues for the continuous provision of conceptual constructs, ideas and views to understand stewardship and stewardship-inspired behaviour. The conceptual premise of this study, therefore, is that agency control solutions support the effort of trustworthy steward managers as both perspectives positively influence firm performance concurrently (Wesley, 2010).

### **Conceptualising internal control and performance**

Stewardship is a concept that has inspired the activities of several organizations whose mission is to preserve, protect and maintain natural, social and economic assets for the benefit of stakeholders and communities (Confratto, 2014). The Committee of Sponsoring Organisations of the Treadway Commission [COSO] (2013) defines internal control as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting and compliance,

and the components are the control environment, risk assessment, control activities, information and communication and monitoring activities. The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization while control activities, performed at all levels of the entity, are the actions established through policies and procedures that help ensure that management's directives to mitigate risks to the achievement of objectives are carried out. Control of financial decisions cover the organization, method, process and internal audit established to ensure that the activities are carried out in compliance with the purpose of the administration, and determined policies and the legislation, the assets and resources are protected, accounting records are kept in an accurate and complete manner and financial and management information is reliably produced (Khoove, 2010). The internal control provides checks and balances that safeguard church income and resources, regulate the disbursement of funds, protect the integrity and reputation of those charged with the responsibility of handling church money, provide timely and accurate information to management and ensures compliance with laws and regulations (Berkley, 2007). Control activities and budget control are components of the church's internal financial controls. Effective control activities reflect the financial prudence and accountability of the managers of the organisation and (Kuye and Sulaimon, 2012; Wakiraba et al., 2014).

Financial controls are known to positively affect qualitative financial performance such as operational efficiency (Kuye and Sulaimon, 2012). Control activities also positively affect financial management and the relationship may be significant (Wakiraba et al., 2014; Muraleetharan, 2013) or insignificant (Ejoh and Ejom, 2014). These studies included statements on the budget as a measure of either internal control or financial performance.

For this empirical study, we examine the following hypothesis:

H1: Control activities will have positive effect on financial performance

H2: Budget control will have a positive effect on financial performance

## Method

Personally administered questionnaire was used to gather primary data for the study. The population of the study was 120 members from twelve (12) societies' (congregation) who handled church finances. They included finance committee members, caretakers, ministers, stewards and some members of the church who had oversight of the church's finance. Ten people were identified for each congregation. Given the nature of the study, the non-probability purposeful sampling technique was a viable option. The COSO framework and the church's standing orders (Methodist Church, 2000), provided the measures selected for the study's construct: control activities, budget and qualitative financial performance. Control activities include a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews with segregation of duties or alternatives built into them. Statements for control activities, therefore, covered policies and procedures on financial practices ('members are familiar with how funds are handled'), access or physical controls ('the procedure for receiving and counting the offering is followed'), access or physical controls ('the place where the offering is counted is right', 'monies received are promptly banked'), authorization (the procedure for approving expenses is followed), record keeping/standardized documentation ('the church's income and expenditure are properly recorded'), verification ('the church's account is audited periodically', 'church accounts are periodically presented to members) and segregation ('members of the tithe trustees and other fund-handlers are changed periodically'). The constructs were measured with items on a 5-point Likert scale that ranged from 1= "strongly disagree" to 5= "strongly agree". The draft questionnaire was pre-tested and ambiguous statements removed. The questionnaires, along with a cover letter highlighting the study's objectives and its potential contributions, were sent by hand to the purposefully selected respondents. Follow-up telephone calls and messages through the various congregations' caretakers were used to improve the response rate and to address missing data issues. It took two days to a week to get back the responses. Out of the 120 questionnaires distributed, 80 usable questionnaires were retained for data analysis, resulting in a response rate of 66.6%. In addition to descriptive statistics, regression analyses were performed to estimate the relationship between internal control activities, budget control and financial performance.

## Results and discussion

### *Demographics*

A quarter of the respondents were females while the rest were males and over 80% of them were adults (Table 1). Based on office held in the church, majority of the respondents indicated that they hold the office of a class leader (32%) or were ordinary members (23%). The majority of the respondents (78%) have been members of the church for 5 years and above. The congregation size of the churches ranged from 78 to 2679 members.

**Table I.** Demographic Characteristics

	Frequency	Percentage
<i>Gender</i>		
Male	60	75
Female	20	25
<i>Office held</i>		
Class leader	24	32.4
Society steward	12	16.2
Caretaker	6	8.1
Finance Advisory Team	7	9.5
Ordinary Member	17	23.0
Tithe Trustees	4	5.4
Others	4	5.4
<i>Age Group</i>		
Youth	15	19.0
Adult	65	81.0
<i>Length of Membership</i>		
Less than a year	4	5.1
1-2 years	5	6.4
3-4 years	8	10.3
5 years and above	61	78.2

### *Congregation Size*

Society	No.	Society	No.	Society	No.	Society	No.
1	2679	4	420	7	147	10	78
2	240	5	280	8	185	11	170
3	122	6	398	9	99	12	82

*Construct measures*

The internal reliability of the items was verified by computing Cronbach's alpha coefficients and items that did not contribute significantly to the construct were removed. The results are represented in Table II.

**Table II.** Construct variables and measures

Construct/ Variable	$\alpha$ Cronbach coefficient	Number of statements	Statements
Control Activities	.826	8	Members are familiar with how funds are handled The procedure for receiving and counting the offering is followed Members of the tithe trustees and other fund-handlers are changed periodically Monies received are promptly banked The procedure for approving expenses is good for accountability The church's income and expenditure are properly recorded in the appropriate book of accounts The church's account is audited periodically Church accounts are periodically presented to entire members
Budget Control	.857	4	The church has a budget policy The church operates an annual budget The church's budget is transparent The church's expenditure is guided by the budget
Financial performance	.773	4	The church's funds are managed properly The performance of stewards is satisfactory The performance of the finance team is satisfactory The performance of the Minister-in-charge in handling church funds is satisfactory

Control activity was measured with 8 items, budget control with 4 items and financial performance with 4 items. The Cronbach's alpha values for the study were all much higher than 0.7 and therefore the constructs had acceptable reliability (Nunnally, 1978). Giving the sample size, the data were tested for normality and the independent variables tested for multicollinearity and they were found to be adequate.

*Descriptive statistics*

The descriptive statistics on aspects of church finance, internal control, budget control and financial performance are shown in Table III.

**Table III.** Descriptive Analysis

	<b>Mean</b>	<b>Std. Deviation</b>
Appoint professionally qualified and spirit-filled people	3.92	0.98
Appoint active members	3.80	0.85
Appoint people based on years of membership	3.01	1.23
Members' financial commitment to the church is satisfactory	3.55	0.88
Adequate funds are raised to meet the needs of the church	3.50	0.92
<i>Major sources of funding</i>		
Tithe	4.00	1.39
Annual harvest	3.90	1.52
Offering	3.29	1.38
Sombi (special efforts)	3.26	1.24
Kofi/ Ama	3.24	1.20
Thanksgiving offering	2.70	1.25
Control Activities	3.58	1.03
Budget control	3.54	1.09
Financial performance	3.56	0.98



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The mean values for appointment of professionally qualified and spirit-filled people to handle church finance (3.92), funds raised to meet the needs of the Church (3.50), members financial commitment to the church (3.55), internal control measures (3.58), budget control measures (3.54) and financial performance (3.56) are quite high and relatively favourable (out of 5). With respect to sources of giving the tithe had the highest mean score (4.00), followed by annual harvest (3.90) and the lowest was thanksgiving offering (2.70). Respondents expect professionally qualified and spirit-filled people to handle the church's finance. Members' financial commitment to the church is well acknowledged and the churches appear to be good at raising funds to meet the needs of the church. Overall, the churches seem to have adequate internal control measures to receive money, disburse or expend and account for the money. Respondents favourably acknowledge that the church has budget control measures that include preparation of an annual budget policy, operating with a budget that is transparent, and that church expenditure is guided by the budget. Respondents are satisfied with the performance of those who manage the churches' finances.

#### *Hypothesis testing*

The results of the multiple regression analysis used to assess the strength of the proposed relationships between internal control, budget control and performance are presented in Table IV. The hypothesis was tested using a multiple regression prediction model with church financial performance as the dependent variable and internal control and budget control as predictor variables. The results revealed that *H1-H2* were significant in the prediction models. The first model tested the contributions of internal control and budget control to church financial performance. Congregation size was made a control variable. Internal control measures and church policy contribute 59.4% of the variance in church financial performance. Internal control had a significant contribution to financial performance in the model ( $\beta=.642$ ,  $P=0.000$ ) but church policy did not have a significant contribution to financial performance ( $\beta=.175$ ,  $P=0.108$ ).

However, in the second model when congregation size was introduced into the model, although its contribution was insignificant, ( $\beta=.046$ ,  $P=0.574$ ) and the overall model explained 59.6 % of the variance in church financial performance, the contribution of church policy became significant at 10%, ( $\beta=.0182$ ,  $P=0.98$ ). The results provide support for hypothesis *H1-H2*, the

relationship between internal control and financial performance, and budget control and financial performance.

**Table IV. Regression results**

Model	Variables	<i>B</i>	<i>t</i> –value	<i>p</i> -value
1	Constant		1.962	.054**
	Internal control	.642	6.003	.000***
	Budget control	.175	1.631	.108
2	Constant		1.709	.052**
	Internal control	.630	5.740	.000***
	Budget control	.182	1.679	.098*
	Congregation size	.046	0.565	.574

**Notes:** Significance at \*  $p < 0.10$ , \*\*  $p < 0.05$  and \*\*\*  $p < 0.001$ ;  $R^2$  (model 1)=0.594;  $R^2$  (model 2)=0.596; dependent variable: financial performance

The study explored empirically the relationship between financial controls and the perceived financial performance of churches. The items developed and included in the scales were reliable and provided a good measure of the latent variables, internal control and financial performance. Control activities included policies and procedures with regard to approval, authorisation, verification, reconciliation, safeguarding of cash and segregation of duties. The results of the study showed that adherence to control activities and budget control is a predictor of financial performance. The study corroborates previous studies that have shown positive relationships between financial controls and financial management performance (Kuye and Sulaimon, 2012). Additionally, the findings show the importance of the size of the church in realizing the benefits of budget control to performance.

### ***Implications and limitations***

The study's contribution to the emerging agency-stewardship theoretical framework is that the findings affirm the notion that agency control solutions support the stewardship objective of managers to maximize organizational performance. The results of the study also have implications for the strategic management of the church's finance. Strategic management imposes on managers the responsibility of managing the internal and external resources of the church to deliver superior value and performance for stakeholders.

Financial control is important for qualitative financial performance. Internal control activities enhance financial performance and should be adopted by churches of all size. While small churches may be liberal with budget control in the short term, for the long haul as churches grow in size they must adhere to budget controls. The exploratory empirical study has provided insights into the strategic contributions that financial controls can make to church financial performance but there are obvious limitations which must be addressed to improve generalisation of the results. The size of the respondents should be increased in future studies. Using the church as the unit of measure, future studies should be undertaken with different denominations to test the robustness of the measuring scales and the relationship between the latent variables. Factor analysis and structural equation modelling may aid the process.

## Conclusion

The study concludes that the presence of internal control activities and budget control positively affect the qualitative financial performance of churches.

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