THE RELATIONSHIP BETWEEN INTERNAL CONTROLS AND DEBTORS MANAGEMENT:

A CASE STUDY OF STAR FM, GARISSA-NORTH EASTERN PROVINCE, KENYA

BY

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A RESEARCH REPORT SUBMITTED TO THE SCHOOL OF BUSINESS AND MANAGEMENT FOR THE PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD BACHELOR DEGREE IN BUSSINESS ADMINISTRATION AT KAMPALA INTERNATIONAL UNIVERSITY

JUNE 2009

DECLARATION

I declare that this research is my original work and has never been submitted to any university or college.

Signed by .... Date...11/06/09...

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APPROVAL

I certify that this proposal was under my supervision and has been submitted for examination with my approval.

Supervisor.. Date 11/06/09

MR. RUTEGANDA MICHAEL **Msc** (UK), **BBA** (USA), **ACIS**.

DEDICATION

This research is dedicated to my parents who gave me both moral and financial support to accomplish my objectives.

ACKNOWLEDGEMENT

I first thank almighty Allah Who guided me and gave a good health through out my life
I am grateful to my supervisor Mr. Ruteganda Michael for his selfless advice, without which the study would not have seen the day
I am grateful to my parents for sponsoring my education. May Allah give them long life
Special thanks goes to Abdullahi Aden Hassan (Bashey), Sheikh Aden Hussein (Bash), Omar Sharif, Abdi Soyan and my sister Ebla Malow for the financial support and guidance given to me during my course. My study would not have seen the day without them
I acknowledge the friends who stood by me during difficulties: Idriss Aden, abdi muhumed, abdi dekow, abdidere, maalim noor and abdifatah (dc). May Allah guide them in their lives
Special thanks go to Ismail, Mohamed Dee, Abdirahim, Fei, Yussuf, Fatuma for their brotherly assistance during my course.
Finally I thank the management of Star FM for their wonderful cooperation.

Abstract

The research study was undertaken on the relationship between internal control and debtors' management.

The main objective of the study was: to ascertain the internal control on debtors, to determine the credit collection by Star Fm and examine the relationship of internal control and debtors' management.

The techniques used in the collection were questionnaire and interviews. The data collected was coded, edited and tabulated with the help of tables and percentages that were essential techniques in presenting and analyzing data.

The study revealed that internal controls on debtors existed but were full of loopholes that made it possible for poor credit collection performance.

The study also revealed that the credit policy variables of credit terms, credit standards and credit collection effort did exist but on close analysis it was found out that Star Fm staffs hardly considers them before any credit extension is made to credit applicants. These have affected the credit collection effort leading to high level of accumulating debtors year after year.

To improve on credit terms and credit standards; the 5 C's of capital, capacity, collateral, character, and condition of every credit applicant should be ascertained as suggested by ***Pandey***.

On credit collection the company should use the remainder letters and if possible personal visits, so as to encourage the customers to pay their over due account and if possible use the credit collection agency.

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CHAPTER ONE

1.0 INTRODUCTION

The purpose of this research was to investigate the relationship between internal control and debtor's management. This study was carried out in Star FM Limited in Garissa district of North Eastern Province, Kenya

This chapter covers the background of the study, statement of the problem, the objectives of the research, research questions, significance of the study, scope of the study. Conceptual framework and definition of terms used in the research.

1.1 BACKGROUND TO THE STUDY

Star fm was established in 2000 to provide Radio broadcasting services through Radio advertisement, commercial and death announcement, entertainment, political-legal, social- cultural and economic issues. Star fm is a private limited company with head office/studio in Garissa of North Eastern Province, Kenya.

Internal controls are guidelines, measures, procedures, financial and otherwise established by management in order to carry on the business of the company in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure the completeness and accuracy of records.

According to Millichamp (1999) there are individual components of an internal control system known as 'controls' or internal controls. Millichamp further adds that there are different types of internal controls which include organization, segregation of duties, physical controls, authorization and approval, arithmetic and accounting, personnel, management supervision, acknowledgement of performance

Internal control on debtors is a set of procedures/guidelines which are designed by each individual business concern so as to minimize expenses/costs associated with the extension of credit whereas maximizing the benefits that accrue from it. In reality every business concern should have a very clearly defined internal control system on debtors due to the following.

Sound receivables control policies are essential in maintaining a greater market share while retaining old customers and creating new ones hence in a declining market, greater market share would edge out your competitors in the market.

A good receivables control system help in reducing and controlling the carrying and opportunity costs associated in extending credit to the credit applicant.

Well established and known internal control systems help in controlling the level of cash flows that may rise to undesirable and unacceptable levels in forms of bad debts.

A good internal control system enables the business concern to attain its expected levels of cash inflows during certain periods thus achieving its essential objectives of profitability

1.2 STATEMENT OF THE PROBLEM

Collection of outstanding debts has been bellow the required level for most organizations partly due to loopholes in internal control systems on debtors and the credit collection that could reduce the levels of debtors. The problems of accounting receivables if not addressed can grow to magnificent levels

Star fm has registered accumulating debts to the extent of writing off some as bad debts. The figures have been on the increase and it seems the situation is getting worse year after year.

Therefore in the light of the above position one wonders whether the company has internal controls on debtors, which are supposed to guard against in creasing debtors.

1.3 THE PURPOSE OF THE STUDY

The main aim of the study is to evaluate the relationship between internal controls and the management of debtors in order to establish whether the weakness of in the internals system is the root cause for the poor performance in credit collection

1.4 THE OBJECTIVE OF THE STUDY

- To ascertain the internal controls on debtors by Star FM
- To determine the credit collection methods used by Star FM on account of receivables
- to examine the relationship between internal and the management of debtors

1.5 THE RESEARCH QUESTIONS.

In order to realize the objectives set out above the researcher will be helped by the questions below

- What are the internal controls on debtors that are followed before credit extension?
- How are the credit standards and screening procedures followed when choosing the credit applicants?
- What is the relationship between the internal controls on debtors and accounts receivables?

1.6 SCOPE OF THE STUDY

The study will be conducted at Star FM limited head office /studio in Garissa town, Kenya

The focus will be on internal control system and management of debtors and credit collection while considering the internal controls on debtors and the three credit policy variables of credit terms, credit standards and collection efforts as regards to advertisements from customers and clients that buy programs and bring announcements.

The study period will be between December 2008 to May 2009

1.7 THE SIGNIFICANCE OF THE STUDY

The study will be of great significance to researchers, students and decision makers in the business enterprises because,

This study will help management to improve the internal control on debtors and credit collection

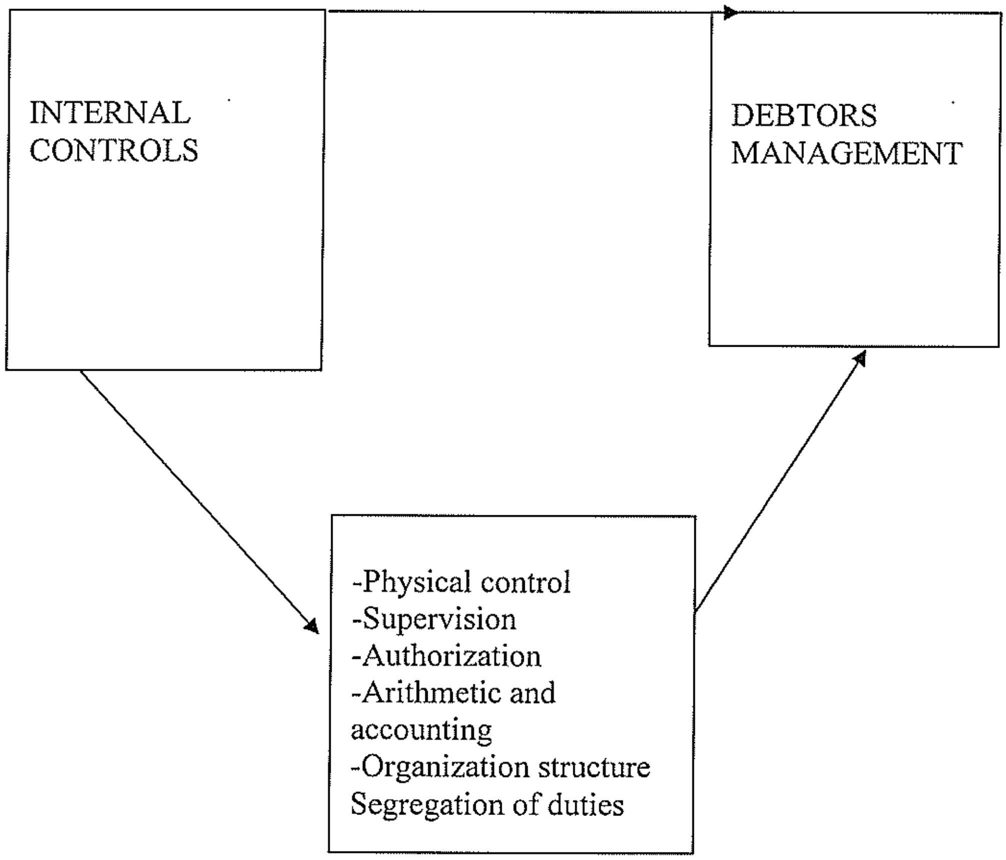
This study will benefit staffs that are responsible to the credit management in the company

This study will benefit scholars in bringing out the importance of efficient internal control systems on credit management to customers in all business sectors and provide the knowledge of research.

It will facilitate in strengthening the credit management of the enterprise and other companies that offers the services so that they can study and make changes in their internal control structures it will enables companies on how they can normally control funds for smooth operations.

1.8 CONCEPTUAL FRAME WORK

The study will have independent variable as internal control and dependent variable as debtor's management



The conceptual frame work of study elaborates the relationship among variables; it explains the theory underlying the relationship among dependent and independent variables and describe the nature and direction of relationship. The procedures of internal control helps in the maintenance of debtors control in firm, they assist the management in determining whether the business is operating efficiently

CHAPTER TWO

2.0 LITERATURE REVIEW

This chapter reviewed all the relevant literature study variables that provide literature on the major aspects of internal control systems, credit collection with particular emphasis on internal control on debtors' management and credit collection policies and methods, and credit policy variables of credit terms, credit standards and credit collection effort in order to fulfill the purpose of the study of relating internal controls on debtor's management.

2.1 INTERNAL CONTROL SYSTEM

According to **millichamp (1999)** internal control is the whole system of controls, financial and otherwise established by the management in order to carry on the business of the company so as to ensure adherence to management policies, safeguard the assets and secure the completeness and accuracy of records. He further adds that there are different types of internal controls among which include; segregation of duties, physical control, authorization and approval, arithmetical and accounting, supervision and management, organization, acknowledge of performance and budgeting.

In the statement of auditing standards adds that control environment refer to the overall attitude and actions of directors and managers regarding internal control and their importance in the company. It encompasses management style, corporate culture and shared values of employees. It provides the background against which various controls operate.

In **Defliese (1975)** a system of internal control extends beyond those matters, which relate directly to the functions of accounting and financial departments. And **Emile Wolf (1994)** supports this as he also asserts that internal controls have an all-embracing nature as is concerned with the controls operatives in every area of corporate activity and the way in which individuals controls inter-relate.

According to **Tasmania (2001),** accounting practice reveals that reliance on internal controls, reasonable assurance is required that controls exists in relation to seven specific objectives of timing, posting, authorization, completeness, classification, valuation and validity.

2.2 INTERNAL CONTROL ON DEBTORS

Accounts receivables / debtors is an area where internal controls are normally applied in any business organization. Millichamp suggested the following objectives of internal controls on debtors:

Ensure all customer orders are promptly executed, ensure that all sales on credit are invoiced, ensure that sales on credit are made only to bon fide good credit risks, make sure that all invoices raised are entered in the books, make sure that all customer complaints and customer-claims are fully investigated before credit are issued, check invoices to confirm completeness as regards to accuracy of prices, trade discounts and taxation, make sure that every effort is made to collect the outstanding debts and ensure authorization is as per the set rules in as far as debtors' accounts are concerned.

In any control system, there are measures that have to be made to ensure the effectiveness of the system or achievement of the set goals. However, **Cooper (1969)** argues that there is no control system whether elaborate or not that can by it safeguard efficient in the administration, completeness and accuracy of records and activities of the organization. It can only provide direction with reasonable assurance that the objectives can be achieved. In **Acito (2000)** he argue that this is due to limitation that includes abuse of authority, collusion, management lapse, inadequacy of procedures, high costs of contra and human error.

2.3 ACCOUNTS RECIEVABLES / DEBTORS

Pandey (1998) argues that accounts receivables constitute a substantial portion of current assets of many organizations. He further suggests that granting credits and creating debtors tantamount to blocking and suffocating the company's funds since the interval

between the sale and payment affects the working capital of the firm hence necessitating getting the funds from alternative sources like banks. In reality trade debtors represent investment and these calls for careful analysis and proper management.
It is therefore the duty of management to ensure that reported accounts receivables accurately reflect all bon fide receivables and provide the data necessary to forecast cash availability, efficiency control and collection process meanwhile protecting assets base of the organization.

According to **Van Horne (1995)** accounts receivables are amounts owed to a firm by customers. And are accounted as current assets. Robertson argues that accounts receivables pose a risk in Auditing and the primary audit risks are: loss of revenue due to invoicing errors or omissions, withholding or delaying the recording of cash receipts, divers ional of receipts to personal or other reasons, improper writing off and diversion of collection to personal use, reducing of account balances by unauthorized transaction and finally delayed invoicing, receipts of improper amounts, or slow in ineffective collection procedures which limit cash inflow.
On the other hand, **Granof (1980)** defined accounts receivable as a claim for money, goods and services that have been earned or paid for but not yet received. He further argued that accounts receivable are usually non-written promises to pay for goods and services that are normally collectible within 30 or 60 days, and are normally "open accounts".

2.3.1 CREDIT MANAGEMENT POLICY

"By nature companies are involved in selling of goods and services", says **Keown (1985).** It should be noted that the selling of goods and services would either be cash to a small extent and on a large extent on credit. Wherever a sale is made it is recorded in the accounts receivables of the company, therefore the importance of accounts receivable management policy depends on the degree to which the firm sells on credit. Credit is a marketing tool acting as a bridge for movement of goods and services through productions and distribution process until it reaches the customer as suggested by Pandey

(1993) and Van Horne (1995). This will help in the maintenance of markets share; retain old customers meanwhile creating new ones.

Forgy 1963 and Pandey 1993 says that in a highly competitive environment companies follow a lenient credit policy so as to maintain sales volume. This generating a relatively large cash inflow of operating revenue hence profits. Again pressure from Rivas companies can force companies to sell on credit **Brigham (1995).**

However, it is clear that some of the people / customers to whom Trade credit is extended will fail to honor their commitments. This trade credit involves risk of defaulting customers hence tying up cash flow leading to loss of revenue and reduction in profitability. This calls for strict scrutiny and screening of customers to whom credit is to be extended in terms of their credit worthiness and proven integrity.

Therefore the main aim of having a well defined and established credit management in company is maximizing sales and cash from debtors at the same time. However carrying receivables is costly but the financial controllers should try as much as possible to balance between the cost and benefit before extending credit to customers.

2.4 GUIDELINESS TO AN EFFECTIVE CREDIT CONTROL SYSTEM.

According to Julius Kakaru (2000) he defined the procedures to follow before companies can extend credit to their client or customers; which include the following

Gathering of credit information.

Companies should try as much as possible to collect numerous information so that they are able to diagonize the credit worthy of a client before extending credit. The following can be used by companies when searching for in formation about their customers:

Credit Bureau Reports. These collect or gather information relating to credit and are to companies. These credit bureaus have all the necessary information concerning different companies on their capacity, financial performance, character, capital condition and collateral assets

Companies can request their client or customers to give detailed information on the financial status through provision of financial statements; s statements / references, trade references so that the companies can evaluate the clients dealing with other companies to further investigation on their credit worthiness so that in case of any default with a certain company their extension of credit is denied to such clients or customers.

Companies can also diagnose clients or customers who want credit by checking their audited financial statements so that they calculate and evaluate their liquidity and profitability.

Credit information can also be obtained through agents or associations and subsidiaries of the company so that diagnosis of clients who want credit cannot escape further and effective screening before companies do credit extension to them.

Credit investigation

Companies can employ the services of a technical expertise to help on assessing the credibility of a given client. Here the expert will analyze deeply all sorts of information available to a client like Bank references, audited financial statements and trade references to establish the capacity, character, condition, capital and collateral.

It is normal practice before extension of credit to clients to carry out credit investigation to usually consider the following aspects.

Nature of the company whereby the companies analyze clients business time and risks associated with such type of business and establish their liquidity and profitability.

One needs to consider the type of customers to would be the client requesting the credit. Here one needs to carry out extensive investigation to new clients whereas for old clients one can use the previous customer ledgers to establish their past performance. In addition one can also consider the nature of goods to would be the clients requesting a credit so that one establishes if the firm is dealing in seasonal good or not, otherwise it would be advisable to change credit period and amount to correspond with seasonal requirements. They are following stringent policy; it is advisable to carry out extensive credit investigation to would be requesting credit. And in case a lenient policy is followed then limited but justified credit investigation is needed. Whatever approach used companies, need to carry out through credit investigation before any credit extension to clients is concerned so that minimization of loss is reduced tremendously and belief case companies who have a high rate of default is reduced.

2.5.0 CREDIT POLICY

Credit policy is a set of policy actions designed to minimize costs associated with credit while minimizing the benefits from it. **JB Kakuru (2000).** The objective of this policy is to have optional investment in the trade off between the benefits and costs associated with it. In other words, as optional level of investment, both objectives of profitability and liquidity are considered.

According to **Dickerson et al (1994)** optional credit policy is the one at which the marginal benefits of the increased sales offset the marginal costs of extending credit.

J.B Kakuru (2000), identifies three elements in the credit policy for any sound able account receivable management among which include;

Credit term

Credit standards

Collection procedures.

2.5.1 CREDIT TERMS

This focuses on conditions under which credit is to be extended and it answers the questions "under what conditions should credit be extended?" **J.B Kakuru (2000).** Credit terms are stipulations under which a firm extends credit to customers.

In a competitive world companies need to follow a lenient credit policy that allows by credit payment periods whereas in monopoly situations companies need to follow a stringent credit policy that allows shorter periods of payment.

Credit period is the length of this allowed to a client within which the client should have cleared off his debt obligation with the company that extended a credit. This could be say

"Net 45" meaning that all the customers are expected to repay their obligation in 45 days. Credit periods differ from firm to firm however it is normally in the range of 15, 30, 45, 60 and 90 days depending on factors like the terms offered by company in the same industry and the demand of the product.

The working capital normally has a greater influence on firm's credit periods to be extended to clients. Hence the level of working capital has an impact before credit extension occurs so would be clients requesting it.

Credit period may affect the company's profitability in the following ways:-
Increase in credit periods leads to a rise in bad debts expenses, which tremendously affect the company's profitability (cash flow).

Increase in average collection period causes increase on investment on accounts receivable which has a negative effect on the cash flow and profitability.
And increase in credit period causes a rise in sales volume, which is favorable hence contributing to the profitability of the company.

Once credit period is used as a competitive tool it should be below that of the average industry as this may lead to loss of customers to company's rivals in the industry. Therefore a credit period extended to would be customers requesting credit needs to be the one that ensures availability of funds on a timely basis and ensure profitability is attained at the same time.

Cash discount is offered to customers in form of a price reduction to induce them to pay their credit obligation within the agreed period of time, which is less than the normal credit period.

It is used as a tool to increase sales and accelerate collection from customers, which helps the firm to reduce the level of receivable, their associated costs. For example if a customer is given a credit under the terms "2/20, Net 45" it means he will have to clear his credit obligation within 2-0 days he will in turn receive 2% cash discount beyond which he will pay the whole amount at an agreed time period.

Procedures / guidelines used to determine the optimal cash discount rate include;
Cash discounts must correspond with customers and sensitivity to price charges.
Bad debts losses have an advert on the maximum discount rate in case of bad debts loss rate being high then higher discounts may be given provided they help in decreasing the loss.
The timing of cash flows is critical in the cash discount decisions since company's discount rates shifts some payments forward while non discount customers are affected either positively or negatively.
The credit terms must be varied as the firm's opportunities charges so that cash discounts extended depends on the firm's cost of funds.

2.5.2 CREDIT STANDARDS

Those are the criteria, which the company follows in selecting customers / clients for credit extension. This is a very fundamental credit policy variable that needs extensive analysis to establish the clients' credit worthiness and integrity. This leads to a greater task to financial managers in scrutinizing and screening credit applicants so as to avoid default and bad debts write off.
The aspect are normally considered and analyzed properly in order to gauge the customers and set credit standards.
The average collection period (ACP) that is to say the period in which the debts remain outstanding.
Defaults rate, which is the ratio of uncollected receivables to the total receivables. From the ration firm is able to determine that the customer will meet his credit obligation. In order to establish the profitability of default the firm should consider the following parameters, which are known as the 5C's of the credit J.B Kakuru (2000).

Character, this relates to the willingness of the customer to pay his obligation. However, to a ascertain this willingness more consideration is accorded to moral factors or power integrity.

The financial manager must try as much as possible to ascertain the customer would be honest enough to meet his obligation hence this calls for evaluation of the customers' character following the below hold aspects.

- **Bank reference** which will give the information on the application bank account with his bankers, this is a very reliable source of information since banks do not extend credit to clients who have good character and prove integrity with sound financial status and collateral security. However, such information is hard to get but takes firm to convince the customer and the bank to lift the veil over the fiduciary relationship with the customer.

- **Marital status**. This is considered because married people / clients are normally stable and secure the grant credit since they are settled in permanent places unlike unmarried ones.
- **Attachment of government agencies**. These are assured of payment for government since they are normally allocated their budgets every end of financial year.

- **Level of education**, since this reflects on the level of one understands in the society.

- **Contact**, the firm needs to establish how to communicate and get clients whenever need arises. This helps in future collections.

- **Occupational stability**, this helps in considering clients who have a long period dealing with the firm extending the credit.

- **Historical background of the client**, this helps to see whether in the process he has ever defaulted or got any financial problem.

- **Capacity,** here the company would look at the ability of the customer to pay his due obligation in analyzing the capacity the financial manager needs to look at.

- **Financial statements**, this requires the following: Customer to present the past, present and projected financial statements like the balance sheet which looks at the financial position and how acquisition of assets was financed; the income statement to determine the performance and forecasted cash statements for the anticipated sources and allocation of funds.

- **Previous experience with the firm,** which involves assessing the customers' regular in setting credit obligation.

- **Bank and trade reference** to cross check the clients dealing with the bankers and other suppliers.

- **Amount and purpose of credit** to determine the possibility by looking at the profitability by looking at the profit margin, cash flow positions and ratio of business and duration one has been in business.

- **Capital:** This is a contribution of interest of the customer in his business and is shown by Capital = Assets – Liabilities. Therefore considering capital the firm would be establishing the state the would be client requesting credit has in the business. It is therefore undesirable to extend credit to persons who have little capital and vice-versa.

- **Collateral.** This would act as a security against failure to pay the due obligation by client requesting the credit for the firm. This security should be free from any in cumbrances and marketable. However, this collateral whether good or not should be the last to consider.

- **Condition,** This relates to prevailing economic and other factors like social and political, which may affect the ability of the client requesting for paying, when debt falls due though he may be having the willingness.

According to the administrative officer of Star FM (K) Ltd. there is no comprehension procedure of assessing the customers' character, capacity, collateral, condition and capital.

There is always little information collected from past clients that would have provided insight just the customer's creditworthiness.

2.5.3 COLLECTION PROCEDURE:

These are efforts applied in order to accelerate collection from slow paying customers and reduce bad debt losses. **J.B Kakuru (2000).**

Brigham (1995) defined a collection policy as the procedures the firm follows to collect past due Accounts.

And to **Chandra (1987)** the collection program of firm is aimed at timely collection of receivables and may consist of;

Sending of credit notes to inform the debtor of the amount due so as to act upon in clearing his debt obligation in question with the company.

Then, sending a letter to remind him or let him know that in actual fact the amount have fallen due According to the credit terms agreed upon.

In case there is no response the financial manager can make a personal and physical contact with the customer through telephone calls or actual visit or appearance to concerned himself and meet face to face.

Threat of legal action against overdue accounts. However, this use of legislation should be used a last resort in the collection effort and it should be applied when the long term relationship with the client is not crucial but when it is crucial should not be used since they tend to make a final point of departure between the business and the client together with his associates.

An effective collection procedure should be instructed aiming at the shortening o ft he average collection period, reducing the possibility of bad debts and increasing the collection expense.

According to **Keown (1985)** he identified the approaches used by manager to monitor accounts receivables and they include:

Ratio Analysis

This involves examining the average collection period, the ration of receivables to Assets, the ratio of Credit Sales to receivables that is account receivable turnover and the Amount of bad debts relative to sales over time

Examples of ratios include;

Average collection period (ACP)

$$= \frac{\textbf{Debtors}}{\textbf{Sales}} \textbf{ x 365 days}$$

This ratio indicates the number of days a company must wait before a debtor can settle in obligation.

Aging of the Accounts receivable

This is a schedule, which provides a breakdown both in dollars, and on percentage terms campaign the current aging of receivables with the past details offers further investigation into the degree of control that is maintained over receivables.

$$\textbf{Receivables turn over} = \frac{\textbf{Credit sals}}{\textbf{Average Debtors}}$$

This indicates the efficiency of the firm's credit Management policy hence it will help in ascertains how fast the firm is receiving its money from debtors.

LB. Kakuru (2000) suggests aggressive collection efforts, which should be targeting to accelerate collection from slow paying debtors and reducing bad debt losses. Firms should select collection procedures that speed up the receipt of cash in flows for debtors without jeopardizing its relationship with the customers.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the research methods that were used in the study and the reasons why such methods were used.

The methods helped to collect data, upon which findings, interpretations and conclusions was based. It also laid down the limitations faced in the study

3.2 Research design

The research is a case study of Star FM. The researcher employed a descriptive and cross-sectional study designs. Both qualitative and quantitative data collection were used since they are considered to be the most appropriate in achieving the set objectives.

3.3 STUDY POPULATION

The study population of these research studies covered all 30 Star FM staff members in the department of finance and accounts: in the revenue collecting centers considered under this study and the 15 customers. These were considered because they had vital information about the internal controls and the rate of bad debtors in these specific divisions where they are located and beneficiaries respectively.

3.4 Sampling design

The research employed purposive sampling in selecting study sample.

Here personnel in accounts and finance department and the customers were the only ones considered in the sample. This is because they are directly involved in the credit management and beneficiaries respectively. The sample size composed of only 30 staff respondents and 15 customers.

3.5 DATA COLLECTION METHODS

The data collection methods that were used in this study are:

3.5.1 Primary data

Collection of primary data necessitated the researcher to go in the field with designed questions which was given to the selected respondents, and they provide the required information.

In debt interviews was also conducted to get data from the respondents who were busy and unable to feel the questioners.

3.5.2 Secondary data

Data required for the literature review was obtained from pamphlets, news papers, files. Also text books from libraries like Kampala International University library, Makarere University library, Kenya National library and private libraries, secondary data was used mainly to supplement the primary data to enable the researcher obtain more concrete information.

3.6 DATA COLLECTION INSTRUMENTS

3.6.1 QUESTIONNAIRES

These are the major techniques that were used to obtained data. The questionnaire had to be delivered to the respondents physically by the researcher.

To increase the response rate, the questionnaires was open-ended and close ended; simple ended simple worded and made relatively short but comprehensive so as not to restrict respondents to particular answers. Where more information was needed open-ended questions and request for recommendations was included in the questionnaire.

3.6.2 INTERVIEW

Face to face in-depth interviews was conducted to collect data from staff members in accounts and finance department and customers who were not having time to fill questionnaires delivered. The researcher used the interview guide that helped him to ask questions at the right time.

3.7 Data processing and analysis

Data collected was analyzed in the form of descriptive statistical methods which include tables and bar graphs.

Data processing and analysis involved the following

3.7.1 Editing

The completed structured questionnaire was scrutinized in order to reduce errors and omission. Each questionnaire undeewent thorough study to clarify on the responses given in order to establish their eligibility and accuracy

3.7.2 Coding

Where question were open ended, data and responses was further coded so as to categorize the responses exhaustively. This was to enable the researcher to easily depict the findings of the study and to interpret them appropriately so as to come up with adequate conclusion from the data collected.

3.7.3 Tabulation

The data was then be analyzed using tables to show the numerical scores and percentage further analysis was carried out to relate dependent and independent variables

CHAPTER FOUR

PRESENTATION AND INTERPRETATION OF FINDINGS

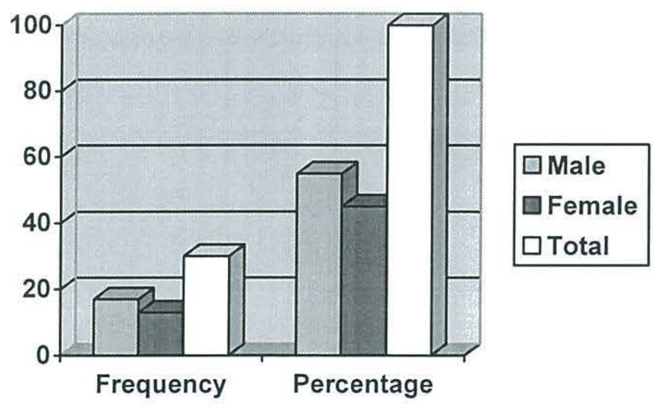
4.0 Introduction

The chapter provides the critical analysis of the data collected/findings and interpretations. The data in this chapter was got from the primary source. It is divided into sub-sections that relate to the variables under study namely, background of the respondents and internal controls on management of debtors and credit collection and relationship. Of the 45 respondents interviewed 30 were from Star FM staff and 15 were customers. Tables and charts have been used to present the better interpretation.

4.1 BIODATA OF RESPONDENTS

4.1.1 Gender of respondents

Among the 30 respondents interviewed, 55% were male and 45% were females as illustrated in the table below:



Source: primary data from the field (2009)

4.1.2 Age of respondents.

Of the respondents interviewed, 40% were in the age bracket of 23-33 years, the second largest of 36% were in the age bracket 34-44 years, the third being 20% with an age bracket of above 45-52 and lastly 4% were in the age bracket of above 52 years. This can be fully illustrated below.

Table 5.Age of respondent

Age	Frequency	percentage
23-33	12	40
34-44	10	36
45-52	6	20
Above 53	2	4
Total	**30**	**100**

Source: primary data from the field (2009)

4.1.3 Level of Education

Twenty-five staff members of Star FM were interviewed, 15% of these were university under Graduates, 25% were Diploma holders, 15% had Certificate while 45% were below A-level Education. This can be illustrated below

Table 6. Level of Education

Education level	Frequency	Percentage
Under Graduate	4	15
Diploma	5	25
Certificate	4	15
Below A-level	12	45
Total	**45**	**100**

Source: primary data from the field (2009)

4.1.4 Period spent in the company

Of the 30 staff members interviewed 25% had been in the company 1-2 years, 45% started with the company when the company commenced business in 2000 and 30% were below 1 year. This is illustrated in the table below

Table 7. Period spent in the company.

Period	Frequency	Percentage
Started with the Co.	14	45
1-2 years	7	25
Below 1 year	9	30
Total	**30**	**100**

Source: primary data

4.2 INTERNAL CONTROL ON DEBTORS

These are the individual elements of an internal control system.

4.2.1 Accessibility to customer records

In the interest of control for the purpose of the debtors, limited access to customer records is of paramount importance since once in place and is being implemented properly no alterations can occur so as to distort the real information. On interviewing the staff of Star FM on about the people who had access to customer records [debtors], 45% of the staff revealed that all employees had access to the customer records, 20% revealed that the administration manager/credit controller had access to the customer records. However 15% said that the marketing manager had access to the records whereas the 10% revealed that the accounts people had access to the records, the 7% said that marketing executives had access to the records and the 3% revealed that it is only the management who had access to the customer records as illustrated below

Table 8. Accessibility to customer records

Staff having access	**frequency**	**percentage**
All employees	13	45
Administration manager/credit manager	6	20
Marketing manager	5	15
Accounting	3	10
Marketing executives	2	7
Top management	1	3
Total	**30**	**100**

Source: primary data

In as far as changing customer records is concerned the majority of 95% of the staff strongly disagreed that all employees could change the customer records and the remaining 5% agreed that the customer records can be changed but emphasized that it is the accounts people who can normally do that. Illustration;

Table 9. Change of customer records

Response	**frequency**	**percentage**
Strongly disagree	29	95
Agree	1	5
Total	**30**	**100**

Source: primary data

4.2.2 Reconciliation of invoices with contract orders

In order to ensure that correct invoices and payments are made, invoices have to be crosschecked with the contract order book. Off the staff interviewed 55% strongly accepted that this was being done, however 35% disagreed, 5% further strongly agreed the reconciliation was done whereas 5% were uncertain as evidenced in the table below:

Table 10. Reconciliation of invoices with contract order

Response	**Frequency**	**Percentage**
Strongly accepted	16	55
Disagree	10	35
Further agree	2	5
Uncertain	2	5
Total	**30**	**100**

Source: primary data

4.2.3 Segregation of duties between receipts of cash and recording of payments

In order to prevent teeming and lading, fraud, collusion by staff, duties of staff receiving cash and those recording payments should be segregated. This seems to be the practice in Star FM since according to this research 55% of the staff strongly agreed that there is separation of duties, 20% agreed, 10% were uncertain and 15% strongly disagreed that there was segregation of duties between the staff receiving cash and those recording payments.

Illustration;

Table 11: Segregation between cash receipts and recording payments

Response	Frequency	Percentage
Strongly agree	16	35
Agree	6	20
Uncertain	3	10
Strongly disagree	5	15
Total	**30**	**100**

Source: Primary data

4.2.4 The preparation and posting of Debtors statement

In updating the customer's Accounts, the debtor's statements have to be prepared and posted to determine the overdue customers' accounts so as to start demanding payments for all those customers whose accounts are long overdue. The staffs that are involved in the preparation debtor's statements should be separated from those posting debtor's books of accounts. On interviewing the Star FM Staff 50% agreed although 15% disagreed, 10% were uncertain and 15% strongly agreed, lastly 10% strongly disagreed that debtor statements were prepared and posted. Table 12 illustrates this.

Table 12. Preparation and Posting of Debtors Statements

Response	Frequency	Percentage
Agreed	15	50
Disagreed	4	15
Uncertain	3	10
Strongly agree	5	15
Strongly disagree	3	10
Total	**30**	**100**

Source: Primary data

As regards to the segregation of duties when preparing debtors statement and posting them, the biggest number did not agree that is 25% disagree and another 30% strongly disagreed. However 40% agreed that the two duties were separated while 5% strongly agreed.

Illustration

Table 13. Segregation of staff preparing debtor statements and invoicing

Response	Frequency	Percentage
Strongly agree	2	5
Agree	12	40
Strongly disagree	9	30
Disagree	7	25
Total	**30**	**100**

Source: Primary data

4.2.5 Writing off bad debts

In case of Accounts, which are overdue with no prospect of being collected, they are normally written off as bad debts. However this should be done after through investigation and Authorization. In Star FM this control is in place as evidenced by the response from the research. 70% strongly agreed, 25% agreed and 5% were uncertain as to whether this control was in place.

Table 14. Writing off bad debts after through Investigation and Authorization

Response	**Frequency**	**Percentage**
Strongly agree	21	70
Agree	6	25
Uncertain	1	5
Total	**30**	**100**

Source: Primary data

4.2.6 Non-invoicing of customers and issuing of wrong invoices

There are situations when the customers are not given invoices or wrong invoices are issued to clients. This can be brought by negligence, errors or collusion and fraud. In trying to find out situation of non- invoicing, 85% agreed that such situations occur, 10% strongly agreed whereas 5% were uncertain as illustrated below.

Table 15. Non-invoicing of customer accounts

Response	**Frequency**	**Percentage**
Strongly agree	3	10
Agree	26	85
Uncertain	1	5
Total	**30**	**100**

Source: Primary data

As regards to issuing wrong invoices to customers 30% agreed, 55 % disagreed, 10% strongly disagree and 5 %Strongly agree that it does happen as illustrated in the table 16 below.

Table 16 Issuing of invoices to wrong Accounts

Response	Frequency	Percentage
Agree	9	30
Disagree	16	55
Strongly disagree	3	10
Strongly agree	3	5
Total	**30**	**100**

Source: Primary data

4.3 CREDIT COLLECTION.

This looks at the three variables of credit policies namely credit terms, credit standards and the collection Effort.

4.3.1 Credit terms

This refers to the period given to customers to clear their accounts and cash discounts given. In this case the normal credit period in Star FM was 30 days as was ascertained by 70% of the respondents interviewed. 10% revealed a credit period of 15 days whereas 15% revealed 2 to 4 months but only on special arrangement, lastly 5% said it was only one week. The research findings revealed that cash discounts are usually given to Star FM Clients except under special circumstances, which must be endorsed by the top management as illustrated below.

Table 17. Credit period allowed to clients

Credit period	Frequency	Percentage
30 days	21	70
15 days	3	10
2 – 4 months	5	15
7 days	1	5
Total	**30**	**100**

Source: Primary data

4.3.2 Credit standards.

Whenever a customer wants a credit, credit application forms have to be filled with details of credit status of the applicants and verification process starts immediately. As regards to this 75% of the staff disagreed, 10% strongly disagree, 15% agreed that verification was done, lastly 5% were uncertain as to whether verification was done as indicated below.

Table l8. Verification of creditworthiness

Response	**Frequency**	**Percentage**
Agree	4	15
Disagree	22	75
Strongly disagree	3	10
Uncertain	51	5
Total	**30**	**100**

Source: Primary data

4.3.3 Collection Effort.

This includes the management of debtors. It consists of the methods used and period taken before embarking on such efforts.

4.3.3.1 Methods of following up Debtors

Of the staff interviewed, 65% revealed that all methods were being used, however 20% revealed that Debt collection agencies were specifically used while 7% said that personal visits was employed and 8% revealed that remainder letters were used as illustrated below.

Table 19. Methods of following up outstanding accounts

Methods	Frequency	Percentage
Remainder letters	2	8
Personal visits	2	7
All methods	20	65
Debt collection agencies	6	20
Total	**30**	**100**

Source: Primary data

In order to enhance payments of outstanding debts, additional methods of collections were employed and the findings were as follows: 45% said that collection agencies were used, 20% revealed legal action and removal from the air whereas 15% sighted use of special arrangements with clients as illustrated below.

Table 20. Additional methods of enhancing collection of outstanding debts

Additional methods	Frequency	Percentage
Collection agencies	14	45
Removal from Air	6	20
Legal action	6	20
Special arrangement	4	15
Total	**30**	**100**

Source: Primary data

4.3.3.2 Late payment of invoices by customers

In this research 15 clients of Star FM were interviewed pertaining to late payments of invoices, 70% reasoned that the late arrival of invoices made it hard to pay earlier as agreed.10% gave reasons of wrong accounts and wrong figures, lastly 10% sighted errors on the invoices submitted. This is illustrated in the table below

Table 21. Reasons for not paying invoices on time

Reasons	Frequency	Percentage
Late arrival of invoices	10	70
Wrong accounts	2	10
Wrong figures	1	10
Errors	2	10
Total	**30**	**100**

Source: Primary data

The research also established that remainders were rarely sent as was confirmed by 60% of the respondents interviewed, 20% asserted that they receive remainders after 3 months and 20% asserted that they have never seen any remainder from Star FM as illustrated below.

Table 22. Frequency of remainders to clear outstanding invoices

Response	Frequency	Percentage
Rarely sent	9	60
After 3 months	3	20
Never	3	20
Total	**15**	**100**

Source: Primary data

CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.0 INTRODUCTION

This chapter gives a summary of the main findings, draw conclusions from the data analysis and advances recommendations for improvement on internal controls on debtors.

5.1 DISCUSSION

5.1.1 INTERNAL CONTROLS ON DEBTORS

There are elements of internal controls that enhance the efficient management of organizations' assets and operations. From the findings, it was observed that internal control measures on debtors were in place in Star FM. However there was weakness in the some controls like accessibility to customer records as a large proportion of respondents interviewed revealed that most of staff had access to customer's records [Table 8].

The segregation of duties-these is intended to ensure that no one person is able to process and record a complete transaction from the beginning to the end without been checked. Segregation of duties minimizes the risk of intentional manipulation and boost the elements of internal check. Particular attention should be attached to the separation of the function of authorization, execution, custody, recording and incase of a computer based accounting system, system development and daily operation. However, segregation of duties was not well instituted in as far preparing debtors statements and invoicing was concerned since a big percentage disagreed as to whether there was separation of duties between those preparing debtor statement and invoicing of customers [reference table 13].

There were also many situations when non-invoicing of customer's accounts and issuing wrong invoices to clients take place. [Table 15 & 16].

Among the areas were internal controls were instituted were, changing of customer records, reconciliation of invoices with contract order book, segregation between receipts of cash and recording payments, preparation and posting of debtors and writing of bad debts after due authorization and investigation as shown in tables 9, 10 11, 12 and 14 respectively.

5.1.2 Credit collection

This looks at the three variables of credit policies namely credit terms, credit standards and the collection Effort. Credit terms refer to the period given to customers to clear their accounts and cash discounts given. Whenever a customer wants a credit, credit application forms have to be filled with details of credit status of the applicants and verification process starts immediately this is called credit standards and collection effort includes the management of debtors. It consists of the methods used and period taken before embarking on such effort.

In as far as credit collection is concerned Star FM gives a credit for 30 days for invoices to be settled [reference table 17]. The verification of creditworthiness was however not done regularly as indicated in table 18 and all collection methods were used to follow up outstanding accounts ranging from remainder letter, legal action, and debt collection agencies. In Table 19 and most customers acknowledged late arrival of their invoices as a reason for late payments [table 21]. However it was notable that majority of clients never received remainders to clear their outstanding debts.

5.2 CONCLUSIONS

From the findings the following conclusions were drawn

1. The access to customers records is not well protected to relevant authorities since bigger percentage of all employees have access to the customer records at all times even those from other un related sections have easy access to records which could be the root cause of issuing wrong invoices.
2. There are situations when wrong invoices are given to customers resulting into many customer complaints and delay in settling of outstanding debts.
3. The creditworthiness of customers is not well evaluated and analyzed to ascertain the character, capital, capacity, condition and collateral before allowing a credit which could be the root cause of non-payment or default.

4. There are high instances of not issuing invoices to customer accounts that culminate into possible loss of revenue and poor credit collection hence high levels of accounts receivables that have been accumulating year after year.
5. The credit period given to customers is thirty days but it actually takes about another month before the company embarks on efforts to collect revenue from its overdue clients.
6. The customers are not regularly followed up for the instances of delayed payments and remainders, resulting into possible delay in clearing outstanding invoices.
7. It is clear that all credit collection methods are used such as remainder letters, personal visits, collection agencies and telephoning although collection agencies, and legal action are specifically employed to accelerate payment of outstanding debts.
8. There is a relationship between the internal controls and the management of debtors sine internal control of debtors have an effect on credit collection and it is even due to some weaknesses in the control system that have lead to poor performance in collection of accounts receivables for overdue debts.

5.3 RECOMMENDATIONS

1. There should be segregation of duties so as to avoid teeming and lading, fraud, changing, customer records, collusions Conniving, overstating and understating the customer invoices and ledger of accounts.
2. Accessibility to customer records needs to be protected to only top management and staff from departments that are related in order to limit possible cases of fraud and alteration of customer records.
3. The department involved in invoicing customers should be changed and given further training in order to increase the efficiency and minimize on invoicing errors and issuing of wrong invoices.
4. Customer complaints should be solved immediately to make customers feel obliged to clear their outstanding debts on time.

5. Revenue Collection Officers needs to be rewarded with incentives like commissions and bonuses on top of their salaries and wages to arouse their morale in collection of over due accounts from debtors.
6. The use of last resort methods of credit collection like removal from the air and legal action should be minimized since they lead to accumulation of bad debts; however they can be employed in instances of very large debtors.
7. The recovery of overdue accounts should be done immediately after the agreed credit period of 30 days so as to avoid delays in settlement of outstanding invoices.
8. In case of potential doubtful debts, discounts should be allowed to enable easy recovery of parts of debts, which would have turned out to be losses.
9. Regular follow up of overdue accounts should be emphasized and issuing of regular remainders to customers should be followed so as to encourage customers to endeavor to pay up their due obligation.

5.4 Limitations to the research study

The following were the problems/limitations encountered during the research study:

- The problem of limited funds became the biggest obstacle met by the researcher since he funded himself. However this was overcome after the intervention of his friends and relatives.
- There was some red tape in getting the information since the staff could not easily fill the questionnaire without express authority from their superiors due to organizations' bureaucracies. This culminated into some delays in time framework
- In spite of having made a time frame for the research, it become problem due to some unavoidable contingencies such as delays by the respondents in filling the questionnaires that culminated in submitting the research on the last day.

- The accessibility of public libraries such as World Bank library, British council library was always met with tough rules and bureaucratic procedures which made hard to reach all the literature the researcher needed. The British council library only allowed the use of management section that had important literature to its subscribers where the World Bank library was always closed.

5.5 Issues of future research

The effect of internal controls on the credit policy.

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APPENDIX I

THE QUESTIONNAIRE FOR ACCOUNTS, FINANCE AND MANAGEMENT OF STAR FM

Dear respondent

I am student of Kampala international university carrying out research to establish the relationship between internal controls and debtor's management. Star FM has been chosen as case study and you have been selected as key respondent because the information you have will greatly aid in this research, which is entirely academic and will to the award of a Bachelor of Business Administration accounting option. Your views and comments will be highly respected and treated with utmost confidentiality

May Allah Bless You!!

Instructions

1) Tick against the applicable answers in space provided
2) For questions with no alternative answers given, comment in the space provided

Gender [ ] Male [ ] Female

Age (years) [ ] below 18 [ ] 21-30 [ ] 31- 40 [ ] 41-50

[ ] Above 50

Level of education: [ ] certificate [ ] Diploma [ ] degree [ ] Postgraduate

How long have you worked in this Company [ ] less than one year [ ] 1-5 yrs

[ ] 6-10 yrs [ ] 11-20 yrs [ ] Above 20 yrs

SECTION: A [INTERNAL CONTROLS ON DEBTORS]

1. Which employees have access to customers records?

[ ] all employees [ ] Accountant [ ] Top management

[ ] Others please specify---

2. Customers can be changed by any staff?

[ ] strongly agree [ ] Agree [ ] Uncertain [ ] disagree [ ] strongly disagree

3. Who authorizes changes to customers' records?

[ ]Credit controller [ ] Accountant [ ] sales staff

others specify---

4. invoices are reconciled with customers' order and receipts during recording

[ ] Strongly agree [ ] Agree [ ] Uncertain [ ] Disagree [ ] Strongly disagree

SECTION B. [CREDIT COLLECTION]

5. How often do you get customers complaints regarding wrong invoices errors?

----

6. Are customers' claims are always recorded and investigated?------------------------

----

----

7. How long does it take to investigate and correct customers complain?

----

8. Is there separation of duties between staff receiving cash payment and those recording payment

----

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9. Are debtors statements are regularly prepared and posted to client

----

----

10. When is writing off of bad debts done

----

11. Are there instances where customers are not invoiced

APPENDIX 11

TIME FRAME

PERIOD	ACTIVITIES
1st February -10th February	Identification of the problem
12th February -20th February	Topic approval
22nd February -28th February	Data collection
1st March - 7th March	Analyzing and interpretation of the data
10th March -20th March	Report writing
22nd March -30th March	Reviewing the repot
1st April -10th April	Binding the book
11th April -20th April	Submission of the final report

APENDIX III

BUDGET

ITEMS	AMOUNT IN KENYA SHILLINGS
Transport cost	2500
Internet	300
Photocopying	1000
Binding	1000
Stationary	500
Printing	1000
Total cost	**6300**