APPLICATION OF FINANCIAL MANAGEMENT IN CO-OPERATIVES: EXPERIENCE FROM THE FIELD

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Abstract

This study examined application of financial management in co-operatives. Specifically, the study intended to examine whether co-operatives adhere to financial management tools and to examine the challenges facing co-operatives in applying financial management. The study was conducted in Kilimanjaro, Arusha and Kagera regions. Both primary and secondary data were collected. Primary data were collected through interviews and secondary data through documentary review.

Findings revealed that co-operatives were found to comply less with financial management tools. The tools tested include internal control, record keeping, accounting system, budgeting, audit, financial accountability, business plan and finance plan, cash flow management and understanding of costing.

On the other hand, lack of skilled personnel in co-operatives, fraud practices by management and board, Low level of education of board members, low members' involvement or participation were found to be among the factors which hinder application of financial management in co-operatives.

The study recommends for co-operatives to regularly organize financial management training for the management and board members. This will improve the level of supervision and monitoring of financial management tools in co-operatives. Furthermore, co-operative laws should stipulate heavy punishment for fraud since fraud has been a regular practice in co-operatives. Regarding low level of member's participation, co-operatives should regularly provide training to its members to enhance their understanding of co-operative operations and their position in decision making.

Key words: co-operatives, financial management, internal control, working capital management

1. Introduction

1.1 Background of the Study

Co-operatives often have the wrong idea about financial management. They consider financial management as something that their accountants should take care of and something new that is too hard to learn. In reality, financial management is one of the most important elements of managing any business. Financial management allows management to have the right information at the right time, in order to make the right decisions. Financial management in business encompasses more than keeping an accurate set of books and balancing business account. It rather comprises four important roles/decisions including (Pandey 2006); first, investing decision which requires a co-operative society to identify and invest in projects which are viable in the sense that they bring positive return to the co-operative.

Secondly, it concerns financing decision where by co-operative boards are required to determine how and when the business should obtain funds while considering the cost of various sources. Every co-operative has its own capital structure that maintains the best equity-to-debt ratio to ensure adequate growth of the society. Financing is the process in which managers, board members and ordinary members decide how best to bring money into the co-operative without assuming too much risk.

The third decision is working capital management which includes the operational budget, current assets, payroll and cash flow. Board and management must regularly assess records, current assets and cash flow to see how much is coming in, how much money is being expended, and how much is tied up in assets. Cash is very important because without money, you cannot pay operating expense including workers and without workers, you cannot get the work done.

Fourth, dividend decision is about fair distribution policy of surplus. Since the people who invest in any venture expect to get a return on their investment, a decision should be made either to distribute surplus to members or to retain it for their co-operative. Therefore, determining the optimum policy for surplus management is crucial to the success of the co-operative. In big companies, the application of financial management is apparent because there are clear systems of operation. This is influenced by their ability to employ qualified personnel (Eversull 2011). In a co-operative society, the concept of financial management is not clear to board members and management. Despite having values of openness and honesty as an integral part of the life and workings of co-operatives, many corruption scandals, financial mismanagement problems and rumours of misuse of funds have undermined co-operatives.

1.2 Statement of the Problem

Co-operatives especially financial co-operatives which take in deposits that they lend to persons, good financial management is essential because, to be able to play this intermediary role, a co-operative financial institution must show the customers its reliability and soundness in order to obtain their confidence. Without this confidence, no one would deposit his savings there. Therefore, if members will not deposit their money members will not get loans thus these institutions will fail to operate and eventually collapse (Cida2010). Likewise in agricultural co-operatives financial management is essential to ensure members are paid on time and their supplies are fetching good prices. There has been the tendency of members of co-operative selling their produce to private traders while they have their co-operatives for the reason that they are paid late and low price in their co-operatives. To gain confidence of members so that they can bring their supplies to co-operatives good financial management should be in place.

1.3 Study Objectives

1.3.1 General objective

The main objective of this study was to examine the application of financial management in co-operatives.

1.3.2 Specific objectives

Specifically the study intended

- to examine whether co-operatives adhere to financial management tools
- to examine the challenges facing co-operatives in applying financial management

1.4 Significance of the study

The study findings will enable co-operative managers and board members to be aware of financial management tools which will enhance the use of those tools in cooperative.

The study will also enable academic institution to develop their curriculums in such a way that will fill the gap of financial management skills in co-operatives.

2. Literature Review

2.1 The Importance of Financial Management in a Co-operative

It might be impossible to design the perfect financial management system in a co-operative. But it is better to have one to ensure self management by members and management over financial affairs. This will ensure governance at a board level is strengthened, informed decisions can be made and limited financial resources are utilized optimally in the co-operative. Also the cash flow position of the co-operative is not jeopardized and capital needs are carefully worked out to ensure the necessary assets are obtained. Moreover, the right sources of finance are targeted, training needs are appropriately supported, and the surplus is divided according to the legal formula and most importantly according to actual financial viability. Lastly, supporting the community for sustainable development and co-operative development can be clearly realized.

2.2 Tools for Ensuring Effective Financial Management

2.2.1 Financial Accountability

Despite having values of openness and honesty as an integral part of the life and workings of co-operatives, many corruption scandals, financial mismanagement problems and rumours of misuse of funds have undermined co-operatives. To overcome this, every co-operative in the co-operative movement has to practice financial accountability. Simply put, to be financially accountable means explaining and accounting for the use of money in your care. It means narrowing the opportunities for corruption, theft or misuse of funds.

On the other hand, all those handling finance must be beyond doubt and suspicion. This can only be secured with a proper system of financial accountability. In all co-operatives, there is a statutory obligation that all members must receive, at an annual general meeting, the financial statements of a co-operative. In addition, all these statements must be audited and copies must be sent to the Registrar of Co-operatives.

However, besides the formal accountability required by law, the role of the board, the manager and the finance sub-committee are also important in terms of ensuring accountability. These structures must lead, manage and ensure financial accountability takes place and, at the end, be accountable to the members of a co-operative. This also means the members of a co-operative must choose the leadership of the co-operative very carefully (Fisher 2006).

2.2.2 Internal Control

To re-enforce financial accountability, it is important to have proper control policies and procedures in place. These finance policies and procedures should be drawn up in a participatory way. The responsibility for monitoring implementation and compliance lies with the Board. Having the policies in place will ensure all finance-related functions would be properly supervised and governed, and this will protect the assets of the co-operative. All reporting on financial matters would be consistent, regular and be able to strengthen the leverage. So long as co-operatives are dynamic institutions and are therefore constantly changing, it is important to review policies on a regular basis to ensure they are up to date and are able to meet the operational needs of the co-operative (Kingori & Sylivia, 2002).

2.2.3 Record Keeping and Accounting System

Financial information flows in and out of a co-operative with all sorts of transactions. All of this information concerning the transactions has to be stored and interpreted. With regard to the accounting system, it is important to understand that bookkeeping means recording transactions while "accounting" is all about analyzing and applying the data from bookkeeping to enhance financial decisions. Thus accounting requires the methods of bookkeeping, but is not the same thing. With the recording and interpretation of financial information, boards of co-operatives can understand the results and performance of the co-operative and make serious financial decisions. It is not enough just to track money coming in or, worse still, to work with the assumption that the money coming in exceeds the costs. Without constant verification and financial analysis, a co-operative can run into serious trouble (wood 2010).

2.2.4 Audits

An audit is an independent examination or verification of accounts and practices, according to set principles, by an accountant who is a certified auditor. In Tanzania, accountants have to be registered with the National Board of Accountants and Auditors in order to conduct audits. Not all accountants are, therefore, entitled to conduct audits. Audits are not about re-doing the financial statements of the co-operative, but are about assessing whether the results and financial situation reported in the statements are as reasonable and as accurate as possible (Millichamp 2002).

2.2.5 Financial Reporting

In a co-operative it is important to ensure that financial statements are presented regularly to the board. On a monthly basis, the following should be presented to the board by the finance subcommittee through the accountant: Income and expenditure statement/profit and loss; cash flow statement, bank statement, a report on the budget, a report on cash flow and any other financial information required by the board. All these should be presented to the members during the Annual General Meeting (URT 2013).

2.2.6 Understanding Costing

Costing is about understanding how to calculate the costs to make or sell a product. It is essentially about understanding the amount of money spent. Without proper information about the product or service produced in a co-operative, the managers, the board members and the members cannot make proper decisions. Costing is the basis for generating proper financial statements and, in particular, in understanding sales revenue and expenditure. Costing assists marketing with the rule that if a non-member or customer of the co-operative wants to pay less than the cost of producing the item, then the co-operative has to stop producing. In other words, it is not price competitive. Costing assists with controlling budgets, costing strengthens cash flow management and costing also assists pricing a product (Drury, 2009).

2.2.7 Budgeting

A budget is a statement about the allocation of money (income and expenditure) according to a set of priorities or a plan over a period of time. Budgeting system ensures the plans and ultimately the objectives of the co-operative are realized. It also provides a means to control expenditure and ensures corrective measures are in place if over-expenditure has occurred or is happening. Also, it assists in communicating financial information to all in the co-operative to know how money coming in will be spent, assists with plan implementation and helps to measure performance of the co-operative. However, it is also a motivational tool because it gives direction. Most co-operatives do prepare budgets and is the most information used in the co-operatives (Shirima, 2013).

2.2.8 Cash Flow Management

A simplistic cash flow starts with the initial cash invested, then goods or services are purchased in order to produce a product, goods are then sold to customers, and finally cash is received. The cycle then starts again with the second step of purchasing goods or services. The cycle can be disrupted by non-payment of customers and hence precautionary measures have to be taken beforehand (Pandey, 2006). Co-operatives must never see credit as the solution to cash flow problems. Actually, when credit is required it means the co-operative is not managing its cash flow properly. If there is proper cash flow management there would be no need for a bank overdraft.

2.2.9 Business Plan and Project Finance

To sustain a co-operative it is important to have a proper approach to planning. The key tool for the start-up, expansion and consolidation of the co-operative is the business plan. Such a plan cannot stay static and throughout the life of the co-operative has to be revised and changed to take account of the new conditions facing the co-operative. As a financial management tool in the co-operative, it should include the costs of producing a product or service both total and unit costs, capital needs of the co-operative for equipment and working capital, sources of finance for the co-operative both internal and external.

3. Methodology

The study used three case studies from Kilimanjaro, Arusha and Kagera Regions. Primary and secondary data were collected. The interview and documentary review were carried out where the qualitative and quantitative analyses were done through documentation of the data and the processes of data. The respondents were members, managers and board members. Quantitative data were analysed descriptively

4. Discussion of Findings

4.1 Adherence to Financial Management tools

4.1.1 Financial Accountability

The study found that many corruption scandals, financial mismanagement problems and rumours of misuse of funds have been still reported in the co-operatives. Also corruption, theft and misuse of funds were explained by the members as the main obstacle to their co-operatives development. Although in all co-operatives it is a statutory obligation that all members must receive, at an annual general meeting, the financial statements of a co-operative, secretary managers were not preparing their accounts timely and being audited. Most board members are not aware that they are accountable for ensuring the accounts are prepared, audited and reported. It was observed that board members leave everything to the secretary managers. When asked why, they could just say “this is our expert; s/he knows what is supposed to be done”. This can be because most of board members in some co-operatives are not educated compared to their managers hence they lack confidence to managers.

4.1.2 Internal Control

Surprisingly, in the Union surveyed, the internal control was not there since internal audit unit was just there with no personnel for that unit. When asked why, they answered that they have not been able to find the qualified person to hold that position. This is very risk to the organisation especially at the level of the union where there is a lot of transactions taking place and which needs much follow-up. In co-operative societies, the procedures and controls might be there but are hardly followed

4.1.3 Record Keeping and Accounting system

Primary Co-operative Societies (PCS) were poor in record keeping because of lack of knowledge. Among visited Primary Co-operative Societies when asked on some important documents they could not be able to show. Some current documents were not in the office and when asked they said were still at Union and others at COASCO. The PCS are lacking bookkeeping and accounting skills which are very important in financial management. The PCS just prepare basic books of account and then take them to union for them to prepare financial statements. Therefore, they were not able even to interpret what is written in the books. The Union representatives will come and read for them during annual general meeting. This indicates how the PCS are not empowered to manage their financial matters and plan for future investments.

At Union level, financial statements were not prepared adequately which lead to the adverse audit report; meaning the necessary information were to the extent that the auditor was unable to form an opinion. When asked they claimed that was because they lacked skilled personnel especially in the record process which leads to have errors. The co-operative could not have even the fixed asset register. Board members did not understand the information portrayed in the financial statements and sometimes managers claimed to deviate from professional work and find themselves to satisfy board members because they want to do as they like even if it is not viable to do so. Currently they have accounting software called Pastel but no one knows how to use it. This implies that financial matters of the organization are in danger because of lack of proper financial management.

4.1.5 Audits

The Union survey has no independent internal auditor and also lacks qualified accountant to manage the accounting system properly. The recording and preparation of the financial statement was poor of which has been notified by the external auditor and led the auditor to give adverse auditor’s report. The supervisory committees which are there were seen not to know the technicalities of accounting process.

4.1.6 Understanding Costing

Costing was a problem to members as well as the co-operatives. For the agricultural co-operative union the question was asked whether they know the cost of production so that they compare with the price they give to their members but they could not be able to explain this. Also for the SACCOS, most of them they could just set the interests without taking into considerations all operating costs. Simply, they could just set arbitrarily depending on the members decisions in the Annual General Meeting.

4.1.7 Budgeting

Budgets in the co-operatives are prepared but most of them are not used as the control mechanisms. For the agricultural marketing co-operative societies (AMCOS), they could put the budget on the notice board merely as evidence that they adhered to the preparation of the budget each year. This is because according to the regulations they are not allowed to start a new season without having prepared the budget.

4.1.8 Cash Flow Management

Cash flow management was seen to be a problem to some co-operatives. In one of the co-operatives, it was observed to have some weakness because expenses have been so high compared to the income they are generating. For the year ended 2012/2013 they generated the gross income of Tsh 294,838,082 and the expenses were Tshs 1,361,697,166. Simply is consuming what you don't have and instead of incurring all those costs they could use the money to increase the price of the coffee hence the members could be attracted by their Union and bring more coffee. These costs are controllable and avoidable so long as they are under the discretion of board and management. Below are the board meeting, staff travel and board member travelling costs compare to income for 2012/2013.

Table 4.1: Relationship between board meeting, staff travel and board member travelling and the profit generated

Item	Board meeting	Staff travel	Board member travelling	Total
Expense(meeting and travelling)	73,593,980	128,692,644	98,507,892	300,794,516
Income/revenue	294,838,082	294,838,082	294,838,082	294,838,082
Percentage	25%	44%	33%	

The main source of finance for the union was the union levy which is from the coffee sold. Internal capacity was almost not there since they have been getting loss for two consecutive years. This has forced them to search for external fund from financial institutions. Because they are not credit worth, the bank could give them conditions to collect 40% of the money the bank is intended to approve before they are given another instalment. This affected the business because the union was not able to buy the coffee from the members on time and is not possible for the members to agree selling their coffee without assurance of money.

4.1.9 Business Plan and Project Finance

To sustain a co-operative, it is important to have a proper approach to planning. The key tool for the start-up, expansion and consolidation of the co-operative is the business plan. Such a plan cannot stay static and throughout the life of the co-operative the plan has to be revised and changed to take account of the new conditions facing the co-operative. As a financial management tool in the co-operative it should include the costs of producing a product or service both total and unit costs, capital needs of the co-operative for equipment and working capital, sources of finance for the co-operative both internal and external.

4.1.10 Financial Reporting

Recording and preparation of the financial statement was poor of which has been notified by the external auditor and led to give adverse opinion concerning their 2012/2013 auditor's report. At the level of the Primary Societies, some of them were not able to report to the Annual General Meeting. Some SACCOS' books are prepared up to trial balance and were sent to COASCO for them to prepare financial statement.

4.2 Challenges hindering application of Financial Management in Co-operatives

4.2.1 Insufficient competent personnel because of low salaries

Co-operatives lack competent personnel due to the financial constraints to pay high salaries. Most of the experts are employed to the co-operatives but staying there for just short periods after getting a good salary elsewhere. Therefore, even if the co-operative could have been able to buy an accounting package, no way it could use it because there was no accounting package expert to run the system.

4.2.2 Education level and skills

Board members do not understand the information portrayed in the financial statements. Sometimes they deviate from professional work and find themselves to satisfy board members because they want to do as they like even if it is not viable. Most of the co-operatives do not set aside the education fund which could be used to train the members especially board members.

4.2.3 Low member's participation

Co-operative organization structure has left more power to member. Therefore, participation of members is of great importance. Low level of member participation gives the room for managers to become more powerful since there is no internal pressure from members. Low member's participation hinders co-operatives to comply with financial management tools because they give room for managers to push in only matters of their interest. The findings concur with Spear (2004) who argued that the co-operative systems of operation contribute to the development of powerful and unshakable managers who have more control than in similar private-sector companies. The findings imply that co-operative members need to be educated that their participation is of great importance. In co-operative settings it is members who accept or reject any request brought by the board. It is members who elect board and be elected as board members. Therefore, if members do not participate, this will result to weak policies passed without being questioned and also weak board members to be elected.

4.2.4 Fraud

The results indicate that frauds were common in co-operative financial institutions. Most of the respondents interviewed by the researcher admit at least once in the life time of co-operative fraud practice has been reported. Respondents further explained that the common fraud practice was collusion between board members and management of co-operative to misappropriate co-operative funds. Since Board members who are supposed to install financial management tools in co-operatives are the ones involved in fraud definitely will not encourage presence of financial management because this will hinder their practice.

5. Conclusion and Recommendations

5.1 Conclusion

On the basis of the findings, it can be concluded that most of the co-operative visited were not fully applying financial management. However, the study found that some co-operatives were, to some extent, applying financial management.

In co-operatives, still lack of financial accountability prevailed as many corruption scandals, financial mismanagement problems and rumours of misuse of funds were still reported in the co-operatives.

Budgets are prepared as required by co-operative rules and regulations but they are not used as controlling tools as required in financial management. Internal control procedures exist in some co-operatives but no one ensures that they are followed. For example, the majority of supervisory committee members who are responsible for internal control lack necessary skills such as accounting skills. Record keeping and accounting system were poor in many co-operatives due to lack of accounting skills of clerks.

External audit is hardly conducted in some co-operatives and always is not conducted on time. This is contributed by incomplete statements by some co-operative and concentrating on one corporation. Management of cash flow is a problem to almost all co-operatives. Running short of fund to buy produce from members is a normal thing and for SACCOS, issuing more loans without making sure that they are repaid on time is normal practice. Almost all co-operatives do not prepare business plans. They just operate through experience which enhances risk of failure and they also fail to raise funds from external sources as a business plan is among the requirement. Understanding of costing in co-operative is very poor. In making decision costs are not considered, for example many agricultural co-operatives were unable to establish the unit cost of their products.

Regarding challenges facing co-operatives in applying financial management, the study concluded that lack of skilled personnel in co-operatives contributed to low application of financial management. Education levels of board members especially in rural co-operatives are primary level and secondary level who cannot appreciate the role of financial management in co-operative. Fraud practices by management and board members hinder application intentionally because they know they would not be able to practice their fraud. Low level of member involvement/participation gives the room for managers to become more powerful since there is no internal pressure from members.

5.2 Recommendations

i. In order to improve the competence of board members in managing financial matters of co-operative, there should be commitment to improve capacity of board members and management. Co-operatives should regularly organize financial management training for the board members and management. This will improve the level of supervision and monitoring of financial management tools in co-operatives. Some co-operative had been found to have relevant internal control systems in place but these procedures were hardly followed or not strictly observed because of the lack of monitoring caused by incompetence of the board members.

ii. In many co-operatives, internal control systems seem to be weak; which influence fraud. Supervisory committees are needed to ensure that the co-operative operating policies and procedures and expenditure control are followed. Supervisory committees should be empowered to be able to undertake responsibilities. Where possible there is need for co-operatives to employ a person with accounting knowledge that will be responsible for internal control.

iii. Since the financial management tools seem to have positive contribution toward performance of co-operatives, then the commission for co-operatives should require its implementation to be mandatory in co-operatives.

iv. Fraud had been regularly practiced in co-operatives. This has been influenced by the insufficient punishment offered to those people caught offensive. The existing co-operative laws also have been little strict on fraud incidences which influence repetitions. It is recommended that co-operative laws should be revised to stipulate heavy punishment for any fraud practice discovered. Also members can reduce fraud through ensuring that only ethical and moral people are elected to be members of the board.

v. Low members' involvement or participation seems to be influenced by the little understanding of members regarding co-operative operations. Co-operatives should regularly provide training to its members to enhance their understanding of co-operative activities. In co-operative structure, members' participation is very important since they are ultimate in decision making.

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