

**THE EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL
PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN MUKONO
MUNICIPALITY, UGANDA: A Case of Paris Corner Supermarket Ltd and City
Shoppers Supermarket Ltd**

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STUDENT'S DECLARATION

I AKANYIJUKA WILBER, declare that this research report is of my own investigation and has never been carried out or submitted by anyone else.

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SUPERVISOR'S APPROVAL

This research report has been prepared under my guidance and is hereby submitted examination with approval.

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DEDICATION

This report is dedicated to my father and mother, Mr. Twijukye Jackson and Mrs. Twijukye Mary Nyamihanda, for their love towards me, and support throughout my academic struggles.

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Single handedly, it would be impossible for me to compile this report and submit it in time and with uttermost faith. I would like to acknowledge this work to people who dedicated their valuable time, efforts, support, prayers and thoughts that gave me enabled me to write this report.

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LIST OF ABBREVIATIONS

ADB: Asian Development Bank

BBA: Bachelor of Business Administration

EFQM: European Foundation for Quality Management

ERM: Enterprise Risk Management GDP:

Gross Domestic Product

GoU: Government of Uganda

ICPAU: Institute of Certified Public Accountants of Uganda

ICS: Internal Control Systems

SME: Small Medium Enterprise

UBOS: Uganda Bureau of Statistics

VaR: Value at Risk

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ABSTRACT

The purpose of the study was to assess the effect of internal control systems on financial performance of small and medium enterprises in Mukono Municipality in Uganda. The study was guided by the following research questions; What is the effect of risk assessment on the financial performance of SMEs in Mukono Municipality, Uganda? What is the effect of monitoring on the financial performance of SMEs in Mukono Municipality, Uganda? What is the effect of internal audit on the financial performance of SMEs in Mukono Municipality, Uganda?

The study used a case study of Paris Corner Supermarket Ltd and City Shoppers Supermarket Ltd.

The total population of 71 staff (management and employees) was targeted for the study though 89% (63 staff) managed to respond.

Primary data was collected was collected using structured questionnaires and conducting interviews. Primary data was collected using structured questionnaire. Statistical Package for Social Sciences (SPSS) computer software program was used in analyzing the data. Quantitative data was analyzed and the output was presented using a descriptive statistic of percentages.

Qualitative data was analyzed and the output was presented by narration.

The respondents agreed that risk assessment is efficient and effective in minimizing financial losses of their company and that monitoring is effective to the financial performance of their company. Further, majority of the respondents disagreed that their company has an internal audit function. The study concludes that absence of internal audit exposes SMEs to financial risk. This study concludes that there exists a significant relationship between internal control systems and financial performance of SMEs in Mukono Municipality in Uganda. The study also recommends that SMEs be transparent on the risk assessment control system to the employees since they form part of the company structure and are directly involved with the hands-on activities.

CHAPTER ONE

INTRODUCTION

1.1 Introduction

This chapter focuses on the background to the study in which the concept of Internal Control Systems (ICSs) is put into perspective, while bringing out a general perception that ICSs leads to improved financial performance of Small and Medium scale Enterprises (SMEs). The chapter handles the purpose of the study which is establishing the relationship between ICSs and financial performance. It also comprises of the specific objectives of the study, the scope and significancy of the study.

1.2 Background to the Study

1.2.1 Historical Background

On a worldwide scale, small and medium enterprises have been recognized as engines of economic growth and development and in most countries, there is some considerable effort to support them so as to increase national benefits derived from them like; employment opportunities, incomes and productive capacity, among many. The history of SMEs dates back at the time of the industrial revolution in the 1760s. Most SMEs were started as small factory workshops (Ruthrock, 2013). They had a number of challenges for example lack of, or inadequate capital. Securing loans from the financial and non-financial institutions took time and in most cases was only on paper. Despite the capital shortage factor, the SMEs continued to survive and perform (Dedan, 2013).

In the United States, the SMEs became common in 1782 having fewer than 500 employees for manufacturing businesses and less than 7 million US Dollars in annual receipts for most nonmanufacturing businesses. In addition to number of employees, other methods used to classify small companies included annual sales (turnover), value of assets and net profit (Lepoutre & Aimé, 2006).

In the European Union, almost 85% of net new jobs from 2002-2010 were created by SMEs (European Union, 2012; European Commission, 2011; Abouzeedan, 2011; and Muhammad et al, 2010)

In the 1920s, the SMEs in India were classified into two categories; those using power with less than 50 employees and those not using power with the employee strength being more than 50 but less than 100. About 45% of total export earnings were contributed by micro and tiny enterprises (National Research Development Corporation, 2008).

In East Africa, SMEs were started as early as 1930s following the introduction of Rupees. By independence time in the 1960s, the industries were playing a stellar role in the economic development of the region.

In Uganda, small scale industries were the backbone during the times of the initiation of cooperative societies between the 1940s and 1960s. There were no clear national policies for SMEs and industrial development at the time. Today, SMEs are reported to contribute about 20% of Uganda's GDP (Tulip and Bitekerezo, 2003). They employ fewer than 5 persons and as many as 90% of the non-farm private sector workers. Since then, the number of SMEs businesses in Uganda has grown from 800,000 in 1995 to about 2,000,000 in 2002. These serve about 6,000,000 people at business and household level of the 26.3 million (Bitekerezo, 2003). It is also reported by the Ministry of Planning and Economic Development that over 80% of Uganda's manufacturing output is by SMEs. The sector also employs up to 2.6 million people in Uganda (Uganda Investment Authority, 2006).

Mukono District has 5,864 business and over 80% of these are SMEs, as reported in a report by Uganda Bureau of Statistics (UBOS) on the Uganda Business Register (2001/2002). The majorities of these operate in shared premises and are set up before they get licenses. Ownership and management is on family basis and as such has a small scale operation. It is labor intensive and skills are acquired on the job, often using adapted technology. According to Kagugube (2011), more than 50% of them fight an uphill battle from the start and fail in the first 5 years with one of the major causes of failure to perform being poor financial performance due inadequate internal control systems.

According to Okello (2007), SMEs are a major component of the Uganda's business sector that sustained the economy through the hard times when all the different sectors of the economy were in disequilibrium. An SME in Uganda, is an enterprise or firm employing less than 5 people but with a maximum of 50 employees and with a value of assets excluding land, building and

working capital of less than 50 million shillings, and the annual income turnover of between 10 to 50 million shillings (Bank of Uganda Sector Report, 2007). The same report describes a medium enterprise as one that employs between 50 – 100 employees.

1.2.2 Conceptual background

According to Luuna (2009), an SME is a business or project which is created on either a small budget or for a small group of people. Small and medium-sized enterprises (SMEs) account for a large number of businesses in the world and have important contributions to employment and economic stability. SMEs have inherent advantages of size and flexibility. They have the ability to innovate, diversify their products and services, and contribute significantly towards job creation (Hussain et al., 2006). Accordingly, SMEs possess dynamic adaptabilities and have the capability of penetration in niche markets and industries with high profit. SMEs have been known as playing an important role in any country (ADB, 2020; Pham, 2017). In Uganda, SMEs in the industrial, services and agricultural sectors employ about 2.5 million people (Government of Uganda (GoU), 2011), and contribute approximately 20% to the GDP (GoU, 2015).

Performance is defined as an act of achieving financial performance, social objectives and responsibilities from the perspective of judging individuals (Praise, 2003). Glenn (2006) defines performance of an organization is one of those tools that can be used to determine an organization's productivity and effectiveness. For this study, performance was measured in terms of growth, level of capital, number of people employed, ability to pay off debts, return on investment (Berhanu and Jaleta (2012).

According to Stoner (2003), performance refers to the ability to operate efficiently, profitably, survive, grow and react to the environmental opportunities and threats. Performance is measured by how efficient the enterprise is in use of resources in achieving its objectives, Sollenberg & Anderson (1995) agree. It is the measure of attainment achieved by an individual, team, organization or process (European Foundation for Quality Management (EFQM), 1999). Hitt, et al (1996) believe that many firms' low performance is the result of poorly performing assets. Low performance from poorly performing assets is often related to strategic errors made in the acquisition process in earlier years, they continue to say. For example, some firms acquire businesses with unrealistic expectations of achieving synergy between the acquired assets and

their current sets of assets. A common reason for such errors is managerial hubris or overvaluation of managerial capability in the acquisition process (Roll, 1986).

According to Oseifuah, (2015), control activities and the control environment are manifested as policies and procedures that help to ensure management directives are carried out. They are critical, and they ensure that the necessary actions are taken to address risks necessary for the achievement of the organization's objectives. As embedded in management's day-to-day duties, they should not only ensure the optimal utilization of internal control systems, but also ensure that internal controls are strategically positioned to achieve the objectives of their business, namely fortifying business sustainability (Ewa & Udoayang, 2012).

Dividing specific duties between employees helps minimize risk and fraud and maximize resources protection. For all the organization activities authorizing, recording, custody and reconciliation must be core to any resource's security (Heirer, 2015). Employees should oversee and authorize to complete the ordering function. However, if a specific act exceeds pre-established levels, the practice manager or owner must intervene.

Similarly, (Cheruiyot, 2014) argues management authorization should play a pivotal role in ensuring that the resources of a firm in procurement of inventory are used in an optimal manner and that inventory or any other asset is acquired at the best cost in the market to prevent fraud and misappropriation. Cheruiyot, (2014), further asserts that it is the role of management in ensuring verification of contents to assure complete order receipt.

As pointed out by Jough (2010), desired levels of effectiveness can be accomplished through regular management and supervisory activities, monitoring adherence to policies and procedures, and other routine actions such as comparisons and reconciliations, supplemented by internal audit or other compliance functions that test, monitor, and evaluate the functioning of controls, or by various self-assessment programs to ensure revaluation of the risk in response to the organization's objectives. If management cannot identify current procedures that provide a basis for concluding the control operates effectively, it should develop procedures to test and evaluate the operating effectiveness of the controls (Ernst & Young, 2013).

Risk assessment refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved (Karagiorgos et al., 2009). According to McCord (2002), risk assessment of material misstatement at the financial statement level and also at the planning stage, clarifies the direction on performing a combined assessment of inherent and control risk, thus leaving the ability for the auditors to assess other risk factors in an audit. In their examination of the effects of the role of the board of directors in assisting in the formulation of corporate strategies on the auditors' planning judgments, they established that auditors respond to the role of the board when making judgments with respect to control risk assessments.

Monitoring refers to the process of assessing the quality of the internal control structure over time (Karagiorgos, Drogalas, & Giovanis, 2011). By monitoring, the organization gets provided with assurance that the findings of audits and other reviews are promptly determined. Monitoring of operations ensures effective functioning of internal control systems. It's through monitoring that an organization determines whether its policies and procedures designed and implemented by management are being carried out effectively by employees (Ewa & Udoayang, 2012).

According to Ershaid, Diala and Mohamed (2017), monitoring can be achieved by regularly supervising and managing activities like monitoring of customer complaints and feedback and audits conducted periodically by internal auditors. Monitoring ensures that the findings of audits on monitoring and other reviews are promptly resolved (Karagiorgos et al., 2011). Internal control system and application of controls change overtime and thus management needs to determine and observe whether the internal control system continues to be relevant and effective in the entity as intended (Ofori 2011).

The purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Internal control is adequately designed and properly executed if all five internal control components (Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring) are present and functioning as designed (Ofori 2011).

Gupta (2001) asserts that internal audit is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal audit is to assist members of the organization in the effective discharge of their

responsibilities. He continues to say that, the scope of internal audit is determined by management. This may however, impair the internal auditor's objectivity and hampers his independence, it is quite hard to report negatively on someone who determines the scope your work. Although at a Seminar organized by the Institute of Certified Public Accountants of Uganda (ICPAU), Sebbowa (2009) in his presentation "The role of Internal Audit function in Organizations," states that independence is established by organizational and reporting structure and that objectivity is achieved by an appropriate mindset.

Sebbowa (2009) also defines "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance processes. He further mentions the principles of Internal audit to include; Integrity, Objectivity, Confidentiality and Competency.

1.2.3 Contextual background

In Uganda, small scale industries were the backbone during the times of the initiation of cooperative societies in 1940s, 1950s and 1960s. There were no clear national policies for small and medium enterprises (SMEs) and industrial development at the time. In Uganda, SMEs in the industrial, services and agricultural sectors employed about 2.5 million people (Government of Uganda (GoU), 2011). SMEs are seen as critical for economic growth of the country, contributing 75% of GDP and constituting 90% of the private sector, creating employment estimated at 2.5 million jobs, improving standards of living and ensuring social and political stability (Hatega, 2007).

Notwithstanding the above, their rate of survival and competitiveness are a cause for concern. Uganda is ranked as one of the most entrepreneurial countries in the world but also one with the highest failure rates. Many Ugandans tend to start and then shut down businesses before completing a year in operation (Brüderl et al., 1992; Boden & Nucci, 2000; Walter et al., 2004; Rooks & Sserwanga, 2009).

According to the Uganda Bureau of Statistics (UBOS) report on the Uganda Business Register (2001/2002), Mukono District has 5,864 business. Over 80% of these are SMEs.

1.3 Statement of the Problem

Every business, (profit oriented or not, large or small,) works towards achieving and maintaining sound financial performance and position. Financial performance is a subjective measure of how well a firm can use its current assets from its primary mode of business and operations and generate revenues for the business (Baxter, 2007). According to Stoner (2003), performance refers to the ability to operate efficiently, profitability, survive, grow and react to the environmental opportunities and threats. However, the problem of financial crimes has continued to be on the increase (Chorafas, 2010). An effective Internal Control in SMEs has the potential of enabling them to succeed and reducing employee fraud (Pathak, 2005). There is a positive relationship between effective internal control systems and improved financial performance, Ogwang, Isabirye, and Abaho (2016). Unfortunately, limited studies have specifically focused on the financial performance and relationship between ICSs and financial performance as well, in the context of SMEs in Mukono Municipality, Uganda. One study conducted by Opolot and Kirumira (2021) explored the factors influencing the financial performance of SMEs in Mukono but did not specifically focus on ICSs. Hence this created the need for research on the topic to fill the literature gap by conducting a study that specifically investigates the effect of Internal Control Systems on the Financial Performance of SMEs in Mukono Municipality, Uganda.

1.4 General Objective of the Study

The general objective of this study was to assess the effect of internal control systems on financial performance of small and medium enterprises in Mukono Municipality in Uganda.

1.5 Specific Objectives of the Study

The specific objectives of this study were;

- i. To assess the effect of risk assessment on financial performance of SMEs in Mukono Municipality, Uganda.
- ii. To assess the effect of motoring on financial performance of SMEs in Mukono Municipality, Uganda.
- iii. To assess the effect of internal audit on financial performance of SMEs in Mukono Municipality, Uganda.

1.6 Research Questions

The study sought to address the following research questions;

- i. What is the effect of risk assessment on the financial performance of SMEs in Mukono Municipality, Uganda?
- ii. What is the effect of monitoring on the financial performance of SMEs in Mukono Municipality, Uganda?
- iii. What is the effect of internal audit on the financial performance of SMEs in Mukono Municipality, Uganda?

1.7 Scope of the Study

1.7.1 Geographical Scope

The study was carried out in Mukono Municipality, Uganda. This location was chosen due to the diversity of businesses in the area hence providing the best hybrid of options among various informed and experienced entrepreneurs.

The study was conducted in Paris Corner Supermarket Ltd and City Shoppers Supermarket Ltd in Mukono because these two retail businesses have been in operation for more than 5 years and the two provide a suitable population size.

1.7.2 Content Scope

This research was to study how Internal Control Systems affect the financial performance of SMEs in Mukono Municipality, Uganda. This area was chosen because of the undeniable importance and relevance of ICSs in relation to financial performance of SMEs in Mukono Municipality, Uganda, and yet limited studies have been conducted, hence a research knowledge gap to fill.

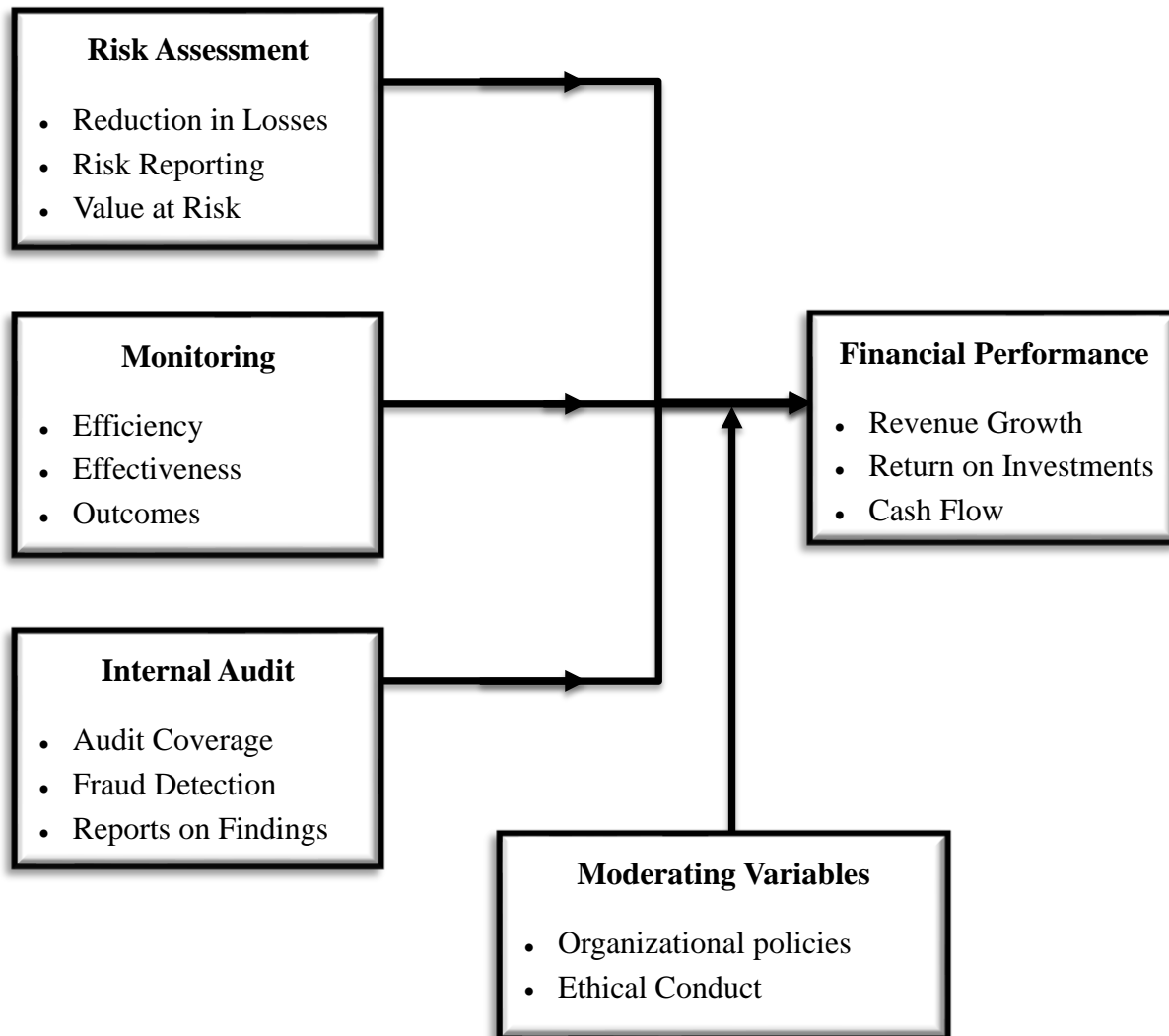
1.7.3 Time scope

This study was undertaken from May to August of 2023. This period was chosen because the study is mainly for academic and a deadline of 15th August, 2023 was given, for submission for grading.

1.8 Conceptual Framework

According to Kotler P. (2000) a conceptual framework is a basic structure that consists of certain abstract blocks which represent the independent and dependent variable of the phenomenon under study.

Figure 1.1: Conceptual Framework



Source: Developed from Literature review

1.9 Significance of the Study

The Management and Directors of SMEs appreciated the importance of ICSs and assist in rating their level of application of ICSs. The management got to know the relationship between, and effects of ICSs and financial performance of SMEs. Additionally, potential investors also

benefited as they were able to determine which companies are properly governed hence make more informed investment decisions.

Researchers and Academicians benefit from the study as it contributes to the existing body of knowledge on the effect of internal control systems and financial performance since a research knowledge gap has been identified on this topic, specifically in Mukono Municipality, Uganda. Researchers benefit from the literature and the findings of this study which aimed at establishing the link between ICSs and financial performance of SMEs in the chosen area. The study also identified further research areas that other researchers may take on in future.

The policy makers gained insight on the effect of ICSs on the financial performance of SMEs and were informed on the type of ICSs to incorporate in SMEs. Other institutions benefit through the understanding of ICSs play in enhancing accountability and transparency, and effect on financial performance.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter summarizes the literature review already in existence regarding the effect of internal controls systems on financial performance of small and medium enterprises. The first objective presented is the effect of segregation of duties on financial performance of SMEs, second is the effect of risk assessment on financial performance of SMEs and lastly is the effect of monitoring on financial performance of SMEs.

The chapter presents an overview of previous work on related topics that provides the necessary background for this research from other scholars. The literature review provides an explanation of theoretical rationale of the problem being studied as well as what research has already been done and how the findings relate to the problem at hand.

2.2 Theoretical Review

This study was be guided by "The Agency Theory" as initially put across by Jensen & Meckling (1976) and later expounded on by Gerrit S. & Mohammad J. A. (2010). Gerrit & Mohammad theory also has connections with the Theory of a Firm articulated by Nicolai J. F. et al.

According to the agency theory a company consists of a nexus or contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources (Jensen & Meckling, 1976). Agency theory posts that agents have more information than principals and that this information asymmetry adversely affects the principals' ability to monitor whether or not their interests are being properly served by agents.

Agency Theory describes firms as necessary structures to maintain contracts, and through firms, it is possible to exercise control which minimizes opportunistic behavior of agents. An assumption of agency theory is that principals and agents act rationally and use contracting to maximize their wealth. A consequence of this assumption was the moral hazard problem by Jensen & Meck ling, indicating that in an effort to maximize their own wealth, agents faced the dilemma of acting against the interests of their principals.

Barlie and Means (1932) posit that in order to harmonize the interests of the agent and the principal, a comprehensive contract is written to address the interest of both the agent and the principal. They further explain that the relationship is further strengthened by the principal employing an expert to monitor the agent. This position is also supported by Coarse (1937) who maintains that the contract provides for conflict resolution between the agent and principal, the principal determines the work and agent undertakes the work. He however, proposes that the principal suffers shirking which deprives him or her from benefiting from the work of the agent.

Nevertheless, the theory recognizes the incomplete information about the relationship, interests or work performance of the agent described as adverse selection and moral hazard. Coarse (1937) explains that moral hazard and adverse selection affects the output of the agent in two ways; not doing exactly what the agent is appointed to do, and not possessing the requisite knowledge about what should be done. This therefore, affects the overall performance of the relationship as well as the benefits of the principal in form of cash residual.

Internal control is one of many mechanisms used in business to address the agency problem while others include financial reporting, budgeting, audit committees, and external audits (Jensen and Payne 2003). Studies have shown that internal control reduces agency costs (Abdel-khalik 1993, Barefield et al. 1993), with some even arguing that firms have an economic incentive to report on internal control, even without the requirements of SOX (Deumes and Knechel 2008).

2.3 Empirical Review

2.3.1 Risk assessment and financial performance

Risk assessment refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved (Karagiorgos et al., 2009). They continue to say that it refers to the identification and analysis of relevant risks associated with achieving the objectives of the organization. Risk assessment is the process of identifying and analyzing management relevant risks to the preparation of financial statements that would be presented fairly in conformity with general accepted accounting principle.

In organizations, management must determine the level of risk carefully to be accepted and try to maintain such risk within determined levels. It is therefore the management's responsibility to

design internal controls to ensure efficiency and effectiveness, reliability of financial reporting as well as compliance with laws and regulations Akimana (2019). This is ensured by periodic performance review and evaluation of the adequacy and effectiveness of the controls designed by the internal auditor department, she continues.

According to McCord (2002), risk assessment of material misstatement at the financial statement level and also at the planning stage, clarifies the direction on performing a combined assessment of inherent and control risk, thus leaving the ability for the auditors to assess other risk factors in an audit. In their examination of the effects of the role of the board of directors in assisting in the formulation of corporate strategies on the auditors' planning judgments, they established that auditors respond to the role of the board when making judgments with respect to control risk assessments.

Risk management has moved from the narrow view that focuses on evaluation of risk from a narrow perspective to a holistic, all-encompassing view (Pagach & Warr, 2011). Enterprise Risk Management (ERM) requires the operation of risk evaluation and mitigation. This can only be successful if there is strong leadership support and top management buy-in without which the ERM process is destined to fail. The board of directors and top management need to be involved in setting the tone from the top and creating a risk culture across the SMEs. The board also secures the integration of ERM in all processes, making available adequate resources and sustained continuous improvement of the level of ERM practices (Manab & Kassim, 2012).

A study on the impact of risk-based audit on financial performance in Kenya's insurance companies conducted by Kasiva (2012) among 44 respondents that included finance officers, internal auditors, credit officers, relationship officers, and accountants found out that risk-based auditing through risk management should be enhanced to enable the organization concerned to detect risks on time.

Kasiva (2012) further argues that fraud risk assessment is one area that deserves significant reliance on internal audit work. In this light, it is reasoned that due to the fact that internal auditors are privier with the operations of the firm they work for than external auditors, are particularly suited to carry out fraud risk assessment. In a survey of internal auditors' risk management practices in the Kenya's banking sector, Kibaara (2007) investigated bank internal

auditors' risk assessment practices and established that, most banks in Kenya were in the process of drafting the ERM process and strategies in line with risk assessment.

A study by Nqala and Dubihlela (2017), on the investigations of how small and medium manufacturers are optimizing their internal control systems in order to mitigate risk. The study seeks to understand how internal controls are utilized by manufacturing SMEs in the Western Cape, South Africa to mitigate and prevent risks, and how internal controls are implemented. Findings were that manufacturing SMEs that are in process of implementing effective internal controls within their businesses would have a better understanding of the importance and value of preventing or mitigate risk.

Madembu and Namusonge (2017) conducted a study on the role of risk management on financial performance of small and medium enterprises in Kenya. The study was guided by the following objectives; to examine the role of enterprise risk management on the financial performance of SMEs; to analyse the role of strategic risk management on the financial performance of SMEs, to evaluate the effect of financial risk management on financial performance of SMEs and to establish the role of operational risk management on the financial performance of SMEs. SMEs should focus on implementing comprehensive risk management systems in their businesses (Madembu & Namusonge, 2017).

2.3.2 Monitoring and financial performance

Monitoring refers to the process of assessing the quality of the internal control structure over time (Karagiorgos, Drogalas, & Giovanis, 2011). Since internal controls are processes, it is usually accepted that they need to be adequately monitored in order to assess the quality and the effectiveness of the system's performance over time, they continue to say. By monitoring, the organization gets provided with assurance that the findings of audits and other reviews are promptly determined. Monitoring of operations ensures effective functioning of internal control systems. It's through monitoring that an organization determines whether its policies and procedures designed and implemented by management are being carried out effectively by employees (Ewa & Udoayang, 2012).

According to Ershaid, Diala and Mohamed (2017), monitoring can be achieved by regularly supervising and managing activities like monitoring of customer complaints and feedback and

audits conducted periodically by internal auditors. Monitoring ensures that the findings of audits on monitoring and other reviews are promptly resolved (Karagiorgos et al., 2011). Internal control system and application of controls change overtime and thus management needs to determine and observe whether the internal control system continues to be relevant and effective in the entity as intended (Ofori 2011). The purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Internal control is adequately designed and properly executed if all five internal control components (Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring) are present and functioning as designed (Ofori 2011).

Monitoring is a process that assess the quality of internal control over time (Muhunyo & Jagongo, 2018). They continue to say that monitoring is the evaluation of an organization's events and transactions to gauge the quality of performance throughout the period and to decide whether controls are effective management should emphasize monitoring efforts on internal control and accomplishes the organization objectives. It is important to monitor internal control to determine whether it is operating as intended and whether any modifications are necessary. All employees need to understand the organization's mission, objectives, and responsibilities and risk tolerance levels for monitoring to be most effective. Monitoring can be done through on-going activities or separate evaluations (Gamage et al., 2014).

Monitoring provides assurance that the findings of audits and other reviews are promptly determined. Theofanis (2011), also notes monitoring of operations ensures effective functioning of internal controls in an organization. Hence, monitoring determines whether or not policies and procedures designed and implemented by management are being carried out effectively by employees. According to Sarens, Abdolmohammadi, and Lenz (2014), organizational performance encompasses accumulated end results of all the organization's work processes and activities.

Monitoring is the assessment of internal control performance over time; it is accomplished by ongoing monitoring activities and by separate evaluations of internal control such as selfassessments, peer reviews, and internal audits (Nqala & Dubihlela, 2017). The purpose of monitoring is to determine whether internal control is adequately designed, properly executed,

and effective. Internal control is adequately designed and properly executed if all five internal control components (Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring) are present and functioning as designed. Internal control is effective if management and interested stakeholders has reasonable assurance. Just as control activities help to ensure that actions to manage risks are carried out, monitoring helps to ensure that control activities and other planned actions to effect internal control are carried out properly and in a timely manner and that the end result is effective internal control. Ongoing monitoring activities include various management and supervisory activities that evaluate and improve the design, execution, and effectiveness of internal control. Separate evaluations, on the other hand, such as self- assessments and internal audits, are periodic evaluations of internal control components resulting in a formal report on internal control. Department employees perform self-assessments; internal auditors who provide an independent appraisal of internal control perform internal audits (Mustafa, Fatima, Saleem, & Ain, 2016).

These activities encompass the physical security of assets, including adequate safeguards such as secured facilities over access to assets and records; authorization for access to computer programs and data files; and periodic counting and comparison with amounts shown on control records (Ljubisavljević & Jovanović, 2011). However, if for financial reporting purposes management relies solely on perpetual inventory records, the physical security controls would be relevant to the audit. Stealing of assets as commented on by can range from shoplifting an accessory, diskettes and software from a store to taking a whole large asset. This when prevented enhances organizational performance (Abbas & Iqbal, 2012).

2.3.3 Internal audit and financial performance

Gupta (2001) asserts that internal audit is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal audit is to assist members of the organization in the effective discharge of their responsibilities.

Whittington & Pany (2001) suggest that internal auditing is performed as part of the monitoring activity of an organization. They continue to say that it involves investigating and appraising internal controls and the efficiency with which the various units of the organization are

performing their assigned functions. An Internal Auditor is interested in determining whether a department has a clear understanding of its assignment, is adequately staffed, maintains good records, properly safeguarding cash, inventory & other assets and cooperates harmoniously with other departments and reports to management.

Meigs et al (1988) hold that there must be a strong internal control system and the internal auditor must verify the operations of the system in much the same way, as the external auditor. It involves the investigation, recording, identification and review of compliance tests of control, they also argued that effective internal audit procedures provide sufficient relevant and reliable evidence in order to detect and prevent fraud.

Sebbowa (2009) also defines Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance processes. He further mentions the principles of Internal audit to include; Integrity, Objectivity, Confidentiality and Competency. However, given that Internal Auditors are appointed by management, report to management, and are employees of an organizations, their objectivity is usually highly compromised.

Internal audit procedure is a form and content manual that includes audits notes and responsibilities, documentation standards, local reporting standards and targets, training requirements and expectations and performance measures and indicators (Watts, 1999).

SMEs are particularly vulnerable to fraud risks, which can significantly impact their financial performance. Matari et al. (2014) found that SMEs with effective internal audit practices had better financial performance due to their ability to identify and address potential risks. Internal audit functions can help in detecting and preventing fraud through regular monitoring and assessment of control mechanisms. Studies by Halil et al. (2018) and Karami et al. (2020) indicated that effective internal audit practices can lead to reduced instances of fraud and consequently improve SMEs' financial performance.

Studies by Al Mamun et al. (2019) and Ntim and Soobaroyen (2013) found a positive relationship between effective internal control systems facilitated by internal audit and SMEs' financial performance. A strong internal audit function reduces the likelihood of fraud, errors, and misappropriation, leading to improved financial outcomes. Al-Twairsh and Alanezi (2019) found that stronger internal control systems, supported by internal audit activities, led to improved financial performance in SMEs.

Studies by Al-Matarneh et al. (2020) and Arumugam and Ong (2018) indicated that effective internal audit practices are associated with reduced instances of fraud and improved financial performance in SMEs. Internal audit plays a crucial role in ensuring compliance with laws, regulations, and industry standards. Complying with relevant regulations positively impacts SMEs' financial performance by avoiding penalties, reputational damage, and legal disputes. Research by Bui and Cheng (2018) and Krishnan and Visvanathan (2014) indicated that internal audit functions significantly contribute to enhancing SMEs' compliance practices, thereby positively influencing their financial performance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the research methodology that was used for the study. The chapter further defines the target population of the study, the sampling size intended used, sampling procedure followed as well as the type of instruments that were used. The data collection procedures and data analysis techniques used in analyzing the results of the study are also discussed.

3.2 Research Design

This study was used a descriptive research design because it enabled the researcher to collect in depth data from the target population and without bias. It aided the researcher to focus on observation, interviewing, referring to relevant past records and documenting the findings. The study employed the qualitative and quantitative approaches.

3.3 Study Population

This study focused on the population of the management and employees of Paris Corner Supermarket Ltd and City shoppers Ltd since they are the targeted study. This made a total target population of 71.

Table 3.1: Population Size

Paris Corner Supermarket Ltd	Population
Top management	4
Middle management	5
Lower-level management	32
City Shoppers Supermarket Ltd	
Top management	3
Middle management	3
Lower-level management	24
Total	71

Source: Primary data

Table 3.1 above shows the target population of this study as of the month of July of 2023. Paris Corner Supermarket had a staff population of 41. The staff population comprises of 4 top level management, 3 middle level management 34 hands on employees. City Shoppers Supermarket had a staff population of 30. They comprised of 3 top managers, 3 middle manager and 24 hands on employees (Primary data).

3.4 Sample Size and Selection Techniques

The study targeted all 4 top managers and 3 middle level management because they all play a role in the internal control systems and financial performance of the business, and purposely identified hands on employees because the study looks to collect specific data that they may not all have access to. The objective was to interview at least 75% of the entire population focusing on the top and middle managers since they are strategists while the hands-on employees are merely implementers.

3.5 Sampling Techniques

The researcher used purposive sampling techniques in selecting the interviewees with an option of replacing those who don't wish to respond to the researcher's plea. These techniques were used because specific data is needed and may be more accessible to top and middle level managers. It was used because the study is targeting strategists of the internal control systems in relation to financial performance. Purposely, it ensured that only people with relevant information were sampled.

Questionnaires interviews were extended to only those respondents who have the capability to provide necessary information. This technique was employed because the researcher targets those members with prior knowledge of the research topic.

3.5.1 Sample Size

The sample size of this study was determined using Yamane's formula with a 95% level of confidence (5% acceptable sampling error).

Yamane's formula

N

$$n = 1 \frac{N}{e} + Ne_2$$

Where; n = Sample

size N = Study

population e =

Sampling error

3.6 Data Source & Collection Methods

Data was collected using primary data collection methods. The data was gathered through structured questionnaires and interviews with key informant members picked on purpose.

Questionnaires were used simply because they save time in data collection and partly because the researcher dealt with elite respondents who may not have a lot of time to spare. Interviews were as well used because the researcher is aware of a certain level of illiteracy on some of the target population. They were also be a good way of supplementing the questionnaires and at the same time they enabled the researcher probe further into the responses given in the questionnaires.

3.7 Data Collection Instruments

The researcher used both questionnaires and interviews to collect data. These instruments ensured maximum credibility and validity of data which is intended to form meaningful information regarding the subject of the study. Questionnaires were structured while interviews were open discussions following the interview guide.

3.8 Reliability and Validity

Reliability was ensured by paying more emphasis on the top and middle level managers who are expected to have more reliable information. The validity of the data was ensured by collecting primary data through interviews and questionnaires.

3.9 Data Collection Procedure

The researcher requested for an introductory letter from Uganda Christian University, which letter was presented to the management of Paris Corner Supermarket and City Shoppers Supermarket. The researcher went on to explain what the research is all about, why the two

businesses were chosen and the benefit of the case study. Following, the researcher sought permission to review past records, to interview employees and also request them to participate in the interview and fill in questionnaires, putting into consideration a high level of confidentiality.

3.10 Data Management and analysis

Data from questionnaires was kept in a file since it is hard copy. Data from interviews was kept on recordings and notes taken. Descriptive and narrative analysis was used to explain the quantitative qualitative data respectively.

3.11 Ethical consideration

Ethical considerations were taken into consideration by first; requesting for an introductory letter from UCU, and then presenting it to the management of Paris Corner Supermarket and management of City Shoppers Supermarket in request for permission to carry on the study.

Questionnaires and interviews were structured in such a way that there was no need to mention the respondents' names or any other confidential information, unless permitted. A statement as to the strict confidentiality with which data was to be held was expressly stated in the questionnaire and before every interview.

Further, responding was optional, basically explaining the reason for replacing respondents who did not wish to respond as mentioned in the "Sample Size and Sample Selection techniques" above. Briefing the respondents as to the purpose of the research, their relevance in the research process, and expectations from them was also be done.

CHAPTER FOUR

PRESENTATION, ANALYSIS AND INTERPRETATION OF DATA

4.1 Introduction

This chapter contains the presentation, analysis and interpretation of collected from the study, based on the research questions guiding the study. The presentations are in form of tables, illustrative figures and statements. The first section presents the demographic information of the respondents, second section presents the findings on the relationship between risk assessment and financial performance, third section presents the findings on the effect of monitoring on financial performance and fourth section presents the findings on internal audit and financial performance.

4.2 Demographic characteristics of respondents

This section presents respondents' general background information. The components include the response rate, gender, level of education, position held in their company, age bracket, and range of years in service.

4.2.1 Response Rate

The response rate shows the percentage of the target population that responded to the study against the percentage of those that did not respond.

Table 4.1: Response Rate

Nature of Response	Distribution (number)	Distribution (%)
Responded	63	89
Did not respond	8	11
Total	71	100

Source: Primary data

Table 4.1 above presents the response rate to the study. Out of the target population of 71, 63 responded who contributed 89% response rate while 11% did not respond, accounting for the remaining 8 respondents that did not respond.

4.2.2 Respondents' Gender

The questionnaire had a section for respondents to indicate their gender.

Table 4.2: Respondents' Gender

Gender	Number	Percentage (%)
Male	44	70
Female	19	30
Total	63	100

Source: Primary data

Table 4.2 above represents the results where 70% (44) of the respondents were male while 30% (19) were female. This means that the respondents of this study were unfairly represented.

4.2.3 Level of Education

The respondents were asked to indicate their level of education attained on the questionnaire.

Table 4.3: Level of Education

Level of Education	Number	Percentage (%)
Senior 4	30	48
Senior 6	19	30
Certificate/ Diploma	4	6
Bachelor's Degree	5	8
Master's Degree	0	0
Others (below Senior 4)	5	8
Total	63	100

Source: Primary data

Table 4.3 above shows the results where 48% had reached senior 4, 30% had reached senior 6, 8% had a diploma certificate while 8% had finished a bachelor's degree, and 8% had not reached senior 4. This implied that the respondents had the ability to read and interpret the questions on the questionnaire.

4.2.4 Position Held in the Company

Respondents were asked to indicate the position they currently held in their company.

Table 4.4: Position Held in the Company

Position	Number	Percentage (%)
Management committee member	7	11
Departmental head	0	0
Former departmental head	0	0
Division head	8	13
Staff member	48	76
Total	63	100

Source: Primary data

Table 4.4 above indicates the results on position held in the company 11% were management committee members, 13% were division heads and 76% were staff members. This implied that the three management levels (top, middle and lower) are well staffed.

4.2.5 Age Bracket

The questionnaire had a section for respondents to indicate their age bracket.

Table 4.5: Age Bracket

Age Bracket (years)	Number	Percentage (%)
18-25	17	27
26-35	32	51
36-45	11	17
46-55	3	5
56+	0	0
Total	63	100

Source: Primary data

Table 4.5 above indicates that 27% of the respondents aged between 18-25 years, 51% aged between 26-35 years, 17% aged between 36-45 years and 5% aged between 46-55 years. This

means that the study had diverse age groups represented. There were no minorities/under age (below 18 years).

4.2.6 Years in Service

Respondents were asked to indicate the number of years they had been in service in their company.

Table 4.6: Years in Service

Years of Service	Number	Percentage (%)
Less than 1	10	16
1-3	35	56
4-6	16	25
7-10	2	3
10+	0	0
Total	63	100

Source: Primary data

Table 4.6 above indicates that 16% had been in service for less than 1 year, 56% had been in the service for a period of 1-3 years, 25% had been in service for 4-6 years and 3% had been in service for 7-10 years. This implies that the respondents had sufficient experience about their company.

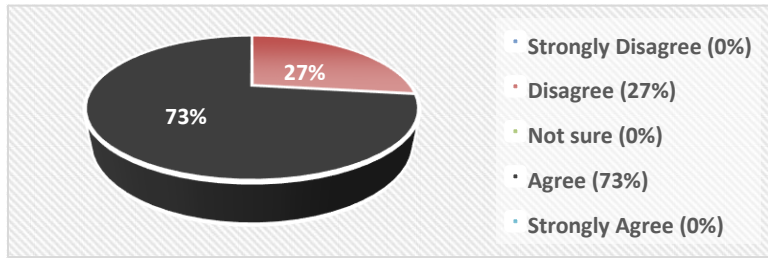
4.3 The effect of Risk Assessment on Financial Performance

This study sought to determine the effect of risk assessment on financial performance. The findings are presented as follows:

4.3.1 Risk Identification

The respondents were asked whether their company attempts to determine financial risk.

Figure 4.1: Risk Identification



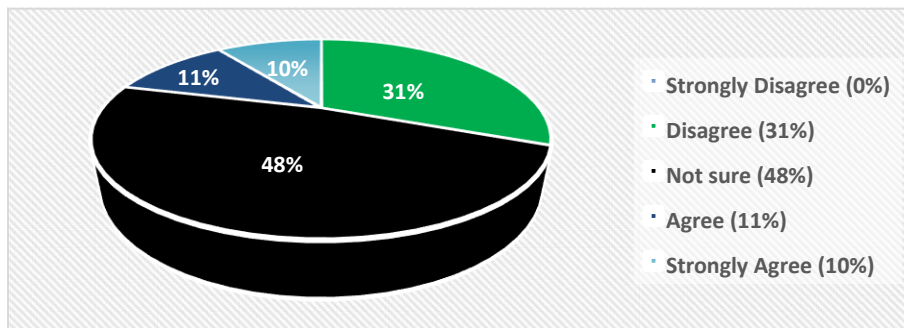
Source: Primary data

Figure 4.1 indicates that 27% disagreed and 73% agreed. It implied that SMEs attempt to determine risk within determine levels.

4.3.2 Risk Management Strategies and Policies

The questionnaire required the respondents to indicate whether their company has risk management strategies and policies in place.

Figure 4.2: Risk Management Strategies and Policies



Source: Primary data

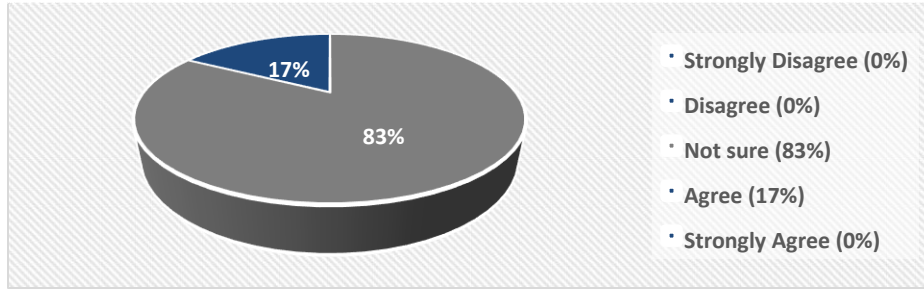
Figure 4.2 indicates that 31% disagreed, 48% were not sure, 11% agreed and 10% strongly agreed.

This implied that SMEs do not employ risk management strategies and Policies.

4.3.3 Manage Risks to Minimize Financial Loss

The respondents were asked to indicate whether it is necessary to manage risks in order to minimize financial loss in their company.

Figure 4.3: Manage Risks to Minimize Financial Loss



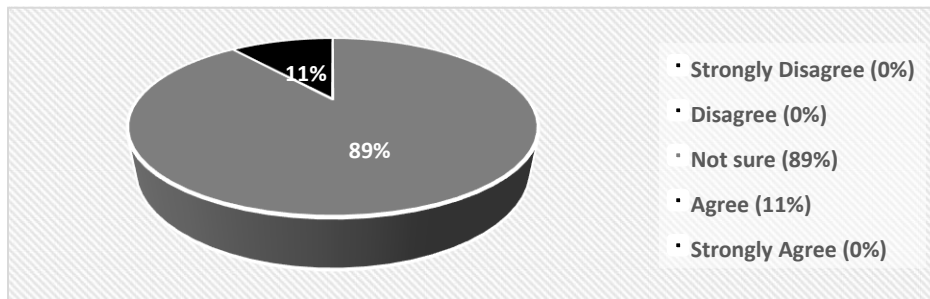
Source: Primary data

Figure 4.3 above indicates that 17% agreed and 83% were not sure. This implied that SME employees are not aware of the effect of managing risks on exposure to financial risk.

4.3.4 Maintenance of a Value at Risk (VaR)

The respondents were asked whether their company maintains a Value at Risk.

Figure 4.4: Maintenance of a Value at Risk



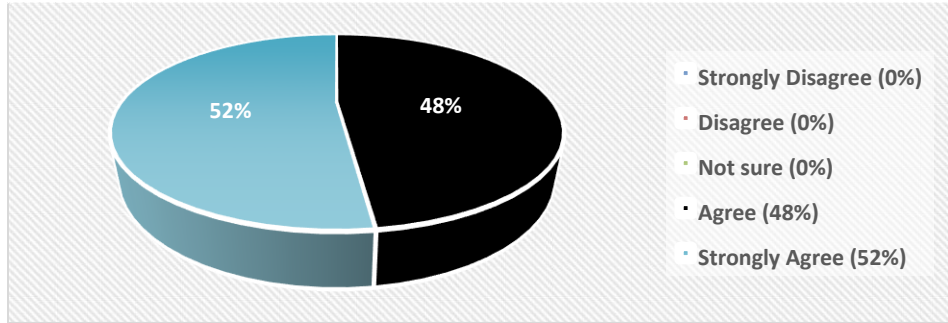
Source: Primary data

Figure 4.4 above indicates that 89% were not sure and 11% agreed. This implied that SMEs maintain a value at risk for their company but unknown to majority employees.

4.3.5 Addressing Financial Risks to Employees

The respondents were asked whether management addresses financial risks in the company to employees.

Figure 4.5: Addressing Financial Risks to Employees



Source: Primary data

Figure 4.5 above indicates that 48% agreed and 52% strongly agreed. This implied that management of SMEs address financial risks to their employees.

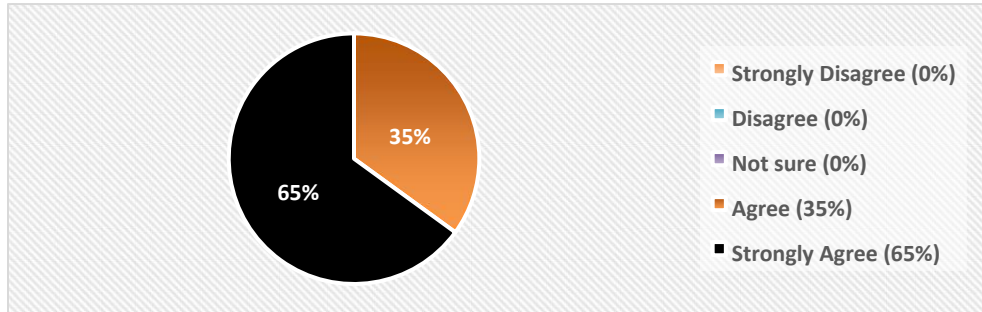
4.4 The effect of Monitoring on Financial Performance

This study sought to determine the effect of monitoring on financial performance. The findings are presented as follows:

4.4.1 Monitoring of Company Activities

The questionnaire required the respondents to indicate whether their company activities are monitored to assess the quality and effectiveness of systems on financial performance.

Figure 4.6: Monitoring of Company Activities



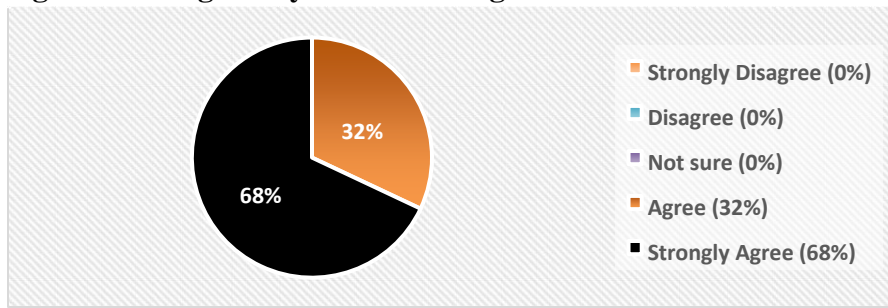
Source: Primary data

Figure 4.6 above indicates that 35% agreed and 65% strongly agreed. This implied that SMEs monitor activities to assess the quality and effectiveness of systems on financial performance.

4.4.2 Regularity of Monitoring

The questionnaire required the respondents to indicate whether monitoring on financial controls in their company is done regularly.

Figure 4.7: Regularity of Monitoring



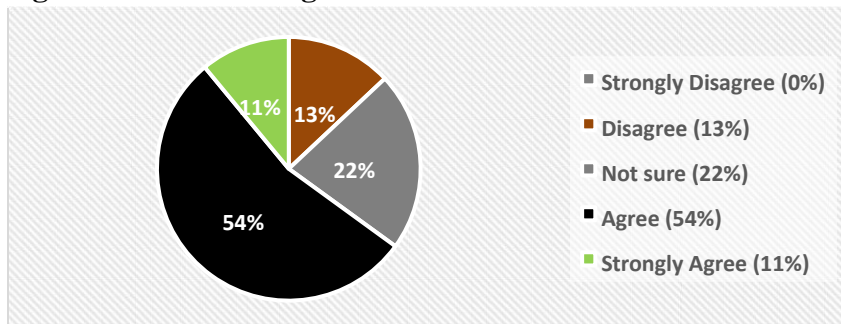
Source: Primary data

Figure 4.7 above indicates that 32% agreed and 68% strongly agreed. This implied that SMEs monitor activities regularly.

4.4.3 Monitoring and Internal Controls

The questionnaire required the respondents to indicate whether monitoring of operations ensures effective functioning of internal controls in their company.

Figure 4.8: Monitoring and Internal Controls



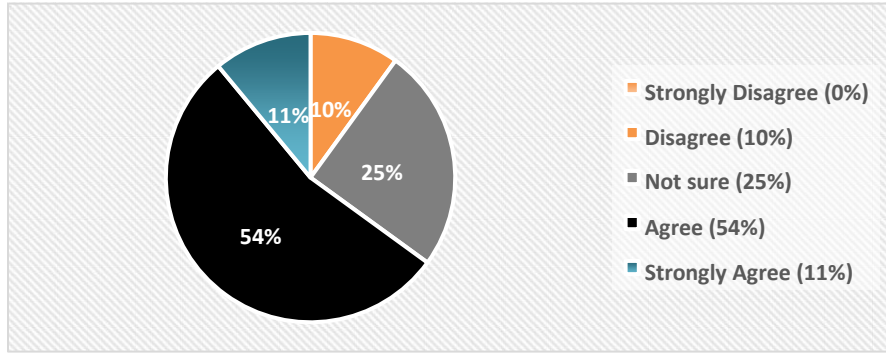
Source: Primary data

Figure 4.8 above shows that 13% disagreed, 22% were not sure, 54% agreed and 11% strongly agreed. This implied that monitoring activities ensure effective functioning of internal controls.

4.4.4 Prompt Solving of Identified Issues

The questionnaire required respondents indicate whether monitoring ensures that the issues found by audits and other reviews are promptly solved.

Figure 4.9: Prompt Solving of Identified Issues

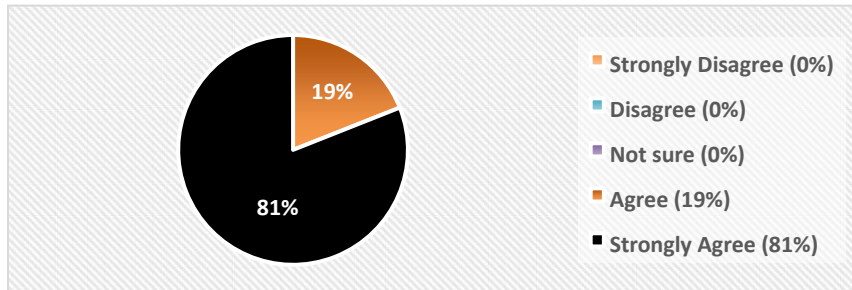


Source: Primary data

Figure 4.9 above shows that 10% disagreed, 25% were not sure, 54% agreed and 11% strongly agreed. This implied that monitoring ensures prompt solving of financial issues found by audits and other viewers.

Figure 4.10: Feedback on Findings During Monitoring

The questionnaire required the respondents to indicate whether management provides feedback on findings during the monitoring process.



Source: Primary data

Figure 4.10 above shows that 19% agreed and 81% strongly agreed. This implied that management of SMEs provides feedback on financial related findings during monitoring.

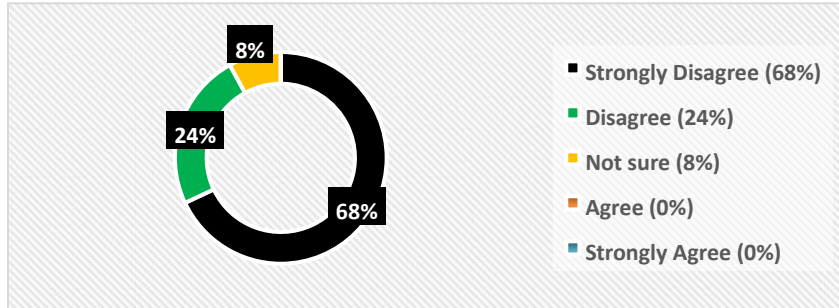
4.5 The effect of Internal Audit on Financial Performance

This study sought to determine the effect of internal audit on financial performance. The findings are presented as follows:

4.5.1 Existence of Internal Audit Function

Respondents were asked whether their company has an internal audit department or function.

Figure 4.11: Existence of Internal Audit Function



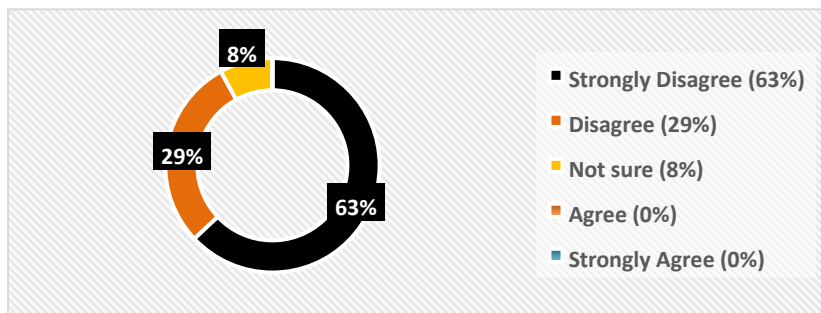
Source: Primary data

Figure 4.11 shows that 68% strongly disagreed, 24% disagreed and 8% were not sure. This implied that SMEs do not employ the function of internal audit.

4.5.2 Internal Audit Reports

Respondents were asked whether internal auditors produce and deliver reports to management on their finding during the auditing exercise.

Figure 4.12: Internal Audit Reports



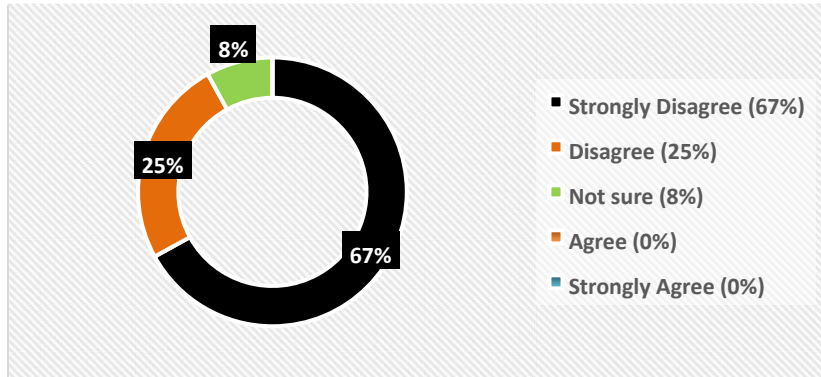
Source: Primary data

Figure 4.12 shows that 63% strongly disagreed, 29% disagreed and 8% were not sure. This implied that SMEs do not generate internal audit reports regularly.

4.5.3 Internal Audit Reports Address Weaknesses

Respondents were asked whether internal audit reports address financial weaknesses in their company.

Figure 4.13: Internal Audit Reports Address Weaknesses



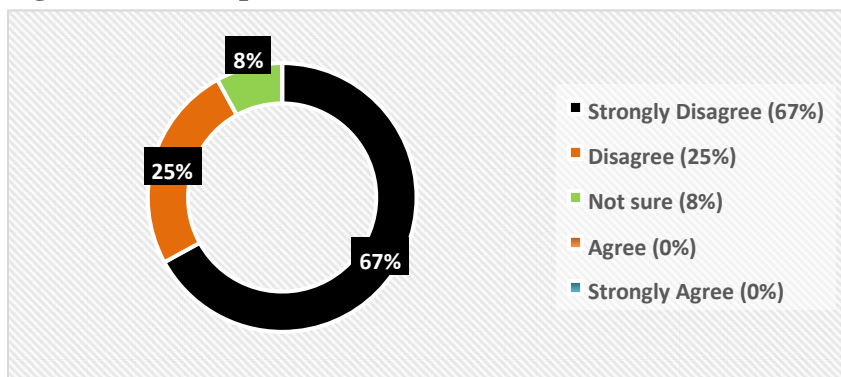
Source: Primary data

Figure 4.13 above shows that 67% strongly disagreed, 25 disagreed and 8% were not sure. This implied that SMEs do not address financial weaknesses through internal audit reports.

4.5.4 Independence of Internal Auditors

Respondents were asked whether internal auditors perform their duties with a great degree of anatomy and independence from management.

Figure 4.14: Independence of Internal Auditors



Source: Primary data

Figure 4.14 above shows that 67% strongly disagreed, 25% disagreed and 8% were not sure. This implied that SMEs do not have an internal audit function that performs their duties with great autonomy and independence.

4.6 Narration of Findings

In trying to assess the effect of Internal Control Systems on Financial Performance in SMEs of Mukono Municipality in Uganda, the researcher conducted a number of interviews with key informant members of Paris Corner Supermarket Ltd Mukono and City Shoppers Ltd Mukono employees. These included the top, middle and lower-level management. The interviews were guided by an interview guide that based on the research questions of the study.

This study conducted face-to-face interviews so as to strengthen the quantitative data collected from questionnaires. For each case study, four group interviews were conducted. The groups were top level management, middle level management and two splits of the lower-level management. Focus was put on the top and middle level managers who are directly involved in implementation of the companies' ICSs on financial performance.

4.4.1 The Effect of Risk Assessment on Financial Performance

The researcher examined and interviewed the respondents on their understanding of risk assessment in relation to financial performance of their company, the adequacy of the process and the efficiency and effectiveness of risk assessment in minimizing financial losses.

All the respondents understand risk assessment in relation to financial performance with a general view of "identifying and managing any potential harm to their company's financial performance." The respondents believe that the risk assessment process in their company is adequate enough to identify and manage risks. They base their belief on four strong give indicators of adequate; Debtors management, Creditors management, Debt management and Cash flow management. They continue to support their argument by saying that the company has never had business damaging challenges with these four components.

The respondents agree that risk assessment is efficient and effective in minimizing financial losses of their company. They support their argument in reference to the above four indicators. Before selling goods to customers on credit, a background check on the customer's past behavior

and the capability to pay is done and management authorizes the sale with a stated limit amount and debtor days, the respondents add. Negotiations are made with creditors on credit amounts and payment terms and periods, and good business relations are maintained. Only the company director is authorized to attain a debt for the company. Cash flows are recorded, analyzed and reported every day and feedback is immediately passed on to the employees. This implied that there is reduction in financial losses and effective risk reporting in SMEs.

However, the respondents are not quite certain of the long-term risk assessment and management plans of the company since the focus is on the short-term plans. This implied that there is more focus on the short-term risk assessment than long-term risk assessment.

4.4.2 The Effect of Monitoring on Financial Performance

The researcher examined and interviewed the respondents on their understanding of monitoring and whether monitoring is done in their company, how it is done and its effect on financial performance of their company.

The respondents expressed a great understanding of the concept of monitoring with a general view that it is the “process of observing, checking and evaluating activities and progress of tasks.” The

respondents agree that monitoring is done in their company and add that it is thoroughly and constantly done by the top and middle level management.

The respondents gave a brief description of how monitoring is done in their company. Middle managers micro-manage all activities and report to the top manager every day. Top managers monitor activities and tasks on a wider view.

Respondents agree that monitoring is effective to the financial performance of their company. They support their argument by saying, monitoring ensures that activities are and tasks are done as and when due, using the least resources possible and ensuring accountability, incurring the least costs and ensuring efficiency and effectiveness of the resources employed. Monitoring also provides reports to the top managers and feedback to the lower level managers on the financial issues observed for informed decision making and better performance. This implied that monitoring ensures that there is efficient and effective financial performance as well as financial outcomes in SMEs.

The respondents however claim that the process of monitoring is excessively done to the extent of “micro-management” which is frustrating for the employees. They continue to say that this has instilled a donkey carrot character in a way that unless employees are directed, controlled and supervised, work may not go on as expected. This implied that whereas this kind of monitoring is efficient and effective, it frustrates the employees.

4.4.3 The Effect of Internal Audit on Financial Performance

The researcher examined and interviewed the respondents on their understanding of internal audit and whether the exercise is done in their company, who hires and evaluates the internal auditors and what internal auditors in their company.

Majority of the respondents expressed a fair understanding of the concept of internal audit with a general view that “internal audit is the process of cross-checking financial reports to see if they are correct or not.” Further, majority of the respondents disagreed that their company has an internal audit function. They continued to argue that they have never witnessed the hiring or evaluation of internal auditors and have never witnessed any internal audit activities. This implied that SMEs do not appreciate the function of internal auditing and the role of internal auditors. It also implied that SMEs are prone to financial risk like fraud, embezzlement, financial reporting errors, financial mismanagement, compliance and regulatory issues, among others.

CHAPTER FIVE

SUMMARY OF FINDINGS, DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary of findings, discussions, conclusions and recommendations and recommendations of the study. The first section of the chapter provides a summary of the study, second section covers the discussion followed by conclusion and last section provides the recommendations of the study.

5.2 Summary of Key Findings

The study found out that there is a fair understanding of the concept of risk assessment. The study also found out that the process of risk assessment is done by management of Paris Corner Supermarket and City Shoppers Supermarket and that risk management strategies and procedures are in place. In addition, the study uncovered that risk assessment minimizes financial loss in the companies.

Regarding monitoring, management and employees of Paris Corner Supermarket and City Shoppers Supermarket understand the concept of monitoring. The study also found out that monitoring is greatly implemented and it is very effective on the companies' financial performance. Further, the study unveiled that monitoring of operations ensures effective functioning of internal controls and ensures that financial issues found by audits and other reviews are promptly resolved, while managers provide feedback on findings found during monitoring.

About the effect of the internal audit, the study found out the internal audit function is non-existent in both companies, internal auditors are non-existent, audit reports are non-existent and neither are the activities of the internal audit function. The study also found that the internal audit.

5.3 Discussions of Key Findings

Risk Assessment

The first research question of this study sought to determine the effect of risk assessment on financial performance. The findings of this study revealed that there exists a significant relationship between risk assessment and financial performance. According to Karagiorgos et al., (2009), risk assessment refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved.

The findings of the study also revealed that internal controls enhances risk mitigation in SMEs. These findings are in line with Nqala and Dubihlela, (2017) conducted a study on the investigations of how small and medium manufacturers are optimizing their internal control systems in order to mitigate risk, in Western Cape, South Africa. The study followed a qualitative research paradigm, adopting case-based interpretive approach employed to support the data collection, data analysis and data presentation methods. An analysis of interviews with managers and owners from manufacturing SMEs indicated that businesses create contingency risk plans and implement internal control systems are less exposed to risk (Davila, Gupta, & Palmer, 2017). In addition, Madembu and Namusonge, (2017) studied the role of risk management on financial performance of SMEs in Kenya. They concluded that SMEs should focus on implementing comprehensive risk management systems in their businesses.

Monitoring

This study sought to determine the effect of monitoring on financial performance. These findings are in line with the findings of Karagiorgos, Drogalas and Giovanis (2011), who assert that monitoring refers to the process of assessing the quality of the internal control structure over time. The findings also agree with Ewa and Udoayang (2012), who say that monitoring of operations ensures effective functioning of internal control systems. It's through monitoring that an organization determines whether its policies and procedures designed and implemented by management are being carried out effectively by employees.

The findings of this study revealed that monitoring can be done through on-going activities or separate evaluations. According to Ofsori (2011), monitoring provides assurance that the findings

of audits and other reviews are promptly determined. Theofanis (2011), also notes monitoring of operations ensures effective functioning of internal controls in an organization. Hence, monitoring determines whether or not policies and procedures designed and implemented by management are being carried out effectively by employees. According to Sarens, Abdolmohammadi, and Lenz, (2014), organizational performance encompasses accumulated end results of all the organization's work processes and activities.

Internal Audit

This study also sought to determine the effect of internal on financial performance of SMEs. The findings were in line with Whittington & Pany (2001) who suggest that internal auditing is performed as part of the monitoring activity of an organization. Further the findings of this study agreed with Matari et al. (2014) who found that SMEs with effective internal audit practices had better financial performance due to their ability to identify and address potential risks. In addition, studies by Halil et al. (2018) and Karami et al. (2020) indicated that effective internal audit practices can lead to reduced instances of fraud and consequently improve SMEs' financial performance.

Studies by Al Mamun et al. (2019) and Ntim and Soobaroyen (2013) found that a strong internal audit function reduces the likelihood of fraud, errors, and misappropriation, leading to improved financial outcomes. Research by Bui and Cheng (2018) and Krishnan and Visvanathan (2014) indicated that internal audit functions significantly contribute to enhancing SMEs' compliance practices, thereby positively influencing their financial performance. Unfortunately, despite a fair understanding of the concept of internal audit as well as its importance in maintaining a sound financial performance, all the respondents disagreed on their company having an internal audit function in their company. They continued to argue that they have never witnessed the hiring or evaluation of internal auditors and have never witnessed any internal audit activities.

Conclusions

Based on the findings of the study, it is concluded that the SMEs have effective risk assessment internal control systems as supported by the study findings on identifying and analyzing potential

financial risks, the risk management strategies and policies. SMEs with risk assessment as an internal control system is able to identify and manage financial risks.

SMEs have effective monitoring control systems as supported by the study findings on monitoring in ensuring effective functioning of internal controls and ensuring financial issues found by audits and other reviews are promptly resolved. This study concludes that SMEs with monitoring as an internal control system have a sound financial performance.

However, there is challenge of failure to appreciate the internal audit function, internal auditors and internal audit activities. The study concludes that SMEs without an internal audit function are exposed to financial risks like embezzlement, fraud, financial errors, resource mis-allocation, among others.

The final conclusion of this study is that there is a significant positive relationship between internal control systems and financial performance of Small and Medium Enterprises in Mukono Municipality in Uganda.

5.4 Recommendations

Since it was evident in the study that the internal audit function is not appreciated in SMEs the study therefore recommends the application and implementation of this function as an internal control system. Internal audit assists to cross-check financial reports, implementation of other controls and compliance to regulations.

This study also recommends that SMEs be transparent on the risk assessment control system to the employees since they form part of the company structure and are directly involved with the hands-on activities. Further, the study recommends that SMEs consider and implement the longterm risk assessment and management.

This study recommends that there should be a deliberate attempt to conduct a study which establishes the reasons as to the lack of appreciation of the internal audit function in SMEs.

5.5 Suggestions for Further Research

This study suggests that research should be conducted on “The Failure of Small and Medium Enterprises to Implement Internal Audit in Mukono Municipality, Uganda.”

The study also suggests that research should be conducted “The Effect of Internal Audit on Financial Performance of Small and Medium Enterprises in Mukono Municipality, Uganda.”

This study investigated the effect of Internal Control Systems on Financial Performance of SMEs but limited in Mukono Municipality. Future studies should investigate the effect of internal control Systems on Financial Performance of SMEs in other regions like Kayunga, Kampala, Jinja and Mbarara.

5.6 Limitations to the study

Some respondents had their highest level of education as Senior four and found it difficult to read and write. This challenge was solved by reading and interpreting the instructions and questions for the respondents.

The employee respondents had limited time to engage with the researcher due to the nature of their job which requires them to be at their work station all the time. This challenge was solved by leaving the questionnaires behind for the respondents to fill in at convenience. The questionnaires were picked the following day. Further, the interviews were conducted in two groups to save time and this was done during their lunch break.

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APPENDIX

QUESTIONNAIRE

Section A:

Introduction

Dear Respondent, my name is Akanyijuka Wilber. I am currently a student of Uganda Christian University and I carry out this study for the purpose of writing a dissertation as a requirement for the award of a bachelor's degree in Business Administration at Uganda Christian University. The topic of study is "The Effect of Internal Control Systems on Financial Performance of Small and Medium Enterprises in Mukono Municipality, Uganda."

You have been with purpose selected to participate in this study due to the importance of your knowledge on this study. The information you provide will only be used for the purpose of this study and will be treated with utmost confidentiality. Your identity will be kept anonymous. Please feel free and answer all the questions truthfully.

Section B:

Respondent's Background

1. Gender (Please tick or circle appropriately)

- a. Male
- b. Female

2. What is your highest level of education?

- a. Senior 4
- b. Senior 6
- c. Certificate/Diploma
- d. Bachelor
- e. Masters
- f. Others (Please Specify)

3. What position do you currently hold in the company that you work for?

- a. Management Committee member
- b. Departmental head
- c. Former Departmental head
- d. Division Head
- e. Staff member

4. In what age bracket do you fall? (Circle where appropriate)

- a. 18-25
- b. 26-35
- c. 36-45
- d. 46-55
- e. 56+

5. For how long have you served in your organization/Institution?

- a. 1-3 years
- b. 4-6 years
- c. 7-10 years
- d. 10+ years

To examine the functionality of Internal Control systems of Small and Medium Enterprises in Mukono Municipality, please rank the following statements on a Likert scale ranging from strongly disagree to strongly agree. Where;

SD=Strongly Disagree D=Disagree NT=Not Sure A=Agree SA=Strongly Agree

Section B: THE EFFECT OF RISK ASSESSMENT ON FINANCIAL PERFORMANCE

Statements	Scale
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Risk Assessment	SD	D	NT	A	SA
Our company carefully identifies and analyses potential financial risks.					
Our company has risk management strategies and policies in place.					
It is necessary for every SMEs to manage its risks in order to minimize financial loss exposure.					
Our company maintains a manageable Value at Risk (VaR).					
Management addresses financial risks in the company to the employees.					

Section C: THE EFFECT OF MOTORING ON FINANCIAL PERFORMANCE

Monitoring	SD	D	NT	A	SA
Our company activities are monitored in order to assess the quality and the effectiveness of systems on financial performance.					
Monitoring on financial controls is done regularly.					
Monitoring of operations ensures effective functioning of internal controls.					
Monitoring ensures that financial issues found by audits and other reviews are promptly resolved.					
Management provides feedback on financial related findings during monitoring.					

Section D: THE EFFECT OF INTERNAL AUDIT ON FINANCIAL PERFORMANCE

Internal Audit	SD	D	NT	A	SA
Internal audit is essential to maintain a sound financial performance.					
Our company has an internal audit department/function.					
Internal audit reports are produced and presented regularly.					
Management discusses internal audit reports frequently.					
Internal audit reports address financial weaknesses in our company.					

Internal auditors perform their duties with a great degree of autonomy and independence from company management.					
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Thanking you for your participation.

INTERVIEW GUIDE

Section A: Introduction

Dear Respondent, my name is Akanyijuka Wilber. I am currently a student of Uganda Christian University and I carry out this study for the purpose of writing a dissertation as a requirement for the award of a bachelor's degree in Business Administration at Uganda Christian University. The topic of study is "The Effect of Internal Control Systems on Financial Performance of Small and Medium Enterprises in Mukono Municipality, Uganda."

You have been with purpose selected to participate in this study due to the importance of your knowledge on this study. The information you provide will only be used for the purpose of this study and will be treated with utmost confidentiality. Your identity will be kept anonymous. Please feel free and answer the following questions truthfully.

Section B: Risk Assessment

1. In your opinion, how do you understand risk assessment?
2. In your opinion, is the risk assessment process adequate in your company? Any reasons to your response?
3. In your opinion, is risk assessment efficient and effective in minimizing financial losses?

Section C: Monitoring

1. How do you understand monitoring? Is monitoring done in your company?
2. In respect to financial performance, how is monitoring done in your company?
3. In your opinion, is monitoring effective on financial performance in your company?

Section D: Internal audit

1. Is the audit function and its activities independent in your company?
2. Who hires and evaluates internal auditors?
3. What do the internal auditors in your company audit?

Thanking you for your participation.



UGANDA CHRISTIAN UNIVERSITY

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SCHOOL OF BUSINESS

1st Aug 2023

TO WHOM IT MAY CONCERN

Name: AKANYISUKA WILBER Reg. No. J21B05/029

A bachelor's student who is seeking permission from your office to collect data for his/her dissertation titled

"THE EFFECT OF INTERNAL CONTROL SYSTEMS ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN MUKONO MUNICIPALITY, UGANDA"

We shall be grateful if you could render assistance to him/her in collecting the necessary data for his/her dissertation

The Uganda Christian University School of Business thanks you in advance

Mukisa Simon Peter
Research coordinator