EFFECT OF INTERNAL CONTROLS ON THE FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS IN UGANDA(A CASE STUDY OF KAKIRA SUGAR WORKS)

BY

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A RESEARCH PROJECT SUBMITTED TO THE COLLEGE OF ECONOMICS AND MANAGEMENT SCIENCES IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE AWARD OF THE DEGREE OF BACHELORS OF BUSSINESS ADMINISTRATION FINANCE AD ACCOUNTING OPTION OF KAMPALA INTERNATIONAL UNIVERSITY

MAY 2016

DECLARATION

I declare that this project is my original work and has not been submitted for an award of a degree in any other University for examination purposes.

Signature.................................... Date..24th/05/2016...

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APPROVAL

This research project has been submitted for examination with my approval as the University Supervisor.

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DEDICATION

This project is dedicated to my family and friends who encouraged me during the study period.

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I wish to extend my gratitude to my supervisor Mr. Timbirimu Micheal for his professional guidance and advice throughout my project.

I also want to sincerely thank Uganda manufacturer association and the staff of the 20 manufacturing firms for the assistance they accorded to me during data collection period.

To the entire academic staff of Kampala international university, School of Business thank you for your great support.

To my family and friends, kindly accept my appreciation in one way or another.

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LIST OF ABBREVIATIONS AND ACRONYMS

ACCA	Association of Chartered Certified Accountants
APB	Auditing Practices Board
CE	Control Environment
COSO	Committee of Sponsoring Organizations
IC	Internal Controls
ICS	Internal Control Systems
INTOSAI	International Organization of Supreme Audit Institutions
SOX	Sarbanes - Oxley
VFM	Value for Money

ABSTRACT

The study sought to determine the effect of internal control system on financial performance of manufacturing firms in uganda. To achieve the objective of this study, the study used hypothesis testing research design. The study tested the following hypotheses: H_1: Internal Controls and Financial Performance are positively related; H_2: Internal Controls have a significant impact on Financial Performance. The population chosen for this study was 65 eployees from kakira sugar works to represent all manufacturing firms in Uganda. The study selected a sample size of 20 employees from a target population of 65 employees. The sample was drawn using stratified random sampling technique. The study relied on both primary and secondary data. Primary data was collected using structured questionnaires while the secondary data was gathered from financial statements based on availability and accessibility of data.

The findings revealed that most manufacturing firms had a control environment as one of the functionality of internal controls of the organization that greatly impacts on the financial performance of the firms. It was also established that the management had put in place mechanisms for mitigation of critical risks that may result from fraud. The study examined the effect of control activities on the financial performance of manufacturing firms in Uganda. The results also revealed that that the staff were trained to implement the accounting and financial management systems (M=3.24, S.D=1.334), the security system identified and safeguarded organizational assets (M=4.20, S.D =1.334). The statistical results from the regression analysis show that there is a positive relationship between internal control and financial performance of manufacturing firms in uganda. The independent variables (Control Environment, Risk Assessment, Control Activities, Information and Communication and monitoring) contributed to 75.7% of the variation in financial performance as explained by adjusted R2 of 0.75.7% which shows that the model is a good prediction.

It was concluded that manufacturing firms that had invested on effective internal control systems had more improved financial performance as compared to those manufacturing firms that had a weak internal control system. Most large scales manufacturing firms that fully invested in strong internal control systems. The study further recommends that the governing body, possibly supported by the audit committee, should ensure that the internal control system is periodically monitored and evaluated. The limitation of this study is that the study was focused on employees of kakira to represent all manufacturing firms in uganda, therefore these findings may not be used for generalizations on all manufacturing firms in uganda. It is therefore important for a study to be conducted using wider scope and coverage then, the findings can be compared and conclusions drawn.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Internal control as "Comprising the plan of an organization and all the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, prorate operational efficiency and adherence to prescribed managerial policies." The definition of internal control is divided into financial internal control and non-financial (administrative) internal control. Financial internal control pertains to financial activities and may be exemplified by controls over company's cash receipts and payments financing operations and company's management of receipts and payments. Non-financial internal control on the other hand deals with activities that are indirectly financial in nature i.e. controls over company"s personnel section and its operations, fixed assets controls and even controls over laid down procedures (Reid and Ashelby, 2002).

A sound internal control system helps an organization to prevent frauds, errors and minimize wastage.Custody of assets is strengthened; it provides assurance to the management on the dependability of accounting data eliminates unnecessary suspicion and helps in maintenance of adequate and reliable accounting records.This study therefore attempts to establish the effectiveness of internal control system in manufacturing firms in uganda.

Despite the fact that internal control system is expensive to install and maintain, it gradually evolved over the years with the greatest development occurring at the beginning of 1940's. Not only have the complexities of the business techniques contributed to this development but also the increased size of business units which have encouraged the adoption of methods which while increasing efficiency of business, acts as a safeguard against errors and frauds.

Mawanda (2008), states that "there is a general perception that institution and enforcement of proper internal control systems will always lead to improved financial performance". It is also a general belief that properly instituted systems of internal control improve the reporting process and also give rise to reliable reports which enhances the accountability function of management of an entity. Preparing reliable financial information is a key responsibility of the management of every public company. The ability to effectively manage the firm's business requires access to timely and accurate information.

Moreover, investors must be able to place confidence in a firm's financial reports if the firm wants to raise capital in the public securities markets. Management's ability to fulfill its financial reporting responsibilities depends in part on the design and effectiveness of the processes and safeguards it has put in place over accounting and financial reporting. Without such controls, it would be extremely difficult for most business organizations especially those with numerous locations, operations, and processes to prepare timely and reliable financial reports for management, investors, lenders, and other users. While no practical control system can absolutely assure that financial reports will never contain material errors or misstatements, an effective system of internal control over financial reporting can substantially reduce the risk of such misstatements and inaccuracies in a company"s financial statements (Kaplan, 2008; Cunningham, 2004; INTOSAI, 2004).

Cunningham (2004) states that internal control systems begin as internal processes with the positive goal of helping a corporation meet its set objectives. Management primarily provides oversight activity; it sets the entity's objectives and has overall responsibility over the ICS. Internal controls are an integral part of any organization"s financial and business policies and procedures. Internal controls consist of all the measures taken by the organization for the purpose of; protecting its resources against waste, fraud and inefficiency; ensuring accuracy and reliability of accounting and operating data; ensuring compliance with the policies of the organization; evaluating the level of performance in all organizational units of the organization.

ICS are applicable to each organization in relation to key risks and are embedded within the operations and not treated as a separate exercise. ICS should be able to respond to changing risks within and outside the company and they are a means to an end, not an end itself . Cunningham (2004), further states that Internal controls are effected by people not merely policy manuals and forms, but people functioning at every level of the institution. Internal control only provides reasonable assurance to the firm's leaders regarding achievement of operational, financial reporting and compliance objectives; promoting orderly, economical, efficient and effective operations; safeguarding resources against loss due to waste, abuse, mismanagement, errors and fraud. Internal controls lead to the promotion of adherence to laws, regulations, contracts and management directives and the development and maintenance of reliable financial and management data, and accurately present that data in timely reports (Kaplan, 2008; Cunningham, 2004; INTOSAI, 2004).

Treba (2003) states that internal control is a tool for ensuring that a firm realizes its mission and objectives. He further notes that much as internal controls are often thought to be the domain of accountants and auditors; it is actually management that has primary responsibility for proper controls. A critical element of any comprehensive Internal Control Systems is regular monitoring of the effectiveness of internal controls to determine whether they are well designed and functioning properly (Treba, 2003).

Treba (2003) explained that weaknesses in internal control systems (control over the payroll, over expenditure commitments and over procurement processes) lead to failure to ensure that resources are allocated to defined priorities and to guarantee that there is value for money will be attained in public spending. The findings of the Treadway Commission Report of 1987 in the United States (USA) confirmed that the absence of internal controls or the presence of weak internal controls is the primary cause of many cases of fraudulent company financial reporting. The widespread global corporate accounting scandals in recent years inform this study.

Notable cases include Enron and WorldCom in the USA, Parmalat in Europe and Chuo Aoyama in Asia. In South Africa, cases of accounting scandals have been recorded in JCI and Rand gold and Exploration companies. In Nigeria, the managing director and chief financial officer of Cadbury Nigeria were dismissed in 2006 for inflating the profits of the company for some years before the company"s foreign partner acquired controlling interest.These scandals emphasize the need to evaluate, scrutinize, and formulate systems of checks and balances to guide corporate executives in decision-making. These executives are legally and morally obliged to produce honest, reliable, accurate and informative corporate financial reports periodically (Hayes et al, 2005).

In the study, internal controls shall be interpreted as "A process that guides an organization towards achieving its objectives." These objectives include operational efficiency and effectiveness, reliability of financial reporting and compliance with relevant laws and regulations." Financial performance is considered in terms of measures like profitability (using absolute and relative measures), liquidity (using liquidity ratios like current ratio, acid test ratios), the ease with which the entity settles its financial obligations and accountability.

Dixon et al (1990) found out that appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives.Stoner (2003) refers to performance as the ability to operate efficiently, profitably, survive, grow and react to the environmental opportunities and threats. In recent years the aspect of internal control system has achieved great importance since it is designed to safeguard the company"s assets against misuse, ensure compliance with the company"s laid policies, ensure the company"s personnel are efficiently utilized and the company runs in an orderly and efficient manner.

Most importantly it ensures the company's reliable records which are a source of information necessary for managerial decision making processes are availed whenever required by management or both the external and internal auditors. It is therefore clear that the adoption of a sound internal control system is not only helpful to the management, but also to the external auditors. However, it's worth noting that internal controls only provide reasonable but not absolute assurance to an entity's management and board of directors that the organization's objectives will be achieved. "The likelihood of achievement is affected by limitations inherent in all systems of internal control," (Hayes et al, 2005).

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1.1.1 Internal Controls

Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of a firm s objectives in the effectiveness and efficiency of operations, reliability of financial and management reporting, compliance with applicable laws and regulations and protect the organization's reputation (Kaplan,2008; Cunningham,
2004; INTOSAI, 2004; Committee of Sponsoring Organizations (COSO), 1992; Auditing Practices Board (APB), 1999).

Effective internal control system operates when some specific procedures are adopted by the management. International Accounting Standards (IAS) categorizes internal control types as a plan of organization, segregation of duties, control of documents, safeguarding of assets, competence of staff, arithmetic and accounting controls, recording and record keeping , supervision, authorization and approvals, vocation and rotation of duties, cost feasibility , routine and automatic checks.

Saleemi (1989) refers to plan of organization as an organization chart showing the organization structure of a company. The purpose of this chart is to show how the company has been divided into departments and departments into sections and most important to show what responsibilities and duties are assigned to each officer. Authority and responsibilities are clearly defined. Employees perform their duties according to the organization plan. This plan allocates and defines responsibilities and identifies lines of reporting for all aspects of business operations. The plan of organization is needed for effective internal control.

Internal controls consist of five components namely: i) Control environment- This is the foundation for all the other components of internal control. It comprises of factors like integrity and ethical values of personnel tasked with creating, administering and monitoring the controls; commitment and competence of persons performing assigned duties, board of directors or audit committees, management philosophy and operating style and organizational structure, Risk assessment process, this refers to the careful assessment of factors that affect the possibility of objectives of the organization not being achieved. 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, information and communication systems Internal controls require that all pertinent information be identified, captured and communicated in a form and time frame that enable people to carry out their financial reporting responsibilities.

Firms should adopt internal control and information systems that produce operational, financial and compliance-related information reports to make it possible to run and controls the business. Effective communications should occur in a broad sense with information flowing down, across, and up within all the sections of the organization (Millichamp, 1999)

Control activities refers to policies, procedures, and mechanisms put in place to ensure directives of the management are properly carried out. Appropriate and accurate documentation of policies and procedural guidelines helps to determine how the control activities are to be executed. Monitoring of controls is the process of assessing the quality of the internal control structure over time. 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.

Millichamp (1999) stated that the term segregation of duties is used these days for internal duties. One of the prime means of control is the separation of those duties which would if combined would enable one individual to record and process a complete transaction. This practice reduces risk of intentional manipulation of accounts and increases element of checking. This makes fraud more difficult to be committed because one transaction is completed by different employees.

Batra el al (1992) said that control of documents involves control of company s sensitive documents for example receipts, cheques, local purchase orders, debit and credit notes. These documents must be handled by a responsible officer and should be pre numbered to ensure control and minimize misuse. They must be kept and controlled from a central point like headquarters or any other reliable control point.

De Paula et al (1990) also noted that internal controls require that business assets like plant and machinery, equipment, motor vehicle, stock and cash should be kept safely and access should be limited to authorised personnel only. The procedures designed and security measures taken to safeguard assets are known as Physical Controls. The type of physical controls common to most companies include employment of watchmen, alarm system, strong electrified fence, strong room, safes and security lights.

Spicer & Pegler (1978) stated that the proper functioning of any system depends on the competence and integrity of those operating it. The staff employed in an organization should be competent and experienced. The company should employ qualified, experienced, competent, motivated and capable people who will have interest in what they do and the company as well should regard their employees as its assets. These employees should be reliable and responsible in order to ensure efficiency in business operations.

Woolf (1997) also stated that arithmetic and accounting controls should be implemented as they aim at ensuring accuracy of transactions and ensuring proper recording of company transactions according to the Generally Accepted Accounting Principles (GAAPs). When examining the internal control system, the auditor should consider the possibility of collusion between close relatives working in related parts of the firm, this may conceal irregularities. The recording of business transactions should be accurate and arithmetically correct hence some controls are introduced e.g. checking of totals, reconciliations, control accounts and trial balances.An effective control system therefore requires implementation of arithmetical and accounting controls and its adequacy has to be examined by the internal auditor differently for different firms.

Woolf (1997) indicated that all transactions must be authorized and approved by the right and responsible officer. This is aimed at preventing frauds, safeguarding the company assets, streamlining the flow of authority to avoid bureaucracy and conflicting authorized activities for example purchases invoices should be approved before payment is made to suppliers, and wages payment be approved before cash withdrawal from the bank. Internal control requires proper system of authorization and approval whose main objective is to prevent fraud and safeguard company assets.Vocation and rotation of duties should also be upheld in organization.

Manasseh (1990) said that the company must give its employees leave especially to accounting staff who should not overstay their leave. This is aimed at checking the efficiency of officers and preventing frauds and errors. It also boosts the efficiency of officers concerned through rest and the company s internal check.Routine and automatic checks are put to practice. Saleemi (1989) said that surprise checks should be conducted especially for such items as petty cash, stock count, cash at hand and wages payment. This will prevent errors and frauds and also will promote the morale at work.

Woolf (1997) noted that with rapidly changing technology, there is need to restructure the controls of various firms to support these documents. The auditor works directly with computers and its records as they exist in suitable machine sensible forms. The auditor therefore concentrates on proving the initial inputs and checking their validity and the calculate output manually which is then compared with computer output.

De Paula et al (1990) noted that there are some system developments controls designed to ensure that a satisfactory standard is maintained in designing, testing, implementing and documenting new system and programs. An auditor has to review controls to ensure the installation staff is divided into a number of sections e.g. system analysis, programming, controlling, library and computer. He must also ensure that there is a clear definition of duties and divisions of responsibilities between the sections.Therefore the auditor should ensure that all computer routines have been properly documented, any unauthorized people are not allowed into the computer room, programmers do not have access to the computers except if necessary when testing programs and that computer operators don't access source documents and are not allowed to amend programs.

1.1.2 Financial Performance

Positive financial performance in a manufacturing firm can be achieved by eradicating waste in benefits services processes and systems. The "critical success factor" for a manufacturing firm is the degree to which it fulfills its set objectives and mission in terms of being efficient, effective and economical. The information obtained from a sound internal control system as reflected from financial statements will provide a report on a firm's financial performance and position that is useful to a wide range of users for assessing the stewardship and making economic decisions (Glendinning,

1998; Davies, 2007).

Internal Control Systems are very instrumental in achieving the firm s set mission and objectives; hence Value for Money. The main approach to VFM is the firm s control over the use of resources in order to achieve its set objectives. Heads of departments should establish sound arrangements for planning, appraising, authorizing and controlling operations in order to achieve positive Financial Performance.Financial Performance and Value for Money are used to assess whether or not a firm has obtained the maximum benefit from the goods and services it acquires and / or provides, within the resources available to it (LGIAM, 2007).

Value for Money is not paying more for a good or service than its quality or availability justifies as well public spending implies a concern with economy (cost minimization), efficiency (output maximization) and effectiveness (full attainment of the intended results. The most effective way to improve Financial Performance is by reducing the level of irregularity and fraud through improvements in the firm s systems of internal financial control. Shareholders need to be assured that their resources are being used efficiently and effectively in providing the right service at the least cost. Financial Performance analysis needs to pay attention to total risks and is related to concepts of efficiency and effectiveness (Deakin, 1998).

1.1.3 Internal Controls and Financial Performance

Internal control systems including internal audits are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organization (Jensen, 2003). Internal control therefore has a much broader purpose such that the organization level of control problems associated with lower revenues, which explore links between disclosure of material weakness and fraud, earnings management or restatements Internal controls provide an independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better revenue generation (Beeler et al, 1999).

Fadzil et al (2005) said that an effective internal control system unequivocally correlates with organizational success in meeting its revenue target level. Effective internal control for revenue generation involves; regular a review of the reliability and integrity of financial and operating information, a review of the controls employed to safeguard assets, an assessment of employees' compliance with management policies, procedures and applicable laws and regulations, an evaluation of the efficiency and effectiveness with which management achieves its organizational objectives (Ittner, 2003).

Most organizations no longer set up internal control system as a regulatory requirement but also because it helps in ensuring that all management activities are appropriately carried out (Kenyon and Tilton, 2006). Further, organizations are making it a point of duty to train, educate, and sensitize their employees on how to use these internal control systems since its effectiveness depends on the competency and dependability of the people using it. All these control actions ensure that any risks that may affect the company s ability to achieve its goals are appropriately avoided and should occur at all levels and in all functions of the organization ((Doyle et al, 2005).

There are three major classifications of internal controls; preventive, detective, and corrective.Preventive controls predict potential problems before they occur, make adjustments, and prevent an error, omission or malicious act from occurring. The detective controls are used to detect and report the occurrence of an omission, an error or a malicious act. Finally, the corrective controls help in ensuring that the impact of a threat is minimized, identify the cause of a problem as well as the correct errors arising from the problem. Corrective controls correct problems discovered by detective controls and modify the processing system to minimize future occurrence of the problem (Singleton, 2006).

1.1.4 Manufacturing Firms in Uganda

The manufacturing sector in Uganda in which the study is based on is one of the major contributors to the economic development of the country. According to the National development Plan 2002-2008 it contributes to employment of a large population of the country s workforce and also contributes about 13% of Gross Domestic Product (GDP). According to the Uganda Economic Survey 2015, the manufacturing sector grew by 4.4% in 2015 when compared to prior year. This was mainly driven by; reliable power supplies arising from favorable weather conditions that boostered electric power generation, favorable tax policies, including the removal of duty on capital equipment and some raw materials, increased credit to the manufacturing

sector increased availability of raw agricultural materials, Growth in the regional market (EAC, COMESA).

In Uganda, the manufacturing sector is divided into sub-sectors which are: Food and Beverages, Building, Construction and Mining, Chemical and Allied, Energy, Electrical and Electronics, Leather Products and Footwear, Metal and Allied, Paper and Paperboard, Motor Vehicle and Accessories, Pharmaceutical and Medical Equipment, Plastics and Rubber, Textiles and Apparels, Timber, woods Product and Furniture (Manufacturing in Uganda: a Survey of Uganda's Manufacturing Sector 2006- UMA).

Although Uganda manufacturing sector is still small when compared to those of industrialized countries it is still second largest in East Africa after kenya(Aosa, 1992).

Ownership of manufacturing firms is a major dimension because it has a strong bearing on the organization's performance and control. In terms of sector concentration, large companies in Uganda account for a large proportion of manufacturing sector s output and employment. From the above arguments, provides reason why the manufacturing sector is important to be studied.

1.1.5 Background of case study

Kakira Sugar works is extracted from cane grown on lush plantations on the shores of Lake Victoria. The sweet, sparkling crystals with their distinctive taste and flavour, and rich golden colour, have sweetened dishes all over Uganda since the 1930s. This is the business sector in which the Group commenced its activities in East Africa and remains an area of core competence for the Group.

This Company was formed in 1985 as a Joint Venture between the Madhvani Group and the Government of Uganda to take over the assets of Madhvani Sugar Works Ltd., which was the Group's flagship prior to 1972. At the time of take-over in 1985, owing to the economic turmoil in the intervening years as well as inadequate management whilst under Government control, the factory was no longer in production and most of the nucleus estate had reverted to bush.

Under the Group's management, the Kakira sugar complex was fully rehabilitated with financing of US$ 60 million from the World Bank, the African Development Bank and Uganda Development Bank.

The sugar factory has been expanded steadily and is currently operating at a crushing capacity of 6,000 Tons Cane per Day ["TCD"] during a 10.5 month crushing season. A confectionery factory within the complex also produces a variety of sweets and toffees and other confectionery items.

Sugar-cane is cultivated on the company's own nucleus estate of over 9,700 hectares (Ha) but the majority of the cane is supplied from 6,000 outgrower farmers with more than 18,000 hectares under cane, for production of 150,000 Tons of sugar per year - making this Uganda's largest sugar producer. To cater to the needs of the agricultural development of Kakira, the Company established a sugarcane nursery for treated seed cane, a full fledged Agronomy Section with an Applied Research Centre.

The Company employs over 7,500 people and has been responsible for the socio-economic development of this rural area.

In addition to direct employment, Kakira's activities support the local community – out grower farmers, cane transporters, ancillary and support industries, etc. This has contributed significantly to the Ugandan Government's poverty alleviation programme. Including dependent families, Kakira Sugar Works provides the means of livelihood to over 75,000 people in the South Busoga region of Uganda.

The Kakira rehabilitation is considered by the World Bank and the African Development Bank to be one of their most successful projects on the continent. It is an outstanding example of industry turn-around under private sector management. Its success is the best example of the Madhvani Group's track record in the sugar industry.

The Group has completed an extensive phased programme for expansion which enhanced Kakira's crushing capacity to 6,000 TCD to produce more than 150,000 tons of sugar each year. The agricultural expansion plan includes increasing the Outgrowers area under cane to 20,000 Ha. The expanded cogeneration plant is already producing steam as well as 22 MW of electric power including 12 MW for sale to the national grid. The sugar expansion was partly financed by a loan of US$ 10.7 million from FMO. Since the cogeneration expansion is based on a renewable bio-mass fuel, it is being supported by a US$ 3.3 million grant from the Global Environment Fund as well as loans of US$ 8.6 million from the East African Development Bank. The project will also earn Carbon Emission Reduction credits from the

World Bank. The balance funding of the total project cost of over US$ 50 million is from own resources as well as medium-term loans from local commercial banks.

Following the expansion and cogeneration project at KSW, further plans are being formulated by the Madhvani Group. These include the production of 60,000 Litre/day of anhydrous ethanol from molasses – to blend with petrol (to reduce fuel imports), setting up of a new 2,500+ Tons Cane per Day sister sugar complex in Amuru District in Northern Uganda, and 'Jatropha' cultivation to produce bio-diesel (another renewable bio-fuel option).

1.2 Research Problem

Effectiveness of internal control on financial performance should be considered most important in every firm because the task of internal controls is to prevent and detect fraud in the firm. Internal controls are put in place to ensure safe custody of all assets; to avoid misuse or misappropriation of the firm's assets and to detect and safeguard against probable frauds. Every firm whether manufacturing or non-manufacturing, should have management of the highest qualifications, caliber and dedication since its inception. The management should meet regularly to review the affairs of the firm and to direct the strategic path of the firm and also ensure continued goal congruence (Reid & Smith, 2000).

Systems in a manufacturing firm should evolve over time and all the departments and units of the firm should undergo positive transformations. The firm should also employ world class professionals to fill all the keys departments and units. This should probably be ensured by having a transparent and open system of selection and recruitment aided by an ably staffed Human Resource Department of the firm. All departments and units should be adequately staffed with qualified and competent staff. The firm s records and accounting systems should be refined overtime and be audited by professionally trained and recognized auditors with a good reputation

(Chenhall,

2003)

A firm should always have an internal audit department to help in compliance with the internal policies and procedures. Most firms put the above efforts in order to achieve positive performance. However, despite all these efforts, firms still struggle with liquidity problems, untimely financial reports, inefficient accountability for the firm's financial resources, frauds and misuse of the firm's resources as well as a number of decisions made not yielding the expected results. Furthermore, business transactions are not carried out according to the Generally Accepted Accounting Principles (GAAPs). This leaves the assets of a firm being improperly safeguarded, records being incomplete and information being inaccurate which often results in misleading financial statements that cannot be relied on by the stakeholders of the firm.

Jeremiah Munene (2013) conducted a study and found out that some of the challenges experienced in regard to internal controls include; struggles with liquidity problems, financial reports are not made timely, accountability for financial resources is wanting, frauds and misuse of institutional resources have been unearthed and a number of decisions made have not yielded the expected results.

Moraa Ondieki (2013) conducted a study and stated that internal controls can have features built into them to ensure that fraudulent truncations are flagged or made difficult, if not impossible, to transact. Internal control audits provide assurance that controls are working, but they do not necessarily detect fraud or corruption. The objectives of internal controls audit relate to management's plans, methods, and procedures used to meet the organization„s mission, goals, and objectives.

Ndegwa E. Wanjohi (2013) stated that measurement and evaluation of performance is central to control, and addresses three questions namely; what happened, why it happened and what to do about it. Financial performance provides short term feedback to the control systems as they monitor the implementation of strategic objectives by checking the organization s position, communicating the position, confirming priorities and compelling progress. It can therefore be construed that internal controls are the means while financial performance is the end.

PROCASUR Africa Report (2012) stated that poor control systems in has led to huge investments lost through fraud and misuse of assets that are used to generate revenues while members and institutions have suffered big losses. Inadequate controls have also led to corruption and collusion of management and external auditors leading to organizations failing to achieve their set objectives. Technological changes have also brought with them challenges in control systems and this has necessitated the development of new ways of controlling organizations.

This study shall attempt to investigate the persistent poor financial performance of manufacturing firms in Uganda from the perspective of internal controls which has hit her to been ignored. The effectiveness of internal controls on a firm's financial performance should be a key concern for most firms. Since internal controls help to prevent and detect fraud in an organization, manufacturing firms in uganda should give much importance to internal audit which is generally a feature of large companies. Its a function provided either by employees of the entity or it can be sourced from an external organization in order to assist management in achieving corporate objectives.

The code of corporate governance highlights the need for a firm to maintain a good system of internal controls in order to manage the risks that the firm is prone to. Internal audit can play a key role in assessing and monitoring internal control policies and procedures. The objective of a manufacturing firm to make profit and generate income can be attained through implementation of strong internal controls which contain different components of control such as the control environment, risk assessment, control activities, information and communication and monitoring.

1.3 Purpose of the study

The study is worth the while since it will tend to identify the relationship between internal control and performance of manufacturing firms in uganda taking kakira sugar works as a case study.

1.4 Objective of the Study

The main objective of this study is to establish the relationship between internal control systems and the financial performance of manufacturing firms in Uganda.

1.5 Research questions

The study attempts to answer the following question;

What is the relationship between Internal Controls and the financial performance of a manufacturing firm in Uganda?

1.5 Scope of the study

The topic of the study is internal control and performance of manufacturing firms in Uganda taking kakira sugar works as a case study located in south Busoga region. The year of study is 2016 and the study is scheduled to last for 3 months.

1.4 Value of the Study

This study is of interest to academicians and future researchers who will be undertaking other researches related to this. This is because it increases their knowledge on internal control and provides the necessary information to be incorporated into their work.

The study also helps them come up with better proposals on internal control systems and their effects on financial performance of manufacturing firms. The recommendations of the study are of interest to the management of manufacturing firms because they point out the areas ignored in the internal control systems as well as the ways of improving the quality of the internal control system. Furthermore the study helps to inculcate scientific and inductive thinking and promotes the development of logical habits and thinking by all staff in the organization.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter focuses on the impact of Internal Control Systems (ICS) in achieving financial performance of firms in view of what other scholars have studied

2.1 Review of Theories

Various theories have been formulated on internal audit and financial performance. They include Agency theory; Contingency theory and Theory of the firm. These are discussed below.

2.1.1Agency Theory

Agency theory is concerned with resolving problems that can exist in agency relationships; that is, between principals such as shareholders and agents of the principals for example, company executives. The two problems that agency theory addresses are: the problems that arise when the desires or goals of the principal and agent are in conflict, and the principal is unable to verify what the agent is actually doing and the problems that arise when the principal and agent have different attitudes towards risk. Because of different risk tolerances, the principal and agent may each be inclined to take different actions.

Adams (1994) in his article stated that agency theory can provide for richer and more meaningful research in the internal audit discipline. Agency theory contends that internal auditing, in common with other intervention mechanisms like financial reporting and external audit, helps to maintain cost-efficient contracting between owners and managers. Agency theory may not only help to explain the existence of internal controls and internal audit in firms but can also help explain some of the characteristics of the internal audit department, for example, its size, and the scope of its activities, such as financial versus operational auditing. Agency theory can be employed to test empirically whether cross-sectional variations between internal auditing practices reflect the different contracting relationships emanating from differences in organizational form.

2.1.2 Contingency Theory

Contingency theory is an approach to the study of organizational behavior in which explanations are given as to how contingent factors such as technology, culture and the external environment influence the design and function of organizations. The assumption underlying contingency theory is that no single type of organizational structure is equally applicable to all organizations. Rather, organizational effectiveness is dependent on a fit or match between the type of technology, environmental volatility, the size of the organization, the features of the organizational structure and its information system. Contingency theories were developed from the sociological functionalist theories of organization structure such as the structural approaches to organizational studies by (Woods, 2009).

Contingency theory is used to describe the relationships between the context and structure of internal control effectiveness and organizational performance, especially reliability of financial reporting. Empirical study suggests that internal auditors who are specialized and higher in internal audit ability will achieve internal control effectiveness analysis and that the firm will benefit from the organizational effectiveness via internal control mechanism efficiency (Cadez and Guilding, 2008).

Cadez and Guilding (2008) identified some factors, which impact management control systems; these are: external environment, technology, structure and size, strategy and national culture. It suggests that the demands imposed by technical tasks in the organization encourage the development of strategies to coordinate and control internal activities. The location of information in relation to technology and environment has an important influence on organization structure. In uncertain environments with non-routine technology, information is frequently internal. Where environments are certain, or where technology is routine, information is external. The dimensions of structure and control include authority structure and activities structure, i.e., rules and procedures that determine the discretion of individuals. Authority relates to social power. In the contingency model, decentralized authority is more appropriate where uncertain environments or non-routine technology exist. Centralized authority is more appropriate when environments are certain.

Contingency theory states that "the design and use of control systems is contingent upon the context of the organizational setting in which these controls operate,"(Fisher, 1998). Therefore the idea of contingency theory is that the selection and use of a management control system is contingent on a variety of internal and external factors. It is therefore clear that, factors such as external environment, technology, structure and size, strategy and national culture impact management control systems. The theory suggests that the demands imposed by technical tasks in the organization encourage the development of strategies to coordinate and control internal activities.

Daft (2012) in his book writes: "Contingency means: one thing depends on other things' and "Contingency theory means: it depends." Audit functions are task-oriented and can be loosely structured. The functions also can vary considerably.

depending on the area of a company under audit and the type of business model, so auditors must carefully manage their inspections and take variables into account to get the job done. The contingency theory also can be applied to an audit teams structure. Typically, audit team managers receive audit projects. They then create ad hoc audit teams for the projects, selecting auditors based on expertise and experience in the subject areas, and on auditor availability, all of which add up to contingencies for any given audit project.

2.1.3 The Theory of the Firm

In simplified terms, the theory of the firm aims to answer these questions: Existence, Boundaries, Organization, why are firms structured in such a specific way, for example as to hierarchy or decentralization?, heterogeneity of firm actions and performances, what drives different actions and performances of firms, and lastly, the evidence, what tests are there for the respective theories of the firm (Thomas, 2008). The theory of the firm consists of a number of economic theories that describe, explain and predict the nature of the firm, company, or corporation, including its existence, behavior, structure, and relationship to the market.

This theory affirms that a firm is a "black box" operated so as to meet the relevant marginal conditions with respect to inputs and outputs, thereby maximizing profits, or more accurately, present value. The theory helps to explain why an entrepreneur or manager in a firm which has a mixed financial structure containing both debt and outside equity claims will choose a set of activities for the firm such that the total value of the firm is less than it would be if he were the sole owner and why this result is independent of whether the firm operates in monopolistic or competitive product or factor markets (Kantarelis, 2007).

This study will thus be guided by three theories namely; agency theory, contingency theory and the theory of the firm. Agency theory shows the relationship between the principal and agent and the agent's responsibilities which include financial reporting, budgeting and providing any other additional information to the principal. The contingency theory on the other hand explains that organizations' behavior and functions are dependent on factors such as technology, culture and the external environment that the organizations operate in while the theory of the firm asserts that, a firm is operated so as to meet the relevant marginal conditions with respect to inputs and outputs, thereby maximizing profits, or more accurately, present value.

2.2 Determinants of Financial Performance of Manufacturing Firms

Dixon et al (1990) said that appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives.

Kotey, Reid and Ashelby (2002) contends that performance is measured by either subjective or objective criteria, arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms.

Whittington and Kurt (2001) found out that objective performance measures include indicators such as profit growth, revenue growth, return on capital employed. Financial consultants Stern Stewart and Co. created Market Value Added (MVA), a measure of the excess value a company has provided to its shareholders over the total amount of their investments (John and Morris, 2011). This ranking is based on some traditional aspects of financial performance including: total returns, sales growth, profit growth, net margin, and return on equity.

Dwivedi (2002) however, mentions other financial measures to include value of long-term investment, financial soundness, and use of corporate assets. John and Morris (2011) mentions accounting based performance using three indicators: return on assets (ROA), return on equity (ROE), and return on sales (ROS). Each measure is calculated by dividing net income by total assets, total common equity, and total net sales, respectively.

2.3 Review of Empirical Studies

Mawanda (2008) conducted a research on effects of internal control systems on financial performance in institution of higher learning Uganda. In his study he investigated and sought to establish the relationship between internal control systems and financial performance in an Institution of higher learning in Uganda. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls. The study established a significant relationship between internal control system and financial performance. The investigation recommends competence profiling in the Internal Audit department which should be based on what the University expects the internal audit to do and what appropriate number staff would be required to do this job. The study therefore acknowledged role of internal audit department to establish internal controls which have an effect on the financial performance of organizations.

Case studies on internal controls in Belgium illustrate the importance of the control environment when studying internal auditing practices. Sarens and De Beelde (2006) found that certain control environment characteristics like tone-at-the-top, level of risk and control awareness, extent to which responsibilities related to risk management and internal controls are clearly defined and communicated are significantly related to the role of the internal audit function and fraud detection within an organization.

Using the analytical approach and focusing on control activities and monitoring, Barra (2010) investigated the effect of penalties and other internal controls on employees propensity to be fraudulent. Data was collected from both managerial and non-managerial employees. The results showed that the presence of the control activities, separation of duties, increases the cost of committing fraud. Thus, the benefit from committing fraud has to outweigh the cost in an environment of segregated duties for an employee to commit fraud. Further, it was established that segregation of duties is a "least-cost" fraud deterrent for non-managerial employees, but for managerial employees, maximum penalties are the "least-cost" fraud disincentives. The results suggest the effectiveness of preventive controls control activities such as segregation of duties is dependent on detective controls.

Ewa and Udoayang (2012) carried out a study to establish the impact of internal control design on banks" ability to investigate staff fraud and staff life style and fraud detection in Nigeria. Data were collected from 13 Nigerian banks using a four point likert Scale questionnaire and analyzed using percentages and ratios. The study found that Internal control design influences staff attitude towards fraud such that a strong internal control mechanism is deterrence to staff fraud while a weak one exposes the system to fraud and creates opportunity for staff to commit fraud.

Kakucha (2009) evaluated the level of effectiveness of internal controls of enterprises operating in Nairobi. The study was quantitative and was conducted between September 2007 and June 2009 using a sample of 30 small businesses as listed in the National Social Security Fund (NSSF) Register of Kenya. Primary data was collected from the managers of the small business using interviews and examination of documents pertaining to internal controls. The study established that there are deficiencies in the systems of internal controls, with the degree of deficiencies varying from one enterprise to another. The components of internal control that were missing in most businesses surveyed were: firstly, risk analysis, and secondly lack of proper flow of information.

In addition, the study established that the sample population had limited awareness of what constituted an effective system of internal control. The study also found that there is a negative relationship between the age of an enterprise and the effectiveness of its system of internal control while a negative correlation between the resources held by an enterprise and its internal control system weaknesses exists. The recommended that these was need to enlighten the operators of small business of what constitutes an efficient and effective system of internal control through forums and seminars.

Amudo and Inanga (2009) also carried out a study in Uganda to evaluate the internal control systems that the regional member countries of the African Development Bank Group institute for the management of the Public Sector Projects that the Bank finances. There are 14 projects of the bank s public sector portfolio in Uganda.

data received and analyzed is for eleven projects. Three projects were omitted because they were not fully operational to install effective internal control systems. The study identified the following six essential components of an effective internal control system: control environment, risk assessment, control activities, information and communications, monitoring and information technology. The outcome of the evaluation process was that some control components of effective internal control systems were lacking in those projects. These rendered the control structures ineffective.

Wee Goh (2009) studied 208 firms on audit committees, boards of directors, and remediation of material weaknesses in internal control. He measured the effectiveness of the audit committee by its independence, financial expertise, size, and meeting frequency, and the effectiveness of the board by its independence, size, and meeting frequency, and by the duality of the chief executive officer (CEO) and chair positions (CEO duality). He also examined other factors that can affect firms' timeliness in the remediation of material weaknesses, such as the severity of material weaknesses, firms' profitability, the complexity of firms' operations, and so on. He found out that the proportion of audit committee members with financial expertise is positively associated with firms' timeliness in the remediation of material weaknesses. Second, firms with larger audit committees are more likely to remediate material weaknesses in a timely manner. Third, that a more independent board is less susceptible to the undue influence of management and more likely to exert pressure on management to remediate material weaknesses.

Jones (2008) compared internal control, accountability and corporate governance in medieval and modern Britain. He used a modern referential framework (control environment, risk assessment, information and communication, monitoring and control activities) as a lens to investigate medieval internal controls used in the twelfth century royal exchequer and other medieval institutions. He demonstrated that most of the internal controls found today were present in medieval England. Stewardship and personal accountability were found to be the core elements of medieval internal control. The recent recognition of the need for the enhanced personal accountability of individuals is reminiscent of medieval thinking.

Romar and Moberg (2003) conducted a case study that showed the following could have contributed to WorldCom scandal in 2002: unrealistic growth targets when expectations were low, management philosophy was aggressive; inadequate assessment of internal and external factors, and objectives before setting aggressive targets; poor segregation of duties; access to data entry and manipulation was not properly segregated and there was a lack of stringent monitoring of the internal control system and therefore quality of the controls around the posting of journal entries to the general ledger was not identified as weak.

Olumbe (2012) conducted a study to establish the relationship between internal controls and corporate governance in commercial banks in Kenya. The researcher conducted a survey of all the 45 commercial banks in Kenya. It was concluded that most of the banks had incorporated the various parameters which are used for gauging internal controls and corporate governance. This was indicated by the means which were obtained enquiring on the same and this showed that the respondents agreed that their banks had instituted good corporate governance with a strong system of internal controls and that there is a relationship between internal control and corporate governance.

A study concted by Wainaina (2011), examined the internal control function. He established that, other than the prevention and detection of fraud, internal controls should reflect the strength of the overall accounting environment in an organization as well as the accuracy of its financial and operational records.

2.4 Summary of Literature Review

From the literature reviews done it has been found out that realization of positive financial performance and value for money depends on whether firms have Internal Controls. Non-compliance to the internal controls is one of the major hindrances to the attainment of positive financial performance in manufacturing firms. Whereas a lot has been done on control environment and control activities there is little done about internal audit in relation to value for money; what is greatly studied is value for money audits. Weak, non-compliance, non-existent or absent public financial management functions (Internal Control Systems) are likely to negate any advantages that might be inherent in achieving positive Financial Performance of a firm.

Therefore, there is need to establish the relationship between the internal control systems and financial performance of manufacturing firms in Uganda. It can be concluded from the literature that Control Environment, Control Activities, Risk Assessment, Information and Communication and Monitoring are significant predictors of financial performance.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter describes the research methodology of the study that was used to achieve the objective of the study. Research methodology is the procedural plan that is adopted by the researcher to validly, objectively, economically and accurately answer the research questions. It is a detailed explanation of the procedures and techniques that shall be used while collecting, processing and analyzing data. This section of the study therefore describes the research design, target population and area, sampling frame, sample and sampling technique, data collection instruments, procedures, analysis management and the ethical considerations that the study shall use.

3.1 Research Design

The research design that was adopted for this study is hypothesis testing research design. The study tested the following hypotheses: H_1: Internal Controls and Financial Performance are positively related; H_2: Internal Controls have a significant impact on Financial Performance.

This type of research design that was selected after considering the type of universe and its nature, the objectives of the study, the sampling frame and the design standard of accuracy. The creation of a sound internal control system in a manufacturing firm greatly influences the area of study. Choosing the research area was therefore based on the control procedures that have been put in place.

3.2 Population

A study population is a well-defined or specified set of people, group of things, households, firms, services, elements or events which are being investigated. The population should fit a certain specification, which the researcher is studying. A target population is one that the researcher wants to generalize the result of the study.The population chosen for this study was 65 employees of kakira sugar works to represent all manufacturing firms in Uganda.

3.3 Sample

It is important to select a representative sample through making a sampling frame. From the population frame the required number of subjects, respondents, elements or firms is to be selected in order to make a sample. The study selected a sample of 20 employees from the target population of 65 employees of kakira sugar works. Kothari's (2004) recommends that a sample of 10% to 30% of the target population is a sufficient representation of the population. The sample was drawn using stratified random sampling technique. The data was treated on the basis of applicability to the study, relevance, accuracy and sufficiency.

3.4 Nature of Data

Donald (2006) notes that there are two major sources of data used by researchers; Primary and Secondary data. The study relied on both primary and secondary data. Primary data was collected using structured questionnaires while the secondary data was gathered from financial statements based on availability and accessibility of data.

3.5 Data Analysis

The statistical tool that was used in the study is Multiple Regression (r^2). It was used to find out the impact of internal control on financial performance. Data analysis was done using Statistical Package for Social Sciences (SPSS Version 22.0) program. The study adopted regression analysis. Regression analysis was used to come up with the model expressing the hypothesized relationship between the independent variables (Control environment, Risk Assessment, Control Activities, Information and Communication and Monitoring) and the dependent variable (Financial Performance of Manufacturing Firms in uganda).

Table 3.1 Measurement of Variables

Variables	Description	Measurement
Financial performance	Ability to operate efficiently, profitably, survive, grow and react to environmental opportunities and threats.	Will be measured using Return on Assets (ROA) ROA= Net Income/Assets
Control environment	Presence of integrity and ethical values, commitment to competence, human resource practices and organization structure.	This will be measured by the level of integrity, ethical values, and competence of personnel tasked with crearing, administering, and monitoring the controls
Risk assessment	Entails risk identification, risk evaluation and risk response.	This will be measuredby level of risk carefully to be accepted and maintained determined levels
Control activities	These are the policies, procedures and mechanisms put in place toensure management directives are properly carried out.	Will be measured bythe number of effective policies, procedures and mechanisms put in place to ensure directives of the management are properly carried out
Information and	This involves good identification of and proper capturing of pertinent	Will be measured in terms of how information is identified.

Communication	information. Also entails proper flow of information across and up within all the sections of the organization.	captured, and communicated in the appropriate form and within stipulated time frame
Monitoring	This is the process of assessing the quality of the internal control structure over time.	Will be measured by how frequent the quality and effectiveness of internal controls are assessed and reviewed over time.

Specifically the regression model used in this study was;

$$FP = \beta 0 + \beta 1X1 + \beta 2X2 + \beta 3X3 + \beta 4X4 + \beta 5X5 + \epsilon$$

Where,

FP – Financial Performance of Manufacturing Firms in Kenya

$\beta 0$ - Constant

X1 – Control Environment

X2 – Risk Assessment

X3 – Control Activities

X4 – Information and Communication

X5 –Monitoring

$\beta 1$ - $\beta 5$= Measure of sensitivity of variable X to changes in FP

ϵ = Error term

3.6.1 Tests of Significance

The study conducted an F- test to establish the significance of the independent variables (control environment, risk assessment, control activities, information and communication, monitoring) against the dependent variable (Financial Performance). The significance of variables was observed at 95% confidence level whereby, variables with a 'p' value of 0.05 and below was deemed significant while those with 'p' values above 0.05 shall be deemed insignificant.

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.0 Introduction

This chapter presents analysis and findings of the study as set out in the research objective and research methodology. The study findings are presented on the effect of internal controls on financial performance of manufacturing firms. To achieve the objective of this study the respondents were highly encouraged and persuaded to respond to the statements in the questionnaire objectively to ensure validity and reliability.

4.1 Response Rate

The study sought to collect data from 20 respondents, a total of 20 respondents responded constituting 100% of the respondent's rates. The study was carried out to establish the effect of internal controls on financial performance of manufacturing firms in Uganda.

4.2 Descriptive Statistics

Descriptive statistics are concerned with explaining the sample of data that the researcher is concerned with. They are used to describe the main features of a collection of data quantitatively. Below are the findings:

4.2.1 The Level of Education Attained by the Respondents

The respondents were asked about their level of education in order to determine whether they understood the internal control systems and its effect on financial performance of the firm.

Table 4.1 Education

The Level of Education

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Certificate/Diploma	2	10.0	10.0	10.0
	Graduate	12	60.0	60.0	70.0
	Post Graduate	6	30.0	30.0	100.0
	Total	20	100.0	100.0	

Source: Research Findings

From the findings in table 4.1 above, the results showed that most of the employees were degree holders at 60%, 30% of the respondents had attained post graduate level and only 10% of the respondents had attained certificates. This clearly shows that most of the employees in manufacturing firms were degree holders at the managerial level.

4.2.2 The Duration that the Institution had been in Operation

The respondents were requested to indicate the period in which the manufacturing firms had been in operation in order to establish whether the effect of internal controls on financial performance had any relationship with the duration that the manufacturing firm had been in operation.

Table 4.2 Duration

Duration in Years	Frequency	Percentage
Less than 5years	1	5%
5-10 years	7	35 %
11-15 years	7	35%
16-20 years	4	20%
Over 20	1	5%
Total	20	.100

Source: Research Findings

From the table 4.2, the respondents were requested to indicate the period that the institution had been in operation. From the findings, majority of the respondents pointed out that the organization had been in operation between 5-10 years, 21.1% of the respondents indicated that the organization had been in operation between 11-15 years, 21.1% of the respondents pointed out that the organization had been in operation for a period between 16-20 years. There was a tie at 5.3%, some respondents indicated that the manufacturing firms had been in operation for over 20 years and the other 5.3% of the respondents indicated that the organization had been in operation for a period of less than five years. It was concluded that the most the manufacturing firms had been in operation for a period of more than 10 years.

4.2.4 Functionality of Internal Controls of Manufacturing firms in Uganda

The respondents were requested to determine the extent of functionality of internal controls in the following aspects of financial performance in a five point Likert scale. The range was „very great extent (5), „no extent (1). The scores of „no extent and

„to less extent;l were taken to present a variable which had an effect to a small extent

(S.E) (equivalent to mean score of 0 to 2.5 on the continuous Likert scale ;(0≤ S.E <2.4).The scores of „to a moderate extent; was taken to represent a variable that had an effect to a moderate extent (M.E.) (equivalent to a mean score of 2.5 to 3.4 on the continuous Likert scale: 2.5≤M.E. <3.4). The score of „great extent; and very great extent were taken to represent a variable which had an effect to a large extent (L.E.) (equivalent to a mean score of 3.5 to 5.0 on a continuous Likert scale; 3.5≤ L.E. <5.0). A standard deviation of >1.5 implies a significant difference on the effect of the variable among respondents.

4.2.5 Control Environment

The study sought to determine the extent to which the functionality of the internal controls of the organization affects the financial performance of manufacturing firms in Uganda. Below are the findings in table 4.4:

Table 4.3 Control Environment

Control Environment	N	Mean	S.D
Our organization has an accounting and financial management System	20	4.77	1.211
Management is committed to the operation of the system	20	3.85	1.332
Management closely monitors implementation of Internal control systems in our institution	20	4.108	0.911
Management provides feedback to the junior officers about the operation of the system	20	3.24	1.334
Appropriate measures are taken to correct misfeasance in operation of our Accounting & Finance Management System	20	3.15	1.313
Management acts with a great degree of integrity in execution of their roles	20	3.88	1.312
Ethical values are upheld in all management decisions	20	4.55	.639
Our organization has an objective, independent and active audit Committee	20	2.17	.546
Our Board of governors and its committees are independent of Management	20	3.27	.746

Source: Research Findings

From the above findings, it was clear that most of the manufacturing firms had controls. The findings shows, the organization had an accounting and financial management system (M=4.77, S.D= 1.211), the management was committed to the to the operation of the system (M=3.85, S.D.=1.332), the management provides feedback to the junior officers about the operation of the system (M=3.24, S.D=1.334),the management acts with a greater of integrity in execution of its actions (M-3.88, S.D=1.312).The Board of governors and its committees are independent of Management had (M=3.27, S.D=.746).From, the above findings, it is evident that the organization observes control environment as one of the functionality of internal controls of the organization that greatly impacts on the financial performance of manufacturing firms in uganda.

4.2.6 Risk Assessment

The researcher examined the effects of risk assessment as functionality internal controls of the organization affects the financial performance of manufacturing firms in Uganda. Below are the results of the findings:

Table 4.4 Risk Assessment

Risk Assessment	N	Mean	S.D
Management has defined appropriate objectives for the organization	20	3.78	1.011
Management identifies risks that affect achievement of the objectives	20	3.85	1.442
Management has a criteria for ascertainment of which fraud-related risks to the organization are most critical	20	4.108	0.911
Management has put in place mechanisms for mitigation of critical risks that may result from fraud	20	3.24	1.879

Source: Research Findings

From the above findings, it was observed that most of the manufacturing firms carried out regular risk assessment procedures. From the results, manufacturing firms defined appropriate objectives for the organization, this had (M=3.78, S.D=1.011), the management identifies risks that affect achievement of the objectives (M=3.85, S.D=1.442), the management has a criteria for ascertainment of which fraud-related risks to the organization are most critical had (M=4.108, S.D=0.911), the management has put in place mechanisms for mitigation of critical risks that may result from fraud had (M=3.24, S.D=1.879).It was also established that the management had put in place mechanisms for mitigation of critical risks that may result from fraud. These results are clear indication that most manufacturing firms observed risk assessment procedures as functionality of internal control of the manufacturing firms.

4.2.7 Control Activities

The study examined the effect of control activities on the financial performance of manufacturing firms in Uganda. Below are the results of this study in table 4.5

Table 4.5 Control Activities

Control Activities	N	Mean	S.D
Our organization has clear separation of roles	20	4.51	1.211
Every employee's work check on the others	20	3.85	1.332
Corrective action is taken to address weaknesses	20	4.19	0.911
Staff are trained to implement the accounting and financial management system	20	3.24	1.334
Our organization has a well-developed Chart of Accounts	20	4.10	.556
It is impossible for one staff to have access to all valuable information without the consent of senior staff	20	3.42	.712
Controls are in place to exclude incurring expenditure in excess allocated funds	20	3.14	.619

Departments have budget reviews where actual expenditure is compared with budgeted expenditure and explanations for the variances given	20	3.22	.972
Our security system identifies and safeguard organizational Assets	20	4.20	.845

From the above findings, it was revealed that control activities were carried out regularly by most manufacturing firms. The findings showed that most manufacturing firms had clear separation of roles (M=4.51, S.D=1.211), corrective actions were taken to address weaknesses (M=4.19, S.D=0.911).The results also found that the staff were trained to implement the accounting and financial management system (M=3.24, S.D=1.334), the security system identified and safeguarded organizational assets (M=4.20, S.D =1.334).It was concluded that manufacturing firms carried out control activities as a functionality of internal control of the manufacturing firms in uganda.

4.2.8 Information and Communication

The study sought to establish the effect of information and communication on financial performance of manufacturing firms in uganda. The results of this analysis are as provided below in table 4.6

Table 4.6 Information and Communication

Information and Communication	N	Mean	S.D
Management has identified individuals who are responsible for coordinating the various activities within the entity	20	4.97	1.211
All employees understand the concept and importance of internal controls including the division of responsibility	20	4.101	1.202

Communication helps to evaluate how well guidelines and policies of the organization are working and being implemented	20	4.108	0.911
The reporting system on organizational structures spells out all the responsibilities of each section/unit in the organization	20	3.24	1.334

From the above findings, it was revealed that information and communication was carried out regularly by manufacturing firms. The findings revealed that information communication was conducted by manufacturing firms as a functionality of internal control. The findings to a large extent exhibit that most manufacturing firms identified individuals who are responsible for coordinating the various activities within the entity (M=4.97, S.D=1.211), the employees understand the concept and importance of internal controls including the division of responsibility (M=4.101, S.D=1.202). Communication helps to evaluate how well guidelines and policies of the organization are working and being implemented (4.108, S.D=0.911).The study concluded that most manufacturing firms especially large implemented information and communication in their activities and functions through established police and procedures.

4.3.9 Monitoring

The study sought to establish the effect of monitoring on financial performance in relation to the length of operation of the organization. The results of this analysis are as provided below in table 4.7

Table 4.7 Monitoring

Monitoring	N	Mean	S.D
There are independent process checks and evaluations of controls activities on ongoing basis	20	3.03	1.211
Internal reviews of implementation of internal controls in units are conducted periodically	20	3.21	1.312
Monitoring has helped in assessing the quality of performance of the organization over time	20	4.11	0.811
Management has assigned responsibilities for the timely review of audit reports and resolution of any non-compliance items noted in those audit reports	20	2.05	1.324

From the above findings in table 4.8, it was found that that monitoring was a functionality of internal control of manufacturing firms. This was demonstrated by the results of the study which showed that there was independent process checks and evaluations of controls activities in the operation of the firm (M=3.03, S.D=1.211), internal reviews of implementation of internal controls in units were conducted periodically (M=3.21, S.D=1.312), monitoring has helped in assessing the quality of performance of the organization over time (M=4.11, S.D=0.811). Some of the manufacturing firms did not assign their responsibilities in a timely manner and this negatively affected compliance in audit report, this is explained by (M=2.05, S.D=1.324). This shows that even though monitoring is an important functionality activity of the internal control of the firm in its operation period, not all manufacturing firms implemented this practice. This therefore, negatively impacted on the financial performance of some manufacturing firms.

4.3 Regression Analysis

A study was conducted on the relationship between internal control and financial performance of manufacturing firms in Uganda. The analysis applied the statistical package for social sciences (SPSS) to compute the measurements of the multiple regression for the study. The study evaluated the independent variables and the dependent using questionnaires.The findings are provided below:

4.3.1 Model Summary

The model summary shows the summary of the regression analysis as shown in the regression model. Below are the findings in the table 4.8

Table 4.8: Model Summary

Model	R	R Squared	Adjusted R Squared	Std. Error of the Estimate
1	.957(a)	.916	.757	.250

Source:Research Findings

In order to explain the percentage of variation in the dependent variable financial performance as explained by the independent variables. The researcher used coefficient of determination that was obtained from the model summary in the table 4.1.Coffecient of determination was used to explain whether the model is a good predictor.

From the results of the analysis, the findings show that the independent variables (Control Environment, Risk Assessment, Control Activities, Information and Communication and monitoring) contributed to 75.7% of the variation in financial performance as explained by adjusted R2 of 0.757% which shows that the model is a good prediction.

4.3.2 Analysis of Variance

The study conducted an Analysis of Variance, in order to test the impact of the relationship between internal controls and financial performance of manufacturing firms in Uganda. The findings were as shown below:

Table 4.9: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	2.117	5	0.4234	4.888	.001(a)
	Residual	1.213	14	0.0866		
	Total	5.24	19			

Source:Research Findings

The results of the findings above revealed that the level of significance was .001(a) this implies that the regression model is significant in predicting the relationship between internal control and financial performance. By the help of an F-test table, the tabulated value for F(5%, 5, 14) is 2.96 which was less than 4.888 meaning that the model was statistically significant.

4.3.3 Test for Coefficients

This table shows the level of significance on the variables, it also provides the standardized and unstandardized coefficients are shown below:

Table 4.10 Test for Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	0.989	2.163		5.331	.000
	Control Environment	.483	.395	.612	1.211	.004
	Risk Assessment	.101	.2005	.328	-.815	.001
	Control Activities	.213	.1331	.637	1.609	.003
	Information and Communication	-.338	1.001	-.961	.976	.006
	Monitoring	.892	0.224	.843	.542	.005

a. Dependent Variable: Financial Performance

Source:Research Findings

From the above table 4.10, the researcher sought to establish the extent to which internal control impact on financial performance of manufacturing firms . The following regression equation was obtained:

$ROA= 0.989+.483X_1+.101X_2+.213X_3-338X_4+.892X_5$

From the above regression model holding all the other factors constant, financial performance is measured by the efficiency and effective implementation of internal controls. The results of the multiple regression model shows that there is a positive relationship between internal control and financial performance of manufacturing firms in uganda. This implies that a single unit increase in any of the independent variables results into a corresponding increase in financial performance of manufacturing firms.

The regression analysis was undertaken at 5% significance level. The criteria for comparing whether the predictor variables were significant in the model was through comparing the corresponding probability value obtained and α=0.05. If the probability value was less than α, then the predictor variable was significant but from the above analysis. The results above shows that the variables were significant since their corresponding predictor values were below 5% apart from information and communication which had 6% meaning that an inverse relationship existed between internal control and financial performance of manufacturing firms in Uganda.

4.4 Summary and Interpretation of Findings

According to the respondents' demographics, it was revealed that most of the employees in manufacturing firms were degree holders. In regard to the duration in which the institution had operated, the study found that most the manufacturing firms had been in operation for a period of more than 10 years. The respondents were asked to comment on the length of service that they had served in the organization to find out whether they were in a position to provide accurate and reliable information in relation to internal controls and financial performance in manufacturing firms in uganda. The findings revealed that most of the employees had adequate experience in relation to the internal controls and financial performance of manufacturing firms.

On whether the functionality of the internal controls of the organization affects the financial performance of manufacturing firms in uganda, the findings revealed that most manufacturing firms had a control environment as one of the functionality of internal controls of the organization that greatly impacts on the financial performance of the firms. The researcher also examined the effects of risk assessment as functionality internal controls of the organization affect the financial performance of manufacturing, it was also established that the management had put in place mechanisms for mitigation of critical risks that may result from fraud. These results are clear indication that most manufacturing firms observed risk assessment procedures as functionality of internal control of the manufacturing firms. The study examined the effect of control activities on the financial performance of manufacturing firms in Uganda.

The results also revealed that that the staff were trained to implement the accounting and financial management systems (M=3.24, S.D=1.334), the security system identified and safeguarded organizational assets (M=4.20, S.D =1.334).It was observed that manufacturing firms carried out control activities as a functionality of internal control of the manufacturing firms in uganda.

The effect of information and communication on financial performance of manufacturing firms was found to be a common practice among manufacturing firms; it was implemented in most of their activities and functions through established police and procedures. It was found that manufacturing firms monitored their activities as part of the functionality of internal control systems, however some of the manufacturing firms failed to assign their responsibilities in a timely manner and this negatively affected compliance in audit report, this is explained by (M=2.05, S.D=1.324).This showed that even though monitoring was an important functionality activity of the internal control of the manufacturing firms, all manufacturing firms did not implemented this practice.

The statistical results from the regression analysis show that there is a positive relationship between internal control and financial performance of manufacturing firms in uganda. This is demonstrated by the level of significance attained by each of the independent variables. All the independent variables have a significance of less than 5% apart from monitoring which has a significance of 6%.This is an indication that the variables are statistically significant apart from monitoring that exhibits an inverse relationship with financial performance.

The regression results revealed that there is a positive relationship between internal controls and financial performance of manufacturing firms in Uganda. The coefficient of determination proved that the independent variables contributed to 75.7% of the variation in financial performance as explained by adjusted R2 of 0.757% which shows that the model was a good predictor. Data was analysed using a regression model and the results of the analysis exhibited a positive relationship between internal controls and financial performance.This study therefore seeks to investigate whether internal control affects financial performance laying more focus on the information and communication and risk assessment.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

This section covers the summary of findings, conclusions, policy recommendation, suggestion of further study and limitations.The study was sought to determine the effect of internal controls on financial performance of manufacturing firms in Uganda taking kakira sugar works as a case study.

5.1 Summary of findings

The main objective of this study was to establish the relationship between internal control systems and the financial performance of manufacturing firms in Uganda. Descriptive research design was adopted for this study. The study used a sample of 20 employees from a targeted population of 65 employees representing manufacturing firms in Uganda. To ensure that all levels of employees are represented, the study used stratified random sampling technique.

The study used primary data collected from semi-structured questionnaires. Quantitative data was analyzed using descriptive statistics while qualitative data was analyzed using content analysis. Quantitative data was coded and entered into Statistical Packages for Social Scientists (SPSS Version 20.0). Analysis was, then, based on descriptive statistics. Multiple regression analysis was used to establish the relationship between internal controls and financial performance of manufacturing firms in Uganda.

From the study findings, in regard to their level of education, the study findings revealed that most of the respondents were graduates. On the length of service, most respondents have worked between 6-10 years and many of the respondents had worked between 2-5 years, in terms of the duration that the organization had been in operation, it was established that most manufacturing firms had been in operation for a period of more than 10 years.

The results of the regression model show that there is a positive relationship between internal controls and financial performance of manufacturing firms. Holding all the other factors constant, financial performance is measured by the efficiency and effective implementation of internal controls. The results of the multiple regression model shows that there is a positive relationship between internal control and financial performance of manufacturing firms in Uganda. This implies that a single unit increase in any of the independent variables results into a corresponding increase in financial performance of manufacturing firms.

The study established how the internal controls affect financial performance of commercial manufacturing firms in Uganda to a great extent. The study further established that most large scale manufacturing firms had invested in modern technologies for example information communication technology to reduce cases of fraud through transactions.

5.2 Conclusions

From the findings of the study, it was concluded that manufacturing firms that had invested on effective internal control systems had more improved financial performance as compared to those manufacturing firms that had a weak internal control system. From the findings, it was revealed that those manufacturing firms that observed integrity, ethical values, risk assessment, control activities, monitoring and information communication technology recorded high financial performance. Most large scales manufacturing firms that fully invested in strong internal control systems were able to mitigate fraud.

Based on the study findings, the results indicated that some small scale manufacturing firms faced challenges in effective implementation of internal control systems due lack of sufficient resources to hire competent staff and to invest in modern technologies for example information communication technology. The findings of the study found that control activities had a significant positive relationship with financial performance indicators.

Similarly the other variables for instance control environment, risk assessment and information communication technology was also found to have a positive relationship with financial performance of manufacturing firms in uganda apart from monitoring that revealed a negative relationship with financial performance of manufacturing firms. From the findings of the study internal reviews of internal control units of most manufacturing firms were not conducted periodically, monitoring was not carried out regularly and untimely assigning of audit reports leading to lack of compliance of audit reports.

5.4 Policy Recommendation

The study recommends that both internal and external auditor should be constantly updated and well-grounded on international financial reporting standards (IFRS) and principles in order to enhance their knowledge and skills in application of accounting practices and to keep them updated on the contemporary issues.

Uganda manufacturers association should monitor and supervise manufacturing firms to ensure that the accountants comply with accounting regulations and conducted using wider scope and coverage then, the findings can be compared and conclusions drawn.

The study period was limited to only three months. Further study is recommended with a study period longer than five years so as to determine the effect of Internal controls on financial performance on manufacturing firms. It will be of great need to assess whether the findings of this study will hold for a period of time span or if the findings will vary with the period under study.

Further research should also be conducted using other measures of financial performance other than Return on Assets such as Return on Equity to establish whether there are is any significance difference on the results.

5.6 Suggestions for Further Study

Due to the turbulent nature of the business environment a similar study should be conducted after a period of ten years in order to investigate whether there are any areas of commonalities or unique factors this is because the level of technology is very dynamic and keeps on changing.

It would be interesting to conduct a study on the determinants of internal control systems and their implications on financial performance; this will shed more light on the appropriate model to choose when implementing better internal control systems that enhance financial performance of firms.

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6. Rank the extent to which your organization practices the following control activities

(1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Little extent, 5- No Extent)

Control Activities	1	2	3	4	5
Our organization has clear separation of roles					
Every employee's work check on the others					
Corrective action is taken to address weaknesses					
Staff are trained to implement the accounting and financial management system					
Our organization has a well-developed Chart of Accounts					
It is impossible for one staff to have access to all valuable information without the consent of senior staff					
Controls are in place to exclude incurring expenditure in excess allocated funds					
Departments have budget reviews where actual expenditure is compared with budgeted expenditure and explanations for the variances given					
Our security system identifies and safeguard organizational Assets					

7. Rank the extent to which the following statements relate to your Organization's information and communication system

(1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Little extent, 5- No extent)

Information and Communication	1	2	3	4	5
Management has identified individuals who are responsible for coordinating the various activities within the entity					
All employees understand the concept and importance of internal controls including the division of responsibility					
Communication helps to evaluate how well guidelines and policies of the organization are working and being implemented					
The reporting system on organizational structures spells out all the responsibilities of each section/unit in the organization					

8. Rank the extent to which the following statements relate to your Organization`smonitoring procedures

(1- Very great extent, 2- Great extent, 3- Moderate extent, 4- Little extent, 5- No extent)

Monitoring	1	2	3	4	5
There are independent process checks and evaluations of controls activities on ongoing basis					
Internal reviews of implementation of internal controls in units are conducted periodically					
Monitoring has helped in assessing the quality of performance of the organization over time					
Management has assigned responsibilities for the timely review of audit reports and resolution of any non-compliance items noted in those audit reports					

Thank you for your participation