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**THE EFFECT OF INTERNAL CONTROL SYSTEMS ON BUSINESS PERFORMANCE  
OF SMES IN UGANDA**

**A STUDY OF SELECTED SHOPS OF NEW TAXI PARK**

A dissertation presented to

**FACULTY OF BUSINESS ADMINISTRATION AND MANAGEMENT**

in partial fulfillment of the requirements for the award of the degree

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**AGABA Brenda  
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Supervisor: Bisaso Rita

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## **DEDICATION**

I wish to dedicate this work to my family, relatives and friends for their unconditional love and support and specifically to my friends Pastor Emmanuel Rutayikirize, Mwanje Joseph, Mrs Rita Bisaso and Mrs Judith Tusasiirwe. God bless you all

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## **LIST OF FIGURES AND TABLES**

### **List of Tables**

Table 1.1: Population and sample used in the study

Table 3.1: Category of Respondents

Table 3.3: Reliability test findings

Table 4.1 Spearman Correlation table between control of information flow and performance

Table 4.2 Spearman correlations of security checks and performance

Table 4.3 Spearman correlations to show the relationship of documentation, serialisation and security of transactions and performance

Table 4.4: Spearman correlation showing the relationship between authorisation to information and resource accessibility

Table 4.5: Relationship between the accounting system and performance shown by Spearman correlation

Table 4.6: Table showing the relationship between the detection of errors using recorded transactions and performance.

Table 4.7: Showing the spearman correlation of credit worthy customers in relation to performance.

Table 4.8: Showing the relationship between every day stock taking and performance in SMEs

Table 4.9: A summary table showing the different relationships between the internal controls and Business performance.

Table 4.10 : Regression Coefficients

Table 4.11: Regression model showing the effect of Internal controls on business performance of SMEs

## **List of figures**

Figure 1.1: Conceptual framework

Figure 4.1: Gender of Respondents

Figure 4.2: Number of Years SME had been in Business

Figure 4.3: Role of Respondents in SMEs

Figure 4.4: Types of Business

Figure 4.5: The Extent of Implementation of Internal Controls by SMEs

Figure 4.6: Internal Control Activities Employed By SMEs

Figure 4.7: Challenges SMEs Face

Figure 4.8: Internal Control and Business Performance of SMEs

### **List of Acronyms and Abbreviations**

BDS	Business Development Service
CVI	Content validity index
GDP	Gross Domestic Product
GNP	Gross National Product
NGOs	Non-government Organizations
PEAP	Poverty Eradication Action Plan
PSFU	Private Sector Foundation Uganda
UIA	Uganda Investment Authority
URA	Uganda Revenue Authority
VAT	Value Added Tax
WB	World Bank
COSO	Committee of Sponsoring Organisations of the Tread way Commission
MIUL	Mukwano Industries Uganda Limited

## Table of Contents

Dedication .....	i
Acknowledgements.....	ii
List of figures and tables.....	iii
Abstract.....	v
List of Acronyms and Abbreviations.....	vi
CHAPTER ONE: GENERAL INTRODUCTION.....	1
1.0 Introduction.....	1
1.1 Background of the Study .....	1
1.2 Statement of the Problem .....	3
1.3 Purpose of Study .....	4
1.4 Specific objectives .....	4
1.5 Research questions .....	4
1.6 Scope of the study .....	4
1.6.1 Content scope .....	4
1.6.2 Geographical scope.....	5
1.6.3 Time scope .....	5
1.7 Justification of the study.....	5
1.8 Significance of the study .....	6
1.9 Conceptual framework .....	6
1.10 Definition of Key terms.....	8
CHAPTER TWO: LITERATURE REVIEW .....	10

2.0	Introduction.....	10
2.1	Internal controls in Small businesses .....	11
2.1.1	Preventive controls in Small Businesses .....	14
2.1.2	Detective controls in Small businesses .....	19
2.1.3	Corrective controls in Small Businesses .....	20
2.2	Challenges faced by Business Enterprises .....	21
2.3	Internal controls and performance of SMEs.....	30
CHAPTER THREE: RESEARCH METHODOLOGY .....		37
3.0	Introduction.....	37
3.1	Research design .....	37
3.2	Area of Study .....	38
3.3	Study population .....	38
3.4	Sampling Procedures.....	39
3.5	Data collection methods and instruments.....	40
3.6	Quality Control Methods.....	42
3.7	Data Management and processing .....	44
3.8	Data Analysis.....	44
3.9	Ethical considerations .....	45
3.10	Limitations of the study.....	46
CHAPTER FOUR: PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS .....		48

4.1	Introduction.....	48
4.2	Demographic data of respondents.....	48
	Figure 4. 4: Types of Business .....	51
4.2	Challenges faced by SMEs.....	57
4.3	The Relationship between Internal Controls and Performance of business enterprises.....	60
	CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS .....	69
5.1	Introduction .....	69
5.2	Summary of findings on Effect of Internal Controls on the Performance of Business Enterprises.....	69
5.2.1	Objective 1: Internal control activities employed by SMEs.....	69
5.2.2	Objective 2: Challenges faced by SMEs.....	70
5.2.3	Objective 3: The relationship between internal controls and performance of Business enterprises .....	71
5.3	Conclusions.....	72
5.4	Recommendations for Action.....	73
5.5	Recommendations for Further Research .....	75
	BIBLIOGRAPHY.....	76
	Appendices .....	83
	Appendix I: (Table for determining sample size from a given population) .....	83
	Appendix II: Questionnaire for SME respondents .....	84
	Appendix III: Raw data.....	88
	Appendix IV :( Work plan and research budget) .....	91

Appendix V: (Pictures During Collection Of Data). .....

Appendix VI: (The Letter from the department to carry out research) ..... 95

## ABSTRACT

This study examined effect of internal control systems on business performance of SMEs in Uganda. The study used a sample of 30 wholesale shops in new taxi park as a case study. The study was a descriptive quantitative survey. A total of 105 respondents in the SMEs, participated in the study. Data was obtained using a questionnaire. Primary Data was collected using a questionnaire completed by both the SME business owners and the employees and analyzed using descriptive and inferential quantitative methods.

The findings showed that there is a directional relationship between internal controls and business performance where the extent to which SMEs implement internal controls is the same extent to which business performance is improved.

The findings indicated that most SMEs implement internal controls at a minimal extent. Most of these SMEs only consider a few elements of controls: approval of transactions, verification and reconciliation of business transactions when carrying out business activities. In most cases, these SMEs place emphasis on preventive controls, to prevent fraud and ignore the detective and corrective controls. The findings showed that preventive controls were done by the different SMEs through thorough documentation and authorization practices. Therefore, internal controls employed by SMEs were done to secure important documents for the business. These findings revealed that SMEs place need to place more emphasis on having accurate records for tax purposes and to prevent fraud.

The findings have also shown that most SMEs have a wrong perception about internal controls. Most SMEs look at internal control implementation as for only large corporate organisations and therefore restrict the awareness of the value of internal controls and the skills to implement the internal controls .Majority of the employees even in management of the different SMEs were not well trained on the business skills to use in the different businesses. Constant implementation of internal controls in SMEs through stronger internal auditing can greatly assist in having greater opportunities for growth and a new strategic outlook. However, the challenges of lack of skills, lack of support and awareness of internal controls by proprietors have to be resolved through practical training, support and appropriate policies.

The study recommends that: SME proprietors should be encouraged to implement the given practical training and education on how to use internal controls in running their businesses; organisations that provide business services to SMEs, such as Enterprise Uganda and the Private Sector Foundation should sensitise and emphasise aspects of internal controls in their training and service provision; government and organisations that provide business services to SMEs should put in place favourable policies that will encourage SMEs to use internal controls. Institutions should encourage SMEs that implement internal controls by awarding credit to SMEs; such as commercial banks, insist, on evidence of implementing internal controls before, extend credit to SMEs.

## **CHAPTER ONE: GENERAL INTRODUCTION**

### **1.0 Introduction**

The chapter consists of the background, statement of the problem, objectives of the study, research questions, scope of the study, significance of the study, justification, key terms and the conceptual framework.

### **1.1 Background of the Study**

The study assessed the contribution of internal controls on business performance of SMEs in Uganda. The study specifically examined whether SMEs implement internal controls, challenges they face and how internal controls affect the performance of SMEs. Internal controls are an integral process affected by an entity's management and personnel designed to address risks and to provide reasonable assurance (COSO, 1992). The use of internal controls helps the organization to flexibly achieve the mission and general objectives. Internal Controls are not a day's event or circumstance but a series of actions that filter through an entity's activities continuously. Internal controls guide the organization towards achieving effectiveness, efficiency, reliability of financial reporting, compliance with relevant laws and regulations. Internal controls as a process is made up of five components that is; control environment, risk assessment, control activities, information flow, communication as well as monitoring (COSO, 1992; Amudo & Inange, 2009).

The COSO framework indicates the presence of an internal control as an important aspect in organisational operations and in ensuring business success especially in the Small and Medium Enterprises (SMEs) where the absence of these Internal Controls is more pronounced. The issue of Internal Control Systems in SMEs provides an interesting area for research because of the inherent problems associated with management behaviour and

capabilities, social and economic characteristics. SMEs are regarded as the driving force to economic growth and rapid industrialisation (Trulsson, 1997). This is realised in their increasing contribution towards the creation of wealth and market for locally-produced products, provision of employment as well income generation. Indeed, in more-developed economies such as the USA and Europe, the dynamic arguments for the existence of SMEs have been stressed in terms of their being more innovative and constituting a seedbed for the development of new firms (Schneider, 2003). One argument given for such commendable contribution in the developed economies is the fact that internal controls within the SMEs in such countries are well-articulated and carried out due to more organised economic environments, robust social characteristics and higher managerial ability.

In Uganda, while SMEs have continuously registered a 10% growth per annum for the last five years and created more than 150,000 jobs annually (Gatsby 2012), an estimated number of more than 1,069,848 SMEs operate informally with no or less-technological input, minimal operating capital, restricted access to finance credit and low managerial capacity factors which affect the business performance thus restricting the survival of the businesses even in the first year of operation (Global Entrepreneurship Monitor Report, 2004).

Most of the SMEs in Uganda are concentrated within the urban centres and engaged in agro-processing and small-scale manufacturing enterprises (Hitega, 2007). Data from the (PSFU 2007) indicates that SMEs in Uganda contribute 75% of GDP and employ about 2.5 million people which is more than 80% of Uganda's working population. There is increased impetus in starting new SMEs yet the rate at which such enterprises collapse is also alarming. It is estimated that of all the SMEs started, only a third survive through their first year of operation (Global Entrepreneurship Monitor Report, 2004). SMEs in Uganda are yet to be as

innovative and creative as those of developed countries so as to be sources of new ideas, better management skills and resources for information if they are to be relevant to the economic and people' needs. This can be achieved through concerted efforts and directed strategies towards improvement of Internal Controls of most of those SMEs that lack them.

## **1.2 Statement of the Problem**

Uganda is one of the countries ranked with the highest business failure rates in the world despite being ranked as the second highest in terms of business start-ups in 2001 (Global Entrepreneurship Monitor Report, 2004). SMEs in Uganda face low-productivity, non-profitability, lack of market competitiveness, low survival and managerial performance which affect their business performance (Hitega, 2007; Kigozi, 2009; KPMG, 2009) .The World Bank (2012) contends that some SMEs are unable to determine their cash inflows and outflows because of lack of effective internal controls. Such business enterprises become less competitive because they cannot easily access credit finance restricting the expansion of their businesses.

Lack of effective Internal Control Systems also leads to bad or no reporting procedures which in return has a bearing on how much and to whom dues are paid. The absence and lack of Internal Controls for SMEs sometimes leads to ineffectiveness of businesses in evaluating business performance which endangers the relationship between the government and non compliant businesses thus affecting business performance and the capacity of the business to remain in operation (DiNapoli, 2007).The study attempts to identify the extent to which the issue of internal control systems has affected the performance of some SMEs with a sample population of selected SMEs.

### **1.3 Purpose of Study**

To establish the relationship between Internal Control Systems and business performance of Small and Medium Enterprises (SMEs) in the business Enterprises.

### **1.4 Specific objectives**

- a) To establish internal control activities employed by the business Enterprises
- b) To establish the challenges faced by Business Enterprises
- c) To assess the relationship of internal control on business performance

### **1.5 Research questions**

- a) Which Internal control activities are employed by the Business Enterprises?
- b) What are the challenges faced by Business Enterprises?
- c) What is the relationship between internal controls and SME performance of the Business Enterprises?

### **1.6 Scope of the study**

The scope of the study is divided into geographical, content and time scope.

#### **1.6.1 Content scope**

This study on internal controls and performance of SMEs involved the establishment of internal control systems in SMEs which are employed to manage their internal environments through monitoring and other activities so as to ensure effective internal controls and cohesion of business activities. The study looked at the current situation on internal controls in some SMEs and suggests possible recommendations for adoption in line with current literature on the subject of internal control systems and practices of SMEs in other environments.

### **1.6.2 Geographical scope**

This study on internal controls and performance of SMEs was conducted amongst selected shops within the New Taxi Park. Specifically, the research was undertaken in thirty wholesale shops that are within the vicinity of the New Taxi Park. The reason for having a large sample size is to allow an adequate number of participants since some of these shops have between two to ten people as permanent employees.

### **1.6.3 Time scope**

The study considered a period of five years (2007-2011). This is the period when new start-ups of SMEs have been on high.

## **1.7 Justification of the study**

The fact that Uganda has been ranked among the highest countries with the biggest number of start-ups and also the highest placed with business collapses within their first year of operation is indicative of serious operational handicaps. Moreover, since more than 80% of the businesses in the country are SME-based, it is important that the reasons for such dismal performance be sought within the SMEs themselves. Furthermore, it is imperative to note that little research has been carried out on the importance of internal control systems as the major reasons for SMEs' failure. For example, studies by (Okurut et al 2004) concentrate on economic instability and poor business-related information regimes while (Okello- Obura et al's 2008) concern is lack of technological skills and (Ocici 2006) fronts the issue of informality and poor management skills as SMEs main cause of failure. Additionally, much

of the literature on SMEs failure seems to assign the blame to lack of access to credit finance (Han et al, 2009; Hanley et al, 2006; Ho et al, 2010; Howorth, 2001; Irwin and Scott, 2010)

### **1.8 Significance of the study**

Undertaking this study opened a door to understanding the underlying private sector policy interventions in regard to internal controls systems and their role into sustained performance of SMEs.

Findings from the qualitative and quantitative research as part of this study offered fundamental knowledge platform from which business owners and managers tapped into to re-examine and appreciate the internal control practices in their businesses used to enhance their business performance and survival in the highly-competitive wholesale business environment.

Additionally, the study adds on the existing academic and professional knowledge into the understanding of the role of internal controls systems towards business performance of SMEs in developing countries.

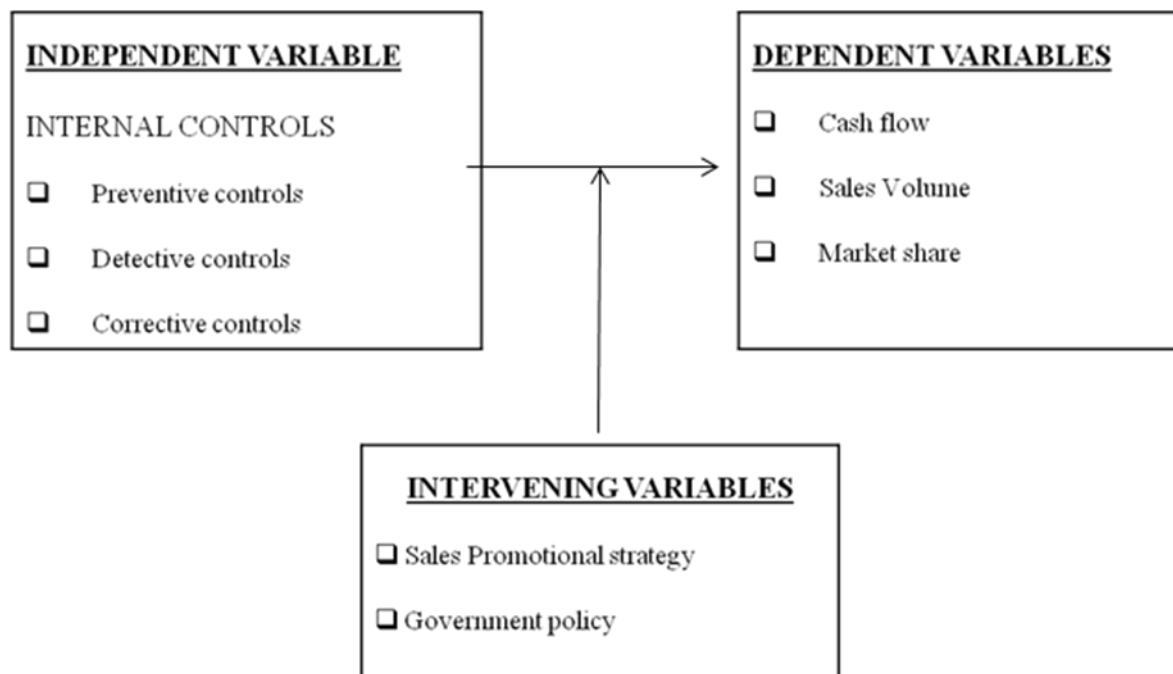
### **1.9 Conceptual framework**

The frame shows that effective Internal controls can serve as engines of growth to businesses through increased competitive advantage which is realized through increased cash flows, sales volumes and market share (COSO, 1992). However, the level at which businesses are able to realize robust and continuous business growth and performance are affected by sales promotional strategy and the government policy factors which are prevailing at the time.

The diagram below gives a graphical conceptual representation of the variables of study and how they relate to each other. The independent variable was internal controls and the

dependent variable was the performance of SMEs and this consisted of; good sales, increase in market share and the cash flow. The moderating variables were government policy and the sales promotional strategy.

Figure 1: The Conceptual Framework



Source: Spafford (2005)

As indicated in the diagram above, Wanjohi and Obuobi (2010) say that in the 21<sup>st</sup> century, for SMEs to succeed they have to place more emphasis on effective business governance which according to this author involves the effectiveness of internal controls. The effectiveness of internal controls is through preventive, detective and corrective controls (Spafford 2005) which greatly contribute to the positivity of business performance. The more effective internal controls are according to the author, the better the business performance of the SME gets in terms of market share, cash flows and sales volume.

Wanjohi and Obuobi (2010) also advise that firms have to ensure that they properly run business through various practices under the different types of internal controls such as approval of transactions, authorization, segregation of duties, verification and reconciliation as well as reviews operating performance and processes (KPMG, 1999).

When SMEs do this, Clarke and dela Rama, (2008) say it will eventually lead to good business performance which will be exhibited in terms of increased sales, increased market share and increased cash flow. However, government legal and business practices and sales promotional strategy may affect the successful interaction between internal control practices and business performance of SMEs.

### **1.10 Definition of Key terms**

Small and Medium Enterprises are used interchangeably with SMEs and business enterprises within the entire report to mean such businesses that are independently-owned and with at least 2-10 employees.

Internal controls are interchangeably used with internal control systems to refer to the different strategies managers and business owners employ to ensure effective flow of information to achieving operational and business competitiveness.

Business performance in this study refers to the output as a result of the different ways in which the employees behave towards achieving the organizational goals.

Population in this study is defined to include all people with the characteristic that one wishes to understand. For this study a thirty shop population was used.

Risk in this research refers to the unexpected events a business undergoes.

Computers in this study involve the use of computer hardware and software for information sorting, processing and dissemination.

Transactions as used in the study refer to the different ways the businesses carry out activities.

Environmental changes in the research was used to refer to the external changes that affect the business enterprises

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.0 Introduction**

This chapter presents a review of related literature based on what other scholars have observed on internal controls and firm performance generally world over based on information obtained from different authorities, journals, text books and electronic sources.

Academic and professional literature on internal controls and business performance is discussed with particular focus on the key concepts of the internal controls, the challenges faced by the business enterprises when using the internal controls and the relationship between the internal controls and the performance of business enterprise.

Internal controls being a process is made up of five components namely; control environment, risk assessment, control activities, information flow, communication and monitoring (International Organization of Supreme Audit Institutions INTOSAI, 2004 & Gelinas et al., 1999). Each component of the internal control influences all aspects of an organization's activities whether administrative or financial and creates a synergistic relationship that is essential in realising improved business performance and creating competitive advantage. The business performance in this section was discussed in relation to internal controls.

#### **Understanding SMEs**

Small and Medium Enterprises (SMEs) are described by their market share being relatively small ; management being by owners or part-owners in a personalized way, and non-

formalised management structure, independent and not forming part of a larger enterprise (Hill, 2001).

The number of employees and turnover are also used to describe SMEs where mid-sized enterprises are categorised as those with less than 250 employees and turnover of between 43 to 50 million pounds while small enterprises are those with less than 50 employees and turnover of 10 million pounds and micro companies have less than 10 employees and turnover of 2 million pounds (European Commission, 2005).

SMEs in Uganda are easily described by the number of employees and the turnover which easily corresponds with the European Commission. An SME is a business that employs between 5 - 100 persons, having a annual turnover not exceeding £95,000 (UBOS, 2010; (Uganda Revenue Authority; Uganda Investment Authority; Uganda's Top 100 Mid-Sized Companies Survey, 2009) and a business with inefficient professionalism in strategic planning, decision making and business planning processes (Kasekende & Opondo , 2003).

## **2.1 Internal controls in Small businesses**

Internal controls in Business Enterprises are management procedures designed to ensure efficiency and effectiveness in operations to improve management decision making, protect resources, ensure maintenance, report reliable information and enforce execution of operations to a manager that is consistent with the established management policy (COSO, 1992). Internal controls being an integral process affected by an entity's management and personnel are designed to address risks and to provide reasonable assurance in pursuit of the business mission (Internal Organisation of Supreme Audit Institutions, 2004).

Internal controls involve different activities which occur throughout the business enterprise at all levels. Some of the activities involved in internal controls include approval of transactions, authorisation, segregation of duties, verification and reconciliation as well as reviews operating performance and processes (KPMG, 1999).

Business Enterprises knowingly and unknowingly when carrying business transactions use three types of internal controls. These types of internal controls used are preventive, corrective and detective internal controls (Spafford, 2005). Preventive controls aim at detecting the instance of errors or fraud, detective controls aim at identifying undesirable occurrences and corrective controls aim at answering the wrongs that slipped through the preventive and detective processes (Draz, 2011).

There are critical elements under the types of internal controls every business implements regardless of the differences in the flow of goods, funds and risks (CPA Austria, 2008). These critical elements are; financial controls, non-current assets, accuracy of sales figures, accounts receivable, cash receipts, purchases, cash ,bank accounts and cash disbursements. Internal controls are able to produce accurate and reliable information through the mentioned critical elements (CPA Austria, 2008).

There are internal control activities carried out by every business enterprise under three types of controls when implementing the critical elements(John Wiley & Sons 1998).The activities include; Proper execution of transactions where authorization and execution is restricted, clearly communicated to managers and employees, Segregation of duties and responsibilities where no single individual in any business can control all key aspects of a transaction or event, Physical control over vulnerable assets counted periodically and compared to control records, Periodic comparison of resources with the recorded accountability made to help

reduce the risk of errors, fraud, misuse, or unauthorized alteration and top level reviews of actual performance.

Internal controls in every business enterprise involve continuous and every day recording of transactions making the accounting system critical for continuity among the transactions of the business (Warren, 1990). The accounting system is needed because it is through the system that all aspects of the business transactions regarding the movement of cash both at hand, in the bank and stock are captured to ensure effectiveness and efficiency during the accountability and decision making processes in the business.

The transactions through the accounting system of the internal controls are recorded either through computers, manually in different ledger books (Weaver *et al* 1988) and some business enterprises go ahead to use both the computers and the ledger books to record transactions in their business (Warren 1990) as a way of ensuring effectiveness and efficiency.

Through computerisation of transactions in the Business Enterprise information is made central and secure to access because the transactions entered into the computer are easily controlled by categorising them into general and applications controls (DiNapoli, 2007). The access to information in the computer needs acceptance in form of a security password. The computer under the general controls concentrates on entity wide security management programme, access controls, application software development, changes, software controls, segregation of duties and service continuity. The computer under the applications controls concentrates on activities to ensure that transactions are valid, properly authorised, processed and reported completely and accurately in the business enterprise.

Internal control systems play an important integrative strategic role as they limit the extent to which business risks can occur and their negative impact (Xianzhi et al, 2011). The business risks are reduced especially in the current age of information technology where fraud is always ahead of contemporary controls. Internal Controls, in addition, have the capacity to ensure efficient integration, allocation and utilization of internal resources in response to the dynamic external environment (Xianzhi et al, 2011). In order to understand Internal Controls and their effect of business performance, it is essential to look at the control environment which is a contextual paradigm that is influenced by both organizational external and internal environment. Microeconomic factors such as economic policies and reforms, traditional culture and governmental supervision, legal and social-historical contexts all have a stake in determining the effectiveness of particular control systems in particular business enterprises (Page& Hooper, 1982).

Internal control activities are therefore the policies and procedures as well as the daily activities that occur within an internal control system. A good Internal Control System should therefore include the control activities that have the ability to preventive, detective and correct the mistakes that have occurred through the preventive and corrective controls (Draz, 2011).

### **2.1.1 Preventive controls in Small Businesses**

Preventive controls in small business enterprises attempt to prevent or deter undesirable acts from occurring (Draz, 2011; Xianzhi, et al, 2011). Effective prevention requires that managers design well-thought out processes and are adapt with risk identification. Preventive controls may be realised in activities such as thorough documentation and authorization practices.

Budget controls are used in small businesses to control the movement of cash (Williamson, 2007). Cash is an important aspect in an organisation that needs control. Cash budgets are used by business enterprises to control the use of cash. Most business transactions involve the movement of cash inwards and outwards. Transactions of this nature include: payment to suppliers, payment to employees. The accuracy of the cash budget is therefore important when dealing with very many aspects of the business.

The managers create separation of duties, ensure proper authorisation procedures, have adequate documentation in place and institute physical security measures over cash and other assets (Draz 2011) which makes effective prevention controls better placed to deter acts such as those that involve fraud.

However, while it is obvious that fraud may be hard to manage even with the strongest of internal controls, strengthening internal control policies, processes and procedures definitely makes companies a less attractive target to both internal and external criminals seeking to exploit internal control weaknesses. Draz (2011) argues that strengthening Internal Controls are not an activity that can be accomplished at ago but in consequential steps. There is need to make a comprehensive review of the risks faced, the existing internal controls already in place and their adequacy in preventing fraud from occurring. This may involve an in depth examination of people, processes and technology.

In addition to the above, Internal Controls may be strengthened through carefully-crafted company policies for example, it is desirable that no single individual should be allowed to initiate the transaction, approve it, record it, reconcile balances, handle assets, and review reports at the same time. There is also segregation of duties which is critical to effective internal control and in the reduction of risk of both erroneous and inappropriate actions.

However, when and where certain functions cannot be separated, due to small department size, a detailed supervisory review of related activities should be carried out as and when appropriate.

Documentation of policies and procedures through a policy statement acts as a preventive control in small businesses (FEE, 2005). When there is a policy statement outlining the consequences of (small) thefts perpetrated by employees, people will be less likely induced to perpetrate fraud: absence of written procedures and systematic control systems can present significant opportunities for fraudulent activities as employees have no explicit rules to follow.

In smaller business enterprises such as the ones under study, preventive controls can be realised in the activities and processes involving the handling of stores and security concerns such as keys for the doors, cheques, passwords for the information technologies and cash storage. Procedures concerning the possession of keys to the business premises should be well-laid out so that in the absence of the rightful person (who is usually the business owner), there is a well-know person that would then take responsibility for these premises. The times when the business premises are opened and closed should be communicated and understood by all the employees concerned.

During sales, an authorised employee is given a duty to write for customers receipts. These receipts are written both for the credit and cash sales by the authorised cashier (Warren, 1990). The cashier then reviews the receipt book and after all reviews, transfers the credit sales to the debtors' ledger book. The business enterprises budget using the recorded transactions about the cash flow budget for the available cash. Budgeting for the available cash helps the business owners plan on what and how much to purchase. Payments to

suppliers in the business enterprises are made by cheque for ease when managing the flow of cash in the business.

When using internal controls in business enterprises, the businesses follow a pricelist given to them by different companies when selling the different products (Collier, 2006). This private pricelist shows the business owner the price at which the different products have been purchased and the different prices at which these different products are sold in the market. The difference between the price at which the product is purchased and the price at which the product is sold is important to the businesses because it is the revenue to the business. The main objective of a business is to maximise revenue in the competitive market. The revenue is therefore the difference between the selling price and the purchase price when the different transaction costs are deducted in the business enterprise (Williamson, 1996).

The best way of fully gaining and maximising the revenue is through satisfying customer needs and offering a better and affordable price of the product in the market.

The arrangement of the products in the warehouse is also a preventive control in small businesses (Warren, 1990). Different products are purchased from different companies with different instructions of how to store them. Some products are very venerable and need to be stored under different conditions. Companies clearly indicate the instructions on how to store the different products in the warehouses. The caution by most companies acts as a preventive measure to avoid the level at which businesses damage the products (Management MIUL, 2007). Companies even state the level at which the products should be stored for example MIUL writes the instructions on the boxes for the customer not to stack the boxes beyond a specified level. Memorandums of understanding are also signed by the customers to these different companies on how the different products purchased are going to be stored in the different small businesses (Management MIUL, 2007). There are situations when the

company specifies the mode and capacity of storage for example when the company even requires a storage of 60 square feet within the area of operation.

There are also different products purchased by the different business enterprises which specify the serial numbers and expiry dates to businesses as a preventive measure to both the businesses and the companies (Kotler & Keller, 2004). These expiry dates specified help the business enterprise to maintain good relationships with their customers because it is through specification of an expiry date that the customer would know for how long to use the product sold to him or her. The serial numbers indicated on the different products are security measures to the business as well as the companies. In situations like fraud, misappropriation of products, these products are easily traced and identified.

Physical stock taking in a business enterprise is equally important under the preventive controls (Weaver et al, 1988). Stock taking is an internal control activity where an authorised employee in the business counts the daily inventory in the business and compares the results with the available stock in the business enterprise. The employee counts and records the opening stock of the business, adds the purchases to the opening stock subtracts the sales and then the figure the authorised employee gets is recorded as the closing stock (Weaver et al, 1988). An authorised employee counts the available stock physically and compares the results with the records to confirm the accuracy of the records. This process prevents the business from keeping inaccurate records of inventory in the business.

Preventive inventory practise is a good preventive control measure used in small businesses (Williamson, 1996). The preventive inventory records very inventory in a different ledger book. Each inventory in the ledger book usually has its own ledger card and when any transaction affecting an item takes place, the store ledger card is updated in accordance to the changes that have take place which affect that particular inventory. This makes it easier for

the business to know any transaction regarding the inventory. The recorded information can be used as a check on the physical balance in the stores and on the bin card.

Banks act as security used in small businesses to restrict the rate at which fraudulent practises occur in the business enterprises. Banks are an important aspect in every business when carrying out daily transactions (Sayers, 1970). Business enterprises have daily cash movements both outwards and inwards. When purchasing, companies require that the transaction be placed through the bank. The document given by the bank as a verification of payment acts as a preventive measure because the receipt from the bank acts as reference of payment by the business enterprise to the company. When these businesses sell products, the most secure way of keeping the money is through the bank. The bank therefore acts as a cash settlement and cash payment internal control for business enterprises.

### **2.1.2 Detective controls in Small businesses**

Detective control activities identify undesirable "occurrences" after the fact. The most obvious detective control activity is reconciliation. An authorised employee goes through the receipt books to verify the correctness of the prices and the quantity of products sold in the business. The quantity of the sales is then subtracted from the opening stock of the day added to the purchases to get the true value of the stock in the warehouse (European Commission, 2008). The store manager supervises the store so that the products are organised in the right shape and position a practise which enables the business enterprise minimise on accidents such as damaged stock in the business. When goods are being carried to the store, there is an authorised employee in charge of counting and confirming the quantity of stock purchased. After confirming the products, the employee signs delivery forms agreeing to the terms and conditions and then records the transaction (Warren, 1990).

They do not only attempt detect undesirable acts that have occurred but also provide evidence after-the-fact that a loss or error has taken place. However, detective control systems and activities do not stop errors or losses from occurring. Whereas, the most obvious detective control activity is reconciliation, other activities can help in realising detective controls. Performance review activities for instance can help management to compare information about current performance to budgets, forecasts, prior periods, or other benchmarks so as to measure the extent to which goals and objectives are being achieved.

This activity is additionally helpful in identifying unexpected results or unusual conditions that require follow-up. In addition, detective controls can be realised through reconciliations where an employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary. Detective controls can also be achieved through; physical inventories, regular supervisory reviews, routine spot-checks, variance analyses, control self-assessments and internal audit.

### **2.1.3 Corrective controls in Small Businesses**

During the continuous process of recording and checking of various business transactions, many mistakes take place which require corrective actions (Draz, 2011). Corrective controls exist to mitigate or lessen the effects of the threat being manifested (Northcutt, 2009). Similarly, corrective controls are crucial in assisting individuals in the investigation and correction of causes of exposures that have been detected corrective controls may include; error detection and resubmission, audit trails, discrepancy reports, error statistics, backup and recovery of data especially when the information in question is electronically stored.

Most researchers and owners of businesses acknowledge the fact that managing businesses takes significant time, effort and planning (Gate wood *et al* 1995) failure of which may lead to poor performance which contributes to closure. To avoid this, business owners must be able to collect and analyze information from the environment which affects their performance and be able to take corrective action for better performance .In other words ability to perform well and survive, business owners need to stop relying on guess work and implement effective internal control systems in their businesses.

The business enterprise is able to compare the planned financial results to the actual results and take corrective action through budget controls (Collier, 2006).The budget when continually updated (McLaney & Atrill 2005) provides a yardstick for comparison and isolation of problems which provide a warning to managers (Buckley & McKenne, 1972).The budgeting process influences management behaviour through evaluation of results and feedback in anticipation of corrective action where necessary. The budget report at all levels therefore shows the actual income, expenditure and variance.

## **2.2 Challenges faced by Business Enterprises**

The main reason for the existence of SMEs is to make profits and to maximise pecuniary wealth (Luire & Thomas 2002) where in these business enterprises pecuniary wealth is easily maximised through maximising revenues and minimising operational costs. The business revenues are increased through maximising the sales of goods and providing better services to the customers. Better services create customer satisfaction which increases the customer turn up contributing to the business growth (Lurie & Thomas, 2002).Continuous growth is a challenge to business Enterprises due to the obstacles mentioned below which stand in the way of the business enterprises' ability to maximise revenues and minimise operational costs even with the presence of internal controls in the businesses (Rabkin & Bradford, 2002).

### 2.2.1 Challenge of Innovation

Though innovation is a primary means by which companies can achieve sustainable growth (Hall & Vrendenburg 2003), the continuous and fast speed rate of innovation by companies in the market restricts the ability of business enterprises to continually grow. The ability of companies to rapidly create new ideas (Christenson 1997) affects the existing businesses because these businesses in fear of rapid change purchase less than what they frequently purchase and even before these businesses are able to complete selling out all the purchased stock, a new idea has already been created affecting the stock they have in the business enterprise warehouses. The speedy rate innovation hinders the efficiency and effectiveness of the business. This therefore makes growth of companies a threat to the business enterprises (Miller 2001) despite the continuous use of internal controls.

### 2.2.2 Challenge Adaptability, Innovation, Organization and Processes by business enterprise

Failure of business enterprises to easily and quickly adapt to the changes in the environment affect the business enterprise ability to maximise revenues and minimise operational costs (Rabkin & Bradford, 2002). The inability of the business framework to translate the business aims and objectives into a series of key performance measures and targets (McLaney & Atrill, 2005) to achieve by the business enterprise. The inability of an internal control system to strike a balance between external measures relating to internal business process, learning and growth causes a challenge to business enterprises.

Most businesses still continue to carryout transactions the same traditional way yet the environment has changed. New products, services and distribution channels have been introduced which have affected the current businesses status yet these businesses insist on carrying out transactions the traditional way of not easily adopting to situations. Failure by the businesses to adapt to the current ongoing changes is hindering the continuous growth of

the business enterprises. Most business enterprises face a problem of looking for the information kept in different books for example tracing for information in the business eventually takes a long time which affects the business enterprise on operations.

### 2.2.3 Challenge in Pricing

Most businesses have no control over the transfer of value from one party of a transaction to the other party in the same transaction (Williamson, 1996). This is so because prices are set as a collaboration of many people in an organisation. Some of the people in the organisation responsible for pricing are the economists who look at the pricing mechanism according to the competitiveness in the market, marketers who look at pricing in respect to the marketing mix and the accountants who discuss pricing in terms of the accounting bases. The difference in the interests of the different personal is beyond a small business ability to control. The decision made by different companies in relation to the pricing mechanism affects the internal controls in a business enterprise.

Prices are a challenge to some businesses because during the sale of products to customers some businesses decide to reduce the prices at which they offer the products to customers. There are situations when the reduction in prices of the different products goes even below the factory price which obstructs other business' ability to maximise revenue (Schoell, 1985). This restricts the ability of the business to attain profits since the selling price is below the fixed price (Collier 2006) even when the internal controls are well implemented.

Different businesses also adopt market skimmers and market penetration strategies (Collier 2006) which restrict the effectiveness of internal control systems when using these strategies, prices vary between each market segment which strategy becomes a challenge to businesses that have already purchased products in the businesses. Market skims become a challenge

because the when new products are offered to a market at a high price and become saturated, the sellers eventually reduce prices for customers reducing the prices restricting the current prices of the customers found in the market. As some businesses are unable to maximise profits, some other businesses are able to fully maximise their profits. Some businesses use price penetration where the sellers offer the products at lower price above the fixed cost to hinder the ability of other businesses from staying in that same market.

Some business enterprises even go ahead to offer bribes to purchasing agents to make decisions in their favour in relation to products which affects other businesses since some businesses maximise revenues and others become ineffective and inefficient in the market (Schoell, 1985). This act is in controversial to (Schoell 1985) where there is need for information transparency when suppliers and companies are offering products to the different businesses in order for all business enterprises to be treated equally. The difference in pricing of the products by different companies therefore affects the business enterprises even with the presence of internal controls.

#### 2.2.4 Marketing challenge

The ability of business enterprises to share business information, maintain business relationships and conduct business transactions by means of telecommunication networks (Ferrell *et al* 2006) is also a challenge to business enterprises even when using the different internal control systems. Suppliers use the telecommunication networks to strategically create, distribute, promote and price different products for different customers in the virtual environment. The consumers easily communicate with the suppliers about the different products which lowers the cost of communication. To the business enterprises, the ability of the consumer to get directly in touch with the supplier restricts the presence of the wholesaler in the business chain. The use of telecommunication networks creates ease in addressability

of the suppliers which reduces the number of customers in business enterprises (Ferrell et al, 2006).The supplier in this case is able to increase the company sales at the expense of business enterprises.

#### 2.2.5 Inflation and Finance challenge

The continuous increase in the prices (Bryan 1997) of the products is a challenge to Business Enterprises because when prices increase businesses are unable to purchase in large quantities. This situation affects the business' ability to meet customers' needs. Most business enterprises resort to banks for loans. The banks offer the loans but with a interest on the loan required by the bank. The interest required by the bank restricts the level of the businesses to minimise operational costs in the business because the loan reduces the business' ability to maximally save the revenues attained.

Some businesses operate informally to the extent that they don't find the banks important when carrying out transactions forgetting that at the end of the day, the business will still need a bank (Sayers, 1970).The banks is important when implementing internal controls. The cash settlement systems which increase cash inflows and reduce cash outflows become easier with the presence of a bank as a control to the business.

The security and requirements needed by different banks restricts the ability of business enterprises to access enough finances to carry out all business transactions (Uganda Budget 2011—2012).The bank requirements at times are hindrance even when these business enterprises use internal controls. Through banks, funds are offered to support the growth of viable and sustainable SMEs in the private sector. The requirements needed by the banks obstruct the ability of small businesses to access enough finances to carry out transactions. Some of these requirements include: expectation of the business enterprise to comply with

the local business licensing requirements making the venture only applicable to particular group of business enterprises. The requirement to the business enterprise where at least four people are employed by the business enterprise by the end of the loan period, two grantees with good reputation to the local community, proof of age, nationality, CRB card and other relevant requirements in the laws of Uganda. The very many restrictions limit the people's ability to get loans from the financial institutions because in the absence of any requirement, the bank does not offer the loan to the client. The different banks' interest therefore create a challenge for business enterprises when accessing finances.

#### 2.2.6 Challenge in re-engineering in appropriate business processes

The way of carrying out transactions in a business affects the customers who contribute to the efficiency and effectiveness of the business in continuation of growth (Wallenburg, 2001). When the process isn't clear, it affects the performance of the business enterprise restricting their continued growth and business innovation (Grant, 2002; Daft, 2009).

The process by which in the business enterprise information flows from the top person to the lower person is also a challenge in the business enterprise (Jiang & Li 2010) since ambiguous information causes impact on the way services are delivered to the customers (Fogli, 2006).

#### 2.2.7 Challenge of Resource development and Management

Most business owners ignore the usefulness of business resources in their businesses which restrict the effectiveness and efficiency of their utilisation to develop and grow the enterprise (Collier, 2007; Broadbent & Collen, 2003). Business resource which may include; company assets, capabilities, organisational processes, firm attributes, information and knowledge normally affect the ability of the business to maximise revenues and minimise the operational costs (Barney, 1991; Grant, 1991). Inadequate resources in the business enterprises hinder the ability of the business to continuously grow in the long run (Hakansson & Waluszewski, 2007).

Business enterprises ability to utilise capacity is a crucial performance driver for businesses (Collier, 2006).When businesses use the traditional accounting system they are unable to fully utilise the available resources and are therefore left with an option of either reducing the supply of resources that perform the business activity or increasing the activities of the available resources which brings an expense to the business restricting the level at which the business reduces the expenses when identifying and eliminating the unused capacity.

#### 2.2.8 Laws and Regulations

Some Companies restrict some business enterprises to dealing in only their products which becomes a challenge for the business because this restriction hinders the ability of the business to maximise revenue since the business will not be able to satisfy the customers need (Johnson *et al*, 2008).Though dealing with the company products is profitable, the business enterprise is unable to fully satisfy the market demands.

There are situations when the company prices of the products being offered to the business enterprises is high and although the quality is good, price change restricts the ability of the business enterprise to maximise sales because customers will prefer to buy cheaper products despite the quality difference in the products (Craves, 1998; Elliot & Acharya, 2003; Kotler & Keller, 2009.)

Business enterprises face a challenge when carrying out transactions due to ignorance of the laws (KPMG, 2009). The fact that most business enterprises carryout very many different transactions with different companies, there is need for the business owners and managers to know the laws protecting the way in which the different transactions are being carried out.

Different companies in which business enterprises have different transactions and knowledge of these laws helps the business enterprises to effectively carryout transactions.

Since most of these business enterprises operate informally, employees become a challenge due to the absence of rules and regulations given to the employees in an employment letter (Collier, 2006).An employment letter helps to clearly inform the employees of the rights and their duties in the business enterprises due to the absence of these employment letters, there is conflict of interest amongst the different employees.

#### 2.2.9 Government Policy

Business Enterprises especially those dealing in locally produced products and imported products are faced with a challenge of taxes where they are overtaxed (Edmiston & Del Granado, 2006).The government also implements stringent conditions which affect the maximisation of the business revenues (Kjaer, 2004). There are situations when the government through respective bodies inspects the different ways in which different businesses carryout business activities.

Government policy on businesses dealing in locally produced good (budget speech 2012-2013) where the President of Uganda emphasized the importance of business enterprises selling locally produced goods as being less productive to the country and according to him, they should be taxed higher than the businesses which export products to other countries.

The taxes imposed by the government on the products sold business enterprises (Kiwawulo, 2012).when the taxation body noted the importance of rice, the taxes where made favourable to 75%.this decision made by the government favoured some businesses because they have a variety of different brands of imported and good quality rice, but this practise affects the

ability of locally produced rice dealers to maximise the profits in their businesses because a kilogram of imported rice was cheaper than locally produced rice by 300 Ugandan shillings (Kiwawulo,2012).

#### 2.2.10 Business Risk

Business failure to manage and control risks appropriately is a challenge in maximising revenue and minimising costs of the businesses (Chow 2005) because business enterprises face a variety of risks from external and internal sources that must be assessed. Some of the risks especially the external risks are a result of economic, industry, regulatory and operating conditions which continue to change. Mechanisms are needed to identify and deal with the special risks associated with change which cause poor performance of the business management (Jiang & Li, 2010).

Unethical and dishonest behaviour among employees is a challenge to business enterprises since it is from such behaviours that the risk of fraud increases (FEE, 2005). Fraud in the business enterprise comes as a result of unethical culture lack of procedures, lack of proper tone at the top and dissatisfaction among employees (Crane & Matten, 2007; Carroll & Buchholtz, 2003).

#### 2.2.11 Challenge of monitoring in Business enterprise

Despite the business enterprises' recording of transactions in their business, the ability some business enterprises to monitor during the course of normal operations is minimal hindering the ability of the business to maximise revenue(Montalvo,2003).Most business enterprises take a long time to review books in which financial transactions are recorded. Indeed, by the time such exercise takes place, chances of serious errors and omissions are high. As a result of these errors business enterprises with such problems get restricted in their maximisation of revenues (Grant, 2008). No challenge is bigger than the other in a business enterprise because each of them affects the business enterprise ability to continuously grow.

### **2.3 Internal controls and performance of SMEs**

The ability of a business enterprise through the management to implement correctly the business mission and to comply with the applicable laws and regulations is a contribution of the internal control system (Draz 2011) though no system is perfect; the ability of an internal system to detect failures which are consequential to the organisation makes the internal control system effective.

Performance of any business enterprise is valuable depending on the time in which the internal controls are able to predict errors and correct them immediately. This brings out an aspect of time as an important aspect in relating the internal controls to the performance of business enterprises. Performance is measured wholly under the ability of the organisations to control, quickly detect the number of mistakes made by the different employees, ability through the controls to follow up the different creditors and the external pressures faced by the business enterprise (Grant, 1999; 2002).

Cost effectiveness, flexibility when meeting future needs, effective reporting, and organisational structure are benefits businesses attain which boost their performance due to the use of internal controls (Warren, 1990). Many business enterprises carry out many transactions at a time and making sure that all these transactions are on track is easily and flexibly done using internal controls in business enterprises. The output of the transactions is then used in the decision making processes of the businesses.

Rules and regulations are easily followed through the implementation of internal controls which contributes to the business performance. During the implementation of rules and regulations, each employee's role in the business is specified which restricts issues like

conflict of interest in the business enterprise. The employees even when get conflicts will stick to working in order to achieve the organisational goals.

Financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations bring about business success (Anderson 2008) when businesses use internal controls. At the specific transaction level, internal controls work to ensure the organization's payments to third parties are for valid services rendered. Internal control procedures reduce process variation, leading to more predictable outcomes. Business Enterprises with internal controls are able to take advantage of available discounts, holding gains and currency fluctuations which boost the business performance. Since a manager is able to predict the business status in relation to the demand of the different products and in case there are any discrepancies, they are easily identified and rectified.

Through a sound internal control system, the business is able to safeguard the shareholders investments and the company assets (Collier, 2006).An internal control is a whole system of internal controls which helps to conduct a review of effectiveness for example through internal financial controls, the business enterprises are able to safeguard the assets like the cash at hand, cash at bank and stock from un authorized use and disposition. The maintenance of proper accounting records and the reliability of financial information is used within the business to evaluate the performance.

Financial information attained by the internal control is used by managers for decision making (Collier, 2006).Financial statements are helpful particularly for externally interested parties like bankers, financiers, government in decision making in relation to business performance. Managers are supposed to serve the interests of anyone who affects and is

affected by the business. When working in the interests of all parties, it is the responsibility of the managers to strike an appropriate balance in the different interests of the different stakeholders.

Hedging by businesses enterprises with internal controls becomes easier which boosts the performance. This is so because the businesses are able to monitor the level of inventory in the warehouse. This therefore helps the businesses take better and more reliable information. Predictability of the business future performance status could easily be through internal controls. Formal information based routine procedures used by managers to alter patterns in organisational activities could easily be implemented through internal control systems

Self assessment in business enterprises is done easily through internal controls which boosts the performance of the businesses (Baines and Langfield-Smith, 2003; Chenhall & Langfield-Smith 1998; Govindarajan & Fisher, 1990) because incorporation of a range of financial and non financial success factors are done. These factors include cash flow, sales volume, and market development.

Adequately chain of command is reflected through the human resource policies and procedures which are documented and updated using internal controls in business enterprises (Amudo & Inanga, 2009). Similarly, responsibilities are delegated and follow up action is made to get feedback on results of performance of tasks delegated.

Despite all this, a number of business enterprises that do not take the issue of internal controls seriously. Most SMEs tend not set the appropriate internal audit bodies, and the management takes no count of the internal supervision mechanism (Jiang and Li, 2010). Even if an internal audit agency is set up, as there is lack of independence, a large number of

enterprise employees accept bribes, annexation property by supervise vulnerabilities within the enterprise, and the phenomenon of unauthorized diversion of fund is serious, so that internal supervision become a mere formality.

Incompleteness of internal controls supervision restricts the role of the internal controls in supervision and inspection, so that enterprise management cannot evaluate the accounting information and the performance of different departments properly. Weak SMEs employ less than 5 people, mostly family members, are not legally registered, apply simple and relatively backward technology in production and, therefore, and the quality of their products are likely to be poor.

The business enterprises suffer from limited market access and fierce competition from many rival producers even when using internal controls. This category of SMEs usually does not have proper physical structures such as premises from which to operate business, and accessible roads and utilities, which are major impediments to accessing formal sector credit which restricts the rate at which businesses perform.

In addition, there is a general lack of professionalism within this category of SMEs who use the internal controls. The lack of professionalism is in terms of strategic planning procedures, decision-making processes and business planning, and management in general (Kasekende & Opondo, 2003) because most of the employees have a low education level. There is need for the business enterprises to use some professional employees to reduce on the training costs and the adaptability of the employee to the activities in the business. Transactions input in the computer need a computer literate to correctly and speedily input the business information.

The opportunities for employees in SMEs to perpetrate fraud and theft by misappropriation of assets can be greater than in larger organisations (FEE 2005), mainly owing to the lack of

a sophisticated internal control system. There is also a tendency in SMEs towards a higher level of trust between people and it is often the case that the owners or managers do not consider the possibility of being defrauded.

Employees are more likely to abuse their position where they have unsupervised responsibilities and work in isolation or when the proper ethical culture or tone at the top is missing. Misappropriation of assets can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorisation.

Management fraud through internal controls causes an impact in business performance. One or more members of management in charge of governance, monitoring and supervision (FEE 2005) commit fraud, the performance of the business becomes minimal. Managers are induced to commit fraud in order to maximize compensation based on performance or to meet market expectations. In smaller entities where the owners are also the managers, they may be motivated to reduce earnings by a material amount to minimise tax or to inflate earnings to secure bank financing.

The most common kind of fraud perpetrated by management or owners is fraudulent financial reporting such as intentional misstatements which include omissions of amounts or disclosures in financial statements or other statements to deceive financial statement users (sometimes called 'window dressing'). They may be accomplished by the following practices which impact on the true financial position of the firm:

Manipulation, falsification, or alteration of accounting records or supporting documentation based on which the financial statements are prepared; Misrepresentation in, or intentional omission from, the financial statements or events, transactions, or other significant financial information; Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure; Social security undeclared or hiring of employees on the black market.

Fraud can damage trust between the business and its most important stakeholders, which impacts on the internal control system and perceived reputation (FEE, 2005). For those SMEs which are dependent on a sole customer or supplier, damage to reputation could lead to loss of a major source of revenue, especially in the case of SMEs operating in a severe competitive environment.

Some types of fraud, or a high incidence of fraud in an organisation, can have a demoralising effect on other employees and create an atmosphere of distrust. This would inevitably impact on their performance and customer service.

In a study on internal control environments in AfDB projects it was observed that when using the internal controls and organizational structure is not adequate, this organisational structure does not reflect chain of command despite human resource policies and procedures being documented and updated (Amudo & Inanga, 2009). Similarly, responsibilities when delegated and not followed up action is made to get feedback on results of performance of tasks delegated which affects the achievement of the project objectives.

The study further found that internal control activities did not adequately reflect management risk mitigation strategies. Key control activities of the projects which were not functioning as intended: included Transactions not being properly authorized no segregation of duties,

verifications of transactions before making payments were not done while key accounts records like bank, cashbooks, loans, accounts payables were not reconciled on a regular basis yet no control over access to resources which negatively influenced project performance.

The above literature suggests internal controls to include internal control environment, internal risk management, internal control activities and procedures, internal control information and internal control monitoring. Each of these internal control aspects are critical for the success of the business which success in terms of financial and none financial performance indicators achievement.

The literature however did not the highlight the internal controls among SMES in a major business capital of a developing country and it affects the performance of whole sale SMEs.

This study will therefore strive to cover this literature gap by examining the influence internal controls on the performance of whole sale SMEs in the wholesale wing of the New Taxi Park business areas of Kampala Capital City

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.0 Introduction**

This chapter presents the research design, study population, sample size and sampling procedure, data collection methods, research instruments, reliability and validity of the research instrument, data analysis, limitations of the study and ethical considerations

### **3.1 Research design**

The study used a cross-sectional correlation research design under the quantitative and qualitative approaches to obtain data on the internal controls and performance of SMEs. The Cross-sectional correlation research design was considered appropriate for this study for easy in quantification of the study findings, clear establishment of all the variables and the relationship between the study variables at a particular point in time with control in the effect of change conditions (Odiya, 2009)

The correlation research design was used to show the quantitative relationship internal controls have on performance of business enterprises (Katebire, 2007).the correlation coefficient as used in the study ranged between -1.0 and +1.0 which helped to show the intensity of the correlation and the direction of the relationship because the extremes of -1 and +1 are rare. A correlation of 0.40 in this study was considered significant as the correlation of 0.70 was considered almost always significant (Katebire, 2007). The positivity of the figure was used to imply the movement of both the independent and dependent variable in the same direction and the negativity of the figure was used to imply the movement of the independent variable in a negative direction from the dependent variable.

### **3.2 Area of Study**

The study was carried out in the wholesale wing of the New Taxi Park business area of Kampala Capital City. The wholesale wing of the New Taxi Park comprises of a chain of wholesale SMEs that engage in the trading of all kinds of commodities to customers within the country as well as those from the neighbouring countries of Rwanda, Burundi and South Sudan. The choice of this area for the study was prompted by their proximity to each other and the fact that most of the businesses suffer from the problem in effectiveness of controls. The fact that most of these enterprises realised colossal sums of revenues on a daily basis creates a fertile ground to identify and analyse what internal controls they employ in their daily business operations.

### **3.3 Study population**

Since it was difficult to reach everyone even within the target population (Katebire, 2007), the study was being carried out on a population of 30 wholesale businesses within the New Taxi Park of Kampala City. This population was considered because of the large inventory from the daily proceeds that raise the risk profiles of most of the business enterprises under research. The population size of between 2-10 participants per shop was deemed adequate since the number provided a reliable sample of participants to be selected. **75 of the respondents were business owners and 52 were employees among the 30 wholesale businesses in the New Taxi Park.**

### 3.4 Sampling Procedures

#### 3.4.1 Sample Size

A sample of 127 respondents was selected based on Krejcie and Morgan (1970) sampling guidelines (see appendix III) as shown in table 1 below because the larger the sample, the more confident the researcher becomes of the results (Katebire, 2007).

#### 3.4.2 Selection Techniques

**Table 1: Population and sample used in the study**

Population category	Population	Sample	Sampling technique
Household consumable	65	42	Stratified sampling
Agriculture related	45	28	Stratified sampling
Construction materials	10	6	Stratified sampling
Electronic gargets	50	32	Stratified sampling
Cosmetics products	30	19	Stratified sampling
Total	200	127	

**Source: New Taxi Park Lock up Owners Association, March, 2012**

The study used a quantitative stratified sampling by classifying the different population categories into different strata which were considered homogeneous to enable gathering of data from the different wholesale SMEs. To arrive at an agreeable ample sample size, the study used proportionate criteria of  $127/200^*$  population in the strata. This sampling technique enabled the researcher ensure that each individual in the target population stands an equal chance of being selected (Katebire, 2007).

### **3.5 Data collection methods and instruments**

The study used a survey approach to collect both primary and secondary data using a questionnaire and documentary review approaches.

#### **3.5.1 Questionnaire approach**

The questionnaires involved a researcher-administered close-ended questionnaire that targeted the selected 127. The questionnaires comprised a series of questions that were aligned to the research questions set. Since the use of self-administered questionnaires (SAQ) normally suffers from low responses, the research adopted the use of a researcher-administered questionnaire (RAQ) to allow high response rates. Researcher Administered Questionnaires further improved response rates as concepts that the respondents found rather 'difficult' to answer were expertly handled by the researcher. The choice to use Researcher Administered Questionnaires further enhanced the fact that the researcher easily administered them herself since the population sample was within her area of daily work.

Additionally, the use of Researcher Administered Questionnaires was preferred over others because these questionnaires had the capacity to collect vast amounts of data in a short time, rather inexpensively and because most respondents' educational levels are between being Primary 7 leavers and Senior 6 leavers. The questionnaires also enabled easy of quantification analysis of study findings.

#### **3.5.2 Documentary review approach**

Also, known as secondary data collection method, documentary review involved scanning and collection of data and information from existing documents. Such documents included

published manual and electronic books, journals, newspapers and professional documents on the subject of internal controls and performance of SMEs in Kampala business area. The use of secondary data was instrumental in allowing comparison with data on similar concepts obtained from the quantitative methods of the Researcher Administered Questionnaires. This use of both qualitative and quantitative methods was essential in ensuring that the data collected is valid and reliable (Denzin and Lincoln, 2000; Bryman and Bell, 2007).

### 3.5.3 Questionnaire

The questionnaire comprised of 28 closed and open-ended questions of which Q1-Q5 were designed to provide background information on the participants. Collected data on the respondents' gender, number of years in business and type of business enterprise helped to relate such characteristics with individuals' ability and enthusiasm in adopting internal control systems for their business. Questions 1-9 under section 2 red a detailed data on the concept of internal controls in small businesses. Questions 1-8 under section 3 as challenges faced by business enterprises, Questions 1-7 under section 4 as internal controls and their influence on business performance. The data was collected through the answers given by different respondents to the subsequently questions. The questions cover data on internal control activities, the challenges of business enterprises and the influence of the internal controls on business performance.

### 3.5.4 Measurement of variables

The variables were measured by operationally defining concepts. For instance the questionnaire was designed to ask responses about the internal control activities and business performance. These were to be channelled into observable and measurable elements to

enable the development of a simple interval quantitative measure which was used to measure both the independent and dependent variables.

### 3.5.5 Procedure for data collection

After the approval of the proposal by the responsible authority at the Institute, the researcher got an introductory letter from the administration which was used to progress to the field for data collection. The letter was presented to the concerned officials in the New Taxi Park Lock up Association (NTPLA) under whose jurisdiction the area of study was. The officials were very critical in providing the necessary understanding between the researcher and the participants. Through prior appointments with the respondents, the researcher engaged over 120 respondents over a period of two weeks. The responses anticipated to be a minimum of 107 out of the 127 which would represent 84.3% respondents'. However the responses were 105 out of 127 compliancy rates which were positive for the survey research questionnaire.

## 3.6 Quality Control Methods

### 3.6.1 Validity

Validity refers to the truthfulness of the findings or the extent to which the instrument is relevant in measuring what it is supposed to measure (Katebire, 2007). The validity of the questionnaire was tested for face validity. The questionnaire was made in simple wording so that even the least educated respondent could easily understand the questions.

The supervisor from the faculty of Business Administration and Management rephrased most questions in the questionnaire. the content validity of each item was evaluated on a scale for which 1=strongly disagree,2=disagree,3=not sure,4=agree,5=strongly agree.

The content validity test (CVI) was then used to measure the extent to which the items in the instrument were relevant in measuring what they are supposed to measure was based on expert (supervisors) judgments. The CVI was established using the formula:

$$\text{CVI} = \frac{\text{Number of items declared valid}}{\text{Total number of items}}$$

Total number of items

In this research, therefore, CVI from the questionnaires was 0.82. This implied that the questionnaire instrument actually measured the study variables which was in agreement with (Katebire 2007) who recommends that for an instrument to be valid, the content validity index has to be 0.8 and above.

### 3.6.2 Reliability

The consistency in the responses when interpreted well rendered the instrument reliable. Reliability brings out the degree of consistency in data collected by an instrument at all times when the data and the conditions are the same (Katebire, 2007). Mugenda and Mugenda (1999) explained that reliability measures indicate the extent to which a phenomenon is devoid of bias across time and various items in the statement.

Pilot data was used to help in enhancing the reliability of the instruments. Data from the 30 wholesale shops was entered into the Statistical Package for Social Sciences where the Cronbach alpha coefficient test of reliability was calculated where variables with an alpha correlation coefficient of at least 0.7 were taken to be reliable (Cronbach's, 1970).

**Table 2: Reliability test findings**

Variable	Alpha coefficient
Internal controls	0.71

Challenges	0.82
Effects on business performance	0.75
<b>Average</b>	<b>0.76</b>

As shown above, all Cronbach alpha coefficients were above 0.7 which indicated that the questionnaire was reliable enough to be used as a research instrument (Katebire, 2007).

### **3.7 Data Management and processing**

The data was collected by the researcher who administered the questionnaires, explained the format in which to answer to the respondents. Raw data generated through the questionnaires was collected, cleaned, sorted and coded. The coded data was then entered, checked and statistically analyzed using the Statistical Package for Social Sciences (SPSS) computer software program.

### **3.8 Data Analysis**

#### **3.8.1 Quantitative analysis**

Quantitative analysis involved manipulating and quantifying study results to enable gaining of inferences on the variables under study (Amin, 2005). Raw data which was generated through the questionnaires was collected, cleaned, sorted and coded. The coded data was then entered, checked and statistically analyzed using the Statistical Package for Social Sciences (SPSS) computer software program. Quantitative data was then presented in form of descriptive statistics using frequencies, percentages, mean, standard deviation and correlation. The correlation techniques used included Pearson's coefficient (+ or to show the direction of the relationship between the variable) and significance tested at 99% and 95%

confidence levels based on two tailed correlation and significance of more than or equal to 0.05. Regression analysis was used in the study to determine the magnitude of the influence of the internal controls on the performance of whole sale businesses in the study area (Amin, 2005).

### 3.8.2 Qualitative analysis

Qualitative analysis involved the manipulation of the study findings which could not be quantified (Denzin and Lincoln, 2000; Amin, 2005). Qualitative research was carried out using survey methodology and use of secondary data. Data collected from the structured survey was categorised into themes and coded. The information was presented in a narrative form to complement the quantitative findings.

## 3.9 Ethical considerations

One of the ethical considerations was to counter the fear that the information and data collected wasn't to be used against the business owners' interests. The fact that the requested data tended to uncover some of the shortcomings especially the fact that most traders used the issue of lack of robust internal controls to evade government taxes meant that there was indeed serious comprehension in this area. For example, even the official of the NTPTA at first sceptical about the intentions of the research. This dilemma dealt with by ensuring that the concerned official as well as would-be participant came to the understanding that the research was purely academic. The introduction letter from the University was very crucial in allaying fears of those concerned. Furthermore, the researcher relied on her proximity and close relationship with some of the traders to put her cause a head way before the research took place.

Another ethical issue was that of individual participation in the research. Whereas the use of NTPTA officials was helpful in convincing their members to participate in the research, some were still adamant and indeed convinced others not to participate.

This issue was solved by carrying out door-to-door awareness in which the importance of the research to the student was emphasised and fears that were deemed important to would-be participants identified and dealt with on a one-to-one basis. This kind of pre-research encounter with would-be participants was very helpful in creating a rapport between the researcher and participants that was later essential in realising less resistance to the research.

### **3.10 Limitations of the study**

The major limitation of the research was inadequacy of financial resources. Data collection turned out to be expensive in terms of transport and daily allowances as the research was carried out from morning to evening. The researcher got financial support from a friend which was to be paid back at a later date.

Another challenge arose from the need to finish the research within a short time, yet there was need to continue with the formally-standardised lectures. This scenario placed a lot of pressure on the researcher but was solved by creating more time and resources into the research process. Also, the researcher managed to secure some days off work so as to concentrate on the research at hand.

The failure by respondents to be cooperative and fill in all parts of the questionnaires which affected the output when collecting data. Some of the respondents even rejected the questionnaires. The researcher kept on encouraging the interested respondents to answer what they can in the questionnaires.



## CHAPTER FOUR: PRESENTATION, ANALYSIS AND DISCUSSION OF FINDINGS

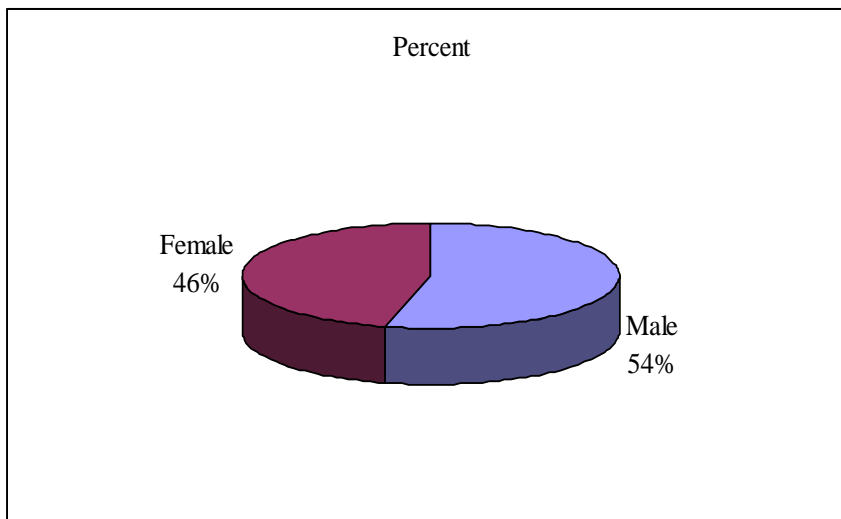
### 4.1 Introduction

This chapter presents the findings and discussion of the study that examined internal control activities employed by SMEs, sought to establish the challenges faced by SMEs and measured the relationship of internal controls and the business performance. Data was collected from 105 respondents under the SMEs. Data is presented below objective by objective using descriptive and inferential statistics. The demographic data on the respondents is presented first

### 4.2 Demographic data of respondents

In the study, the researcher collected demographic information on respondents. This was then used to explain the findings.

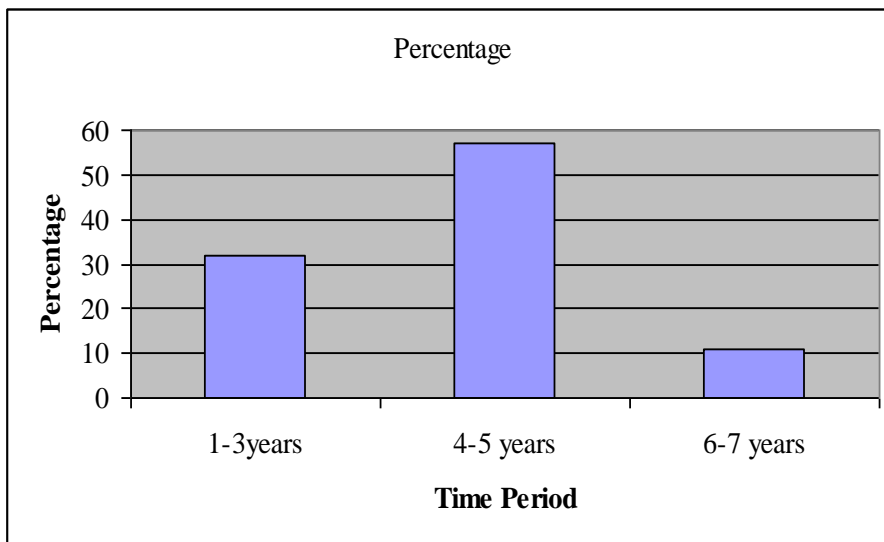
Figure 4.1: Gender of Respondents



According to the findings in figure 4.1, majority of the respondents (54%) were male while the rest (46 %) were females. Male respondents being majority is proof that SME trade business is dominated by men. This may also be an indicator that it is a risky and challenging venture. Though male respondents were the majority, the finding implies that the opinions of both genders were well represented. SMEs employ more than 2.5 million people with 90% in the private sector. Both genders are therefore needed for the maximisation of the country GDP and that is why financial support is being given to the SMEs in Uganda. Enterprise Uganda has even gone ahead to train the business enterprise business owners and employees on how to effectively carry out internal control in order to boost their performance. The 46% representation of women respondents implies that unlike the past situation where only men participated in the business world, today women have also become active in the business world (Minton, 2008). Women nowadays are also capable of: achieving any task, becoming entrepreneurs, being strong at handling different situations and are creative. Women have grown in businesses today by showing their ability and positivity towards work. Women work day by day in order to cater for their social needs and have a better life as a symbol of success. Women unlike in the past where they were seen as inferior today are also seen as a fuel that enflames the company's onward progress and therefore strategies to protect their rights, offer financial support and train them in order to perform better are being implemented in Uganda.

Respondents also mentioned the number of years their SME had been in operation. This information was needed to indicate the level of knowledge they had on the contribution of internal controls on the performance of SMEs.

**Figure 4 .2: Number of Years SME had been in Business**

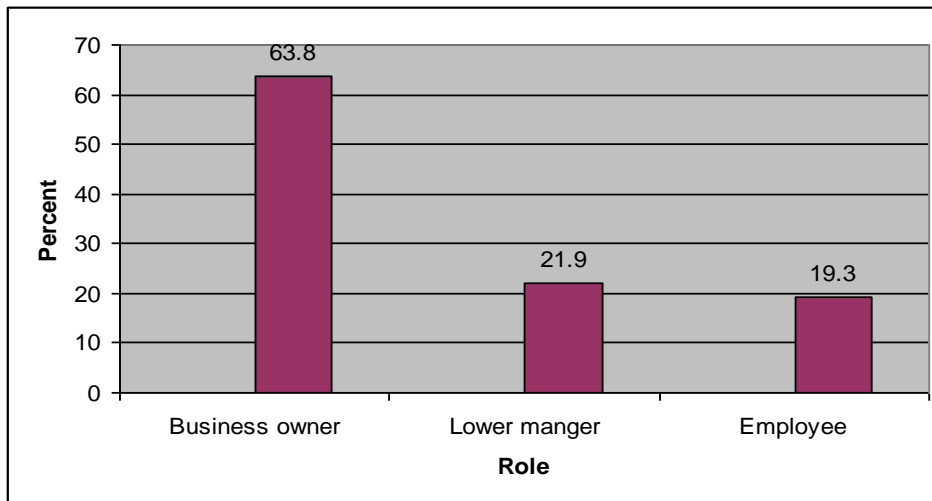


*Source: Primary data*

As indicated in the figure above, the majority of SMEs (57%) had been in business for 4-5 years. Others (11%) had been in business for 6-7 years and 32% had been in business for 1-3 years. This implies that the respondents who have been in business for a period long enough to understand the issues related to the contribution of internal controls on business performance of SMEs. It can, therefore, be concluded that the responses they gave were validity and reliable. The years SMEs had been in business also imply that the selected SMEs should be growing to graduate into large business enterprises and thus increase their need for internal controls.

In order to increase the validity of the findings, the researcher sought information rich respondents. To achieve this, respondents mentioned their role in the SME. As indicated in the chart below, three roles were mentioned by respondents.

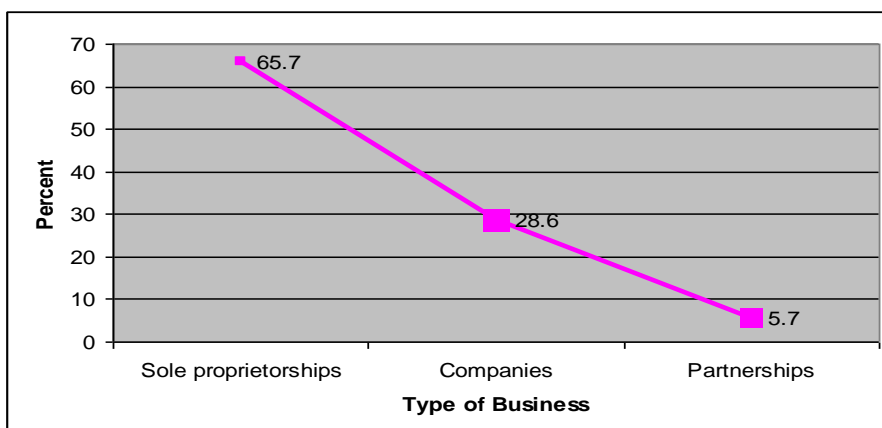
**Figure 4. 3: Role of Respondents in SMEs**



*Source: Primary data*

With regard to the role (see figure above) of the respondents in SMEs, the majority (63.8%) were owners, (21.9%) were lower managers, and just rest (19.3 %) were employees. This implies that most of the respondents were involved in the day to day running of the SMEs and therefore provided reliable information about the research questions.

**Figure 4. 4: Types of Business**



*Source: Primary data*

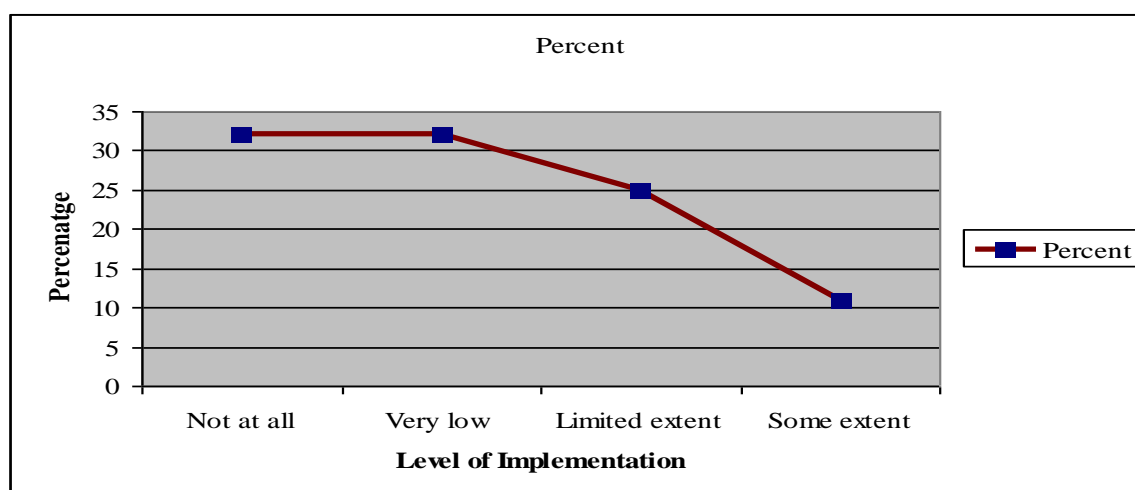
The findings in the figure above show that 65.7% of the business enterprises were sole proprietorships, 28.6% were companies and 5.7% were partnerships. The finding implies that most SMEs in Uganda are sole proprietorships being owned and run by business owners. This also explains why the majority of respondents were the owners of the businesses. The completion of primitive accumulation of capital causes companies to shift from individual owners to the form of partnership, and eventually corporate form. Corporate enterprise is a form of enterprise organization where shareholders have the right to all the business activities of enterprise assets by the business.

Control activities should therefore be able to prevent other than detect problems and should be carried out at all levels of the entity to enhance transparency of every business activity.

#### **4.3 Internal Control Activities Employed By SMEs,**

The first objective of the study was to examine internal control activities employed by SMEs. However, first the respondents were to indicate the extent to which their SME use internal controls. The findings are indicated in the chart below.

Figure 4. 5: The Extent of Implementation of Internal Controls by SMEs

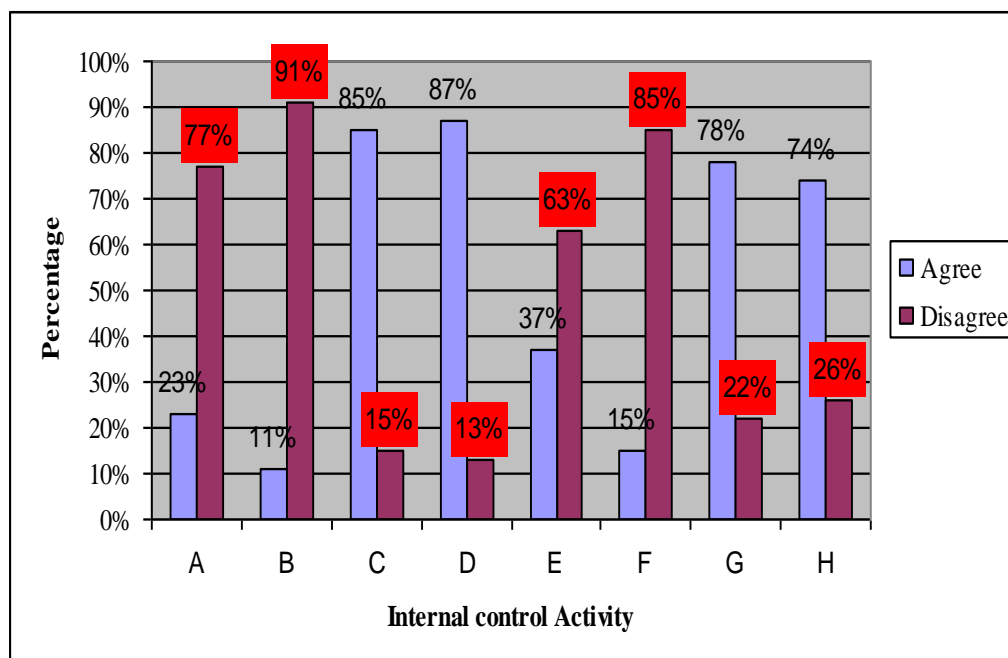


*Source: Primary data*

As indicated in the figure above, the majority (32%) of respondents indicated that their SME does not have any specific internal controls. They gave reasons for this scenario. They asserted that internal controls were intended for large corporations that were operating on a large scale, were legally established and had a significant level of public ownership, internal controls were expensive to implement and even when implemented, are expensive to maintain in the business enterprise. However, the majority of selected SMEs were still owned by individuals or families. This finding agrees with Shleifer and Vishny (1997), who stated that most SMEs in Africa might fail to implement internal controls because they did not think they were necessary since they operated on a small scale and it was easy for the owners to oversee their businesses without internal control systems. Some respondents mentioned that internal controls were implemented to a very low extent (32%) and 25% said they were implemented to a limited extent while 11% said its implemented to some extent. This finding shows that respondents agree that despite SMEs being small, in order for them to grow, they need to implement internal controls. This finding concurs with the recommendations of PSFU (2010), that what ever their nature, SMEs need internal controls to improve their management practices, so as increase opportunities for growth.

In the table below, respondents indicated the aspects of internal control that they implement. This was done by indicating whether they agree or disagree to the use of the specified internal control activity.

**Figure 4.6: Internal Control Activities Employed By SMEs**



*Source: Primary data*

**Key to Letter codes**

Letter	Internal control activity
A	Information flow strictly controlled
B	Security checks done on all transactions
C	Transactions ,documented, serialized , secured
D	Information, resources accessible by authorization
E	Transactions centralized in accounting system
F	Recorded transactions used to detect errors
G	Credit offered only to credit worthy customers
H	Authorized employees physically count stock every day

The findings in figure 4.6 show that, SMEs use specific internal controls in their businesses. Respondents agreed that their SMEs have document, serialise and secures business transactions and activities (85%) against 15% who did not. The findings also indicated that SMEs make sure that company information and resources are accessible only by

authorization (87%) against 13% who said they do not. Respondents also revealed that their SMEs do limit credit or give it to only credit worthy customers who are regularly followed for payment (78%). This implies that SMEs implement two aspects of controls mentioned by KPMG (1999) which were; approval of transactions, and verification and reconciliation of business transactions. The implemented activities are mainly for preventive purposes. Preventive controls are mainly realized in activities such as thorough documentation and authorization practices. With correspondence to the respondents, the SMEs that document transactions, serialize and secure transactions in their day to day activities are easily able to detect errors in their businesses as compared to the (15%) who disagree to the ability to detect errors through documentation, serialisation and ensuring security of transactions.

This also proves that the major aim of internal controls employed by SMEs is to secure important documents for the business. This finding may reveal that SMEs place emphasis on having accurate records for tax purposes. This is due to the fact that in Uganda, all businesses are supposed to pay some taxes which are charged through the Uganda Revenue Authority either directly or indirectly. Good records lead to fair tax assessment and improper record keeping may cause SMEs to fail to calculate even their returns. Without well implemented controls, business transactions no longer reflect accuracy about facts of asset operations and it is from the internal control system that the small businesses will be able to detect and protect their assets from errors of accuracy and validity of the transactions in the business.

The findings further concur with Hooper (1982) who said that accurate documentation is very important in keeping track of activities in any business enterprise this is because these business enterprises have very many different transactions which take place daily these need

to need to be verified in order to prevent fraud. Documentation is therefore an important aspect in internal control system (Warren, 1990). When records are kept track of through documentation in a business enterprise, the information is easy to trace in the business. The controls implemented also have a proportion of control. This agrees with Draz (2011) who said that good Internal Controls should include the control activities that are preventive; whose aim is to deter the instance of errors or fraud; detective – that help in identifying undesirable occurrences and corrective – those controls that help to remedy the wrongs that slipped through the preventive and detective processes.

However, modern businesses require internal controls for a variety of other reasons. The few internal controls implemented by SMEs are proof of limited emphasis on controls. Some important controls that were neglected included strictly controlling information (77%) and doing security checks on all transactions (91%). The controls not implemented are in the category of detective and corrective controls. This means that SMEs may have a simplistic view of the value of internal controls. SMEs may also be experiencing challenges in terms of skills of identifying the needed controls and implementing them. Uganda still has problems in internal controls. Therefore as advised by the World Bank (2000), BDS can empower SMEs to succeed (Themba et la 1999) by showing them the importance of internal controls.

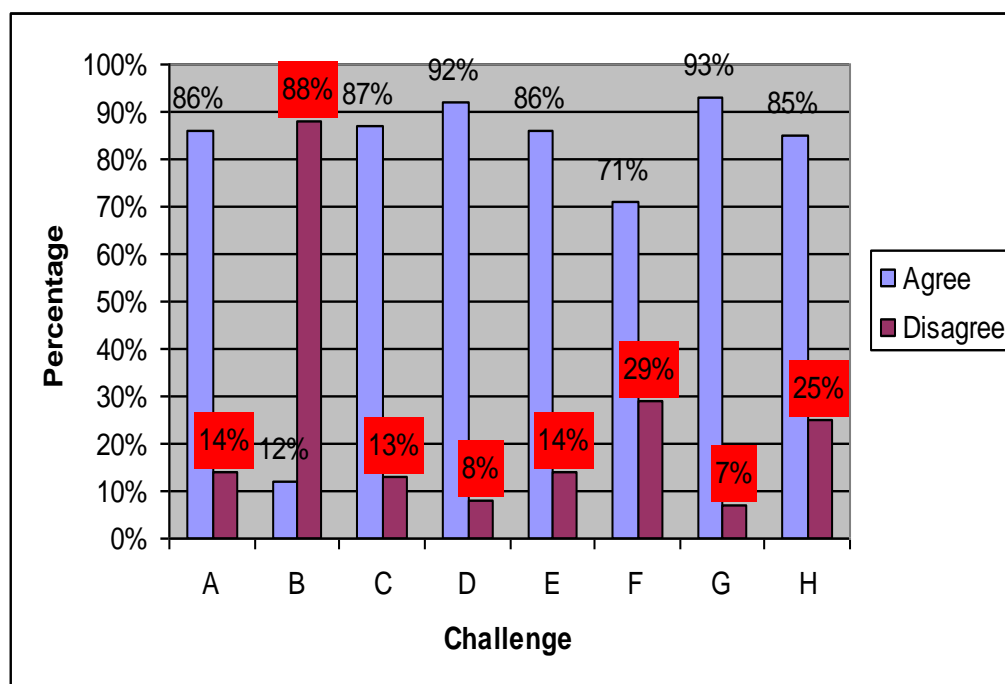
However, COSO (1992; Amudo & Inange 2009) advise small the business on the need to implement all categories of controls. Without this, the businesses owners are likely to fail to realize their profits and losses in the business not knowing that this affects the business performance at the end of the day. This is because it becomes tiring for the business owners to keep on estimating all this at once because the information isn't centralized but if there are internal controls, this becomes less tiresome as a result of the centralized information.

As advised by Northcutt (2009), all categories of controls work together to prevent fraud and support effective business practices. Therefore, this can eliminate stealing by employees and cash embezzlement. Fraud, mistakes by employees and misappropriation of assets when carrying out every day transactions is reduced.

## 4.2 Challenges faced by SMEs

The second objective of the study was to identify challenges faced by SMEs in their business operations. Respondents indicated the major challenges faced by their SME by agreeing or disagreeing to facing challenges that were listed. The findings are presented in the figure below.

**Figure 4.7: Challenges SMEs Face (N=105)**



*Source: Primary data*

**Key to letter codes**

<b>Letter</b>	<b>Challenge</b>
A	Adjusting to market demands
B	<b>Inadequate government support</b>
C	Inadequate skills
D	Limited business resources
E	Low market prices
F	<b>Const Unstable commodity prices</b>
G	Inadequate financial capital
H	<b>Unpredictable business Environment</b>

The findings above indicate that SMEs in Uganda are facing significant challenges that may affect their performance. Respondents feel that the major challenge faced by SMEs is limited financial resources, due to high interest rates for loans (93%). This implies as mentioned by Luire and Thomas (2002) that limited finance prevents SMEs from maximising revenues and minimising operational costs. Another significant challenge is inadequate government support that was mentioned by 88% of respondents. This finding reveals that government policies in Uganda supporting the growth of SMEs are still ineffective and therefore preventing SMEs from benefiting from any available support. Respondents also mentioned difficulties in adjusting to new products in the market (86%) and low market prices (86%). This implies that SMEs have limited control on commodity prices and customers can reduce the prices to a point below factory price. This obstructs SMEs ability to maximise revenue as mentioned by (Schoell, 1985). This concurs with Collier (2006) who said that unstable prices are one of the major bottlenecks affecting the performance of SMES in developing countries. This is because it restricts the ability of the business to attain profits as SMEs may be forced to sell below the cost price in order to stay in business. Also a large

(71%) proportion of respondents mentioned unstable prices. This shows that SMEs are facing business operation challenges. This is further indicated by the large percentage (85%) of respondents, against 15% who mentioned unpredictable business environment. This finding confirms Mueller & Thomas's (2001) recent findings on major challenges of SMEs in Africa that indicated that SMEs significantly needed support to improve their capital base, ability to respond to Market changes and cope with rapid and unpredictable changes in the business environment. This implies that lack of financial capital and technically competent manpower may be preventing SMEs from accessing needed technology. SMEs still need added support from government and BDS in areas of financial capital, technical and business skills and difficult business environment. Therefore, any business support organization would need to target their support in these areas if they are to meaningfully empower SMEs to succeed. This finding agrees with (Robertson et al 2001) who said that one of the factors inhibiting SMEs success is unsupportive economic policies. According to Luiz (2002), the above mentioned unfavourable business environment raises the cost of doing business which forced many SMEs out of business. These uncertain changes in the business environment make it difficult for SMEs to take advantage of market opportunities.

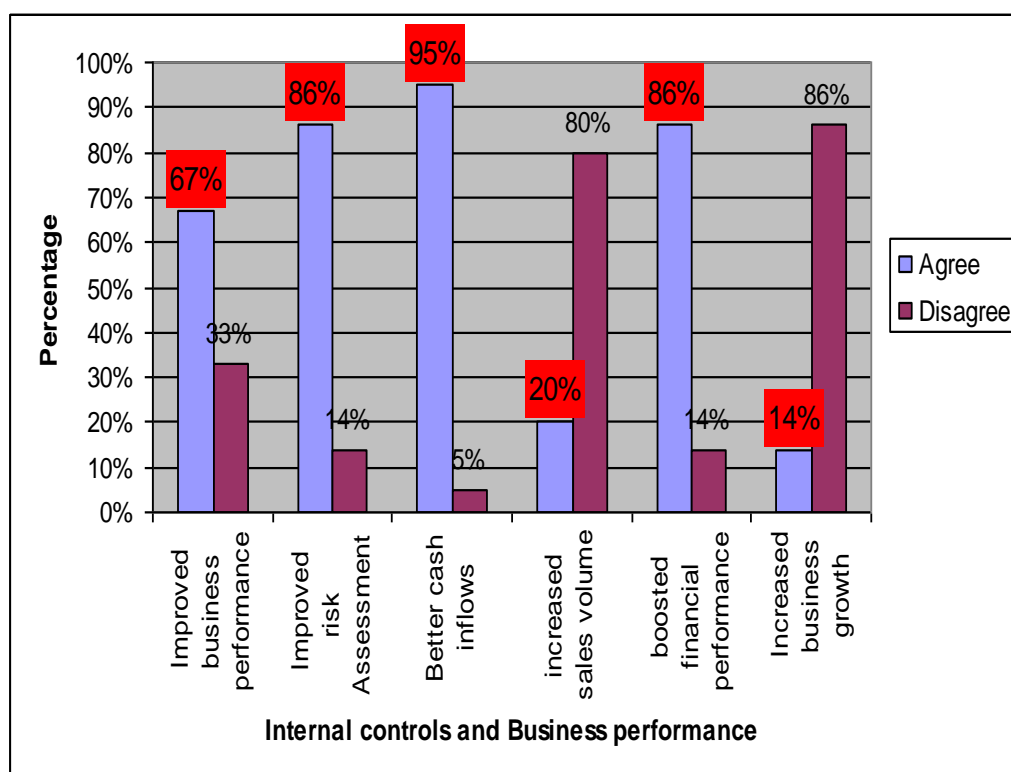
These findings also agree with (Morris & Zahra 2000) who said that most SMEs in developing countries have no ability to deal with unpredictable economic policies announced by government at the reading of budgets every year. Most of these policies lead to rapid changes in the business environment that leads to losses among SMEs. There is need for Supportive economic and operations policies in support of SMEs. The current Poor or unimplemented government policies are affecting the level of performance of SMEs. The government must adopt more horizontal structures for developing and implementing an integrated policy approach. As advised by (Howorth 2001), SMEs in Uganda need supportive macro-economic policies, legislation, frameworks, regulations and laws to

facilitate their success. They need encouragement to apply internal controls to enable them cope with unpredictable changes. SMEs need to be more prepared to cope with unstable prices and unpredictable price reductions in order not to reduce their sales.

### 4.3 The Relationship between Internal Controls and Performance of business enterprises

The last of objective of the study was to measure the relationship between internal controls and performance of business enterprises. In order to do this, the researcher first assessed the current business performance of SMEs. This was done in order to collect data on the contribution of internal controls on the performance of SMEs. The findings are indicated in the figure below.

**Figure 4.8: Internal Control and Business Performance of SMEs**



*Source: Primary data*

The findings in the figure above show that, despite the challenges faced, SMEs that were surveyed are not performing badly. Respondents agreed that using internal controls has enabled them to realize better cash inflows (95%). They also mentioned that internal controls had enabled them to their financial business performance (86%). They further agreed that internal control has been critical in assessing their business performance risks (86%). This has enabled them to reduce costs and losses. This implies that SMEs have been able to benefit from internal controls and this has enabled them to increase and improve their performance. Controls have specifically led to positive influences on sales and productivity. This finding concurs with Jing & Li, (2010) who said that effective implementation of internal controls reduces risks, loss and increases sales in SMEs.

The researcher further statically explored the effect of internal controls on the performance of SMEs. Specific internal control activities were correlated with the performance of SMEs. Given the fact that internal controls data was categorical, spearman correlational analysis was used. The findings are summarized in the table below.

**The relationship between internal control activities and Business performance**

A relationship between information flow control and performance was measured using spearman correlational analysis. The findings are shown in the below.

**Table 4:1 Spearman Correlation table between control of information flow and performance**

		Information Control	Performance
Information control	Spear man Correlation	1	.34*
	Sig. (2-tailed)		.035

	N	105	105
Performance	Spearman Correlation	.34*	1
	Sig. (2-tailed)	.035	
	N	105	105

**Source: Primary data**

A weak positive relationship was shown between information flow and performance of SMEs.

This implied that majority of the SMEs don't have control over information flow.

**Table 4:2 Spearman correlations of security checks and performance**

		Security checks	Performance
Security checks	Spearman Correlation	1	.45*
	Sig. (2-tailed)		.021
	N	105	105
Performance	Spearman Correlation	.45*	1
	Sig. (2-tailed)	.021	
	N	105	105

**Source: Primary data**

Based on the information presented above, there is a weak positive relationship between the security checks done on all transactions and performance. This therefore implied that despite the positivity of the security checks done on all transactions as an effort to influence the performance of the business enterprise, only a few of the security checks are done and even done are not maximally implemented by the different SMEs.

**Table 4:3 Spearman correlations to show the relationship of documentation, serialisation and security of transactions and performance**

	Documentation	Performance
Documentation Spear man Correlation	1	.69*
Sig. (2-tailed)		.041
N	105	105
Performance Spearman Correlation	.69*	1
Sig. (2-tailed)	.041	
N	105	105

*Source: Primary data*

The data shows that there is a positive strong relationship between documentation and serialisation of transactions in relation to performance of SMEs. These results implied that in most SMEs, the documentation and serializing and security of transactions is evident and a routine practise.

**Table 4.4: Spearman correlation showing the relationship between authorisation to information and resource accessibility**

	Information authorisation	Performance
Information Spear man Correlation authorization	1	.68*
Sig. (2-tailed)		.032
N	105	105
Performance Spearman Correlation	.68*	1
Sig. (2-tailed)	.032	
N	105	105

*Source: Primary data*

A strong positive relationship is evidenced between the accessibility of information and resource authorisation. This implied that there is frequent and recognised use of authorisation to access the SME information and resource.

**Table 4.5: Relationship between the accounting system and performance shown by Spearman correlation**

	Accounting system	Performance
Accounting system	1	.25*
Spearman Correlation		
Sig. (2-tailed)		.043
N	105	105
Performance	.25*	1
Spearman Correlation		
Sig. (2-tailed)	.043	
N	105	105

*Source: Primary data*

A weak positive relationship in SMEs is illustrated through the spearman correlation above. These results implied that despite the necessity of centralising transaction in an accounting system, most SMEs have implemented the accounting system to a small extent.

**Table 4.6: Table showing the relationship between the detection of errors using recorded transactions and performance.**

	Detection of errors	Performance
Detection of errors	1	.35*
Spearman Correlation		
Sig. (2-tailed)		.011
N	105	105

Performance	Spearman Correlation	.35*	1
	Sig. (2-tailed)	.011	
	N	105	105

*Source: Primary data*

A weak positive relationship is seen in SMEs on the rate at which SMEs use recorded transactions to detect errors in their businesses. This implied that only a few SMEs use their recorded transactions to detect the companies' errors. This therefore hinders the effectiveness of the internal controls because the SMEs failure to use recorded transactions to detect errors restricts the SME ability to detect a problem when carrying out daily activities.

**Table 4.7: Showing the spearman correlation of credit worthy customers in relation to performance.**

		Credit worthiness	Performance
Credit worthiness	Spearman Correlation	1	.46*
	Sig. (2-tailed)		.023
	N	105	105
Performance	Spearman Correlation	.46*	1
	Sig. (2-tailed)	.023	
	N	105	105

*Source: Primary data*

A weak positive relationship is illustrated from the table above implying the most Businesses follow the credit worthiness of customers when offering to them credit to a minimum extent. The SMEs therefore don't efficiently follow this policy when carrying out transactions.

**Table 4.8: Showing the relationship between every day stock taking and performance in SMEs**

	Stock taking	Performance
Stock taking Spearman Correlation	1	.38*
Sig. (2-tailed)		.031
N	105	105
Performance Spearman Correlation	.38*	1
Sig. (2-tailed)	.031	
N	105	105

*Source: Primary data*

A weak positive relationship has been shown between every day stock taking by authorised employees and performance. This implied that despite the importance of every day counting stock, most businesses pay minimum attention to this internal control practise yet this practise affects the SME performance.

**Table 4.9: Here is a summary table showing the different relationships between the internal controls and Business performance.**

Independent variable	Dependent variable	$r_s$	p-value
Information flow strictly controlled	Performance	0.34	0.035
Security checks done on all transactions	Performance	0.45	0.021
Transactions ,documented, serialized , secured	Performance	0.69	0.041
Information, resources accessible by authorisation	Performance	0.68	0.032
Transactions centralized in accounting system	Performance	0.25	0.043
Recorded transactions used to detect errors	Performance	0.35	0.011

Credit offered only to credit worthy customers	Performance	0.46	0.023
Authorized employees physically count stock every day	Performance	0.38	0.031

*Source: Primary data*

The nature and magnitude of the overall relationship between implementing internal controls and business performance of SMEs, and the specific contribution of internal controls on the performance of SMEs was also examined. Correlation and regression analysis were done to establish the relationship and overall contribution of internal controls on business performance. In order to make it possible, categorical data was turned into continuous data by summing up the categorical responses. The transformed continuous data made correlation and regression analysis possible. In this case therefore, a correlation and regression were calculated between scores of internal controls and SME performance and the findings are indicated in the table below.

**Table 4.10 : Regression Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	5.236	4.103		1.632	.034
Internal controls	.240	.092	.421	2.396	.011
Business performance	-.029	.025	-.043	-1.185	.041

a. Dependent Variable: Business Performance

Table 4.10 gives the regression equation used to predict business performance from internal controls. Business performance (dependent) = 5.236 + 0.421 Internal Controls (Independent). This regression equation is in relation to the equation  $Y=a + bX$ .

**Table 4.11: Regression model showing the effect of Internal controls on business performance of SMEs**

<b>R</b>	<b>R<sup>2</sup></b>	<b>Adjusted R<sup>2</sup></b>	<b>Std. Error</b>	<b>Sig.</b>
.752 <sup>a</sup>	0.57	0.54	3.14	.033 <sup>a</sup>

**Predictor: Internal controls, Dependent variable: Performance of SMEs**

*Source: Primary data*

From the regression model summary in Table 4.11, the correlation (linear relationship) between business performance (dependent variable) and implementation of internal controls is indicated by adjusted  $R^2=0.54$ . This implies that, generally, implementing internal controls is highly related to business performance of SMEs. As indicated by table 4.11, the relationship was significant at  $p\text{-value} < 0.05$ . This means that if SMEs implement more controls this can lead to positive changes in SME performance and hence can strongly increase business success of SMEs. The results of the regression model indicated an R-square of 57%. This implies that a change in implementation of internal controls causes a change in the level of business performance.

## **CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Introduction**

This chapter presents a discussion of the findings, the conclusion and the recommendations of the study that examined internal control activities employed by SMEs, sought to establish the challenges faced by SMEs and measured the relationship of internal controls and the business performance. A summary of the findings is presented first.

### **5.2 Summary of findings on Effect of Internal Controls on the Performance of Business Enterprises**

#### **5.2.1 Objective 1: Internal control activities employed by SMEs**

The first objective of the study was to establish whether SMEs implement internal controls and the type of controls implemented. The findings have indicated that to a limited extent SMEs implement internal controls. Two aspects of controls that is approval of transactions, and verification and reconciliation of business transactions were the common ones implemented. SMEs mainly placed emphasis on preventive controls, to prevent fraud, and

over taxation by tax authorities. Preventive controls were done through documentation and authorization practices. Therefore, internal controls employed by SMEs were done to secure important documents for the business. This finding revealed that SMEs place emphasis on having accurate records for tax purposes and to prevent fraud. SMEs may hold the view that internal controls are supposed to be implemented by large corporate organisations. SMEs may also lack awareness of the value of internal controls and the skills to implement internal controls due to the fact most of the management of SMEs were not well trained in business skills.

### **5.2.2 Objective 2: Challenges faced by SMEs**

The second objective of the study was to establish the challenges faced by SMEs in their operations. The findings have indicated that SMEs face significant challenges that negatively affect their performance. Business enterprises are faced with both internal and external challenges but the internal challenges though affect the business performance can easily be minimised and where possible eliminated unlike the external challenges which cause more complexity in business efficacy. The external factors reduce the business enterprise ability to maximise profits and minimise operational costs in businesses transactions.

SMEs have limited financial resources, due to high interest rates required for loans making the situation difficult in adjusting to new products in the market. This implies that SMEs are facing financial constraints. A large proportion of respondents also mentioned un stable prices. This shows that SMEs are facing business operation challenges. This is further indicated by the large percentage of respondent who mentioned unpredictable business environment. This implies that the major challenges of SMEs in Africa that SMEs significantly needed support from to improve their capital base, bad business environment, limited policy support and lack of business management skills. This implies that lack of

financial capital and technically competent manpower may be preventing SMEs from accessing needed technology. Government policies in Uganda supporting the growth of SMEs are still ineffective and therefore preventing SMEs from benefiting from any available support. SMEs still need added support from government and BDS in areas of financial capital, human resources, technical and business skills, technology and difficult business environment. Therefore, any business support organization would need to target their support in these areas if they are to meaningfully empower SMEs to succeed. The major factor inhibiting SMEs success is unsupportive economic policies. Unfavourable business environment raises the cost of doing business as many SMEs. These uncertain changes in the business environment make it difficult for SMEs to take advantage of market opportunities.

The majority of the respondents stated that they were not able to implement internal controls because they lacked technical knowledge regarding what it is and how to implement it. Others stated that they lacked awareness of the different aspects of governance and got limited support from the business support services for implementing internal controls. Respondents advised that SMEs could be helped to implement internal controls by training in ways and means of implementing it, through government and business support service providers making it mandatory to implement it and through creating awareness about the value of internal controls.

### **5.2.3 Objective 3: The relationship between internal controls and performance of Business enterprises**

The last objective of the study was to establish the relationship between internal controls and performance of Business enterprises. The findings have indicated that even among SMEs, internal controls are significantly related to business performance. An increase in the implementation of internal controls produces a significant increase in business performance.

This was especially with regard to preventive control such as the case with regard to (Collier, 2006). This implies that SMEs and their business support partners should strengthen use of internal controls. The study established that there is a significant relationship between internal controls and business performance. Therefore based on the information presented, different internal control activities contribute to the increase in the market share, cash flows and the sales volume of business enterprise. For example the documentation aspect and its relationship with the business ability to often review and update the documents. Most of the internal controls though not perfectly related, they significantly contribute to the business enterprise ability to maximum performance in the market in relation to competitors.

### **5.3 Conclusions**

The study investigated the effect of internal controls on business performance of SMEs. The study specifically sought to look at the different internal controls used, the challenges the business faces and the relationship of the internal controls and business performances. Internal controls can greatly assist the SME sector by infusing better management practices, stronger internal auditing, greater opportunities for growth and a new strategic outlook. It is clear that internal controls structures influence the performance of SMEs in Uganda.

However, SMEs in Uganda are facing significant challenges that prevent them from implementing internal controls fully. The major challenges include lack of skills and knowledge about the value of and how to implement governance, and lack of support and incentive to implement internal controls. If these challenges are eliminated through practical training, support and appropriate policies, then internal controls could be an engine of growth for SMEs.

## **5.4 Recommendations for Action**

In view of this, the researcher makes the following recommendations:

### **Increasing the level of use of internal controls by SMEs in Uganda**

SME proprietors need to be made aware of the practical training and education regarding how to use internal controls in running their businesses. This training will show them the value of internal controls in improving their performance.

Organisations that provide business services to SMEs need to clearly include aspects of internal controls in their training and service provision.

The government and organisations that provide business service to SMEs need to put in place favourable policies that will encourage SMEs to use internal controls.

Institutions that award credit to SMEs, such as commercial banks, can insist on evidence of implementing internal controls before they extend credit to SMEs. This will motivate SMEs and improve their business management through getting them to implement internal controls. Since not all internal control activities can be followed due to the nature of small businesses, the business should only select some which are applicable to the business which are; an accounting system, physical counting of inventory and following up the movement of flow stock, control activities in the way assets move for example cheque payment to suppliers. These are the major control activities at least every business enterprise should have when carrying out operations.

### **Reducing the challenges faced by SMEs**

SMEs need a uniting, governing and regulating body called the National SME Coordinating Council. This council can strengthen and expand the entrepreneurship and business management skills of the proprietors through small business management programmes and their outreach, including internal controls. The council can also enhance the capacity of SMEs for understanding and applying formal accounting and financial management systems, which is a step towards internal controls. The council can also introduce incentives for service providers to develop innovative products and services targeting cross-cutting issues.

SMEs also need a government regulatory body called the National SME Authority (NSMEA). This body would be concerned with education, service provision and monitoring of sourcing for infrastructure. The authority, with the active support of the new National Coordinating Council, could provide monitoring and policy implementation regarding the use of internal controls by SMEs.

There are challenges faced by the business enterprises when carrying out internal controls in their business enterprises. The business owners should often purchase from recognised companies as a way of creating a relationship with these companies so that in case of any need in change of prices, these companies are able to make decisions in favour of the business enterprise.

Business enterprises should have a specific bank in which all and most business transactions are done. When businesses create a relationship with the bank, the bank is able to act as security to business transactions. The business enterprise is able to quickly get short-term

loans, be given at negotiable interest rates and bank grantees. The money used from these banks could help the business enterprise meet its obligations.

Business enterprises even when using internal controls should market their services and products at an affordable price to the market more often so that these businesses are easily identified by the customers. When a business puts a poster at the entrance, the customer is easily directed which encourages growth in the business.

The researcher has urged that in this report, most business enterprises need to implement effectively internal controls in their businesses because through the respondents views, it is noted that some business enterprises carryout the internal controls the ignorant way and those that implement the activities don't effectively implement them because according to them the cost is high to implement all the internal controls. It is against this background that the researcher recommends that business enterprises should make it a point to effectively carryout internal controls because if not catered for there is a possibility that many business owners are unlikely to know the business status as to whether the business is making profits or losses which affects the growth rate in the long run.

### **5.5 Recommendations for Further Research**

The researcher recommends that further research be conducted on the following issues related to internal controls in SMEs:

1. There is need to explore the actual skills needed by SME proprietors in order to implement internal controls.
2. It is also important to know the perception by SMEs of the relevance of internal controls to SME operations in the Ugandan business environment.
3. There is also need to explore the role of business service providers in motivating SMEs to adopt internal controls more fully.

4. There is need for businesses to understand the role of paying taxes when carrying out daily business operations.

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## Appendices

### Appendix I: (Table for determining sample size from a given population)

N	S	N	S	N	S	N	S	N	S
10	10	100	80	280	162	800	260	2800	338
15	14	110	86	290	165	850	265	3000	341
20	19	120	92	300	169	900	269	3500	246
25	24	130	97	320	175	950	274	4000	351
30	28	140	103	340	181	1000	278	4500	351
35	32	150	108	360	186	1100	285	5000	357
40	36	160	113	380	181	1200	291	6000	361
45	40	180	118	400	196	1300	297	7000	364
50	44	190	123	420	201	1400	302	8000	367
55	48	200	127	440	205	1500	306	9000	368
60	52	210	132	460	210	1600	310	10000	373
65	56	220	136	480	214	1700	313	15000	375
70	59	230	140	500	217	1800	317	20000	377
75	63	240	144	550	225	1900	320	30000	379
80	66	250	148	600	234	2000	322	40000	380
85	70	260	152	650	242	2200	327	50000	381
90	73	270	155	700	248	2400	331	75000	382
95	76	270	159	750	256	2600	335	100000	384

Note: "N" is population size

“S” is sample size.

## **Appendix II: Questionnaire for SME respondents**

Dear Respondent I Agaba Brenda a student of Uganda Martyrs University Nkozi is doing a research about internal controls and business performance of wholesale wing businesses in the New Taxi Park of Kampala City. Your business has been selected to participate in this study by providing me with the necessary information to help achieve the objectives of this study. Please tick your choice of response in the space provided and answer the questions according to your understanding. The information you provide will be treated confidentially and will be used for academic purposes ONLY. Thank you for your cooperation.

### **Section A: Demographic Information**

1. Gender of respondents

Male     Female

2. Number of years in business

1-3                       4-5                       6-7

3. Managerial position held in the business enterprise  
 Top manager       Lower Manager     Employee

4. Type of business enterprise  
 Sole proprietorship     Partnership       Company     Do not know

5. Perceived extent to which SMEs implement internal controls  
 Some extent     Limited extent     Very low       Not at all

**Section B: Internal control activities employed by the Business Enterprises**

In the sections below, please indicate the extent to which you agree or disagree the contribution of internal controls on the performance of SMEs by ticking the response that best suits your feeling on the statement given. Please tick the most appropriate using the following scale *1 = strongly Disagree, 2 = Disagree, 3= Not sure 4= Agree 5= strongly Agree scale.*

No.	Statement	1	2	3	4	5
1	Information flow on business transactions and activities is strictly controlled					
2	Business policies and procedures are often documented and updated					
3	All business transactions and activities are always recorded, serialized and secured					
4	company information and resources are accessible only by authorization					
5	Duties and responsibilities are clearly stated at my work place					
6	Regular reviews and balances are made on all activities and					

	transactions					
7	credit limits are only offered to credit worthy customers and they are regularly followed					
8	Company always considers security when offering credit to its customers					
9	Records of credit transactions are always separated from the cash transactions					

**Section C: Challenges faced by SMES**

**In this section Please circle the number on the scale that best indicates the challenges you are facing in your operations.**

		1	2	3	4	5
1	Adjusting to new products in the market					
2	Inadequate government support					
3	Inadequate business and technical skills					
4	Limited business resources					
5	Low market prices					
6	Constant Unstable commodity prices					
7	Inadequate financial capital					
8	Un predictable business Environmental changes					

**Section D: The effect of internal control on the business performance**

**In this section Please circle the number on the scale that best indicates the level of your business performance as a result of internal control in the aspects below.**

		<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1	Internal control activities have improved business performance					
2	Internal control has been critical in assessing our business performance risks					
3	Use of internal controls has enabled us to realize cash inflows and outflows					
4	Internal control have enables us to increase our sales volume					
5	Use of both the manual and computerized internal control systems has helped us improve our business performance					
6	Internal controls have boost our financial business performance					
7	Internal controls have been essential in our business growth					

Thank you for your cooperation

### Appendix III: Raw data

#### Internal Control Activities Employed (N=105)

Internal Control Activities Employed	% response			
	Agree		Disagree	
	f	%	f	%
Information flow on business transactions and activities is strictly controlled	30	23%	75	77%
We have security checks on all our transactions	19	11%	86	91%
All business transactions and activities are documented, serialized and secured	80	85%	25	15%
company information and resources are accessible only by authorization	82	87%	23	13%
All transactions are centralized in the accounting system	29	37%	66	63%
Recorded activities and transactions are always used to detect errors	22	15%	83	85%
credit is only offered to credit worthy customers and they are regularly followed	81	78%	24	22%
Authorized employees physically count stock every day	76	74%	19	26%

**Performance of SMES (N=105)**

<b>Business success</b>	<b>% response</b>			
	<b>Agree</b>		<b>Disagree</b>	
	<b>f</b>	<b>%</b>	<b>f</b>	<b>%</b>
Internal control activities have improved business performance	7	17%	73	83%
Internal control has been critical in assessing our business performance risks	69	86%	11	14%
Use of internal controls has enabled us to realize cash inflows and outflows	76	95%	4	5%
Internal control have enables us to increase our sales volume	10	20%	70	80%
Use of both the manual and computerized internal control systems has helped us improve our business performance	57	67%	23	33%
Internal controls have boost our financial business performance	69	86%	11	14%
Internal controls have been essential in our business growth	11	14%	69	86%

**Challenges SMEs face (N=105)**

challenges SMEs face	<b>% response</b>	
	<b>Agree</b>	<b>Disagree</b>

	<b>f</b>	<b>%</b>	<b>f</b>	<b>%</b>
Adjusting to new products in the market	81	86%	24	14%
Inadequate government support	22	12%	83	88%
Inadequate business and technical skills	82	87%	23	13%
Limited business resources	19	8%	86	92%
Low market prices	69	86%	11	14%
Const Unstable commodity prices	79	71	23	29%
Inadequate financial capital	87	93%	28	7%
Un predictable business Environmental changes	68	85%	12	25%

## **Appendix IV :( Work plan and research budget)**

### **1. Work Plan**

<b>ACTIVITY</b>	<b>DURATION</b>	<b>PERSON TO CONDUCT RESEARCH</b>
Proposal Writing	January – February	Researcher
Preparation and Pre-testing of Instruments	March – May	Researcher
Data Collection and Recording	May – August	Researcher and Respondents
Data analysis	May-August	Researcher
Report Writing	June-August	Researcher
Submission of Final Report	August 31 <sup>st</sup>	Researcher

## **2. Budget**

<b>Particulars</b>	<b>Quantity</b>	<b>Cost (Ug. Shs)</b>
Stationery	2 reams of paper, 10 pens, Rulers and Pencils	38,000
Binding and Printing Services		150,000
Transport Costs		150,000
Airtime		90,000
Feeding		45,000
Miscellaneous		1,400,000
Total		1,873,000

### **Appendix V: (Pictures During Collection Of Data).**

The reseacher collecting during data collection in the field





**The researcher helping the respondents to count the stock getting out of the business**

**Appendix VI: (The Letter from the department to carry out research)**



making a difference

**Office of the Dean  
Faculty of Business Administration and Management**

Your ref.:  
Our ref.:

Nkozi, 20<sup>th</sup> April 2012

**TO WHOM IT MAY CONCERN**

Dear Sir/Madam,

**Re: Research Work Assistance**

Greetings from Uganda Martyrs University.

This is to introduce to you AGABA, BRENDA who is a student of this University. As part of the requirements for the award of the Master of Business Administration and Management of this University, the student is required to carry out field research for the submission of a Project paper.

I therefore request you to render the student such assistance as may be necessary for the research.


Thank you in advance.

Yours Sincerely,

Sr. Prisca Kobusingye  
Dean



**Appendix VII: (The new title of the proposed building of the New Taxi Park)**



FRV.706/24  
47025  
LEASEHOLD REGISTER

Volume 4277 Folio 2

THE REPUBLIC OF UGANDA

REGISTRATION OF TITLES ACT

**CERTIFICATE OF TITLE**

DESCRIPTION OF LAND


The Leasehold land edged red on the plan attached hereto and situate and known as follows:-

PLOTS 3A-5A NAMIREMBE ROAD AND 1A-7A, 9A-11A AND  
 Street Number: 15A HACKAY ROAD  
 Road Name:  
 Township/Municipality/City: KAMPALA  
 District: KAMPALA Area: APPROX.1.132HECT.


TERM from 1ST APRIL 2011 for 5 years and --- months  
 at the rent and subject to the covenants and conditions contained or implied in Lease  
 Number bound up herewith and to the incumbrances (if any) entered in the  
 Incumbrance Register.

Easements

PROPRIETORSHIP

Date, time and Inst. No.	Name and Address of Proprietor	Signature of Registrar
REGD.18.11.2011 AT.10.05A.M. INST.458513.	NEW PARK LOCK UP OWNERS ASSOCIATION LTD. P.O.BOX 26741, KAMPALA.	 Registrar of Titles

Date of issue: 23RD NOVEMBER, 2011

  
 Registrar of Titles.

NEW TITLE OF THE NEW TAXI PARK

