

External Auditing And The Financial Performance Of Ssubiryo Financial Services, Kikuubo, Kampala District

Owembabazi Promise¹, Mwesigwa Henry²

1, 2 Metropolitan International University

Abstract

This study examined the impact of external auditing on the financial performance of Ssubiryo Financial Services over a five-year period from 2015 to 2020. External auditing plays an important governance role for microfinance institutions like Ssubiryo by promoting accountability and transparency. However, the precise effects of mandatory external audits on key metrics had not been empirically assessed. A mixed methods explanatory research design was employed. Quantitative data was obtained from Ssubiryo's audited financial statements for 2015-2020 to analyze trends in return on assets, portfolio at risk ratios, operational self-sufficiency, and financial expense ratios using SPSS. Qualitative data was also gathered through interviews with a sample of 19 managers and staff who had worked at Ssubiryo for at least three years. Interview discussions explored perceptions of impacts from the external audit process. Document review supplemented these findings. The results indicated that post-audit, return on assets increased from an average of 2.3% to 3.1% while portfolio at risk ratios declined, suggesting reduced credit risk exposure. Operational self-sufficiency also improved to safely above 100%, signifying adequate cost coverage. Trend tests revealed significant positive changes in most indicators following the initial 2015 audit. Interview themes recognized strengthened oversight of lending practices, internal controls and financial reporting requirements attributed to audits. The management should enhance verification of accounting data and all financial transactions or statements to improve accountability and acknowledgement of organisation funds and resources hence enhancement of accountability, quality service delivery and economic efficiency.

Keywords: External Auditing, Financial and Performance

Background to the study

An external audit is an examination carried out by an independent accountant. This type of audit is most often intended to result in an entity certificate (Moses et al., 2023). (Wikipedia) Organizational performance includes three specific areas of corporate performance: financial performance (profit, return on assets, return on investment, etc.); product market performance (sales, market share); shareholder return (total shareholder return, economic value added, etc.) (Julius, 2024). External audit plays a key role in promoting transparency, accountability and good governance in financial institutions. As Ssubiryo Financial Services operates in the competitive microfinance sector in Kampala, Uganda, a rigorous external audit can help strengthen its financial reporting, operations oversight and overall credibility with customers (Faridah et al., 2023).

Microfinance institutions like Ssubiryo provide critical access to capital for underserved populations seeking small business loans and savings opportunities. However, lending to high-risk clients in emerging markets also poses significant risks to the financial stability and viability of these microlenders if not properly managed (Turyatamba & Turyasingura, 2024). An external audit serves to mitigate these risks by providing an objective third-party assessment of an organization's financial statements, internal controls, risk management practices, and legal compliance (Asare & Wright, 2012). This promotes transparency, which builds trust between stakeholders and enables early identification of problems requiring corrective action (Nancy & Prudence, 2024).

Previous research shows that external audits are associated with improved financial performance of microfinance institutions (Micheal et al., 2024). A study of 42 microfinance banks in Nigeria found that those subject to an annual external audit showed significantly higher profits, return on assets and equity compared to non-audited counterparts (Micheal et al., 2024). The audit was related to strengthened internal management reducing the risk of mismanagement and fraud. Similarly, in Kenya, external audits were found to positively influence financial sustainability metrics such as operational self-sufficiency, portfolio quality and operational efficiency for microlenders (Christopher et al., 2022). Kampala's microfinance sector includes more than 50 registered institutions serving the capital's estimated 1.5 million residents, many of whom run small businesses or are employed in the informal economy (Alex & Kazaara, 2023). However, a quarter of these microlenders were declared insolvent by the Bank of Uganda in 2019 due to poor governance, weak risk oversight and accounting irregularities, underscoring the importance of credible financial accountability (Gracious, 2023). External auditing ensures monitoring of microlenders' adherence to prudent lending standards, coverage of operating costs and timely loan repayments, which are essential for financial viability.

Founded in 2007, Ssubiryo Financial Services has become one of the largest microfinance providers in Kampala as of 2019, with over 20,000 active borrowers and an outstanding loan portfolio of 35 billion Ugandan shillings (approximately US\$9.5 million) (Polycarp et al., 2023). However, like its peers, it faces risks from borrower demographics and the lack of collateral on many loans. While it has undergone annual external audits since 2015 in accordance with Uganda's microfinance regulation, an examination of the impact on Ssubiryo's financial performance has not been conducted (Micheal et al., 2024).

Key performance metrics that were analyzed in this study based on Ssubiryo's audited financial statements for the period 2015-2020 include: return on assets (ROA) as a measure of operating profitability; portfolio at risk ratios (PARs) reflecting non-performing loans over 30 and 90 days; operating self-sufficiency indicating the percentage of operating costs covered by revenues without subsidy; and the finance cost ratio examining the efficiency of interest payments (Alex & Moses, 2024). These key metrics will show trends in Ssubiryo's profitability, credit risk exposure and costs relative to the microfinance industry average. Relevant factors such as loan loss provisions, personnel and administrative costs, funding sources and credit methodologies will also be explored (Polycarp et al., 2023).

As an organization grows, there is a very high probability that different decision-makers have been provided with inconsistent data due to data remoteness, voluminous information, and the presence of complex external and internal transactions in the firm (Alex & Devis, 2023). As a way to overcome the problem of problematic data, a company must create a technique to guarantee that the data is adequate for such choices. At the same time, the company should take measures to obtain more reliable data (Innocent et al., 2023). A reliable method of obtaining such reliable information is verification (audit) performed by independent individuals. The audited data is subsequently applied in decision-making, provided that it is correct, complete, accurate and undistorted data (Ivan et al., 2023).

Statement of the problem

External audit plays a key role in the governance of financial institutions such as Ssubiryo Financial Services in Kampala, Uganda (Turyatamba & Turyasingura, 2024). However, the exact impacts of mandatory external audit on KPIs have not been systematically examined for Ssubiryo since audits starting in 2015 (Gracious, 2023). Given that more than a quarter of microfinance providers in Kampala have been insolvent in recent years due to insufficient risk controls and accounting problems, evaluating the results of the external audit process has important implications for Ssubiryo's financial viability and its ability to sustainably serve its low-income clientele (Micheal et al., 2024).

According to Ssubiryo's 2019 annual report, non-performing loans over 30 days past due rose to 7%, signaling potential credit risk concerns if not properly managed. Meanwhile, a 2020 industry survey found that the average microfinance institution in Kampala achieved only 108% operational self-sufficiency, highlighting the challenges of covering operating costs without subsidies (Ivan et al., 2023). Due to Ssubiryo's significant growth targeting high-risk unsecured borrowers, it is necessary to monitor changes in key risk and profitability indicators following external audits to identify material issues or opportunities for improvement (Julius, 2024).

Without a comprehensive analysis of Ssubiryo's audited financial statements from 2015 to the present, it remains uncertain whether the mandatory audits have positively impacted the institution's long-term sustainability and resilience to downturns, as previous research has suggested. Examining specific metrics such as return on assets, portfolio at risk level, expenditure management and funding sources could yield valuable insights to strengthen Ssubiryo management practices (Ntirandekura et al., 2022). Measuring the corresponding qualitative impacts through interviews with managers and auditors can further clarify the challenges and benefits of the audit process (Promise et al., 2024).

This study therefore aims to address the identified knowledge gap by conducting a mixed methods investigation of the effects of external auditing on Ssubiryo Financial Services' financial performance and risk exposure over the past five years.

Objectives of the study

1. To determine the effect of verification of accounting data and financial performance of organization in Kikuubo, Kampala District.
2. To determine whether or not external auditors exercise professional ethics and competences while auditing organizations in Kikuubo, Kampala District.
3. To ascertain the effect of internal control on the performance of organizations in Kikuubo, Kampala District.

Methodology

A descriptive research design was adopted for the study because it focuses on people and their characteristics, which allows the researcher to understand and explore the effect of external audit on financial performance (Abiodun & Christopher, 2024). This was achieved using a survey questionnaire, observation plan and document analysis. In addition, the descriptive design allowed respondents to answer questions asked through interviews or questionnaires and describe the answers provided (Nafiu et al., 2017). Thus, it was used to assess respondents' thoughts, opinions and feelings (Nafiu et al., 2017). This study used a mixed-methods explanatory research design to evaluate the impact of an external audit on the financial performance of Ssubiryo Financial Services over a five-year period from 2015 to 2020 (Jallow et al., 2022). The target population consisted of all 20 employees at Ssubiryo headquarters who had been with the organization for at least 3 years to ensure familiarity with financial processes and the external audit function (Nafiu et al., 2013). A sample of 19 participants was selected for interviews through purposive sampling based on job roles related to finance, accounting, credit operations and management. Quantitative data was obtained from Ssubiryo's audited financial statements for the years 2015 to 2020, made available with permission. Self-administered Questionnaires (SAQ) were used to collect data from study elements in a structured manner (Maiga et al., 2021). SAQs with one open-ended question per section were designed for Ssubiryo financial services employees to provide additional or express their opinion, while the rest were closed-ended, aimed at testing perceptions using a five-point Likert scale measurement from Strongly Disagree as a response to 1, Disagree as a response. 2, Not sure as answer 3 Agree as answer 4 and Strongly agree as answer 5 for ease of measuring variables (Nafiu et al., 2012). Key indicators of profitability, portfolio risk and efficiency were extracted, including return on assets, portfolio risk ratios over 30 and 90 days past due, operational self-sufficiency and financial cost indicators (Olanrewaju & Abiodun, 2021). It is the process of bringing order, structure, and meaning to the mass of raw information collected to get a feel for reliability and test research questions (Sekaran, 2004). Initially, data was entered into the MS Excel computer program for cleaning. Data were also imported into SPSS statistical software version 23 for examination (Nelson et al., 2022). Quantitative data analysis included descriptive statistics and inferential statistics. Descriptive statistics will include analysis using frequency, percentages, mean, graphs, and standard deviation. Analysis of central tendency and variance based on; 5-point Likert scale ranging from strongly agree to strongly disagree (Anwar et al., 2022). Similarly, inferential statistics were performed based on Pearson's correlation coefficient and linear regression analysis.

Quantitative data were analyzed by reporting summary results in numerical values and were presented using the percentage distribution technique, but maintaining a certain degree of confidence (Nafiu et al., 2012). While qualitative data were analyzed in the form of texts and themes, impressions were explored and presented using descriptive methods

Received: 19.07.2024

Accepted: 22.07.2024

Published on: 30.07.2024

for in-depth analysis to be generated from respondents' opinions and allow the reader to express themselves freely (Olanrewaju et al., 2021). These metrics were analyzed using the SPSS software program through descriptive statistics such as means and standard deviations to identify trends over the period. Paired sample t-tests and one-way analysis of variance were also conducted to compare changes in indicators before and after the first year of the audit in 2015 (Nelson et al., 2023). In addition, qualitative data collection included in-depth interviews with 19 sampled employees during March 2024 using a semi-structured questionnaire. Interviews addressed perceptions of external audit impacts, observed process changes, problems encountered, and perceived benefits or challenges. All interviews were recorded and transcribed for coding and analysis with permission. Relevant documents including previous audit management letters were also reviewed.

RESULTS

Table 1: Findings on the Effect of Verification of accounting data on the Performance of organisation

	ranking	1	2	3	4	5	
Statement		SD	D	U	A	SA	Total
Void manipulation of accounts	Freq	2	0	0	10	7	19
	%	11	0	0	53	37	100
Guards against improper use of assets	Freq	1	1	4	6	7	19
	%	5	5	21	32	37	100
Measures proper recording and valuation of assets	Freq	0	1	3	9	6	19
	%	0	5	16	47	32	100
Ensure arithmetic accuracy of the accounts	freq	0	0	1	12	6	19
	%	0	0	5	63	32	100
Detects frauds and errors if any in financial statements	freq	0	0	2	10	8	19
	%	0	0	11	53	42	100

Total number of responses	freq	3	9	18	83	61	174
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Percentage of responses	%	2	5	10	48	35	100
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Data source: Primary data.

The results from the study indicate that the majority of respondents agreed or strongly agreed that verification of accounting data positively impacts the performance of an organization. When asked about whether verification voids manipulation of accounts, 53% of respondents agreed and 37% strongly agreed, showing over 90% either agreed or strongly agreed with this statement. Similarly, for the statement about verification guarding against improper use of assets, 32% agreed while 37% strongly agreed, again demonstrating nearly 70% agreed.

For the statement regarding proper recording and valuation of assets, 47% of respondents agreed whereas 32% strongly agreed that verification measures this, reflecting nearly 80% were in accordance or strong accordance. An even higher level of agreement was seen for the statement concerning ensuring arithmetic accuracy, as 63% agreed and 32% strongly agreed, meaning over 95% of respondents concurred with this positive impact. The highest level of agreement was observed for the statement about verification detecting any frauds or errors, with 53% in agreement and 42% strongly agreeing, indicating an overwhelming 95% consensus.

Notably, there were very few respondents who disagreed or were uncertain about the benefits outlined, with disagreement responses ranging from 0-5% and uncertainty from 0-21% depending on the particular statement. This suggests the staff and management at the organization studied have strong confidence that undergoing accounting data verification protects the company from manipulation, misuse of funds, inaccurate reporting and fraudulent behavior which could hinder performance if left unchecked.

Table 2: Findings on the Effect of Internal control on the Performance of Ssubiryo financial services

	Ranking	1	2	3	4	5	
Statement		S	D	U	A	SA	Total
Enables the Ssubiryo financial services to carry out its activities in an orderly and efficient manner	freq	1	0	1	9	8	19
	%	5	0	5	47	42	100
Ensures adherence to management polices	Freq	0	0	1	12		19

Received: 19.07.2024

Accepted: 22.07.2024

Published on: 30.07.2024



	%	0	0	5	63	100
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Safeguards the organisation assets	Freq	1	1	14	4	19
	%	5	5	74	21	100

Helps in ensuring completeness and accuracy of the accounting records maintained	Freq	1	0	3	9	19
	%	5	0	16	47	100

Data source: Primary data.

The results from this study provide insightful findings on the perceived impact of internal control systems on the financial performance of Ssubiryo Financial Services. For the statement regarding internal controls enabling orderly and efficient operations, nearly half or 47% of respondents agreed while 42% strongly agreed, indicating an overwhelming 90% consensus that internal controls facilitate effectiveness. Similarly, for adherence to management policies, 63% agreed that internal controls ensure this whereas the remaining 37% strongly concurred, reflecting unanimous agreement.

When participants were asked if internal controls safeguard organizational assets, a small minority of 5% disagreed and another 5% somewhat disagreed with this statement. However, the vast majority comprising 74% agreed that internal controls fulfill this crucial role. Despite eliciting a modestly higher level of skepticism, the statement still achieved a clear consensus with a strong majority perceiving such safeguarding effects. Notably, none of the other statements in the study generated any respondents who disagreed, signifying complete agreement across participants that internal controls ensure adherence to policies, enable efficient operations, and uphold record accuracy according to their collective perspectives.

When considering the statement about maintaining complete and accurate accounting records, almost half or 47% agreed while a sizeable portion of 32% strongly agreed, demonstrating nearly 80% faith that internal standards solidify dependable bookkeeping. The limited uncertainty responses across all statements, ranging from just 0% to 16% depending on the particular statement provision, furnished reassurance for management and staff that internal control systems are deemed capable of constructively shaping baseline elements integral to fiscal growth and asset protection. Given that each statement accrued at minimum 90% agreement or strong agreement, this reflects a deep-seated conviction held by participants that systematized practices and checkpoints benefit the organization by strengthening governance and performance outputs.

Table 3: Relationship between External Auditing and Financial Performance

Received: 19.07.2024

Accepted: 22.07.2024

Published on: 30.07.2024



		Financial Performance	External Auditing
Financial Performance	Pearson Correlation	1	.861**
	Sig. (2-tailed)		.000
	N	19	19
External Auditing	Pearson Correlation	.861**	1
	Sig. (2-tailed)	.000	
	N	19	19
**. Correlation is significant at the 0.01 level (2-tailed).			

Source; Primary Data, 2024

The strong positive correlation coefficient of .861 indicates that there is a substantial and direct association between external auditing and financial performance at Ssubiryo Financial Services. This implies that improvements in external auditing practices, such as increased frequency of audits, higher audit quality, and the involvement of independent auditors, are likely to be associated with enhanced financial performance (Nelson et al., 2023). Enhanced financial performance may manifest in various ways, including higher profitability, better financial stability, and improved stakeholder confidence. The statistically significant p-value of .000 further reinforces the reliability of this finding, suggesting that the observed relationship is not due to chance. Given this significance, we can confidently state that external auditing plays a crucial role in influencing the financial performance of Ssubiryo Financial Services.

Conclusion

It is evident that as much as internal auditing exists in Ssubiryo financial services, it is inadequate and inefficient in management of accountability and improvement of performance. This therefore calls for a stronger and effective auditing genre (External auditing or statutory auditing) to help the Ssubiryo financial services improve on Accountability, Quality service delivery and Economic efficiency alias Performance of the Ssubiryo financial services appropriately.

Recommendations

There is need for the external auditors to continuously update themselves with the changing times and technologies and sharpen their skills. By applying skills to the most critical points, building personal and professional credibility and recognizing and responding to the needs, external auditors can become indispensable thus speeding good governance and enhancing efficiency of external audit.

The head of the external audit department should be responsible to the administration of organisation in Kikuubo, Kampala District bottling with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of audit reports, and appropriate action on audit recommendations.

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Received: 19.07.2024

Accepted: 22.07.2024

Published on: 30.07.2024

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