
**Internal Control Environment And Financial Performance Of Kitgum Municipal Urban Council, Northern
Uganda**

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Abstract

This study investigated how the internal control environment affects FP in KMUC. It used a descriptive research survey design and adopted both qualitative and quantitative methods. The study targeted 70 respondents but 58 returned the survey questions, indicating a response rate of 83%. Stratified sampling techniques were used to select administrative staff, and purposive sampling used to select political leaders and top-level administrators. Data analysis involved frequencies, percentages and inferential statistics such as correlations, and coefficient of determinations. The study finding reveals a significant relationship between internal control environment and FP (0.335). The study concludes that internal control environment and audit positively affected FP in one way or the other. The study recommends that the environment for the implementation of ICS should be improved by ensuring that management is committed to the operation of the system, closely monitoring its implementation and giving feedback to the staff. District Public Accounts Committee capacity should be built and their office properly facilitated to enable them follow up on the internal audit reports so that corrective measures are taken.

**Keywords: Internal Control Environment, Financial Performance, Audit, District Public Accounts
Committee.**

Introduction

The ICS profession has continued to evolve with management advances, especially at the end of World War II. It is conceptually similar to financial auditing performed by public accounting firms, quality assurance and banking compliance activities (Innocent et al., 2023). Much of the theory underlying ICS is derived from the management consulting and public accounting professions with implementation (T. Christopher, 2022). The growth of the profession has accelerated as many internal auditors have acquired the skills needed to help companies and public institutions meet the requirements of narratives (SAS 300). According to the Auditing Standard Board, ICS is a measure of checks and balances, a method and procedure established by an organization to implement a systematic approach that management can rely on to

achieve its intended goals (F. Christopher et al., 2022). However, this was in the US and was for private entities, which may not be applicable in public entities, and many internal auditors may not have the required skills to help companies and public institutions meet their goals (Moses et al., 2023). Recent developments show the need for public institutions or organizations to have the ability to improve the level of financial performance in order to add value to their activities such as development projects and progress in service delivery in their structures (Faridah et al., 2023). .

The concept of ICS and FP has taken a big leap in the twenty-first century. It originally developed in Britain when a powerful, administratively strong, centralized state emerged. It was probably the most sophisticated state since the time of the Romans (Tasha et al.,

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2023). The English state, especially under Henry I (1100 – 1135) and Henry II. (1154 – 1189), was based on an efficient, financially strong administrative system. The findings of the Treadway Commission Reports (1987, p, 17) in the United States of America (US) confirmed that the absence or weakness of internal control and poor FP are the primary causes of many cases of fraudulent practices and reduced work standards. leading to poor quality work, value for money is not realized in public services and financial reporting of other business organizations (Racheal et al., 2023). In Uganda, this is evidenced by the various scandals rocking the National Social Security Fund (NSSF) and the Office of the Prime Minister (OPM), the Ministry of Public Service, among others. If internal control systems were strong, such transactions would be detected and blocked.

Therefore, the widespread global corporate and institutional scandals that have reached near-epidemic proportions in recent years have created concerns that this study seeks to explore. Notable cases include: Enron and World com, Xerox and more recently alleged fraud cases such as Lehman and Brothers in the United States of America, Parmalat in Europe and (Tasha et al., 2023) In South Africa there have been cases of accounting scandals in JCL and Rand gold and Exploration Companies (Rashid et al., 2023). In Nigeria, the CEO and CFO of Cadbury Nigeria Plc. she was fired in 2006 for inflating the company's profits several years before the company's foreign partners acquired a controlling stake (Kazaara & Kazaara, 2023). It is widely believed that properly implemented internal control systems improve financial performance, but despite this, an elaborate ICS FP has eluded most entities;

and this required investigation of the effects of ICS on FP (Michael C. Jensen, 1993, p. 852).

The Government of Uganda (GoU) has had massive cases of mismanagement of public funds despite the establishment and existence of the ICS. Examples include: UG V ONEG OBEL, Anti-Corruption Criminal Case No. 153 of 2010, NSSF scandals where hundreds of billions of shillings were lost. In the case of David Chandi Jamwa in the NSSF (National Social Security Fund), (Alex & Kazaara, 2023) three billion one million shillings of employees' monthly savings were embezzled and in the case of Geoffrey Kazindavs. Attorney General Crt. Pet. Funds from the Prime Minister's Office No. 50 of 2012 intended for the Northern Uganda Reconstruction Program were fraudulently transferred to personal accounts for personal gain. Many billions of shillings were diverted; these culprits were convicted (Faridah et al., 2023).

This study followed the “principal agency theory” introduced by Jensen and Meckling (1976, p. 1) and later extended (Wegulo et al., 2023). According to the theory, society consists of a combination of contracts between owners of economic resources and managers who are charged with the use and control of these resources (Jensen and Meckling, 1976, p. 5). Principal agency theory assumes that agents have more information than principals and that this information asymmetry adversely affects principals' ability to monitor whether agents are properly pursuing their interests. The theory also assumes that principals and agents act rationally and use contracts to maximize their wealth, which can lead to a moral hazard problem, suggesting that in seeking to maximize their own wealth, agents may face the

dilemma of acting against the interests of their principals (Micheal et al. , 2023).

As Tanzi (2000, p. 445) argues, between their creation and final implementation, fiscal decisions go through many stages in which errors, indifference, passive resistance, implicit opposition, and various forms of the principal agent problem can distort the outcome. Uganda's Public Financial Management Act of 2015 was met with such indifference and passive resistance that it was amended less than a year after its enactment. The Accountants Act 2013 also met with such opposition, which led to the recruitment of non-professional members of the Institute to the Accounts and Audit Department in violation of Section 34(2) of the Act, which affected FPs in the MUC. (Ntirandekura & Christopher, 2022) noted that with agency theory, the firm itself is seen as a 'nexus' of contracts. These contracts are used with the intention of ensuring that technocrats who are agents align their own interest with that of the council to achieve its goals. The central government (chairman) does not directly support the achievement of the council's goals, but uses municipal structures to do so by setting government rules and incentives to align the interests of the technocrats with those of the council.

Internal control as one of the many mechanisms used in business to solve the main agency problem and internal control has been shown to reduce agency costs. However, these studies may not be applicable in government entities because they were conducted on private entities. But for the purposes of this study, the main theory of agency was chosen. The GoU introduced a reward system for top performing

government entities to ensure that the technocrats who are the agents in this study are motivated to maximize the value of the entity (Micheal et al., 2023).

The said theory may be applicable in other parts of the world but not in Uganda and Kitgum Municipal Council (KMUC) where professionalism is not very important. Despite the enactment of Section 34(2) of the Accountants Act 2013, which requires all Heads of Accounts, Finance and Internal Audit to be professional members of the Institute of Certified Public Accountants of Uganda, the municipal council continued to recruit non-professionals for these positions. .

According to the Annual Report of the Auditor General (2011, p.vii), internal control is a set of systems that ensure that financial and other records are reliable, complete and ensure compliance with the principles of governance of the entity, the proper and effective management of the entity. accounting unit and proper registration and protection of assets and resources. A process performed by the entity's board of directors, management, and other personnel to provide reasonable assurance about the achievement of objectives in the categories of reliability of financial reporting, efficiency and effectiveness of operations, and compliance with applicable laws and regulations. Financial performance is assessed in terms of measures such as profitability (using absolute and relative measures), liquidity (using common ratios, acid test, the entity's ability to meet its financial obligations) and responsibility (in terms of financial responsibility) (Akankwasa et al., 2022).

Statement of the problem

Public sector entities exist to serve the public (Frank et al., 2023). This mandate is a filter through which key characteristics of public sector entities are distinguished from less relevant attributes. In order to achieve this mandate, public sector entities have been granted powers, rights and responsibilities, including responsibility for policy development and implementation (Allan et al., 2023). The mandate to serve the public over the long term and the powers, rights and duties conferred require public accountability for the actions, decisions and results of a public sector entity. This need for public accountability is a major characteristic of public sector entities (Frank et al., 2023). The Government of Uganda has established audit committees to assist accountants in their oversight responsibilities regarding financial practices, internal controls, corporate governance issues, legal compliance, ethics and audit matters (Public Financial Management Act, 2015, p, 48). The research is considered necessary as policy makers and practitioners continue to share concerns about policy deviations in city councils affecting financial performance. The rationale behind this study is to enable KMUC and all its stakeholders to improve internal control systems and financial performance (Racheal et al., 2023).

Objective Of The Study

The objective is to find out how internal control environment affect financial performance in KMUC.

Research Question

How does control environment affect financial performance in KMUC?

Research Hypothesis

There are positive relationships between control environment and financial performance in KMUC.

Methodology

This study adopted a cross-sectional survey design, together with a case study design, where both qualitative and quantitative paradigms were considered. Cross-sectional design was used because it allows collecting data at one point in time hence minimizing costs and time, putting into consideration the limited time and resources available (Saunders, 2007, p. 610). A case study was used because it allowed for intensive investigation and focuses on a case or a few cases of a phenomenon. The study took both quantitative and qualitative approaches because quantitative approach helps to describe nature of relationships between the study variables, while qualitative approach is an ideal method when a holistic and in-depth investigation is needed. This called for mixed methods approach or triangulation approach in the study, thus enabling the researcher to compare findings from both paradigms. Kothari (2014, p.153) defines population as the total number of items about which information is desired. The study population comprised all members of the Urban Technical Planning Committee (UTPC), Town Clerk (TC), all accounts Assistants (AA) and Senior Accounts Assistants (SAAs), all Community development officers (CDOs), members of the Urban Executive Committees, all members of the District Procurement Committees, and all the technical staff in the Internal Audit Department. The above categories of urban staff form the leadership in KMUC and are responsible for internal control systems in the urban Council. The researcher used both probability and non-probability sampling methods. Probability sampling is one in which every member of a population has a chance of being selected in the sample and the probability can be

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accurately determined. The combination of both methods limits bias in sample selection. Non-probability sampling is any sampling method where some element of the population has no chance of being selected or where selection cannot be accurately determined. Stratified random sampling was used to select members of TPC, Accounts Assistants, Senior Accounts Assistants and Urban Executive Committee of Council. This technique was used to give more respondents in the population a chance to be part of the sample. To arrive at the sample, the researcher used proportional method where the accessible population was divided by the total accessible population of the study, multiplied by the total sample of the study. Data was analyzed in form of tables, frequencies and percentages using SPSS & STATA (Nelson et al., 2022)

RESULTS

Table 1: Shows results how internal control environment affects Financial Performance of Kitgum Municipal Urban Council

Items	M	SD	D	N	A	SA
Our entity has accounting and financial management system.	3.82	2 3.4%	7 12.1%	6 10.3%	30 51.7%	13 22.4%
Management is committed to the operation of the system	3.8	2 3.4%	5 8.6%	4 6.9%	42 72.4%	5 8.6%
Appropriate means is taken to correct mistakes in operation of our accounting and financial management system	3.8	0	9 15.5%	4 6.9%	35 60.3%	10 17.2%
Ethical values are upheld in all management decisions	3.5	2 3.4%	7 12.1%	12 20.7%	35 60.3%	2 3.4%
Our entity has an objective, independent and active public accounts committee	3.4	2 3.4%	12 20.7%	15 25.9%	21 36.2%	8 13.8%
Managements provide feedback to the junior officers about the operation of the system	3.6	0	8 13.8%	16 27.6%	26 44.8%	8 13.8%
Management closely monitors the implementation of internal control system	3.6	2 3.4%	6 10.3%	13 22.4%	27 46.6%	10 17.2%
Average mean	4.0					

Source: Primary data (2023)

The study findings in the above table show that the internal control environment in KMUC is moderately positive (aggregate mean = 4.0). A comparison of these items shows that the percentage of respondents that opposed ranged from 0% to 20.7%; the percentage of those who were not sure ranged from 6.9% to 27.6%, while percentage of those who concurred ranged from 3.4% to 72%. From these comparisons it can be seen that the range of percentages

of those who concurred and those who are not sure are lower compared to those who opposed. Thus from this analysis the following is the interpretation (Ronet et al., 2023).

The results in the table above shows that KMUC has accounting and financial management system (mean = 3.8), management is committed to the operation of the system (mean = 3.8). This means the environment in which internal control system is implemented is conducive to improved FP. Appropriate means is taken to correct mistakes in the operation of the accounting and financial management system in KMUC (mean = 3.8), ethical values are upheld in all management decisions (mean = 3.5). The above findings mean that corrections can be made where the council gets it wrong and ethical values are upheld which can improve financial performance KMUC (Polycarp et al., 2023).

The study respondents also proved that there is an objective, independent and active public accounts committee in place (mean = 3.4). This means internal audit reports are reviewed quarterly and corrective measures are taken to improve FP in KMUC Management also provide feedback to junior officers about the operation of the system (mean = 3.6) and management closely monitors the implementation of ICS (mean = 3.6). This means that work well done is appreciated and weaknesses are pointed out for improvement which eventually leads to improved FP in KMUC.

TESTING THE INFLUENCE OF INTERNAL CONTROL ENVIRONMENT ON FINANCIAL PERFORMANCE OF KITGUM MUNICIPAL URBAN COUNCIL

In order to determine the influence of internal control environment on FP of KMUC, correlation and regression analysis was conducted the results are summarized in the tables below.

Table 2: Relationship between internal control environment and Financial Performance

Internal Control environment		Internal Control environment	Financial performance
	Pearson Correlation	1	0.335*
	Sig-2-tailed)		0.010
	N	58	58
Financial performance	Pearson Correlation	0.335*	1
	Sig-2-tailed)	0.010	
	N	58	58

Source: Primary data (2023)

According to the result table above, internal control environment was found to have positive relationship ($r = 0.335$ $p < 0.05$). Thus, the hypothesis that stated that there is a positive relationship between internal control environment and FP in KMUC is accepted. This means that internal control environment has a positive effect on FP of KMUC. This practically implies that FP in KMUC improves with better internal control environment (Nelson et al., 2023).

In order to determine the extent to which internal control environment influences FP, a regression analysis was carried out. The results are summarized in the table below.

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Table 3: Correlation Coefficient showing the influence of internal control environment on Financial Performance

R Square= 0.112, P=0.010		
	Standardized Coefficient	
	Beta	Sig.
Internal control activities	0.335	0.010

Source: Primary data (2023)

According to the result in the summarized Table 10, findings show that internal control environment significantly affects FP ($r = 0.335$). This means that internal control environment is a significant determinant of FP in KMUC. Correlation just implies a casual effect, coefficient of determination which is a square of correlation coefficient ($r^2 = 0.112$) was computed and expressed as a percentage to determine the variance of FP in KMUC as a result of internal control environment. Thus, findings show that internal control environment accounted for 11.2% variance in FP in KMUC (Nelson et al., 2023).

Test of significance (p) was also carried out and it shows that the significance of correlation ($p = 0.335$) which is more than the recommended significance at 0.05. This means that internal control environment has a significant positive effect on Finance performance. In practice, this means FP improves with improvement of internal control environment.

Summary Of Findings

The study tested the second objective “*To find out how internal control environment affects FP in KMUC*” and it was accepted. This was because there was a significant positive relationship ($r = 0.335^*$) between internal control environment and FP in KMUC, whereby an improvement in internal control environment translates into improvement in FP and enable adherence to strong ICS. The study respondent accepted that the environment in which ICS is implemented is conducive. The study respondents agreed that KMUC has accounting and financial management system, it was accepted that management is also committed to the operation of the system. It was established that KMUC has an active and independent public accounts committees, management provides feedback to junior staff on important issues relating to the implementation of the ICS.

According to the study respondents, management closely monitors implementation of ICS, ethical values are upheld in decision makings and appropriate means is taken to correct mistakes in implementation of the ICS in KMUC.

Therefore internal control environment and FP were found to have moderate positive relationship.

Conclusions

The study also concluded that there is a moderate positive relationship between internal control environment and FP in KMUC. The environment in which ICS operates contributes a lot to the success of the system and that was proven by Boyle, Cooper and Geiger (2004, p.9) control environment is accepted as a tangible component of a strong

system of internal control which can have a substantive impact on the nature and extent of the audit. However, direct research and guidance to link control environment characteristics to audit procedures is still needed.

Recommendations

ICS needs a conducive environment for efficient implementation to minimize fraud; efficient and effectiveness of performance including management integrity and ethics are emphasized and strongly adhered to as they determine the strength of control environment and improved financial performance in public institutions. Appropriate means are always adopted to correct mistakes in operations of the accounting systems and feedback is provided to junior officers about the operations of the system. This can be achieved by close monitoring of the implementation of internal control systems.

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