



**Muniru Sewanyina, Baineamasanyu**

Assistant Lecturer, Faculty of business and Management; Kampala International

University Kampala, Uganda, +256785129847 [sewanyina.muiru@kiu.ac.ug](mailto:sewanyina.muiru@kiu.ac.ug)

Lecturer, Faculty of Business and Management; Kampala International University

Kampala, Uganda +25677947742 [Bainemry2001@gmail.com](mailto:Bainemry2001@gmail.com)

**Abstract**

*This study thought to answer a question whether control environment affects financial performance of SACCOs in Bushenyi-Ishaka municipality. It was guided objective which to determine the relationship between control environment and financial performance of SACCOs in Ishaka division. The study adopted descriptive cross sectional and correlational designs with both quantitative and qualitative approaches. A total population of 130 was involved which included employees, supervisory committee, loan committee and board members from which a sample of 98 respondents were selected using Slovene's formula. Out of 98 respondents, 90 respondents responded positively. Data was collected using questionnaire and interview guide and analyzed using descriptive statistics and chi-square for quantitative data and thematic analysis was used for analyzing qualitative data. Findings indicate that there is a significant relationship between control environment and financial performance of SACCOs and control environment contributes 69% to the financial performance of SACCOs in Bushenyi-Ishaka municipality. From the study findings, the study recommended that SACCOS in Bushenyi-Ishaka municipality should create conducive control environment like putting place disciplinary committee to handle disciplinary issues and include communication as part of their internal control system.*

**Key Words:** Control Environment, Financial Performance and SACCOs

**Introduction**



SACCOs are professional association where members puddle their savings together and get loans from which they can use for different purposes (Jenik, Lyman & Nava, 2017). They play an important role in mobilizing financial resources for most development activities especially for local population (Shibutse, Kalunda & Achoki, 2019). SACCOs are also cooperative societies aimed at encouraging members to save for the purpose of creating capital which can be lent to members at a friendly interest rates and conditions than other financial institutions (Njenga & Jagongo, 2019). The members are able to mobilize their own funds within themselves without depending on outside sources and lend to members at lower interest rates and better conditions and they are unique from other financial institutions in a way that they are the micro-finance institutions that allow the owners to use the services they offer (D'Espallier, et.al. 2017). Uganda Cooperative Alliance asserted that they are owned, used and controlled by members for their own benefits. Their main objective is to promote savings amongst the financially poor section of the community (Okello et.al. 2018). In Uganda, SACCOs have been preferred to MFIs because they are controlled directly without the interferences of donors. This initiated a plan of government looming for presidential vote

in 2006 and this was done to gather support from the locals through rendering financial support indirectly (Bayai & Ikhide, 2016). SACCOs are able to operate in hard to reach areas and this makes them more desirable to customers that other financial institutions (Lydia, 2018). However, indicated that frauds have increased in SACCOs (Kamau, 2016). Over 26% of the loans given to customers remained unrecovered by the SACCOs and could be attributed to failure to assess and control credit risks and over 60% of the SACCOs established are not able to celebrate their first birth day (Anania, Gikuri & Hall, 2019). SACCOs in Uganda have suffered many challenges in managing their liquidity and insufficient loan portfolio and their profitability is still low (Mmari & Thinyane 2019).

### **Problem statement**

SACCOs in Ishaka- Bushenyi Municipality have been increasing in number since 2011 and by the end of 2016 had reached a total of seven and their average profitability stood at 2% and the average liquidity stood at 10% by 2019 which is below the required percentage of 15% as per the SACCO society Act 2008 (Arthur, et.al. 2019). Furthermore the SACCOs in Ishaka- Bushenyi Municipality

are not doing financially well and has not yet met the required level due challenges in liquidity and profitability like the return on assets is still very low and the liquidity ratio is also still below the required standard of 15%. This article seeks to investigate whether the SACCOs' low profitability and liquidity is as a result of control environment and it is this belief that inspired the researcher to undertake this study.

### **Study objective**

To analyze the relationship between control environment and financial performance of SACCOs in Ishaka- Bushenyi Municipality.

### **Null hypothesis**

There is no significant relationship between control environment and financial performance of SACCOs in Ishaka- Bushenyi Municipality.

### **Theoretical Review**

This study was based on the stewardship theory and according to Donaldson and Dan (1991 &1993) and Rita (2016) this theory takes managers as collectivists, dependable, proorganizational, with behaviors which are associated with the interests of the

principal. The theory indicates that managers will act in the organization's best interest even if there are no controls in place (Kerzner, 2017). Managers are seen as good care takers who attentively work to enable the organization achieve higher profits and share holders value (Grundeis, 2008). However, this theory ignores the fact that, sometimes managers have diverging interests from those of the organizations they manage and are likely to work towards their interests at the of their organizations. According to Rita (2016), it is also important to provide alternative theories that may try to challenge the chosen theory by taking into account the limitations of the chosen theory. In the alternative theory, managers are seen as agents and are willing to work in the best interest of the principal.

### **Agency theory**

Agency theory was evolved from the seminal papers of Alchian and Demsetz (1972) and Jensen and Meckling (1976) and it looks at the relationship between the shareholders and the management of companies. It also involves tackling the problem that may arise in principalagent relationship. That is to say, the shareholders and company executives; this theory solves the problem that comes from the desires of

the principal in conflict that of the agent and the ones from the diverging perspectives towards risks (Kamau, 2014). Other scholars like Adams (1994) contends that this theory give a wealthier significant research in internal controls. He adds that the theory of agency is more helpful in maintaining the costefficient contract between the shareholders and the managers. This theory is quite related to the above in such way that it also emphasizes the agent principal relationship, though in this case the relationship is mandatory.

### **Empirical Review**

Maraleetharan (2013) notes that control environment begin with the top management and the board of directors who lay a foundation by devising policies, good governance and morals. This implies that when directors and managers relax, more frauds and errors are likely to occur in financial reporting and control environment is an important factor in a firm's efforts to achieve high financial performance (Harrell-Cook, Levitt & Grimm, 2017). Kamau (2014) in his study states that control environment features such as the level risk, control awareness and the extent to which the responsibilities pertaining to risk management and internal controls are

stated and communicated are strongly correlated with the role of the internal audit function and fraud detection in the organization. Control activities like penalties on employees' proclivity to fraud and established that when there is a clear control environment, employees are deterred from being fraudulent. In a study on Nigerian banks, Ewa and Udoayang (2012) discovered that the internal control environment and the structure influences employee feelings towards fraud. Kakucha (2009), studied the effectiveness of the internal control systems of the firms in Nairobi and discovered that the inefficiencies of internal control systems differ from firm to firm and their effect on financial performance of such firms also differs. He further notes that the communities are less aware of what an effective internal control system should constitute. Amudo and Inanga (2009) conducted a study in Uganda and looked at the internal control systems that African development Bank regional members place on management of public sector projects and discovered that most projects were mismanaged due to lack of complete working internal control systems. Goh (2009) evaluates different factors that affect firm's performance and discovered that an audit committee with financial knowledge helps the firm to reduce on financial

weaknesses and its independence also contributes significantly to the effectiveness of internal control systems and has significant impact on the financial performance of firms. Kamau (2014) also maintains that most firms in Kenya that had effective control environment in place witnessed an improvement in their financial performance. This indicates that big investments have been lost due to weak internal control systems and this has been due to fraud and mismanagement of assets that are used to generate revenue. Romar and Morberg (2003), in their study of the causes of WorldCom scandals of 2002 discovered that aggressive management thinking and inadequate environmental analysis were among the factors that contributed to the down fall of the company; and recommended that there should conducive control environment in order for companies to enhance their financial performance. Finally, Wainaina (2011) contends that internal control systems should not only be in place for detecting fraud but also to create accounting environment in firms.

### **Methodology**

The study adopted a descriptive cross-sectional research design, using both

qualitative and quantitative methods in a methodological triangulation framework. Qualitative method was used to enable the researcher in collection and analysis of qualitative data and quantitative method helped the researcher in collection and analysis of quantitative data to establish the relationship between internal control systems and financial performance of SACCOs in Bushenyi Ishaka Municipality. The study population was 150 people from five SACCOs in Ishaka- Bushenyi Municipality and it included the board of directors, supervisory committee, loan committee members and employees of those SACCOs and a sample size of 109 was taken from total population of 150 using Slovene's formula. Stratified sampling with simple random and purposive sampling was used to select respondents from different SACCOs. Descriptive statistics and inferential statistics were used to analyse data.

### **Results**

#### **Descriptive Statistics**

This measures the level of agreement and disagreement about the existence and working of control environment in SACCOs in Ishaka- Bushenyi Municipality. Questions were designed

about control environment and the responses of the respondents were measured on a five Likert scale were 5= strongly agree, 4= agree, 3= neutral, 2= disagree and 1 = strongly disagree. The researcher used mean and standard deviations to measure the level of agreement and disagreement as shown below.

errors and weaknesses in the system		
Integrity is observed by management and employees when executing their duties and responsibilities	4.00	0.838
Management and employees are ethical in conducting their duties and responsibilities	3.95	0.729
There is a disciplinary committee in the SACCO to handle indiscipline cases	2.25	0.946
The board of directors and supervisory committee are independent of management	4.35	0.626
The SACCO has objective set and are followed	4.47	0.644

**Table 4.1 Control environment of SACCOs in Ishaka-Bushenyi Municipality**

Statements	Mean	SD
The SACCO has put in place a well built accounting and financial system	4.13	0.811
The SACCO is always committed to the working of the system in place	2.25	0.863
The regularly monitor the operation of internal control system	3.97	0.805
The senior management give feedback to their subordinates about the working of internal controls	2.21	0.890
The SACCO takes corrective measures to rectify the indentified	3.85	0.865

*Source: Primary data, 2020*

From table above, the results indicate that SACCOs in Ishaka- Bushenyi Municipality have a well built accounting and financial systems in place (Mean=4.13, SD=0.811) but they were not committed to the working of such system (Mean=2.25, SD=0.863). This made them not to benefit from the accounting and financial system in place. The results also indicate that SACCOs were

regularly monitoring the operation of internal controls (Mean=3.97, SD=0.805) but the senior management were not giving feedback to their subordinates about the current working status of internal control systems (Mean=2.21, SD=0.890). At the same time, results indicate that they also take collective measures to rectify the errors and weaknesses identified in the internal controls (Mean=3.85, SD=0.865) as well as observing the integrity by management and employees while carrying out their duties (Mean=4.00, SD=0.838). In the same regard, the results show that management and employees are ethical when conducting their duties (Mean=3.95, SD=0.729) but the SACCOs in Ishaka-Bushenyi Municipality had no disciplinary committee in place to handle disciplinary cases in case they arise (Mean=2.25, SD=0.946). The results further indicate that the board and supervisory committee were independent from management (Mean=4.35, SD=0.626), this implies that all of them were able to do their work without interferences and the SACCOs had objectives set and followed (Mean= 4.47, SD=0.644). The overall result indicates that control environment of SACCOs in Ishaka-Bushenyi Municipality was working averagely (Mean=3.54, SD=0.885). The results indicate that the most control environment in place were setting and

following the objectives, observing the integrity and having strong systems in place while the worst were not having the disciplinary committee in place to handle indiscipline cases and not giving feed back to employees about the status of internal control systems. This implies that much as the SACCOs were aiming at having strong internal control systems, they were not able to clear indiscipline since they never had a disciplinary committee in place.

### **Hypothesis testing**

This involved establishing the relationship between control environment and financial performance of SACCOs in Ishaka-Bushenyi

Municipality. The researcher did that by testing the set hypothesizes using Chisquare as a statistical tool of analysis due to the nature the data that was collected and they hypothesizes were stated as below.

$H_0$  = there is no significant relationship between control environment and financial performance of SACCOs in Ishaka-Bushenyi Municipality .

$H_1$  = there is a significant relationship between control environment and financial

performance of SACCOs in Ishaka-Bushenyi Municipality.

**Table 4.13: Relationship between control environment and financial performance**

	Model fitting coefficient	Likelihood ratio tests		
		Chi Square	df	Sig
Intercept	163.431	48.09	2	0.002
Final	115.344			

Source: Primary data, 2020

From table above, indicates that pvalue (0.002) < level of significance (0.05), the null hypothesis which states that there is no significant relationship between control environment and financial performance of SACCOs in Ishaka- Bushenyi Municipality was rejected and the alternative hypothesis accepted. This implies that there is a significant relationship between control environment and financial performance of SACCOs in Ishaka- Bushenyi Municipality. Therefore for SACCOs to boost their financial performance, there a need to a conducive control environment in place.

### Multi level analysis

The determined coefficient of determination to help examine the level of change in financial performance that is explained by percentage in internal control systems and the results are summarized in the table below:

**Table 4.3: Coefficient of determination**

R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Standard Error
0.83	0.69	0.54	2.1065

From the above table 4.15, shows that there is a strong positive relationship between internal control systems and financial performance of SACCOs in Bushenyi-Ishaka municipality (r=0.83). The results also indicate that control environment contributes 0.69 (69%) to the financial performance of SACCOs in Bushenyi-Ishaka municipality.

### Discussion

The study findings shows that SACCOs in BushenyiIshaka municipality had a well built accounting and financial systems in



place (Mean=4.13) and were regularly monitoring the operations of internal controls (Mean=3.97) and the top management was in charge of monitoring the working of internal control systems. This is in agreement with Maraleetheran (2013), who notes that control environment begins with the top management and board of directors who lay a foundation by devising policies and good governance. The study findings also indicate that employees and management were ethical and were also observing integrity while conducting their duties (Mean=3.95&4.00 respectively). This is in agreement with Kamau (2014) who contends that control environment lay a foundation for other components of internal control systems and it comprise of integrity and ethics of employees and management. This was also in agreement with the stewardship theory by Donaldson and Davis (1991), who takes managers as trustworthy with high level of ethics and integrity. However, SACCOS were not committed to the working of the systems (Mean=2.23) and also top management giving feedback to were not giving feedback to their subordinates about the current status of working of internal control systems (Mean=2.21). Furthermore the SACCOS in Bushenyi-Ishaka- Bushenyi Municipality had no disciplinary committee to handle indiscipline cases (Mean=2.25).

This is in disagreement with Berra (2010) who established that when there is a clear control environment; employees are deterred from being fraudulent The study findings also revealed a significant relationship between control environment and financial performance of SACCOS in Bushenyi-Ishaka municipality (P-value (0.002) <sig value (0.05)). This implies that for SACCOS in Bushenyi-Ishaka municipality to boost their financial performance, they must have favorable control environment. This is in agreement with Cole (2002), who contends that control environment is an important factor in a firm's effort to achieve high financial performance. Results from the interviews showed that SACCOS in Ishaka- Bushenyi Municipality a well built accounting and financial systems, employees were ethical and they were also carrying out monitoring. One of the interviewee indicated that "much as they were carrying out monitoring of the internal controls but they were not giving out the feedback to their employees because they thought was not important". Another interviewee maintained that "SACCOS have objectives set and followed but sometimes they fail to achieve them due to stringent government policies concerning management of cooperatives like on borrowing non members and amount of money to be

borrowed are restricted to the number of shares and this limit them from getting a lot of clients for loans”

### Conclusions

From the study findings, the most control environment practiced were building accounting and financial systems and the worst practiced was that management was not committed to the working of those systems. This implies that the SACCOs were not able to realize the benefits of such built accounting and financial systems in place. The study findings also concluded that there is a significant relationship control environment and financial performance of SACCOs in Bushenyi-Ishaka municipality and control environment contributes 20.7% to the financial performance of SACCOs in Bushenyi-Ishaka municipality.

### Recommendations

From the study findings and conclusions made, the researcher also recommends that management should improve on their commitment about the working of the systems in place. This will help them to realize the benefits of having a well build accounting and financial systems. There is a need by management to always give feedback after monitoring to employees

about the current status on the working of internal control systems in place since employees are implementers to know where they need to make improvements. This implies that on top of risk assessment, control activities and control environment, management should add communication if they are to strengthen their internal control systems. There is a need to establish Disciplinary committee in each SACCO to handle disciplinary cases that arise. This will help the SACCOs to reduce indiscipline cases since those that will fall into the trap will be punished and guided accordingly and others will fear to do them.

### References

- Amudo, A., & Inanga, E. L. (2009). Evaluation of Internal Control Systems: A case study From Uganda, International Research Journal of Finance and Economics, ISSN14502887 Aosa, and Company Ltd. Ram Nagar, New Delhi
- Anania, P., Gikuri, A., & Hall, J. N. (2019). SACCOs and Members' Expectations: Factors Affecting SACCOs Capacity to Meet Members' Expectations.
- Arthur, S., Caleb, T., Caroline Masiko, M., George Stanley, K., Godfrey, B., Keneth, N., & Moses, A. (2019). Management



- Control System and Financial Performance of Micro Finance Institutions in Central Region Uganda.
- Bayai, I., & Ikhide, S. (2016). Financing structure and outreach of selected SADC microfinance institutions (MFIS). *Corporate Ownership & Control*, 284.
- D'Espallier, B., Goedecke, J., Hudon, M., & Mersland, R. (2017). From NGOs to banks: Does institutional transformation alter the business model of microfinance institutions?. *World Development*, 89, 19-33.
- Donaldson, L., & Davis, J. H. (1991). Stewardship Theory or Agency Theory: CEO governance and shareholder returns. *Australian Journal of Management*, 16, 49-65.
- Ewa, E. U., & Udoayang, J. O. (2012). The impact of internal control design on banks' ability to investigate staff fraud, and life style and fraud detection in Nigeria. *International Journal of Research in Economics & Social Sciences*, 2(2), 32-43.
- Goh, B. W. (2009). Audit committees, boards of directors, and remediation of material weaknesses in internal control. *Contemporary Accounting Research*, 26(2), 549-579.
- Grunde, J. (2008). Are managers agents or stewards of their principals?. *Journal für Betriebswirtschaft*, 58(3), 141-166.
- Harrell-Cook, G., Levitt, K., & Grimm, J. (2017). From Engagement to Commitment: A New Perspective on the Employee Attitude-Firm Performance Relationship. *International Leadership Journal*, 9(1).
- Jenik, I., Lyman, T., & Nava, A. (2017). Crowdfunding and financial inclusion. CGAP (Consultative Group to Assist the Poor) working paper.
- Jensen, M. C. & Meckling, W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 3, 305-360.
- Kamau, E. N. (2016). An investigation into the causes and characteristics of fraud in Kenyan SACCOs and whether Benford's Law can be used to detect fraud in the accounting data (Doctoral dissertation, Strathmore University).
- Kerzner, H. (2017). *Project management: a systems approach to planning, scheduling, and controlling*. John Wiley & Sons.
- Lydia, C. (2018). Effect of asset performance management on profitability of deposit taking saccos in nakuru county (doctoral dissertation, JKUAT).



- Mmari, G. A., & Thinyane, L. C. (2019). Analysis of Factors Influencing Financial Performance of Savings and Credit Co-operative Societies in Lesotho: Evidence From Maseru District. *International Journal of Financial Research*, 10(2), 121136.
- Muraleetharan, P. (2013). Control activities and its impact on the performance of private banks (Jaffna District). *International Journal of Marketing, Financial Services & Management Research*, 2(4), 10-16.
- Njenga, R., & Jagongo, A. (2019). Effect of financial management decisions on financial performance of selected non-deposit taking SACCOs in Kiambu County, Kenya: Theoretical Review. *International Academic Journal of Economics and Finance*, 3(3), 204-217.
- Okello Candiya Bongomin, G., Ntayi, J. M., Munene, J. C., & Malinga, C. A. (2018). Mobile money and financial inclusion in sub-Saharan Africa: the moderating role of social networks. *Journal of African Business*, 19(3), 361-384. PhD thesis, United States International University-Africa
- Rita (2016). Corporate Governance and financial performance in the financial service industry. Romar, E. J., & Calkins, M. (2006). WorldCom Case Study Update 2006. Santa Clara, CA: Santa Clara University, Markkula Center for Applied Ethics.
- Shibutse, R., Kalunda, E., & Achoki, G. (2019). Effect of Liquidity and Dividend Payout on Financial Performance of Deposit Taking SACCOs in Kenya.
- Wainaina, S. W. (2011). An evaluation of the internal control function: The Case of Kenya Polytechnic University College. Unpublished MBA Thesis, University of Nairobi, Kenya.