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# Relationship Between Internal Control Systems And The Financial Performance Of Selected SMEs In Wakiso District.

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**Abstract**

The study examined the relationship between internal control systems and financial performance of small and medium enterprises (SMEs) in Wakiso District, Uganda. A cross-sectional survey design was employed with a sample of 170 SMEs selected through stratified random sampling. Data were collected using structured questionnaires and analyzed using descriptive statistics, Pearson correlation, and regression analysis. Results revealed that internal control systems had a significant positive relationship with financial performance ($r = 0.741$, $p < 0.01$), explaining 54.9% of variance. Specifically, control environment ($r = 0.692$, $p < 0.01$), risk assessment ($r = 0.658$, $p < 0.01$), control activities ($r = 0.671$, $p < 0.01$), and monitoring ($r = 0.649$, $p < 0.01$) all demonstrated strong positive relationships with financial performance. The study concluded that effective internal control systems significantly enhanced SME profitability, operational efficiency, and asset protection. Recommendations included strengthening control environments through segregation of duties, implementing systematic risk assessment procedures, enhancing control activities documentation, and establishing continuous monitoring mechanisms to improve SME financial sustainability and competitiveness.

**Keywords: Internal control systems, financial performance, small and medium enterprises, control environment, Wakiso District**

## Background of the Study

Small and medium enterprises (SMEs) constituted a fundamental pillar of Uganda's economic structure, accounting for approximately 90% of the private sector, contributing 20% to GDP, and providing employment to over 2.5 million Ugandans (Ministry of Finance, Planning and Economic Development, 2021). In Wakiso District, one of Uganda's most economically vibrant regions surrounding Kampala, SMEs proliferated across diverse sectors including manufacturing, trading, services, and agro-processing, driving local economic growth and poverty reduction (Wakiso District Local Government, 2019). Despite their economic significance, SMEs in Uganda faced persistent challenges related to financial sustainability, with studies indicating that approximately 60% failed within their first five years of operation (Tushabomwe-Kazooba, 2006).

Internal control systems emerged as critical determinants of organizational performance and sustainability. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013), internal control was defined as a process effected by an entity's board of directors, management, and personnel, designed to provide reasonable assurance regarding achievement of objectives relating to operations, reporting, and compliance. For SMEs operating in resource-constrained environments with limited management expertise, effective internal controls were

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particularly crucial for safeguarding assets, ensuring financial information reliability, promoting operational efficiency, and facilitating compliance with applicable laws and regulations (Ojua, 2016).

The COSO framework identified five interrelated components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring activities (COSO, 2013). The control environment set the organizational tone and provided discipline and structure, encompassing integrity, ethical values, management philosophy, organizational structure, and human resource policies (Amudo & Inanga, 2009). Risk assessment involved identification and analysis of relevant risks to achievement of objectives, forming a basis for determining how risks should be managed (Ge & McVay, 2005). Control activities referred to policies and procedures ensuring that management directives were executed, including approvals, authorizations, verifications, reconciliations, and segregation of duties (Hla & Teru, 2015). Information and communication systems supported internal control functioning by capturing and exchanging relevant information. Monitoring encompassed ongoing evaluations, separate evaluations, or combinations of both to ascertain whether internal control components were present and functioning (Sarens & De Beelde, 2006).

Financial performance represented the ultimate measure of organizational success, typically assessed through profitability ratios, liquidity indicators, efficiency metrics, and growth measures (Kaplan & Norton, 1996). Previous research established linkages between internal control quality and financial performance in large corporations, demonstrating that strong controls reduced fraud, minimized errors, improved decision-making quality, and enhanced investor confidence (Ashbaugh-Skaife et al., 2008). However, the internal control-performance relationship in SME contexts remained less explored, particularly in developing economies where SMEs operated with informal systems and limited resources (Siwangaza et al., 2014).

In Wakiso District, preliminary observations suggested that many SMEs lacked systematic internal control mechanisms. Common deficiencies included absence of segregation of duties, inadequate documentation of transactions, weak authorization procedures, limited risk assessment practices, and minimal monitoring activities (Nuwagaba, 2015). These control weaknesses exposed SMEs to fraud, theft, errors, regulatory non-compliance, and poor decision-making based on unreliable information, ultimately undermining financial performance and sustainability. Understanding the relationship between internal control systems and financial performance was essential for SME owners, financial institutions, business development service providers, and policymakers seeking to enhance SME success rates and economic contributions in Uganda's most economically dynamic district.

**Problem Statement**

Small and medium enterprises in Wakiso District experienced persistently poor financial performance characterized by declining profitability, irregular cash flows, and high failure rates despite operating in a relatively favorable economic environment with proximity to Uganda's capital city and access to diverse markets (Katono et al., 2017). A significant contributing factor was the widespread absence or inadequacy of internal control systems, with studies

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indicating that over 70% of SMEs in the district lacked basic control mechanisms such as segregation of duties, formal authorization procedures, and systematic record-keeping (Bakunda, 2014). This internal control deficit manifested in frequent financial irregularities including employee theft, supplier fraud, inventory shrinkage, and misappropriation of funds, with estimates suggesting that SMEs lost 10-15% of annual revenues to internal control failures (Nkurunziza, 2018). Furthermore, weak internal controls resulted in unreliable financial information that impaired management decision-making, prevented access to bank financing requiring audited accounts, and exposed enterprises to regulatory penalties for non-compliance with tax and statutory reporting requirements. The problem was compounded by limited awareness among SME owner-managers regarding internal control importance and implementation, with many viewing controls as unnecessary bureaucracy rather than value-adding mechanisms (Turyahebwa et al., 2013). Consequently, SMEs operated reactively, addressing control issues only after losses occurred rather than implementing preventive systems. While existing literature examined internal controls in large organizations and public institutions (Sserwanga & Kiconco, 2017), limited empirical research investigated the specific relationship between internal control systems and financial performance of SMEs in Wakiso District, creating a knowledge gap that hindered evidence-based interventions to improve SME sustainability and competitiveness.

**Objective of the Study**

To examine the relationship between internal control systems and financial performance of SMEs in Wakiso District.

**Methodology**

This study adopted a cross-sectional survey research design to examine the relationship between internal control systems and financial performance of small and medium enterprises in Wakiso District. The design was appropriate as it enabled collection of data from multiple SMEs at a single point in time, facilitating analysis of existing relationships without variable manipulation (Saunders et al., 2016). The target population comprised 680 registered SMEs in Wakiso District as documented in the district commercial office records for the fiscal year 2022/2023, encompassing enterprises in manufacturing, trading, and service sectors.

Using Krejcie and Morgan's (1970) sample size determination table, a sample of 170 SMEs was determined, ensuring adequate representation at 95% confidence level with a margin of error of 5%. Stratified random sampling was employed to ensure proportional representation across business sectors and geographical locations within Wakiso District. The SME population was first stratified into three sectors: manufacturing (28%), trading (45%), and services (27%), yielding 48 manufacturing enterprises, 77 trading enterprises, and 45 service enterprises in the sample. Within each stratum, simple random sampling was applied using random number tables to select specific enterprises, ensuring every SME had equal probability of selection and minimizing selection bias.

Data were collected using self-administered structured questionnaires distributed to SME owner-managers or senior managers identified as key informants with comprehensive knowledge of their organizations' internal control systems and financial performance. The questionnaire comprised four sections: demographic and enterprise characteristics,

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internal control systems assessment (24 items covering four COSO components), financial performance measures (10 items), and open-ended questions for additional insights. Internal control systems were operationalized across four dimensions: control environment (6 items), risk assessment (6 items), control activities (6 items), and monitoring (6 items), measured on a five-point Likert scale ranging from 1 (strongly disagree) to 5 (strongly agree). Information and communication component was excluded due to preliminary pilot findings indicating significant overlap with other components in SME contexts. Financial performance was assessed using self-reported indicators including profitability, revenue growth, return on assets, liquidity, operational efficiency, and business expansion over the previous two years.

Instrument validity was established through expert review by four university lecturers specializing in accounting and finance and two certified public accountants with SME advisory experience. Their feedback led to modifications improving question clarity, relevance, and cultural appropriateness. Content Validity Index was calculated at 0.88, exceeding the threshold of 0.70 recommended by Amin (2005). Reliability was tested through a pilot study conducted with 25 SMEs in neighboring Mukono District sharing similar characteristics with Wakiso but excluded from the main study. Cronbach's alpha coefficients computed for each scale demonstrated high internal consistency: control environment ($\alpha = 0.884$), risk assessment ($\alpha = 0.869$), control activities ($\alpha = 0.891$), monitoring ($\alpha = 0.876$), and financial performance ($\alpha = 0.863$), all exceeding the acceptable threshold of 0.70 (Nunnally & Bernstein, 1994).

Data collection was conducted over six weeks between August and September 2023. Research assistants were trained on ethical research conduct, questionnaire administration, and data quality assurance. Response rate was 94.1% with 160 usable questionnaires returned out of 170 distributed, representing excellent participation likely attributable to pre-notification visits and follow-up contacts. Data analysis was performed using Statistical Package for Social Sciences (SPSS) version 26.0. Descriptive statistics including frequencies, percentages, means, and standard deviations summarized respondent characteristics and variable distributions. Pearson product-moment correlation analysis tested relationships between internal control system components and financial performance. Multiple regression analysis determined the predictive power of internal control systems on financial performance, with financial performance as the dependent variable and control environment, risk assessment, control activities, and monitoring as independent variables. Statistical significance was set at $p < 0.05$ level. Ethical considerations included obtaining informed consent from all participants, ensuring confidentiality through anonymous questionnaires, securing approval from the district commercial officer, and providing participants with summary findings upon request.

## Results

### Demographic Characteristics of Respondents

The study successfully collected data from 160 SME owner-managers in Wakiso District. Gender distribution showed that 56.3% (n=90) were male while 43.8% (n=70) were female, indicating reasonable gender representation in SME

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ownership. Age distribution revealed that 36.3% (n=58) were aged 31-40 years, 30.0% (n=48) were 26-30 years, 21.3% (n=34) were 41-50 years, and 12.5% (n=20) were above 50 years, demonstrating that SME ownership concentrated in economically productive age groups. Educational qualifications indicated that 46.3% (n=74) possessed tertiary education (diplomas or degrees), 35.6% (n=57) completed secondary education, 15.0% (n=24) had primary education, and 3.1% (n=5) had no formal education, suggesting relatively educated entrepreneurship in Wakiso District.

Business sector distribution comprised trading enterprises (48.1%, n=77), service enterprises (28.1%, n=45), and manufacturing enterprises (23.8%, n=38). Enterprise age showed that 33.8% (n=54) had operated for 3-5 years, 28.8% (n=46) for 6-10 years, 23.8% (n=38) for 1-2 years, and 13.8% (n=22) for more than 10 years. Number of employees revealed that 51.3% (n=82) employed 6-20 workers, 30.6% (n=49) employed 21-50 workers, and 18.1% (n=29) employed 5 or fewer workers, confirming genuine SME classification. Annual turnover distribution indicated that 38.8% (n=62) generated UGX 50-100 million annually, 35.0% (n=56) generated UGX 100-200 million, 15.6% (n=25) generated over UGX 200 million, and 10.6% (n=17) generated less than UGX 50 million.

**Internal Control Systems Assessment**

**Table 1: Internal Control System Components (N=160)**

| **Internal Control Component** | **Mean** | **SD** | **Interpretation** |
|---|---|---|---|
| **Control Environment** | | | |
| Clear organizational structure exists | 3.42 | 1.18 | Moderate |
| Duties and responsibilities are clearly defined | 3.36 | 1.22 | Moderate |
| Segregation of duties is practiced | 2.89 | 1.31 | Moderate |
| Code of conduct guides employee behavior | 3.28 | 1.25 | Moderate |
| Management demonstrates integrity and ethical values | 3.76 | 1.14 | High |
| Competent personnel are recruited and retained | 3.51 | 1.19 | Moderate |
| **Control Environment Overall** | **3.37** | **0.96** | **Moderate** |
| | | | |
| **Risk Assessment** | | | |
| Business risks are regularly identified | 3.18 | 1.24 | Moderate |
| Risk assessment is conducted systematically | 2.84 | 1.28 | Moderate |
| Fraud risks are specifically assessed | 2.76 | 1.33 | Moderate |
| Risk mitigation strategies are developed | 3.04 | 1.26 | Moderate |
| Changes in business environment are monitored | 3.33 | 1.21 | Moderate |
| Risk management responsibilities are assigned | 2.91 | 1.29 | Moderate |

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| | | | |
|---|---|---|---|
| **Risk Assessment Overall** | **3.01** | **1.02** | **Moderate** |
| | | | |
| **Control Activities** | | | |
| Proper authorization procedures exist | 3.45 | 1.20 | Moderate |
| Financial transactions are adequately documented | 3.58 | 1.17 | Moderate |
| Physical controls protect assets | 3.31 | 1.23 | Moderate |
| Regular reconciliations are performed | 3.24 | 1.26 | Moderate |
| Independent checks and reviews occur | 2.98 | 1.30 | Moderate |
| Documented policies and procedures exist | 3.11 | 1.27 | Moderate |
| **Control Activities Overall** | **3.28** | **0.99** | **Moderate** |
| | | | |
| **Monitoring** | | | |
| Internal control effectiveness is regularly evaluated | 3.06 | 1.25 | Moderate |
| Deficiencies are identified and reported | 3.19 | 1.22 | Moderate |
| Corrective actions are taken promptly | 3.27 | 1.21 | Moderate |
| Management reviews financial reports regularly | 3.54 | 1.18 | Moderate |
| External audits are conducted periodically | 2.73 | 1.35 | Moderate |
| Continuous monitoring mechanisms exist | 2.87 | 1.28 | Moderate |
| **Monitoring Overall** | **3.11** | **1.01** | **Moderate** |
| | | | |
| **Overall Internal Control Systems** | **3.19** | **0.87** | **Moderate** |

**Source: Primary Data, 2025**

The assessment of control environment in Table 1 revealed moderate overall implementation (M=3.37, SD=0.96), with management demonstration of integrity and ethical values scoring highest (M=3.76, SD=1.14), suggesting that SME leaders generally exhibited ethical conduct and set positive organizational tones. Recruitment and retention of competent personnel also scored favorably (M=3.51, SD=1.19), indicating attention to human capital quality. However, segregation of duties emerged as the weakest element (M=2.89, SD=1.31), with many SMEs struggling to separate incompatible functions due to limited staff numbers and cost considerations. This deficiency created opportunities for errors and fraud as single individuals controlled multiple transaction stages. Clear organizational structures (M=3.42, SD=1.18), defined responsibilities (M=3.36, SD=1.22), and codes of conduct (M=3.28, SD=1.25) all demonstrated moderate implementation, suggesting foundational control environment elements existed but required strengthening.

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Risk assessment practices showed moderate but concerning implementation levels (M=3.01, SD=1.02), representing the weakest component of internal control systems. Monitoring of business environment changes scored highest within this component (M=3.33, SD=1.21), indicating awareness of external market dynamics and competitive pressures. However, specific fraud risk assessment was notably weak (M=2.76, SD=1.33), suggesting limited systematic evaluation of internal fraud vulnerabilities despite their prevalence in SME contexts. Systematic risk assessment processes (M=2.84, SD=1.28) and assigned risk management responsibilities (M=2.91, SD=1.29) also scored low, indicating that risk management remained largely informal and reactive rather than proactive. Regular risk identification (M=3.18, SD=1.24) and mitigation strategy development (M=3.04, SD=1.26) showed moderate implementation, though consistency and comprehensiveness remained questionable.

Control activities demonstrated moderate implementation (M=3.28, SD=0.99), with documentation of financial transactions scoring highest (M=3.58, SD=1.17), likely driven by tax compliance and accounting requirements. Authorization procedures also showed reasonable implementation (M=3.45, SD=1.20), suggesting awareness of approval importance for financial commitments. Physical asset protection controls (M=3.31, SD=1.23) and regular reconciliations (M=3.24, SD=1.26) demonstrated moderate application, indicating basic control activities existed. However, independent checks and reviews scored lower (M=2.98, SD=1.30), reflecting limited internal audit functions or external verification mechanisms. Documented policies and procedures (M=3.11, SD=1.27) showed moderate existence, though preliminary interviews suggested many policies remained unwritten or inconsistently applied, relying heavily on owner-manager oversight rather than systematic processes.

Monitoring activities revealed moderate implementation (M=3.11, SD=1.01), with management review of financial reports scoring highest (M=3.54, SD=1.18), indicating regular financial statement examination by SME leaders for decision-making purposes. Prompt corrective action (M=3.27, SD=1.21) and deficiency identification and reporting (M=3.19, SD=1.22) demonstrated reasonable practice, suggesting reactive problem-solving capacity when issues emerged. However, external audits showed weak implementation (M=2.73, SD=1.35), with many SMEs forgoing independent audits due to cost considerations or lack of mandatory requirements. Continuous monitoring mechanisms (M=2.87, SD=1.28) and regular evaluation of control effectiveness (M=3.06, SD=1.25) also scored low, indicating that monitoring occurred sporadically rather than systematically, relying on periodic management reviews rather than embedded ongoing processes.

Overall, internal control systems in Wakiso District SMEs demonstrated moderate implementation (M=3.19, SD=0.87), suggesting that while basic control awareness and practices existed, significant gaps remained in systematic risk assessment, segregation of duties, independent verification, and continuous monitoring. This moderate control environment created vulnerabilities that potentially undermined financial performance and sustainability.

**Financial Performance of SMEs**

**Table 2: Financial Performance Indicators (N=160)**

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| **Financial Performance Indicator** | **SA (%)** | **A (%)** | **N (%)** | **D (%)** | **SD (%)** | **Mean** | **SD** |
|---|---|---|---|---|---|---|---|
| Business profitability has increased over past two years | 24.4 | 43.8 | 16.3 | 10.6 | 5.0 | 3.72 | 1.13 |
| Revenue growth has been consistent | 21.9 | 40.6 | 18.8 | 13.1 | 5.6 | 3.60 | 1.16 |
| Return on investment has improved | 18.8 | 38.1 | 21.3 | 15.0 | 6.9 | 3.47 | 1.19 |
| Operating costs are well managed | 22.5 | 41.3 | 18.1 | 12.5 | 5.6 | 3.63 | 1.16 |
| Cash flow is adequate for operations | 20.0 | 39.4 | 19.4 | 14.4 | 6.9 | 3.51 | 1.20 |
| Business assets have increased | 19.4 | 37.5 | 21.9 | 14.4 | 6.9 | 3.48 | 1.19 |
| Market share has expanded | 16.3 | 35.0 | 23.1 | 17.5 | 8.1 | 3.34 | 1.21 |
| Ability to access credit has improved | 13.8 | 31.3 | 23.8 | 21.3 | 10.0 | 3.18 | 1.24 |
| Financial reporting accuracy has improved | 23.1 | 42.5 | 17.5 | 11.3 | 5.6 | 3.66 | 1.15 |
| Overall business sustainability has strengthened | 21.3 | 40.0 | 19.4 | 13.1 | 6.3 | 3.57 | 1.18 |
| **Overall Financial Performance** | - | - | - | - | - | **3.52** | **0.95** |

**Source: Primary Data, 2025**

The financial performance assessment in Table 2 indicated moderate to high overall performance (M=3.52, SD=0.95) among SMEs in Wakiso District. Profitability increase emerged as the strongest performance indicator (M=3.72, SD=1.13), with 68.2% of respondents reporting improved profitability over the previous two years, suggesting successful value creation and cost management despite competitive pressures. Financial reporting accuracy improvement also scored highly (M=3.66, SD=1.15), with 65.6% reporting better reporting quality, likely attributable to increased computerization and professional accounting support adoption.

Operating cost management demonstrated strong performance (M=3.63, SD=1.16), with 63.8% effectively controlling expenses, indicating operational efficiency consciousness and cost optimization efforts. Revenue growth consistency scored favorably (M=3.60, SD=1.16), with 62.5% achieving stable revenue increases, reflecting market penetration success and customer retention. Overall business sustainability strengthening (M=3.57, SD=1.18) was reported by 61.3% of respondents, suggesting growing enterprise resilience and long-term viability prospects.

Cash flow adequacy for operations showed moderate performance (M=3.51, SD=1.20), with 59.4% maintaining sufficient liquidity for daily operations, though 21.3% faced cash flow challenges potentially constraining growth and operational flexibility. Asset accumulation (M=3.48, SD=1.19) was reported by 56.9% of SMEs, indicating capital investment and business expansion capacity, while return on investment improvement (M=3.47, SD=1.19) affected 56.9%, demonstrating enhanced efficiency in resource utilization.

Market share expansion demonstrated more modest results (M=3.34, SD=1.21), with 51.3% expanding market presence, suggesting that while many SMEs grew, competitive intensity limited market capture for others. Most

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concerning was credit access improvement (M=3.18, SD=1.24), where only 45.1% reported enhanced borrowing capacity. This financing constraint limited growth potential, with 31.3% struggling to access formal credit possibly due to collateral limitations, inadequate financial documentation, or stringent lending requirements. The moderate overall financial performance suggested that while SMEs in Wakiso demonstrated business success, significant room existed for improvement particularly in market expansion and financial access.

**Relationship Between Internal Control Systems and Financial Performance**

**Table 3: Correlation Analysis (N=160)**

| **Variables** | **1** | **2** | **3** | **4** | **5** |
|---|---|---|---|---|---|
| 1. Control Environment | 1 | | | | |
| 2. Risk Assessment | 0.745** | 1 | | | |
| 3. Control Activities | 0.768** | 0.723** | 1 | | |
| 4. Monitoring | 0.731** | 0.706** | 0.754** | 1 | |
| 5. Financial Performance | 0.692** | 0.658** | 0.671** | 0.649** | 1 |

**p < 0.01 (2-tailed)*

**Source: Primary Data, 2025**

The correlation analysis in Table 3 revealed that all four internal control system components demonstrated strong positive and statistically significant relationships with financial performance at the 0.01 level. Control environment exhibited the strongest correlation ($r = 0.692$, $p < 0.01$), indicating that SMEs with clear organizational structures, defined responsibilities, ethical management, and competent personnel achieved superior financial outcomes. This strong relationship suggested that foundational organizational culture and governance structures were critical determinants of business success, operating through enhanced employee accountability, reduced misconduct, and improved operational discipline.

Control activities showed the second strongest correlation with financial performance ($r = 0.671$, $p < 0.01$), demonstrating that SMEs implementing proper authorization procedures, adequate documentation, physical asset controls, reconciliations, and independent checks achieved better profitability, revenue growth, and sustainability. This relationship likely operated through fraud prevention, error reduction, asset protection, and improved operational efficiency resulting from systematic control procedures. The strong correlation validated the practical importance of implementing specific control mechanisms rather than relying solely on general management oversight.

Risk assessment demonstrated significant positive correlation ($r = 0.658$, $p < 0.01$), indicating that SMEs systematically identifying, analyzing, and mitigating business risks achieved superior financial performance. This relationship suggested that proactive risk management enabled better strategic decision-making, reduced unexpected losses, and enhanced competitive positioning by anticipating and addressing threats before they materialized into

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performance problems. The correlation underscored the value of moving beyond reactive crisis management toward systematic risk-based planning.

Monitoring activities also correlated significantly with financial performance ($r = 0.649$, $p < 0.01$), showing that regular evaluation of internal control effectiveness, deficiency identification and correction, management reviews, and external audits contributed to improved business outcomes. This relationship operated through early problem detection, continuous improvement, accountability reinforcement, and information quality enhancement that supported better managerial decisions.

Inter-correlations among internal control components ranged from 0.706 to 0.768, all highly significant, indicating these components were interrelated yet distinct dimensions of internal control systems. The strong inter-correlations suggested that internal control components reinforced each other, with strength in one area supporting effectiveness in others, reflecting integrated system functioning rather than isolated practices.

**Table 4: Regression Analysis Results (N=160)**

| **Model Summary** | | | | |
|---|---|---|---|---|
| R | $R^2$ | Adjusted $R^2$ | Std. Error | F |
| 0.741 | 0.549 | 0.537 | 0.647 | 47.253** |

**Sig. = 0.000*

| **Predictor Variable** | **B** | **Std. Error** | **Beta (β)** | **t** | **Sig.** |
|---|---|---|---|---|---|
| (Constant) | 0.682 | 0.214 | - | 3.187 | 0.002 |
| Control Environment | 0.289 | 0.087 | 0.293 | 3.322 | 0.001 |
| Risk Assessment | 0.215 | 0.081 | 0.231 | 2.654 | 0.009 |
| Control Activities | 0.238 | 0.085 | 0.248 | 2.800 | 0.006 |
| Monitoring | 0.197 | 0.083 | 0.209 | 2.373 | 0.019 |

*Dependent Variable: Financial Performance*

**Source: Primary Data, 2025**

The regression analysis in Table 4 demonstrated that internal control systems collectively predicted financial performance significantly ($F = 47.253$, $p < 0.001$), explaining 54.9% of the variance in financial performance ($R^2 = 0.549$). The adjusted $R^2$ of 0.537 confirmed robust explanatory power not inflated by the number of predictors, while the standard error of 0.647 indicated reasonable prediction accuracy. This substantial variance explanation demonstrated that internal control systems represented a major determinant of SME financial success in Wakiso District, with more than half of performance variation attributable to control system quality.

Examining individual predictor contributions, control environment emerged as the strongest predictor ($\beta = 0.293$, $t = 3.322$, $p = 0.001$), with a regression coefficient of 0.289 indicating that each one-unit increase in control environment strength led to 0.289 units increase in financial performance when other factors were controlled. This dominant effect

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validated the foundational importance of organizational tone, ethical culture, clear structures, and competent personnel as prerequisites for SME success. Control activities was the second strongest predictor ($\beta = 0.248$, $t = 2.800$, $p = 0.006$), with a coefficient of 0.238, demonstrating that specific control procedures significantly contributed to performance beyond general environmental factors.

Risk assessment contributed significantly ($\beta = 0.231$, $t = 2.654$, $p = 0.009$) with a coefficient of 0.215, showing that systematic risk management practices enhanced performance independent of other control components. Monitoring also predicted performance significantly ($\beta = 0.209$, $t = 2.373$, $p = 0.019$) with a coefficient of 0.197, indicating that regular evaluation and corrective action mechanisms added incremental value. The significance of all four components in the multivariate model demonstrated that comprehensive internal control systems incorporating all dimensions yielded optimal financial outcomes, with each component contributing uniquely beyond the others. These findings provided strong empirical support for implementing integrated internal control systems in SME contexts and validated the COSO framework's applicability to small and medium enterprises in developing economy settings.

**Conclusions**

Internal control systems implementation among SMEs was generally moderate across all components, with control environment demonstrating the strongest implementation while risk assessment showed the weakest. Significant deficiencies existed particularly in segregation of duties, systematic risk assessment, fraud risk evaluation, external audits, and continuous monitoring mechanisms. These gaps reflected resource constraints, limited internal control awareness, and prioritization of immediate operational concerns over systematic control development. The moderate implementation suggested that while SME owner-managers recognized control importance, practical implementation challenges related to cost, expertise, and organizational capacity constrained comprehensive system deployment.

Financial performance of SMEs in Wakiso District was moderate to high, characterized by improving profitability, consistent revenue growth, effective cost management, and strengthening sustainability for the majority of enterprises. However, performance remained constrained by limited credit access affecting over half of SMEs, moderate market expansion, and cash flow challenges for a significant minority. The overall positive performance trend suggested that Wakiso's economic environment and market opportunities supported SME success, though business-specific factors including management quality and operational efficiency differentiated high performers from struggling enterprises.

Internal control systems demonstrated strong positive and statistically significant relationships with SME financial performance, with control environment emerging as the most influential component. The research established that internal control systems explained approximately 55% of financial performance variance, representing substantial practical importance beyond statistical significance. This relationship operated through multiple mechanisms: control environment fostered accountability and ethical conduct reducing fraud and theft; risk assessment enabled proactive

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threat mitigation and strategic adaptation; control activities prevented errors, protected assets, and enhanced operational efficiency; and monitoring facilitated continuous improvement and information reliability supporting better decision-making.

All four internal control components contributed significantly and independently to financial performance when considered simultaneously, demonstrating the value of comprehensive integrated systems rather than selective implementation of individual components. The findings validated COSO framework applicability to SME contexts in developing economies, contrary to assumptions that such frameworks were only relevant for large corporations. The research provided empirical evidence that even resource-constrained SMEs could benefit substantially from systematic internal control implementation, with performance gains likely offsetting implementation costs through fraud reduction, error minimization, and efficiency improvements.

**Recommendations**

SME owner-managers should prioritize strengthening control environments by developing clear organizational structures with documented reporting relationships, establishing written codes of conduct specifying expected behaviors and consequences for violations, implementing segregation of duties even in small teams by rotating responsibilities or instituting dual controls for critical functions, and investing in competent personnel through targeted recruitment and continuous training (Hla & Teru, 2015). Given that control environment was the strongest performance predictor, these foundational interventions would yield substantial benefits by setting appropriate organizational tone and preventing opportunistic misconduct.

SMEs should implement systematic risk assessment procedures including quarterly risk identification workshops involving key personnel, development of risk registers documenting identified risks with likelihood and impact assessments, specific fraud risk evaluations examining vulnerabilities in cash handling, inventory management, and procurement, and documented risk mitigation strategies with assigned responsibilities and timelines (COSO, 2013).

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