

## The effect of risk management on financial performance in Uganda. A case of Kabale municipal council, Kabale district

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### ABSTRACT

To examine the effect of risk management on financial performance in Uganda. We explored literature on risk management and the relationships with financial performance in public sector organizations. We designed a theoretical relationship between risk management and financial performance. A descriptive research design was adopted and a sample size of 169, which constituted council employees and beneficiaries was used. Data were collected through questionnaires and interviews. The study found a significant effect of risk management on financial performance. The study also established positive and significant relationships between risk management and financial performance at ( $r = .627$ ; sig.  $< .05$ ). Generally, risk management accounts for 39.3% of the total variations in the financial performance of Kabale municipality. The study shows that local governments in Uganda have strong risk management systems and are likely to register a 50% variation in their financial performance. The study recommends to both public and private organizations improve their risk management systems for high financial performance. The audit departments should strengthen risk management and control activities at the department level.

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### Introduction

Risk refers to any event that may threaten or cause disastrous effects to any sphere of an organization. The concept of risk management comes in to encompass all the strategies, actions, and measures geared toward controlling the effects of risks (Kapuscinska and Matejun 2014). While it's known that no organization is insulated against risks, all organizations can implement potential measures to reduce the impact of risks (Kiseleva, et al. 2018). In the public sector, the reoccurrence of misappropriations of public resources and financial mishandling confirm the existence of risks. Notwithstanding, these institutions have relied on external auditors and consultancies to offer only short-term solutions to the occurrence of risks (Kong, et al. 2018). They ignore the fact that organizations grow and so do risks. If rightly applied, risk management in public sector organizations reduces financial loss and increases cost savings (Tworek 2016). Public sector finance has been a subject of scholarly work for many centuries, and its focus has increased with the quest for value-for-money and quality of public services (Amudo & Inanga, 2019). In spite of this modest increase in financial performance focus, several

African countries still experience financial performance shortfalls. Vivid examples are observed in fast-growing African economies like South Africa, Nigeria, and Egypt (Hayes, 2012). The performance of organizations in government entities including municipalities is predominantly explained by financial performance effectiveness. To realize this effectiveness, these entities including, Kabale Municipal Council focus on having a fully-fledged and functional internal control system [ICS] (Kabale Municipal Council, KMC Annual report, 2019). However, for the last five years, to date, KMC has not realized its financial performance targets. The council still struggles with unrealized financial targets. While KMC had set to realize 100% financial performance, only 45% was realized in 2017, 62.5% in 2018, 55.9% was realized in 2019, and only 30.9% was attained in 2020. A persistent below financial performance target of an average of 48.6% (Annual Report of the Auditor General, 2020; KMC Annual Performance report, 2019). This shows persistent unrealized financial performance targets at KMC have further increased the number of incomplete projects and liquidity problems. It has also been characterized by untimely financial reports, delayed accountability, and cases of financial mismanagement among financial controllers (KMC Annual Performance report, 2020). Irrespective of this persistent below-target financial performance, there is no recent study that has been done to explore the effect of risk management on financial performance. While a few studies and reports (Auditor-General report, 2020; Eton *et al.*, 2018; Eton, 2019) reflect on the aspects of ICS, and financial accountability and some describe the financial performance of public entities including Kabale District, they have not specifically focused on KMC. Indeed, the scope and effect of risk management, attributes of risk assessment, on financial performance at Kabale Municipal council remain unexplored. This study, therefore, examined the effect of risk management on financial performance in Kabale Municipal Council

## Literature Review

### Risk assessment

Risk assessment remains one of the key activities in the ICS, and how the company deals with this is critical for its effectiveness in its functions and operations (COSO, 2013). Several scholars have defined risk assessment as forecasting, identifying, and analyzing the possible risks that may occur to the company (COSO, 2013; Ndifon & Ejom, 2015). Indeed, proper risk assessment is a prerequisite for achieving the right scope of managing physical and financial resources. Often studies concur that appropriate risk assessment critically evaluates the risks, making it possible for the company to meet its goals (Petrovits *et al.* 2011; Rafindadi *et al.* 2019). These aspects are underscored in line with managerial decisions and control of resources. Chan, Chen, and Liu (2020) note that risks threaten the accomplishment of objectives and when not well assessed, can affect the performance of the organization, especially its finances. At whatever levels, management must not only identify but also control and regulate risks to meet the study objectives. Additionally, Mohammed & Aksoy (2020) also revealed that organizations must analyze such circumstances that are likely to increase the likelihood of risk occurrence. However, both Chan *et al.* (2020), and Aksoy and Mohammed (2020), did not focus on the public sector. Earlier, Bett and Memba (2017) had also agreed that risk Assessment minimizes the impact of a risk, however, their findings could not address it in a public sector context. This makes it vital to base on these descriptions to explore risk assessment and how it influences the financial performance of the organization. In other usages, risk management notes strategic management because it helps public organizations watch out for potential areas of risk and uncertainties in their operation (Tworek 2016). In unnoticed instances, risks may feature as reporting errors, poor employee training, changes in service delivery, and natural disasters

(Kong, et al. 2018). Therefore, public organizations must be vigilant in watching for the occurrence of such risks and offer proper forecasting measures to combat risks and minimize their impact on the organization.

### **Financial performance**

Financial performance is the extent to which a business maintains a stable staff within a stable financial state over. In other words, it brings out the ability of the staff to maintain a stable business over time (Mayne & Zapico-Goni, 2007). However, Visser and Erasmus (2018) noted that financial performance varies between profit and non-profit making organizations. Financial performance is critical, and often a prime measure of a firm's performance (Sontag-Padilla, Staplefoote & Gonzalez, 2012). Studies continue to show that financial performance is critical in shaping an ethical imperative for local government, as well as a key feature of the giving landscape (Mayne & Zapico-Goni, 2007; Visse & Erasmus, 2018). In this context, financial performance would be explored from the perspectives of accountability, transparency, and reporting exhibited in their performance. In local government organizations such as Kabale Municipal council, financial performance is an engine to demonstrate the accountability potentials of financial controllers, and value-for-money by the entity. Indeed, financial performance is often depicted in financial reporting, accounting for the financial resources allocated to different service and administrative units. Relatedly, Sarens & De Beelde (2016), revealed that financial performance is key in shaping the resources management of the company. Pina, Bachiller & Ripoll (2020) show that organizations must ensure they have adequate resources to fund their business motives continually. A recent study by Duncan (2020), showed that financial performance is vital for supporting the overall performance of the organization as it develops its short-term and long-term goals.

### **Risk assessment and financial performance**

Risk assessment helps an organization eliminate sources that may potentially harm the operations of the company and save the danger of uncontrolled risk-taking (COSO, 2013). Ntongo (2012), in her study, revealed that risk assessment is critical for financial performance as it shapes the extent to which employees respond to risk; transfer, tolerance, treatment, and termination. Related studies especially Sarens & De Beelde, (2016), further show that proper risk assessment is vital for financial performance although they explored the private and not the public sector. This provides room for the researcher to explore these aspects at Kabale Municipal Council, in Kabale District. A study by Kinyua et al. (2015) noted that risk assessment helps organizations identify risks that might otherwise prevent firms from operating outside acceptable standards (Kipkemboi, Ayuma & Terer, 2016). Besides the use of systematic procedures to identify and analyze relevant risks and manage risks, is core to shaping financial performance activities in any organization (Inusah et al. 2015).

Magara (2013) noted that risk assessment regulates the occurrence of credit fraud in an organization. These findings show that risk assessment is a key to the financial performance of an organization, but do not give a direct reflection of the Ugandan perspective, which this current study would focus on addressing at Kabale Municipal Council, in Kabale District. Schulze et al (2013) revealed risk assessment is a key in identifying, evaluating, and mitigating risks. Most organizations operate amidst scarce resources. These can be protected from waste with full implementation of risk assessment Ntongo (2012) and Magara, (2013). Relatedly, studies on financial performance further show that risk assessment is key for reducing risks, controlling failure, and harnessing financial performance (Sarens & De Beelde, 2016). More so,

Verstegen (2010) noted the importance of risk assessment in defining the methodology adopted for any audit function, which influences financial performance levels. However, these studies do not give the scope of the public sector firms, especially in a Ugandan setting. Similarly, Magara (2013) revealed that risk assessment shapes organizational financial performance, by controlling uncertainties and meeting its audit activities.

COSO (2013) recommends that once a risk has been identified, performing a complete analysis is needed to prioritize the risk. Complete analysis, in this case, would estimate the potential impact of the risk and its likelihood to occur (Anh *et al.* 2020). It is therefore important to prioritize the risk to allow for its management in case it has occurred and to control its effects from spilling over. In addition, also included in the determination of how to manage risk. Setting priorities is one of the ways that enable the organization to focus on risks with a reasonable likelihood of occurrence and higher effects (Sharma & Senan, 2019). Regardless of the size of the organization and the extent of risk assessment, all organizations need to control activities in their functions. Risk materials should be reorganized continually before they affect the company's goals. Management must ensure that the materials that serve as the basis for assessing the risk cover the entire organization (Bayyoud, Mohammed & Sayyad, 2015). Relatedly, Schulze *et al.* (2013) noted that risk assessment is one of the key areas for shaping the financial performance of the company, in the short and long run. The COSO framework (2013), also showed that risk assessment through its risk identification and analysis is vital for shaping the company's way of progress. While several of these studies especially Schulze *et al.* (2013), risk assessment is a key aspect of ICS for the purposes of managing proper resources, procedures, and policies, and how these have a bearing on the operations of the organization.

## Methodology

The study used a descriptive research design, specifically focusing on correlation analysis of the study data. This study was conducted in Kabale Municipal Council, in Kabale district, south Western Uganda on employees and service beneficiaries. The study population was 300 out of which a sample size of 169 study units was derived randomly and purposively, determined using Krejcie and Morgan's sample determination tables (Krejcie & Morgan, 1970). Data were collected using questionnaires and interviews and analyzed using mean, standard deviation, and correlation. The questionnaire had close-ended scale items on risk management and financial performance, which were constructed from the literature review. The study tools were pre-tested indicating a content validity index of 0.82 and a reliability alpha coefficient of 0.719.

## Results

The findings on gender show that 53.9% were males while 46.1% were female. The study was therefore dominated by male participants. The study shows that 34.0% of the participants had diplomas and were the majority while 14.2% had certificates. The statistics suggest that besides diploma holders, degree holders were common in the study. Few participants indicated having a master's. Regarding participants' age bracket, 45.4% belonged to the 36 – 60 years age bracket and were the majority, followed by those who fell in the age bracket of 18 – 35 years. The study further established that 36.2% had stayed in KMC for 10 years and over and were the majority. Those who had stayed at KMC for a period of 6 – 10 years were only 14.9% and were the least in participation.

## Descriptive analysis

The researcher used mean to measure the extent to which participants' opinions on risk management and financial performance clustered. Standard deviation measured the extent to which participants' opinions differed from one participant to the other. Table 1 summarizes participants' opinions on risk management.

**Table 1:** Risk Management.

Variable List; N = 141	Mean	Std.
<b>Risk Management</b>		
1. There are strong risk assessment measures at each financial control desk	4.05	1.00
2. Senior officials assist junior staff to analyze risks	4.04	0.96
3. The risks are assessed in terms of achievement of objectives	3.99	0.84
4. We are trained to forecast financial risks	3.94	0.92
5. The risks are assessed based on visible consequences	3.94	0.97
6. Financial controllers communicate likely risks to all staff	3.94	1.10
7. Risks are identified in terms of occurrence likelihood	3.77	0.78
8. Risks that occur are carefully analyzed by all staff	3.48	1.19
<b>Average</b>	<b>3.89</b>	<b>0.97</b>

*Source: Field data, 2021*

The findings indicate that Risk management (mean = 3.89; std. = .97) was strong. The statistics imply that Kabale municipal council conducts risk management, and according to the standard deviation, respondents' opinions on risk management in the municipality were consistent. Specifically, Kabale municipal council has a financial control desk (mean = 4.05; std. = 1.00), with senior officials who assist in analyzing risks (mean = 4.04; std. = .96). However, not all staff are involved in carefully analyzing risks (mean = 3.49; std. = 1.19). These statistics provide some evidence that though Kabale municipality conducts risk management, it is narrowly conducted only among senior officials and financial controllers who communicate likely risks.

## Financial performance

The researcher used a set of statements to indicate financial performance in KMC. The study, using the descriptive statistical procedure of SPSS ran the mean of the responses for each item on the questionnaire. As a guide to interpreting the mean score, 0 to 2.49 was interpreted as 'poor', 2.50 to 3.49 was interpreted as 'average' while 3.50 to 5.00 was interpreted as 'good'. Table 2 summarizes the financial performance at KMC.

**Table 2:** Financial performance

Variable List; N = 141	Mean	Std.
1. The Auditors present financial reports to management in time	4.34	0.84
2. Financial reports are prepared in time	4.23	0.76
3. Financial controllers' staff regular present departmental reports	4.21	0.75
4. KMC always accounts for unused cash at the end of every financial year	4.20	0.85
5. All finances received at this council are well reported to stakeholders	4.19	0.85
6. KMC meets all its short- and long-term financial obligations whenever they are due	4.07	0.78
7. All user departments present detailed financial performance reports	3.99	0.97
8. The local revenue for KMC has increased	3.79	1.09
9. Staff at KMC are transparent in their financial performance activities	3.68	1.02
10. There are reports of financial mismanagement in some divisions of KMC	3.57	1.15
11. There are reports of unauthorized public expenditure at some KMC's divisions	3.41	1.21
<b>Average</b>	<b>3.97</b>	<b>0.94</b>

Source: Field data, 2021

The study found that financial performance (mean = 3.97; std. = .94) was generally good. This good performance is mostly attributed to the timely presentation of financial reports by the auditors (mean = 4.34; std. = .84). Besides the timely presentation of financial reports, the good financial performance is due to preparing on time (mean = 4.23; std. = .76), regular presentation of reports by financial controllers (mean = 4.21; std. = .75), and accounting for unused cash (mean = 4.20; std. = .85) contribute to the good financial performance. From the lowest extreme, this study found some reports of unauthorized expenditures (mean = 3.41; std. = 1.21), which are likely to affect the good financial performance of KMC. The mean scores indicate that good financial performance is mostly due to auditors' work. However, a comparison of standard deviations suggests that the financial performance observed at KMC is mostly due to financial controllers who present their reports timely.

### Inferential Analysis

The researcher used correlation to test for the relationship between internal control systems and financial performance.

**Table 3:** Coefficients (a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.968	.213		9.229	.000
	Risk Management	.515	.054	.627	9.493	.000
R = .627; R Square = .393; F Statistic = 90.1						

a Dependent Variable: Financial Performance



The study also established positive and significant relationships between risk management and financial performance ( $r = .627$ ; sig.  $< .05$ ). Generally, risk management accounts for 39.3% of the total variations in the financial performance of Kabale municipality. The study shows that local governments in Uganda have strong risk management systems and are likely to register a 50% variation in their financial performance.

## Discussion

Risk management has a significant effect on the financial performance of Kabale Municipal Council (KMC). By implication, organizations that observe risk management are likely to perform financially better than those which do not. Evidence from KMC on risk management points to the presence of a financial control desk, the presence of senior officials who assist junior officials on how to analyze risks, and training staff on forecasting financial risks. The findings agree with (COSO, 2013) who reports that risk assessment helps organizations to eliminate harmful operations of the company such as misappropriation of resources, manipulation of transactions, and corruption tendencies among others. The findings also agree with (Ntongo (2012; Kinyua et al., 2015; Kipkemboi, Ayuma & Terer, 2016) who revealed that risk assessment shapes the extent to which employees respond to risk; which includes transfer, tolerance, treatment, and termination. Firms that identify risks hardly operate outside the acceptable standards whereas there could be a minimum acceptable level of risk by any organization which is deemed not very dangerous.

## Conclusion and Implication

The study established that risk management significantly affects the financial performance of Kabale municipality. Therefore, local government institutions that adhere to risk management in their operations are likely to register positive financial performance. Most importantly, local governments that have established financial controls desks, with specific officers to analyze risks are likely to register improvements in their financial performance. However, the fact that not all staff consider risk management seriously many times limits the effectiveness of risk management in local governments. This study contributes empirical evidence on the role of risk management in promoting financial performance in public sector organizations. The findings may help audit departments to strengthen risk management and control activities at the department level.

Conflict of interest.

The authors declare no conflict of interest.

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