ST.MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES

PRACTICE OF INTERNAL CONTROL SYSTEM AND ITS CONTRIBUTION TO FINANCIAL PERFORMANCE OF PRIVATE BANKS IN ETHIOPIA

BY
BERHANU EDEA

MAY 2016
ADDIS ABABA, ETHIOPIA

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A CASE STUDY OF SEVEN PRIVATE BANKS IN ETHIOPIA

BY
BERHANU EDEA REGASSA
SGS/0324/2007A

A THESIS SUBMITED TO ST.MARY'S UNIVERSITY, SCHOOL OF GRADUATE STUDYIES IN PARTIAL FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTERS OF BUSNESS ADMINSTRATION (MBA)

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APPROVED BY BOARD OF EXAMINERS

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DEDICATION

I thank God for the precious gift of life, wisdom and health that he awarded me during my study period and the rest of my life.

I dedicate this dissertation to my lovely family (My wife and two sweet and kind daughters) who encourages and stands beside me at any point of discontents and fatigues without fail.

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LIST OF ACRONYMS AND ABBREVATION

AIB -   Awash International Bank

AICPA-   American Institute of Certified Public   Accountants

BRSB-   Banking Regulation and supervision Board

CBB-   Construction and Business Bank

CBE-   Commercial Bank of Ethiopia

CBO-   Cooperative Bank of Oromia

CIPFA-   Chartered Institute of Public Finance and accountant

COCO-   Committee of Sponsoring Organization

DB-   Dashin Bank

DGB-   Debub Global Bank

ICT-   Information Communication Technology

IIA-   Institute of Internal Audit

LIB-   Lion International Bank

NBE-   National Bank of Ethiopia

OIB-   Oromia International Bank

RoA-   Return on Asset

RoE-   Return on Equity

SPSS-   Statistical Package for Social Sciences

TSR-   Total Share Return

ABSTRACT

The study sought to establish a relationship between internal control and organizational financial performance of Private banks in Ethiopia. Objectives of the study were; to examine the effectiveness of internal controls used in Banks, to establish the level of performance and relationship between internal control and financial performance in private Banks of Ethiopia. The study mainly target and test some qualitative dependent financial performance variables like- Efficiency, Responsibility and Reporting over seven selected private bank of Ethiopia. A cross sectional survey was used in the course of the study. Qualitative data was gathered in order to establish the relationship between the independent and dependent variables, so as to examine how internal controls are used in private banks and therefore account for the performance levels. The study comprised of 60 employees. Purposive sampling was used to select respondents for the research merely to attain the purpose of the study. Data was collected using both primary and secondary sources. After collecting data, the researcher organized well-answered questionnaire, data was edited and sorted for the next stage. The data was presented in tabular form and pie charts with frequencies, percentages, mean and standard deviation. The researcher used Statistical Package for Social Sciences (SPSS) to analyze the relationship between the variables under study. From the finding, the study identified that there is a positive relationship between internal control system and financial performance of private banks. Moreover, the finding underline that currently there is a moderate effective and efficient internal control system across the tested banks though lots of works like; periodic evaluation of budget against actual expenditure, fixed asset defragging and proper usage and periodic revision of banks' risk tolerance limit are remaining works that have to improved to enhance performance of banks. The study recommends that equal attention should be given to some qualitative financial performance contributors by the Management of the Bank as that of liquidity management, enhancing RoA and RoE and the likes so as to keep the existing profitability and enhance financial performance of their Bank.

Keywords: **Control Activities, Financial Performance, Internal Audit, Internal control, and Private Bank.**

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Internal control is not only essential to maintain the accounting and financial records of an organization, it is essential to manage the entity. Everyone from the external auditors to management to the board of directors to the stockholders of large public companies to government, have an interest in internal controls. In many parts of the world, regulators have emphasized the importance of internal control by requiring management to make annual public statements about the effectiveness of internal controls.

Internal control is defined in different terms, among which Committee of Sponsoring Organizations COSO (2011) defines as;

> Internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of a firm's objectives in the effectiveness and efficiency of operations, reliability of financial and management reporting, compliance with applicable laws and regulations and protect the organization's reputation.

A system of effective internal control is a critical component of effective and efficient operational performance of an organization. A system of strong internal controls can help to ensure that the goals and objectives of bank will be met, that it will achieve long-term targets and maintain reliable financial and managerial reporting. Such a system can also help to ensure that the banks will comply with laws and regulations as well as policies, plans, internal rules and procedures, and reduce the risk of unexpected losses and damage to the organization's reputation.

In their publication Whittington and pany (2001), attempt to explain the meaning, significance of internal Control, and the Components of a company's internal control.

They also attempt to explain the relevancy of internal control in large scale business organization. They emphasize that internal control is a process and not an end in or of itself. They note that internal control provide reasonable but not absolute assurance about the attainment of an entity's objectives.

Abdulmena Hamza UK 2016 on Addis Fortune newspaper indicates that Unlike their counterparts in sophisticated financial systems, Ethiopian banks are not prone to complex risks. As their business remains predominantly traditional and the majority of tasks are undertaken manually, the nature of their risks chiefly relates to credit, liquidity and operations. Most of these relate to internal control systems. Indeed, it is the holes in the internal control systems that enabled several fraud cases to happen.

As explained by European Central Bank Report (Sep.2010), Among the large set of performance measures for banks used by academics and practitioners alike, a distinction can be made between traditional, economic and market-based measures of performance. Traditional performance measures are similar to those applied in other industries, with return on assets (RoA), return on equity (RoE) or cost-to-income ratio being the most widely used.

Ethiopian's banking sector currently comprises of 17 commercial bank and one development bank. Among which 16 banks are owned privately. In recent Years , the Banking sector has shown some signs of dynamism. As a result, the two State owned Private Banks, i.e Commercial Bank of Ethiopia (CBE) and Constriction Bank of Ethiopia (CBB) has recently merged officially though some remaining works are under way. However, most financial depth and financial breadth indicators display a significant lag compared with other East African countries (Ethiopian Bankers Association magazine Vo.1, 2014)

As indicted above there are lots of financial measurement applied across Banks, but for this particular study; the researcher prefer to focus on these three variable (Efficiency, Accountability and reporting), in which to the best of the researcher's knowledge no

significant research has been conducted locally . But, equally important and can be applied in Commercial Banks.

1.2 Statement of the Problem

Proper internal control in any felid of activities and particularly banking sector plays a significant role in upholding the banks' efficiency and effectiveness and safeguarding assets and loss. In effect, these will enhances financial performance of an organization. (COSO-integrated internal control frame work 2011). Further studies suggest that, the internal control will influence the organizational performance by setting objectives; management can then identify risks to the achievement of those objectives. To address these risks, management of an organization may implement specific internal control (Douglas, 2011).

Notwithstanding, internal controls only provide a reasonable assurance, and not absolute assurance, this is because it is people who operate the internal controls, break down can occur, human error, management override, and improper Management style, collusion among people who are supposed to act independently can cause failure of internal control to achieve corporate objectives and corporate performance in general.

On top of the above facts, Senior Management and other Management group are usually focused on their companies profitability, growth in capital, Market share and earnings per share etc. at the expense of compromising the internal control established in their Bank since they assume as internal control has no significant role on financial performance of an organization as supported by the study conducted by Kamis H.Ali (2013). Therefore, this has motivated the researcher to assess the practice of internal control system and its contribution to financial performance of private Banks in Ethiopia, in short the research problem is identified as "lack of proper internal control system in Banking Operation may affect efficiency, accountability and financial reporting which ultimately affects financial performance of Banks in Ethiopia.

1.3 Research Questions

The study tries to answer the following basic research questions:

    I.   Are the existing controls in banking sector efficient?

    II.   What are the existing controls to the private Bank over the financial performance?

    III.   What is the significance of effective internal control system to financial performance of private commercial Bank?

    IV.   Are there any relationship between financial performance and internal audit function and control activities to the financial institution?

1.4 Objectives of the Study

1.4.1 General Objective

Internal Controls in an organization are normally instituted to provide reasonable assurance about the achievement of the entity's objective with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. These will ultimately translated into improved financial Performance. Therefore, the general objective of this study is to investigate practice of internal control system and its contribution to financial performance of some selected private Banks in Ethiopia.

1.4.2 Specific Objective

The study has the following specific objectives

- To evaluate the efficiency of internal control system on the performance of private Banks.

- To find out the existing internal control system over financial performance of private Banks in Ethiopia.

- To find out the significance internal control system over Financial Performance of Bank.
- To examine the relationship between financial performance, Internal Audit and Control activities.
- To recommend alternative actions to overcome lack of internal control system.

1.5 Significance of the Study

This research work provide a conceptual framework on which Banks could assess their internal control system and judge their effectiveness. In other words, the study is to provide common understanding and a practical way for companies to assess and improve their internal control systems. Moreover, to the researcher who will be interested on the same idea, it will provide the proper path of what this research could not cover considering its limitation.

 Therefore, this study attempted to establish the linkage between internal controls and improved financial performance as measured by efficiency, accountability and financial reporting. Moreover, the recommendations given will help to complement and support the banking sector in addressing basic problem in this regards.

1.6 Scope of the Study

The study mainly focused on practice of internal control system and its contribution on corporate financial performance of some private Banks in Ethiopia, hence the researcher only concentrate with Internal Audit department, Accounting and Finance department, Risk/Compliance Department and selected high grade Branches form each selected banks which are assumed to be more important to get relevant information through the designed research.

1.7 Limitation of the Study

The major limitation of the study is that a lot of research has been done on financial performance and internal control specifically by considering some quantitative data like ROA,ROE and liquidity. But, researches that has been done based on qualitative data were not locally found to the best of the researcher's knowledge. Moreover, the findings and recommendations may not be generalized and applied to all Banks and some variables may not be explained as required.

1.8 Organization of the Study

This study has comprises of five Chapters. The first chapter introduces the topic and subject matter of internal control system along with the research objectives and its scope. The second chapter of the study contained the prior knowledge and study on this specific topic. As a result, both theoretical and empirical literatures are reviewed and incorporated in this chapter regarding internal control and financial performance. The third chapter elaborates the methodologies the researcher applied in carrying out this study. Moreover, the instrument of data collection and source of data that assure to have the right information which in effect the pillars of this research were detailed in this chapter. The fourth chapter would look at the data presented and analyzed in generally accepted way. Also the fifth chapter would see the conclusion and recommendation of the study, this is where the findings and result of the study would be conclude and suitable recommendations would be issued.

CHAPTER TWO
REVIEW OF RELATED LITERATURE

2.1 Introduction

The research is intended to assess the practice of internal control system and its contribution to financial performance with emphasis of selected private Banks in Ethiopia. The review of available literature therefore attempted to establish whether there is a relation between Internal Control systems as an Independent variable and financial performance as a dependent variable. The review particularly focused on Control environment, Risk Assessment and Control activities as the main components of Internal Control. The other components of internal control were ignored for purposes of this research. The review also examined financial performance and in particular focusing on efficiency, accountability and reporting. All other financial performance measures were ignored for purposes of the study. The review examined the common systems of internal controls employed by private Bank.

The review also tried to determine the main objectives systems of internal control are normally intended to achieve. The ultimate objective of this review was therefore to examine the relationship between internal controls systems and financial performance. The review examined the theory surrounding systems of internal control and the methods used by previous researchers in dealing with internal control systems.

2.2 Theoretical Framework

2.2.1 Definition of Internal control

The Committee of Sponsoring Organization of the Tread way Commission (COSO) integrated framework (Dec 2011) defined internal control as follows:

Internal Control is a process, effected by an entity's Board of directors, Management, and other personal, designed to provide reasonable assurance regarding the achievement of Objectives in the following categories;

- Effectiveness and efficiency of operation
- Reliability of reporting
- Compliance with applicable laws and regulation

The definition of integrated framework (COSO) give an emphasizes as internal control is;

- − A process consisting of ongoing tasks and activities. It is a means to an end and, not an end by itself.
- − Effected by people, it is not merely about policy, Manual, System and forms, but about people at every level of an organization that impact internal control.
- − Able to provide reasonable assurance, not absolute assurance, to an entity's senior Management and Board.
- − Geared to the achievement of Objectives in one or more separate but overlapping categories.
- − Adaptable to the entity structure.

Apart from the above definition and expiations, numerous experts in business both academicians and practitioner have written on the subject matter of internal control and have defined it from different perspectives. In many organizations, accountants have often used the term internal control as a synonym for control within business organization. This term has been defined by the American Institute of Certified public Account. (AICPA) as;

"The plan of organization and all of the co-ordinate methods and measures adopted within a business to safeguard its assets; check the accuracy and reliability of its accounting data, promote operational efficiency and encourage adherence to prescribed managerial policies"

Holmes A. (1964) in his definition states ; Internal control constitutes the methods followed by a company.

    I. Protect assets;

    II. Protect against improper asset disbursement;

    III. Protect against incurrence of improper liabilities;

    IV. Assure the accuracy and dependability of all financial and operating information.

    V. Judge operating efficiency and;

    VI. Measure adherence to company's establishment policies.

He further stressed that internal control may be administrative or financial. Administrative control normally pertains to activities which are not directly financial in nature and are built into the system to promote the attainment of the major goals of internal control. Financial control pertains to financial activity and may be exemplified by the separation of the duties of personnel in disbursing cases and recording related cash transaction.

2.2.2 Internal Control and Internal Control System

Under the committee of sponsoring Organization of the Treadway Commission (2011), defined as a process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objective in, effectiveness and efficiency of operations, reliability of financial reporting and compliance with laws and regulations.

According to A.H Milichamp (2002), Internal Control System is defined as the whole system of control, financial and otherwise, established by the management in order to carry on the business of safeguarding the assets and secure as far as possible the completeness and accuracy of the records. Further analyses the redefinition as follows.

The Financial and otherwise, the distinction is not important. Perhaps the financial would include the use of control accounts and otherwise may include physical access restrictions to computer terminal.

Moreover, (ISA 400) also defined internal control system, as all the policies and procedures (internal control) adopted by the management of an entity to assist in achieving management's objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

The internal control system extends beyond those matters which relate directly to the functions of the accounting system and comprises; the control environment and control procedure.

2.2.3 Type of Internal Control

The various definitions given by different authors depict that some types of internal control exist in many organizations.

As S.K.BASU(2007) explanation internal controls is categorized as the follows:

a) Organizational: The delegation of authority and responsibility should be clearly specified. An employee should always know the precise power delegated to him, the extent of his/her authority and to whom he/she should report.

b) By segregation of Duties: No one person should be responsible for the recording and processing of a complete transaction. Function for given transaction which should be separated include initiation, authorization, execution, custody and recording.

c) Physical: Physical custody of asset and involves procedure designed to limit access to authorized personnel only.

d) and Approval: All transaction should require authorization or approval by an appropriate person. The limits to these authorizations should be specified.

e) Arithmetical and Accounting: There is a control in the recording function. Procedures include checking the arithmetical accuracy of the records, Maintenance and checking of totals, reconciliation, control account, trial balance, accounting for documents and preview.

f) By Personnel: Procedures should be designed to ensure that the personnel operating a system are competent and motivated to carry the task assigned to them.

g) By supervision: All actions by all level of staff should be supervised. The responsibility for supervision should be clearly laid down and communicate to the person being supervised.

h) My management: There are controls, exercised by Management, which are outside and over and above the day-to-day routine of the system.

2.2.4 Components of Internal Control

COSO framework (2011) summarized internal control in to five components and set seventeen principles representing the fundamental concepts associated with each components.

- Control Environment;
- Risk Assessment;
- Control Activities*;*
- Information and Communication*, and*
- Monitoring Activities.

Moreover, COSO framework (2005), try to show little relation between the two variable (internal control and financial performance), is the major function of internal control system that plays an important role in preventing and detecting fraud and protecting the Organization's resources.

2.2.5 Risk Assessment

COSO (2011) emphasizes the importance of objective setting in the entity and relates it to risk assessment as a precondition. However, it should be emphasized that the company internal control framework should be established in order to have reasonable assurance to achieve established objective, risk identification and analysis are the critical components. In evaluating the effectiveness of internal control activities, it is essential to assess them against entity's objectives and related risks.

Risk assessment is a systematic process for integrating professional judgment about probable adverse conditions and events, and assessing the likelihood of possible losses (financial and non-financial) resulting from their occurrence. The second internal control standard addresses risk assessment. Internal control should provide for an assessment of the risks the agency faces from both internal and external sources. Once risks have been identified, they should be analyzed for their possible effect. Management then has to formulate an approach for risk management and decide upon the internal control activities required to mitigate those risks and achieve the internal control objectives of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations.

The objective of financial reporting and performance in the entity, the production of accurate, complete, relevant, timely and reliable financial information to demonstrate and maintain accountability, to meet statutory reporting requirements, to account for an organization's stake holders for its financial performance (CIPFA, 2002:24)

Basel Committee in Banking supervision (1996) explains risk recognition and assessment as Banking organizations will set objectives for the efficiency and effectiveness of activities, reliability and completeness of financial and management information, and compliance with laws and regulations. Risk assessment entails the identification and evaluation of the risks involved in meeting those objectives. This process helps to ensure that the bank's internal controls are consistent with the nature, complexity and risk of the bank's on- and off-balance sheet activities.

2.2.6 Financial Performance

European Central Bank report (Sep.2013) analyses bank performance in terms of its capacity to generate sustainable profitability. Profitability is a bank's first line of defense against unexpected losses, as it strengthens its capital position and improves future profitability through the investment of retained earnings. An institution that persistently makes a loss will ultimately deplete its capital base, which in turn puts equity and debt holders at risk. Moreover, since the ultimate purpose of any profit-seeking organization is to preserve and create wealth for its owners, the bank's return on equity (RoE) needs to be greater than its cost of equity in order to create shareholder value.

The report emphasis that Over the crisis, RoE may have provided misleading information in differentiating good performers from bad ones. To this end, it is important to obtain a comprehensive view may influence banks' performance, including of the key factors that the adequacy of business models in relation to risk appetite, and the question of how this adequacy is handled inside and outside banks through governance processes. Against this backdrop, appropriate benchmarks, sensitivity analyses as well as stress tests ought to be considered in order to assess the real capability of banks to face stressed market conditions and absorb consecutive shocks on the basis of their business strategy and degree of risk tolerance.

2.2.7 Internal Control in Banking

Banking Regulation and Supervision Board (BRSB) has defined internal control system as all of the financial, operational and other control systems which are carried out by internal controllers and which involve monitoring, independent evaluation and timely reporting to management levels systematically in order to ensure that all the bank activities are performed by management levels in accordance with current policies, methods, instructions and limits.

The definition elaborates the concept from a broader coverage and examined the vital role played by the independent internal control in identifying and assessing that practices are aligned with the industry policies. Bahu, Melloul and Walsh (June 2015) in their literature have also identified the importance of independency in internal control as the key aspect. They argued that without independency, the internal controls cannot be deemed as efficient and successful. An independent controller is therefore required to look after the actions of management and the overall operations of the business organization.

2.3 Empirical Review of Literature

Empirical literature review involves citing researchers and recent books and journals or recent time observations and experiments. Some of the studies that have been conducted on internal control system include information and communication as one of the internal control compact, which result the financial performance. Smooth flow of information and communication across and within the organization is influenced by the nature of the working relationship within the organization at all levels. Steinhoff (2001)

According to K. Douglas, (2011), express the topic of internal control has little relation with financial performance by recommending internal audit units for each branch across the country, so that there shall always be the availability of internal audit personnel's to ensure compliance to the internal controls that exist in their organization. This is to make the internal audit part of the daily activities of the organization to ensure daily compliance to the internal controls but should not wait till the end of the month. In as much as possible, this office should be part of the branch management team. In doing so, they will report directly to the country management team. The internal audit personnel should also be rotated at regular intervals to avoid any form of malpractices.

Furthermore the research work tries to research by expressing the relation with internal control and performance based on the research submitted by O. John (2011) to Makerere University provides a stronger test than prior studies which shows that there is a connection

between control environment, risk assessment, control activities and performance of the organization. In their study, firstly they used data taken directly from interview rather than through questionnaires; secondly they employed a key internal control characteristic (management integrity).

According to Khamis H.Ali (2013), Measuring performance of Internal control in organization is very important because it can help the management to know whether the internal control contributes the financial performance of the bank and adds value to the organization. In his study, he identified that there is a positive relationship between internal control and financial performance. But, he claims that the performance of the Bank depends on various variable other than it, for instance monopoly of other bank, culture and other factors.

2.3.1 Internal Audit and Financial Performance

Whittington & Pany (2001) suggest that internal auditing is performed as part of monitoring activity of an organization. It involves investigation and appraising internal control and the efficiency with the various units of the organization are performing their assigned functions. An Internal Auditor is normally interested in determining whether a department has a clear understanding of its assignment, is adequately staffed, maintains good recodes, properly safeguarding cash, inventory and other assets and cooperates harmoniously with other departments.

Ndifon Ejoh (2014) stressed that appropriate performance measure are those which enable organizations to direct their actions towards achieving their strategic objectives. Performance is measured based on either subjective or objective criteria; argument for subjective measures include difficulties with collecting qualitative performance data from organizations and reliability data.

2.3.2 Accountability

According to Hayes, et al. (2005), Managers need regular financial reports so as to make informed decision. Reporting (particularly, financial reports) is one way through which managers make accountability for the resource entrusted to them.

As the primary users of financial reports, members of the public may be less financially sophisticated than users of other types of financial reports. They likely have less access to intermediaries, such as investment analysts, who can interpret the financial reports for them. Therefore, financial reports must place great emphasis on the understandability of the information reported in them. The financial reports cannot exclude complex transactions nor simplify complex transactions such that their substance is misleading but the emphasis on understandability would need to be considered in determining the reporting of items in financial reports. Preparers of financial reports should assume that users have a reasonable understanding of economic activities and accounting, together with a willingness to study the information with reasonable diligence.

General purpose financial reports prepared to respond to the needs of the public and their elected representatives for accountability purposes may also provide information useful to other users and for other purposes. For example, government statisticians, analysts, the media, financial advisors, public interest and lobby groups and others may find the information provided by the financial reports useful for their own purposes. Some users have the authority to require the preparation of financial reports tailored to meet their own specific information needs but may also use the information provided by general purpose financial reports for their own purposes (for example, regulatory and oversight bodies, subcommittees of the legislature or other governing body, central agencies and budget controllers, entity management and, in some cases, lending institutions and providers of development and other assistance). While these other users may find the information provided in general purpose financial reports useful, the reports would not be prepared to specifically respond to their particular information needs.

2.3.3 Reporting

Whittington and Pany (2001), emphasize on internal controls in addressing the achievement of objectives in the areas of financial reporting, operations and compliance with laws, and regulations. They further note that "Internal control also includes the program for preparing, verifying and distributing to the various levels of management those current reports and analysis that enable the executive to maintain control over the variety of activities and functions that are performed in a large organization". The mention internal control devices to include use of budgetary techniques, production standards.

John J. Morris (2011) believes that the enterprise Resource Planning System provide a mechanism to deliver fast, accurate financial with built- in controls that are designed to ensure the accuracy and reliability of the financial information being reported to shareholders.

2.3.4 Growth of Private Commercial Bank in Ethiopia

As indicated on National Bank Yearly published Bulletin (2013-14), the growth of banks are mainly determined by the asset growth of the bank and expansion of its key area of operation which are mainly collecting deposit and providing loan. Therefore, based on these variable it is possible to see the growth of Ethiopian Commercial banks. Accordingly, the asset level of commercial banks in Ethiopia increase from 84 billion birr from the Year 2012 to -157 billion birr in the year 2015 with annual average growth rate of 23 percent. This suggests that the Ethiopian Banking sector has grown rapidly. Overall deposits collected by all commercial banks also increase from 181 billion birr in the year 2012 to 366 billion birr in the year 2015 with annual average rate of 26 percent. Given bill purchase imposed by the central bank during the year 2012, the increase in banks' lending was of course the same as the growth of deposit in the year 2015. As a result, over the period of 2012-2015 the amount of loan and advances provided by private commercial banks generally increased from 144 billion birr in the year 2012 to 285 billion birr in the

year 2015 with annual average growth rate of 26%. Therefore, from this analysis we can conclude that Ethiopian banking sector is booming and the Banking industry showed very strong growth (see the table below)

Table-2.0 List of private Commercial Bank in Ethiopia and their key performance Areas.

Peer Group	No	Private Commercial Bank	Establishment Year	Paid up Capital in birr as of Dec. 2015 in '000,000'	Earnings per share June 2015
Peer 1	1	Awash international Bank	1994	1,888	44.5
	2	Dashen Bank	1995	1,239	58.9
	3	Abyssinia Bank	1996	1,132	38.1
	4	Wegagan Bank	1997	1,769	24.4
	5	United Bank	1998	996	40
	6	Nib International Bank	1999	1,267	27.4
Peer 2	7	Cooperative Bank of Oromia	2004	868	36.4
	8	Lion International Bank	2006	538	42.5
	9	Oromia International Bank	2008	700	36.4
	10	Zemen Bank	2008	500	32.2
	11	Bunna International Bank	2009	522	28.7
	12	Birhanu International Bank	2009	623	20.7
Peer 3	13	Abay Bank	2010	631	27.2
	14	Addis International Bank	2011	412	18.7
	15	Debube Global Bank	2012	232	13.3
	16	Enat Bank	2013	448	16.4

 Source: Data collected during fieldwork

Figure 1 Conceptual frame work.

Independent Variable
(Internal Control)

Dependent Variable
(Financial Performance)

- Control Environment
- Risk Assessment
- Control Activities

- Efficiency
- Accountability
- Reporting
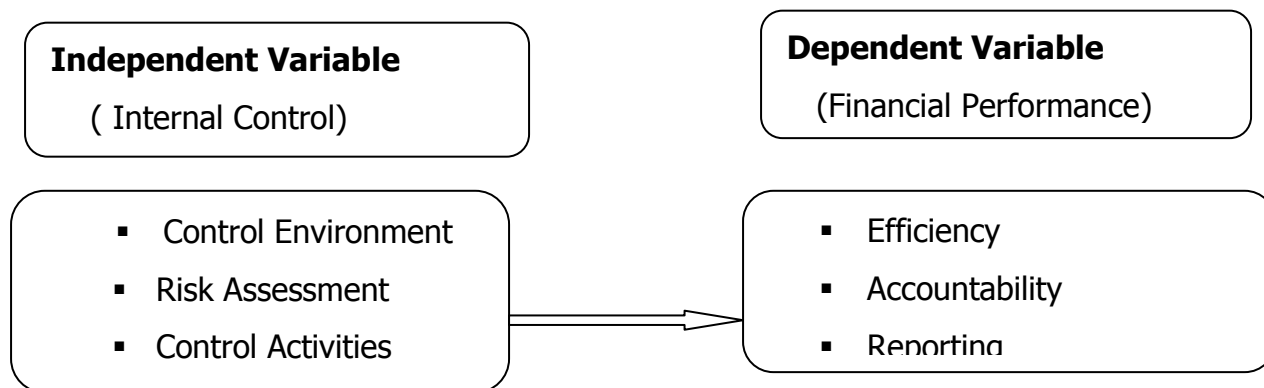
Source: developed from Literature review

From the above conceptual frame work it is clear that internal control as an independent variable as measured by the control environment, risk Management and control activities and affect the financial performance of dependent variable as measured by efficiency, Financial accountability and Financial reporting.

2.3.5 Research Gap

From the literature review, several researchers seem to concur that there is a relationship between internal control and financial performance. However, some parameters that can be equally impacts internal control of an organization like integrity and ethical practice were not discussed though they were the principal contributors of internal control as indicated on integrated frame work published by COSO on fraudulent financial reporting. Contribution of Information technologies in strengthening internal control were not also touched though information communication is one of the integral part of internal control.

CHAPTER THREE
RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

This chapter covers basic techniques and tools for data collection and analysis. This chapter shows how data would be collected and eventually analyzed. The chapter includes the area of the study, Population of the study, sampling technique, and method of data collection as well as data analysis techniques.

3.2 Area of the Study

The study focused on seven private banks that are categorized under different peer groups based on their capital, profitability, market share etc., for the purpose of assessing the effect of internal control in financial performance of private bank in Ethiopia.

3.3 Population of the Study

The study was carried out over seven selected Private Banks in Ethiopia namely, Awash Bank, Dashen Bank, Lion International Bank, Cooperative Bank of Oromia and Oromia International Bank, Debub Global Bank and Addis International Bank. Those Banks are selected from different category of peer groups of the industry formed by National Bank of Ethiopia (NBE). Participants for this study were selected from different sample of employees working in the Banks at different levels of posts (Top, Middle, and low level Management).

The researcher was interested in considering only private banks since they are operating under the similar ownership status and similar political, economic, environments. Such as, all private Banks in our countries are In addition, the private banks operate to serve the interest of their shareholders in general and they have the same motive and uniform playing field unlike government owned Banks. The researcher's work, concern with two qualitative variables, independent variables and independent variables that result the financial performance of private Bank.

Table-3.1 Sample Distribution

S.N	Category of Respondent	Population	sample	Percentage from the total Sample
1	Department Directors/Managers (DD/M)	21	7	11%
2	Division Managers (DM)	21	16	27%
3	High Grade Branch Managers in A.A with (BM)	60	15	25%
4	Senior Officer	48	22	37 %
	Total	**150**	**60**	100%

Source; Primary Data

Table 3.1 Detail Sample Frame

Peer Group	List of Selected Banks	Category and population					Target Sam.siz	% age
		DD	DM	BM	SO	Total		
1	Awash International Bank (AIB)	3	3	12	7	25	9	36%
	Dashen Bank (DB)	3	3	12	7	25	9	26%
2	Anbessa Bank (AB)	3	3	10	8	24	9	38%
	Oromia International Bank (OIB)	3	3	10	10	26	12	46%
	Cooperative Bank of Oromia (CBO)	3	3	10	8	24	11	46%
3	Debub Global Bank (DGB)	3	3	3	5	14	6	43%
	Addis International Bank (AIB)	3	3	3	3	12	4	33%
	Total	21	21	60	48	150	60	40%

Source; Primary Data

3.4 Sampling Techniques

The researcher preferred to use one of the non-probability sampling technique named purposive sampling which was more convenient to get realizable data. In doing so, the researcher tried to avoid any bias and attempt to get better representatives. Accordingly, The study had focused on employees at different level from Internal Audit Department, Accounting and Finance Department, Risk and Compliance Department and selected high grade branches of respective Banks. The three departments in Banking industry have better opportunity to know regarding internal control and financial performance of their respective Bank than other parallel Departments. The researcher distributed questioners to Department Directors, Division and branch Managers selectively. Out of 150 population size 40% of target sample was taken. As a result, to the maximum of (60) sixty questioners was distributed and out of them four respondents were not respond for the questioner they have been received.

3.5. Data collection

Both primarily and secondary data sources were used. Primary data was obtained through self administered survey questionnaire. To the possible extent, the questions include exhaustive responses categories to include all possible responses.

The secondary source of data includes different books, journals and researches and internet.. Other published document by the banks may also be used after scrutiny is made about their relevance.

3.5.1 Measurement of Variables

Table 3.3 Variables and their Measurement

S.N	Variables	Operational definition	Measurement
1	Control Environment	Proper planning and control, Presence and functioning of board of director, Proper organization policies, Measure taken to the correction of the proper	▪ Does the management committed to the operation of the system? ▪ Does the management closely monitor and implement the control?
2	Risk Assessment	▪ Risk identification ▪ Risk analysis ▪ Management of risk ▪ Inherent and detection risk ▪ Control risk	▪ Have proper strategies for managing risks been established? ▪ Is there appropriate measure of controlling the risk? ▪ Does The internal audit exist?
3	Control activities	▪ Proper planning and control. ▪ Presence and functioning of board of director. ▪ Proper organization policies. ▪ Measure taken to the correction of the proper operation of internal control system	▪ Does the management committed to the operation of the system? ▪ Does the management closely monitor and implement the control systems? ▪ Are the policies and procedure exist and functioning ? ▪ Does the organization structure clearly defined?
4	Accountability	▪ Review the transaction and report ▪ Provision of reasonable assurance of the information	▪ Does the management act on behalf of shareholder and other stake holder? ▪ Does the agency theory exist ?
5	Reporting	▪ Validity of reporting ▪ Time line of report ▪ Appropriate source of report	▪ Does the report show true and fair view? ▪ What is the relevance of the report ?
6	Efficiency	▪ Enforcement of rules and regulation. ▪ Proper usage of assets.	▪ Does the Bank implement all operational rules and procedures ▪ Does the fixed asset kept properly and get maintenance as required.

Source; Different literature

3.5.2 Questionnaire

The questionnaires were the main primary source of data collection. The identified sample was served with the questionnaires directly by the researcher. This is an easiest way of collecting data that can help to get response from unreached persons and give respondents enough time to think and give well thought and answer. Questionnaire were distributed to concerned staffs, and these questionnaires were containing more close ended and only two open ended questions were there so as to facilitate coding and data analysis and keep respondents convenience. The researchers has given the questionnaire to selected relevant bank officials by hand due to the sample being easily reachable by researcher and collected by the same way.

3.5.3 Secondary Data

Through documentation includes a review from earlier studies on the topic, from the books, journals, reports, and some documents. The researcher reviews the Banking sector in Ethiopia and regulatory requirements, moreover COSO Framework reviewed as it is used as a standard framework for bank internal control.

3.6 Pre-Testing for Validity and Reliability of the Research Instruments

Mugenda and Mugenda (2003) defined validity as the degree of accuracy and mindfulness of outcome, which are based on the research result. On the other hand, Saunders, Lewis and Thornhill.(2009) defined reliability as measure of the degree to which a research instrument yields consistent result after repeated trials. To fit these definition, the researcher developed a structured questionnaire and forward to expert in the area. Before it was administered, the questionnaire was cross-examined for content and comprehensiveness by experienced research officer.

3.7 Reliability and validity of the Data collected

The primary goal of validity and reliability is to minimize the risk of having error and avoid biasness in the study.

To ensure the reliability and validity of this study, the researcher cautiously in his capacity interpreted all gathered information throughout the entire research. Data that were collected from respective bank officials was carefully compared and evaluated to obtain the highest possible level of reliability and validity.

To ensure that the data was reliable and bears validity researcher conducted through carful reviewing and comprehension of the appropriate literature, article and website that gave insight to the aspect of the study.

3.8 Method of Data Analysis

Data analysis is the ways of sorting the data so as to establish statistical patterns and identification of relationships. Mostly, descriptive statistics analysis used to analyze data obtained from respondents through questionnaire. These include percentages, and frequencies and tables were major types of the descriptive statistic analysis of the study. The Statistical Package for Social Sciences (SPSS) and Microsoft Excel Computer Software were used to enter data collected from respondents.

The collected data/information from primary sources will be edited, coded, summarized and analyzed by using Statistical Package of Social Science (SPSS) and Microsoft excel computer software, and tabulation will also used to enter data collected from sources through questionnaire.

3.9 Ethical Consideration

Ethical consideration were taken into consideration by first seeking authorization from the selected Banks' Top management. Questionnaires were structured in such a way that there was no mention of the Interviewee's name. A statement as to the strict confidentiality with which data will be held was expressly stated in the questionnaire. Further, responding was optional, basically explaining the reason for replacing respondents who didn't wish to respond as mentioned in the "Sample Size and Sample Selection techniques" above. Ethical considerations were also taken care of by the researcher briefing the respondents as to the purpose of the research, their relevance in the research process, and expectations from them.

CHAPTER FOUR
PRESENTATION OF RESEARCH FINDINGS

4. Introduction

This chapter presents the results obtained from questionnaires and explains the findings obtained from the field work. The tables and figures are some of the results presentation techniques which were employed in this study. Data which were collected and analyzed were based on the specific research objectives and questions, which were used as a guide during the actual research work. The questionnaires were distributed to 60 Bank officials found at different level of post. Out of which four senior officers were not responding.

4.1 Profile of the Respondents

This study involved fifty six (56) respondents. The respondents were from seven private Banks working in the Department of Accounting and Finance, Internal Audit and Risk and Compliance. The profile of the respondents covers their age, current position, gender and education as presented in the following subsections;

4.1.1 Gender of the Respondents

The study involved 56 respondents, whereas 82.1% were male and 17.9% were female as shown in Table 4.1. This indicates that majority of the respondents found in banking sector of managerial positions were in male. This showed us though the ratio of male to female as a country has no significant variation, still females are not equally get education, not fully empowered and not treated equally.

As a result, there are a lot of woks have to be done so as to bring female to the desired level as their presence help in management decision and they could contribute a lot to bring efficiency and effectiveness in any type of business.

Table 4.1 Respondents' Gender

Variable	Frequency	Percent	Valid Percent	Cumulative Percent
Female	10	17.9	17.9	17.9
Male	46	82.1	82.1	100.0
Total	56	100.0	100.0	

Source: Primary Data

4.1.2 Current Position of the Respondent

During the field work the researcher found that about 12.5% respondents were seven Department Heads working in a position of Director accounting and Treasury, Chief Internal Auditor (Controller) and Chief Risk and Compliance Management. 28.6% of respondents were division managers of those three departments. And 26.8% of the respondents were Branch Managers of of Grade III branches of seven Banks from different peer groups. The remaining 32.1% of respondents were senior officers (Senior auditors, Risk and compliance officers, senior accountants etc,) working at head office of each sample Banks as shown in table 4.2 and figure 4.1 below.

Table- 4.2 Current position of respondents

Respondents position	Frequency	Percent	Valid Percent	Cumulative Percent
Dept Head	7	12.5	12.5	12.5
Division Manager	16	28.6	28.6	41.1
Branch Manager	15	26.8	26.8	67.9
Senior Officer	18	32.1	32.1	100.0
Total	56	100.0	100.0	

Source: Primary Data

All these sort of heterogeneous respondents who are involved mainly on the oversight activities of their respective banks, that helps the researcher to attain the valuable and reliable information and foster the researcher's confidence so as to get better information on existing internal control of Banks.

Figure 4.1 Respondents position
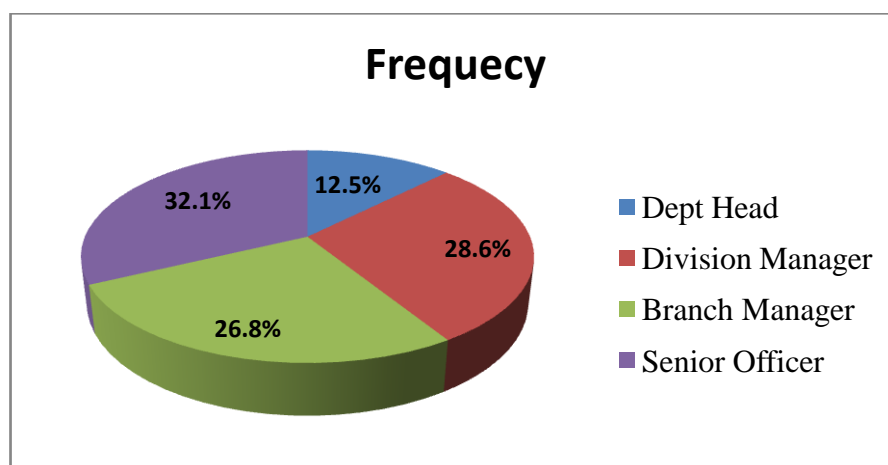
Source: Primary Data

4.1.3 Respondents' Composition of Age

The researcher found that the age of the respondents ranged from below twenty five to sixty years. Grouping the respondents was based on their age at the interval of twenty fifteen years and from that four categories were found from the researcher finding. The larger number of the respondents lied into second category of the age distribution 25 to 40 years; the respondents under this category were (82.1%), while that of the respondents whose age ranged between 41 to 55 years were (14.3%). However, there were no respondents whose ages are above 55 and only 3.6% respondents were found below 25. The data shows that age of most Department Directors, Division Managers and Senior Officers are found between 25-40 which is more desirable in financial institution specially in banking industry based on their productivity.

Table 4.3 Respondents' age

Age category	Frequency	Percent	Valid Percent	Cumulative Percent
below 25 years	2	3.6	3.6	3.6
25-40 years	46	82.1	82.1	85.7
41-55 years	8	14.3	14.3	100.0
Total	56	100.0	100.0	

Source Primary Data

4.1.4 Respondent's Educational level

Education is the most important input for Banking operation and, generally, the education facility influences proper performance of an individual and any other occupational performance. It has more prone effects on entity operation and control. In this study, the educational level of the respondents differs in relation to specialization and experience in business operation. The findings from Table 4.4 depicted that, 83.9% of respondents attained First degree level while 14.3% of the respondents are the Postgraduate Diploma. On other hand one respondent educational qualification were not defined well.

Table 4.4 Respondents Educational Level

Variables	Frequency	Percent	Valid Percent	Cumulative Percent
first degree	47	83.9	83.9	83.9
master degree	8	14.3	14.3	98.2
other	1	1.8	1.8	100.0
Total	56	100.0	100.0	

Source: Primary Data

Moreover, these level of education possessed by respondents enabled the researcher to get reliable data concerning the efficiency of internal control placed by their respective Banks, because the person who have this level of education has got good understanding and reasoning so can provide more reliable information concerning the efficiency and effectiveness of internal control and how it contributes to the organization success.

4.1.5 Work Experience of the Respondents

The study requested respondent to indicate the number of years they had served for. From the findings the study established that 42.9% of the respondents had worked for a period of 6 to 10 years 33.9% of the respondents indicate they had worked more than ten years,17.9% of the respondents indicate they had worked a period of 3 to 5 years, only 3% of respondents were found less than three years of work experience, this implies the majority of the respondents had served in a bank a considerable period which indict that most of the respondents had vast knowledge which could be relied upon by this study.

Table 4.5 Respondents' work Experience

Year of Experience	Frequency	Percent	Valid Percent	Cumulative Percent
less than 3 years	3	5.4	5.4	5.4
3-5 years	10	17.9	17.9	23.2
6-10 years	24	42.9	42.9	66.1
more than ten years	19	33.9	33.9	100.0
Total	56	100.0	100.0	

Source Primary Data

4.2 Presentation of Specific Objective one

To Explore the efficiency of existing internal control system to the performance of private Banks.

4.2.1 Responses of Organizational Structure of Bank and responsible personnel of setting it.

It was found that, the organizational structure of selected private bank is set as evidenced by most of the respondents in all department and all level of Directors, Managers and Senior officers, as depicted under the following percentage-wise, about 67.9% clearly state

that the structure is clearly defined to provide the room for effective control while only 32.1% no response, that is, the structure is not clearly defined or not sure on this. This is shown on the following table 4.6

Table 4.6 Setting Organization Structure of the Bank

Variable	Frequency	Percentage(%)
Yes	38	67.9
No	18	32.1
Total	56	100.0

Source: Primary Data

However, the researcher found that, 89.3% of the respondents believed that is Executive Management team who are responsible in setting the organization structure, 3.6% showed that its Head office Management team only is involved in organizational structure's setting and 7.1 % of respondents respond that others are involved in setting organizational structure of their Bank as shown in the table below 4.7.

Table 4.7 Responsible Personnel in setting organization structure

Variables	Frequency	Percentage (%)
Executive Management Team	50	89.3
Head Office Management Team	2	3.6
Branch Management Team	0	0
Other	4	7.1
Total	56	100.0

Source: Primary Data

4.2.2 Close monitoring and administrative measures taken for any misappropriation

The Researcher found that there was moderately close monitoring of existence and implementation of internal control which is the basic instrument for improvement of financial performance as the result from the respondents indicates 60.7% were confirmed the existence of close monitoring. However, 39.3% of respondents agree that there was no close control as indicated in table 4.8 hereunder.

Table 4.8   Close monitoring   and implementation of internal control

Variables	Frequency	Percentage (%)
Yes	34	60.7
No	22	39.3
Total	56	100.0

Source: Primary Data

In addition, 85.7% of the respondent prove that administrative measure has been taken while significant breach of internal control has been committed. Only 14.3% of respondents responded as there was no administrative measure has been taken even though violation of internal control has breached.

From the total response the researcher conclude that private banks have close supervision of internal control and take administrative measure for violation of the established control tolls. This is show in table 4.9.

Table 4.9 Administrative Measure taken for breach of procedure

Variables	Frequency	Percentage (%)
Yes	48	85.7
No	8	14.3
Total	56	100.0

Source: Primary Data

4.2.3 Response of the commitment of management in operation of the internal control.

On the extent of commitment of management in operation of the internal control which ultimately contributes a lot for financial performance of private Banks. 60.7% of respondents indicate that all management level were looking after their responsible employees and 33.9% of respondents were not sure that the management was not committed on operation of management of internal control. Out of the respondents 5.4% of respondents were not respond on this specific issues. The table 4.10 indicates this.

Table 4.10 Management commitment in operation of internal control

Variable	Frequency	Percentage (%)
Yes	34	60.7
No	19	33.9
Total	53	94.6
Missed	3	5.4
Total	56	100.0

Source: Primary Data

4.2.4 Response on Evaluation of internal control efficiency and effectiveness

Evaluating efficiency and effectiveness of internal control of banks at any level of activities are the main duty of management. As a result, the 53.6% of respondents agree with the frequent evaluation of internal control's efficiency and effectiveness, though 44.6 % of respondents were not sure as shown in table 4.11 hereunder.

Evaluating periodically the implementation of internal control and its effectiveness would help banks financial performance. Moreover, banks could get an opportunity so as to close the loophole identified while carrying our frequent evaluation.

Table 4.11 Frequent evaluation of Internal Control Efficiency and Effectiveness

Variable	Frequency	Percent
Yes	30	53.6
No	25	44.6
Total	55	98.2
Missed	1	1.8
Total	56	100.0

Source: *Primary Data*

Banks are establishing policy and working procedure to ensure effective internal control and follow up any payment and collections as indicated on the response which is 83.9% as indicated on table 4.12.

Table 4.12 Adequacy of Policy and Procedure

Variable	Frequency	Percentage (%)
Yes	47	83.9
No	9	16.1
Total	56	100.0

Source: *Primary Data*

4.3 Presentation of Objective Two

To explore the existing internal control to the financial performance of Private Bank

4.3.1 The Study of Internal Control to Financial Performance

In this study the researcher found that about 83.9% of the respondents said that there was an internal control to the financial performance of their respective banks, this indicates that private Banks introduced proper controlling procedure over key performance area which in turn contributes for enhancement of financial performance.

Also the researcher found that about 5.4% said that there was no internal control within the bank for the financial performance. This refers to table 4.13.

Table 4.13 Existence of Internal control to the financial performance

Variable	Frequency	Percentage (%)
Yes	47	83.9
No	3	5.4
Total	50	89.3
System	6	10.7
Total	56	100.0

Source: Primary Data

This variable tested the respondent's knowledge of the existence of control system, the type of the control system and the people responsible for setting those internal control system in their banks.

From the qualitative data collected, the respondents were identified some existing internal control tools over financial performance of their respective Banks as categorized hereunder;

✓ Working policies, procedures and guidelines like Risk management program, Fraud monitoring policy, expense management policy, asset management policy and procedure are most respondents response.

✓ Existence of check and balance, setting authorization limit, comparison and monitoring of actual against budget, checking daily general ledger balance are among the responses identified.

✓ Existence of post and pre audit of daily transactions, Economic efficient use of resource and proper application of leading interest rate and collection of service charge and fees also the existing internal control in placed as the respondents explain.

4.3.2 Type Of Internal Control Placed With The Bank For The Financial Performance

The researcher in his finding found that, all of the respondents concluded that there was transactional internal control in the banks' core banking systems operation (Verification, reconciliation, authorization and approval). About 42.9% of the respondents showed that except physical control over fixed asset there was control. This was the indicator of lack of safeguarding the bank's assets, 23.2% of respondents showed that there are internal control over any transaction that was passed through the banks' core banking system in the form of authorization and approval. Further, researcher found that 7 respondents 12.5% supported that there was control over financial transaction in the form of verification, authorization and approval., this implies that the existence of control helps banks to achieve objectives of financial performance.

This was evidenced through the table 4.14   the results indicate the commitment of private Banks towards the internal controls over any transaction that would pass through core banking system and effective operation for achieving the financial performance, even though it is believed that there are different challenges on the operation.

Table 4.14 Type of internal control in transaction and Core Banking system

S.No	Variable	Frequency	Percentage (%)
1	Verification	4	7.1
2	Reconciliation	2	3.6
3	Authorization and approval	13	23.2
4	Physical control	1	1.8
5	all except 4	24	42.9
6	1 and 2	7	12.5
7	2 and 3	5	8.9
	Total	56	100.0

Source: Primary Data

4.3.3 Banks Risk Tolerance Limit And Frequency Of Revision

The researcher found that most private banks has set comprehensive risk tolerance limit which enables them to monitor the risk level of key performance areas and take appropriate measure. This is substantiated by table 4.15 as 51.8% of the respondents were agree on the presence of comprehensive risk tolerance limit. But, 35.7% of the respondents were not sure on the presence of comprehensive risk tolerance limit while 10.7% were agreed on its absence.

Table 4.15 Existence of comprehensive risk tolerance limit

Variable	Frequency	Percent
Yes	29	51.8
No	6	10.7
I am not sure	20	35.7
Total	55	98.2
Missed	1	1.8
Total	56	100.0

Source: *Primary Data*

In addition to the presence of risk tolerance limit the researcher found that 48.2% of the respondents were not sure about is timely revision. Whereas, 25% of the respondents agree on timely revision and the same no disagree on its timely revision after external and internal factors has been assessed and analyzed. This is shown in Table 4.16

Table 4.16 Timely revision of Risk tolerance limit

Variable	Frequency	Percent
Yes	14	25.0
No	14	25.0
I am not sure	27	48.2
Total	55	98.2
Missed	1	1.8
Total	56	100.0

Source: *Primary Data*

4.3.4 Communicating Special Incidents to all Staffs

Despite the issues are confidentially kept in banks, Special Incidents like Fraud, Embezzlement, Criminal acts etc. are committed frequently and the amount is also devastating.

To curve this incidents, creating awareness among staffs are one of the best mechanism among others. As a result, 62.5% of the respondents agreed on timely distribution and communication of such incidents while the remaining 37.5% were not agreed as indicated in table 4.17 below.

Table 4.17 Communicating special incidents to all staffs

Variable	Frequency	Percent
Yes	35	62.5
No	21	37.5
Total	56	100.0

Source: *Primary Data*

4.4 Presentation of Objective Three

To examine the significance of Internal Control system over Financial Performance of Bank.

4.4.1 The Response on Whether there was Relationship Between Internal Control and Financial Performance.

The result in the table 4.18 and figure 4.2 below indicate a significant positive relationship between internal controls and organizational financial performance of Banks. forty three (43) respondents equivalent of 76.8% showed that there relation between internal control and financial performance, while 16.1% indicated that there is no relation or not sure of internal control and financial performance.

Table 4.18 Relationship between internal control and financial performance

Variable	Frequency	Percent
Yes	43	76.8
No	9	16.1
Total	52	92.9
Missed	4	7.1
Total	56	100.0

Source: *Primary Data*

Figure 4.2 Level of relationship between internal control and financial performance
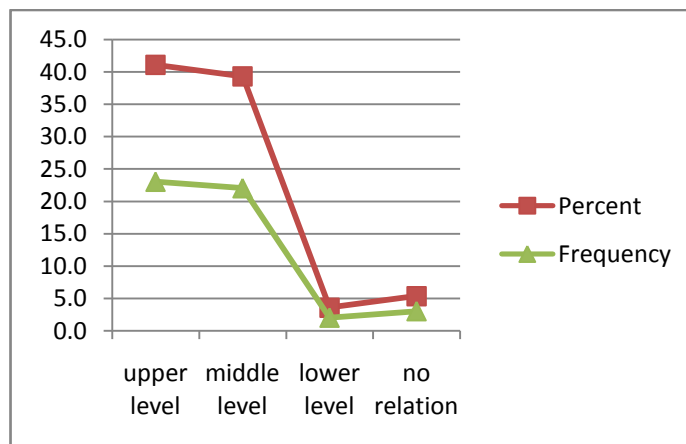
Source: Primary Data

Qualitative data regarding the existing relationships between internal control and financial performance is collected from respondents are summarized as follows;

✓ Financial performance measured with cost per unit, goal attainment and profitability; likewise, internal control system plays a critical role in allocating and utilizing financial resources, as a result the two variable have positive relationship towards improvement of banks wealth.

- ✓ Financial performance is to measure how well the company can uses asset from its primary mode of business and generate revenue with objective of wealth maximization; similarly, internal control imposes to have quality asset management, expense management and better asset utilization which in turn enhance financial performance of the bank.

- ✓ Most respondents agree on the timely collection of service charges and setting of proper interest rates on loan disbursed contributes to financial performance. Finally, proper control over liquidity management and regular inventory of physical asset are me are mentioned as the relationship observed.

4.5 Presentation of Objective Four

To examine the relationship between financial performance, Internal Audit and Control activities.

4.5.1 Relationship between Financial Performance and Internal Audit

The study sought to establish the level at which respondents agree or disagree with the statement relating to Internal Audit, from the finding the study established that majority of the respondents strongly agree that their respective bank has an objective independence and active Board Audit committee that carried out an oversight activities regularly as shown by mean of 1.93. In private banks of Ethiopia internal audit was not sufficiently staffed as sand shown by mean of 2.67.

Internal Audit activities addresses major weakness in internal control system of the bank as indicated by mean of 2.23 and the activities were conducted with a greet degree of autonomy and independence as shown by mean of 2.29.

Respondents are indifferent regarding management deliberation over the auditors finding regularly as shown by mean of 2.61, respondents were agreed in the communication of internal audit findings for proper correction, moreover, risk level of all auditable activities were identified before the audit work has been conducted as shown by mean of 2.45 and 1.49 respectively.

Table 4.19 Financial Performance and Internal Audit

Statement of Internal Audit	strongly agree	agree	neutral	disagree	strongly disagree	Total respondents	mean	sd deviation
Our Bank has an objective, independent and active Board audit committee.	26	16	7	6	1	56	1.93	1.093
Our internal audit is sufficiently staffed.	7	19	15	13	1	55	2.67	1.037
Internal audit report addresses weakness in our internal control system.	10	31	10	2	3		2.23	0.972
Internal auditors are performing their duties with a great degree of autonomy and independence from Management.	15	23	7	9	2	51	2.29	1.14
Management deliberate on /discusses on internal audit report regularly.	13	16	14	6	7	56	2.61	1.303
Risk level of each auditable activities are identified before conducting audit work.	8	25	15	2	6	56	2.45	989
All audit findings are communicated to the auditee immediately for on spot correction.	23	26	4	2	1	56	1.79	0.868

Source: Primary Data

4.5.2 Relationship between Financial Performance and Control Activities

Among five major components of Internal Control activities are one of the component that contributes a lot for improvement of financial performance of a Bank. As a result, the study sought to determine the level at which respondents agree with the statements relating to control activities and its contribution to financial performance in private bank of Ethiopia.

From the finding the study established that majority of the respondents agree on the presence of segregation of duties over all operational units as indicated by mean of 2.2, moreover, the corresponding standard deviation also reveal a value of 0.87 which indicates less dispersed result from mean. Fixed assets under position of the Bank contributes huge financial impacts unless carefully protected and controlled, as a result, most respondents were not sure whether the physical assets are protected and controlled well as shown by mean of 2.65, in addition the corresponding standard variation of 1.17 indicates moderately dispersion of data from the mean which is in agreement with Whittington and pany (2001) internal control and control activities comparison.

On the subject of the existence of check and balance among supervisions and the remaining staffs, respondents were not sure on its existence as shown by mean of 2.61 and responding standard deviation of 1.186,   concerning corrective action taken by management to address the identified weakness the respondents were agreed as indicated by mean value of 2.55. However, with regard to management deliberation over the observed findings by auditors (both external and internal), the level of agreement on the side of respondents were not sure as indicated by mean of 2.82.

Table 4.20 Relationship between Financial Performance and Control Activities

Statement of Control activities	strongly agree	Agree	neutral	disagree	strongly disagree	Total Respondents	mean	sd deviation
There is segregation of duties with in all operational units.	10	33	7	4	1	55	2.15	0.87
Your organizations' assets are secured and controlled fully by the Bank.	7	24	10	9	5	55	2.65	1.174
There is an appropriate supervision by senior staff on the work of their junior (Check and Balance existed).	7	27	9	7	6	56	2.61	1.186
Corrective action is taken timely to address the weakness identified by external and Internal Auditor or Inspection of regulatory body.	11	23	8	8	6	56	2.55	1.264
Management deliberate on /discusses on internal audit report regularly.	4	21	18	7	6	56	2.82	1.097
Departments and Branches have budget review system where actual expenditure is compared with budgeted expenditure and explanation for the variance is adequately given.	7	25	13	6	4	55	2.55	1.086

Source: Primary Data

Establishing budget review system in banking industry enhance financial performance of departments and branches in addition to a monitoring tools for significant and unacceptable variation. As a result, respondents were agreed on the existence of budget review system as indicated by mean of 2.55 and responding dispersion value of 1.086.

CHAPTER FIVE
SUMMARY OF FININGS, CONCLUSION AND RECOMENDATIONS

5.1 Introduction

This chapter presents the summary of the research results as indicated and explained in chapter four. It gives conclusion, remarks and recommendations to the approaches and strategies that can be adopted in order to ensure that there is contribution of internal control to the financial performance of Banks.

The study was conducted focus on seven private Banks named, (Awash International Bank, Dashin Bank, Anbessa Bank, Oromina International Bank, Cooperative Bank of Oromia, Debub Lobal Bank and Addis International Bank) at head office and selected big grade branches from each banks. This study was concerning with the Effect of internal control over financial performance to the success of the banks. The literature was reviewed and after that research questions were developed. Then answers were obtained from the research questions after critical analysis which resulted to the following conclusion.

5.2 Summary of Findings

This part presents the summarized result and findings based on the study objectives as established at the beginning of the study.

5.2.1 To Explore the Efficiency of Existing Internal Control System to the Performance of Private Banks.

The result from 4.2.1, 4.2.2 and 4.2.3 indicate that there a positive relationship between the organization structure and financial performance of banks as shown in the researcher's findings that most respondents in all selected department and branch within the selected seven banks, that there is clear organizational structure about 67.9% clearly defined to provide the room of effective control.

However, it has been found that 89.3% of respondents believed that it is Executive Management who are responsible in setting the organizational structure. This implies that most private banks are not participate the middle level management who are functionally dealing with operation of daily activities and enable the bank to achieve its objective of financial performance during setting structure of the bank.

The result from table 4.8 shows that there was a management close monitoring of implementation of existing internal control at all level. This implies that close monitoring of existence internal control may foster the enforcement of controlling tools that was established by the Bank.

Furthermore, the extent of commitment of management in the operation of internal control of private banks contributes to financial performance as indicated on 4.9 and 4.10. 85.7% of respondents agree that immediate administrative measure has been taken for any misappropriation, moreover, 60.7% of respondents agree that management at all level are committed to execute their roles and responsibility.

Finally, the researcher found that there are adequate policy and procedure in Banks which is the basic instrument of internal controls. As indicated on table 4.12   83.7% of respondents agree on the presence of policy and working procedure which guides the performer to comply with and finally enable to improve the financial performance of the Bank.

5.2.2 To Explore the Existing Internal Control to the Financial Performance of Private Bank

It has been found that about 83.9% of the total respondents agree that there is internal control within the bank by introducing several control elements to enable the bank to operate efficiently and effectively to achieve the organizational objectives of the banks. In line with this, banks are establishing several type of internal control tools like; putting in place fraud monitoring policy, risk management program, expense management policy, asset management and safeguarding policy and procedure and maker and checker principle are the major points indicated from the respondents.

Moreover, as indicated on table 4.15, 51.8% of respondents agreed controlling tools in most private banks were introduced a comprehensive risk tolerance limit for key performance areas and special incidents in relation to fraud and other criminal acts were circulated among operators/staffs to create awareness and strengthen internal control as 62.5% of respondents agreed on this issues. But, revision of the documents were not done based on the external and internal factors.

Although different sort of controlling tools like verification authorization and approval and reconciliation of data are used in banking operation as respondents were confirm that physical asset safeguarding was not practiced as indicated on summary of table 4.14.

5.2.3 To Examine the Relationship Between Internal Control and Financial Performance of Bank

To measure performance of internal control in organization is very important because it can help the management to know whether the internal control contributes the financial performance of the bank and add value to the organization.

Result in figure 4.2 indicates a positive relationship between internal control activities as a components of internal control system with financial performance of financial institution. Internal control activities further relate positively with accountability, reliability of financial reporting and performance, effectiveness, efficiency and over all organizational objectives. this seems to agree with Ray and pany (2001)'s belief that "control activities are policies and procedures that help ensure that management directives are carried out". Therefore, internal control activities affect financial performance. While COSO (Dec. 2011) depicted that " Internal Control is a process, effected by an entity's Board of directors, Management, and other personal, designed to provide reasonable assurance regarding the achievement of Objectives in the following categories; Effectiveness and efficiency of operation, Reliability of reporting and Compliance with applicable laws and regulation.

The researcher's findings depicted that about 76.8% respondents agreed on the existence of internal control within the banks and there is a positive relationship between two components.

Moreover, as the qualitative data indicates, financial performance is to measure how well the company can uses asset from its primary mode of business and generate revenue with objective of wealth maximization (Nadifon and Patrick Ejom 2014); similarly, internal control imposes to have quality asset management, expense management and better asset utilization which in turn enhance financial performance of the bank.

5.2.4 To examine the relationship between Financial Performance, Internal Audit and Control activities.

Internal Audit

The result in table 4.19 indicates the level of agreement on which the existence of internal audit's major dimensions. As a result the respondents were agreed on average on the presence of the points seven as depicted by total mean of 2.2. This result seem to agree with IIA Standard where noted as:-

> Internal auditing is an independent, objective assurance and consulting activities designed to add value and improve an organization's operation. It helps an organization accomplish its objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance process.

This is also in line with Whittington and pany assertion that *"Internal auditing is performed as part of monitoring activities of an organization"*. Since there is a positive relationship between internal audit function and dimension of financial performance; accountability, responsibility, and reporting.

Control activities

Whittington and Pany (2001) also mention Control activities as another component of Internal controls. They note that control activities are policies and procedures that help ensure that management directives are carried out. Controls activities in an organization basically comprise; performance reviews (comparing actual performance with budgets, forecasts and prior period performance), information processing (necessary to check accuracy, completeness and authorization of transactions), physical controls (necessary to provide security over both records and other assets), and segregation of duties (where no one person should handle all aspects of a transaction from the beginning to the end). The last component of internal control according to Ray and Pany is monitoring.

5.3 Conclusion

There is a general fact from the findings that effect of internal control depends largely on the performance of various variables: Internal Audit, Control environment, accountability, efficiency, reporting and risk assessment so as to achieve banks' objective of the financial performance. the researcher concluded that;

I.   Based on the findings of the study, it is concluded that most Private Banks have an effective and efficient internal control system as supported by the study findings of clear separation of duties, close management monitoring for implementation of the existing internal control system and as the same time commitment of the Management to take action was the positive side identified. In addition adequate policy and working procedure were available in the Banks as the findings summary of findings show us.

However, there are challenges in Private Banks in implementation of the required controlling system despite there where an instrument to monitor the existence of control.

Moreover, During setting organizational structure, it was found that only Executive Management members are participating. The middle Level and lower level management has not been participate in this critical and considerable issues. Therefore, the Financial Performance of our local private Banks are highly affected by the efficiently of internal control system.

II.   As indicated on 5.1.2 above, the existing internal control over financial performance of private banks were supported by different tools at head office and branch level like;

   − Establishing sound policy, procedures and guidelines for all high risk activities;
   − Establish risk profile of the bank and set risk tolerance limit of all risky operation;

- Existence of check and Balance (checker and Maker principle);
- Most transactions were controlled by means of verification, authorization and reconciliation;
- Moreover, Special incidents in relation of fraud were circularize to all employees so as to create awareness as indicated on table 4.17.

However, the respondents were confirm that banks were not revised the existing risk tolerance limit despite the changing external and internal environment were there and also weak in safeguarding of physical asset which in turn affects financial performance of the bank.

III.   From the finding,   the researcher conclude that by considering other several variables are contributor of financial performance, there is a appositive relationship between the two variables (internal control and financial performance) based on the feedback from the respondents (figure 4.2). But,   no one has measured the performance of   their internal control even the management themselves they measured performance of their staffs, because the researcher in the field work observed that the responsibility regarding measurement   of internal control performance is merely given to Internal audit department.

The final conclusion of this study is that there is a significant positive relationship between internal control system (control environment, internal audit, and control activities) with financial performance (efficiency, accountability, and reporting). The co-operation between the upper level management, internal audit office, and other department is very important in the success of organization.

5.4 Limitation of the Study

The limitation of the study will those associated with time allowed conducting the research work by the university, availability of information as well as respondents willingness to answer some open-ended questions.

5.5 Recommendations

- The effectiveness of internal control depends on management involvement and requirement. Therefore, the management in all Private Banks should increase is co-operation and support to the internal audit department and other department.

- Management should establish the indicator and put benchmarks that can help them to measure the performance of internal control so as know exactly of the internal control add value to organization.

- The executive management private Banks should promote involve, involvement of all level management in objective setting of the bank, so as to attract excellent internal control. An efficient internal auditing department should be regarded as a good place to developed employees' careers, because internal auditors can understand the whole operation in organization.

- Setting a risk tolerance limit and revising periodically in Banking industry is mandatory based on the nature of the business. Therefore, banks shall update their risk tolerance limit based on the existing internal and external facts.

- The Management has a significant responsibility so as to bring to the ground the internal control imbedded in all operational activities. Enforcements and sound measurement of internal control adequacy shall be existed.

- Physical asset shall be safeguarded properly in order to serve the intended purpose and generate profit to the organization. As a result proper maintenance shall be given for nonfunctioning properties and a proper disposal mechanism shall be maintained.

- Findings identified by Internal Audit Department shall be carefully identified and deliberated by the management so as to know the level of internal control at each point pass appropriate decision.

- Attention shall be given to other financial performance contributors (Efficiency of internal control, responsibly and reporting) in addition to focusing on traditionally known factors like, liquidity management, enhancing ROA and ROE.

- Finally the researched recommend that a sound and piratical budget review system shall be maintained in banks so as to get adequate explanation for all types of budget expenditure variation and proper budget control.

5.6 Suggestion for Future Studies

The researcher focused specifically on the effect of internal control in relation to financial performance in private banks. Moreover, the researcher only focused on some components of internal controls. But I suggest other area for farther study in this perspective such as;

1. The effect of ICT on the efficiency of internal control system
2. The effect of integrity and behavioral factors on financial performance of banks.
3. The contribution of Internal Auditor for financial performance of banks.

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Appendix 1: Questionnaire on Practice of Internal Control System and Its Contribution to Financial Performance of Private Bank In Ethiopia

Dear Respondent,

My name is Berhanu Edea. I am currently carrying out a study for the purpose of writing a dissertation as a requirement for the award of Master of Business Administration in S.Mary's University School of Graduate Studies.

The topic of this study is "**Practice of Internal control system and its contribution to Financial Performance of Private Bank in Ethiopia**". The purpose of the study is to examine the relationship and impact of Internal control over financial performance in the banking sector specifically in Private Bank of Ethiopia. You have been selected to participate in this study due to the importance of your information in the study. The information you provide will only be used for the purpose of this study and will be treated with utmost confidentiality. Kindly tick in the space provided with the correct answer or supply the required information where required.

In case you have any question or request for clarification, you may contact me at 0911-104970 or e-mail at birhanuedea@yahoo.com

Thank you in advance for your cooperation and timely response of this survey.

Sincerely Yours

Berhanu Edea

Part I Demographic Information

1) Gender

   Female [ ]   Male [ ]

2) What is your current position?

   Dep't Head/Director/Manager [ ]   Branch Manager [ ]

   Division Managers [ ]   Senior officer   [ ]

   Other [ ] Specify....................

3) Which of the following categories described your age?

   Bellow 25 years [ ]   25 – 40 years [ ]

   41– 55 years [ ]   Above 55 years [ ]

4) Which of the following categories your level of education?

   Diploma [ ]   Advance diploma [ ]

   First Degree [ ]   Masters degree [ ]

   Other (specify) ………………………………………….

5) How long have you worked in Bank?

   Less than 3 years [ ]   3-5 years [ ]   6-10 years [ ]

   More than ten years   [ ]

Part II: To explore the efficiency of the existing control to the financial performance of Bank

6) Is the organizational structure of your bank clearly defined and communicated to all staffs?

   Yes [ ]   No [ ]

7) Who is responsible for setting the organization structure in your Bank ?

   Executive management team [ ]   Head office management team [ ]

   Branch management team [ ]   Others [ ]

8) Is the Management closely monitors implementation of existing Internal control system in your Bank?

        Yes [ ]   No [ ]

9) Are there appropriate measure taken to correct errors and misappropriation in operation of accounting and finance system or any transaction ?

        Yes [ ]   No [ ]

10) Are the Management acts with a great degree of integrity in execution of the roles and responsibility.

        Yes [ ]   No [ ]

11) Do you routinely evaluate the overall efficiency and effectiveness of your internal control system.

        Yes [ ]   No [ ]

12) Are there adequate policy and procedure to ensure effective collection and follow up of due accounts like; interests, charges, commissions, or any other fees.

        Yes [ ]   No [ ]

Part III To Explore the existing internal control

13) Are there any internal control to the financial Performance of your bank ?

        Yes   [ ]   No [ ]

14) Please Identify the Existing controls placed over financial performance of your Bank.

    ....

    ....

15) Does the Bank has set comprehensive risk tolerance limit in all operational area?

        Yes   [ ]   No [ ]   I am Not sure [ ]

16) Does the Bank's risk tolerance limit revised timely based on external and internal factors?

        Yes [ ]   No [ ]   I am not sure [ ]

17) Do all level of Management Participate in setting your Bank Objective.

Yes   [ ]   No   [ ]

18) Does special incidents in relation to fraud like (Cheating, embezzlement, criminal acts etc) circulated to all employees so as to create awareness?

Yes   [ ]   No   [ ]

19) Which type of Transaction control System does your Core-Banking system supports? you can tick more than one?

Verification [ ]   Reconciliation [ ]

Authorization and Approval [   ]   Physical control   [ ]

Part IV To examine the significance of internal control over financial performance of Bank.

20) Is there a relationship between internal control and financial performance in your Bank?

Yes [ ]   No [ ]

21) What is the level of correlation between the two variables?

Upper level/strong [ ]   Middle level [ ]

Lower level [ ]   Have no relation [ ]

22) In your opinion, briefly point out the existing relationship between internal control and financial performance.

....

....

Part V Internal Audit and Control Activities

23) What is your level of agreement with the following statements that relate to existing internal control of your Bank (**1-Strongly agree, 2-Agree, 3-Neutral, 4 Disagree and 5-Strongily Disagree**)

Dimension	Statement	1	2	3	4	5
Internal Audit	Our Bank has an objective, independent and active Board audit committee.					
	Our internal audit is sufficiently staffed.					
	Internal audit report addresses weakness in our internal control system.					
	Internal auditors are performing their duties with a great degree of autonomy and independence from Management.					
	Management deliberate on /discusses on internal audit report regularly.					
	Risk level of each auditable activities are identified before conducting audit work.					
	All audit findings are communicated to the auditee immediately for on spot correction.					
Control Activities	There is segregation of duties with in all operational units.					
	Your organizations' assets are secured and controlled fully by the Bank.					
	There is an appropriate supervision by senior staff on the work of their junior (Check and Balance existed).					
	Corrective action is taken timely to address the weakness identified by external and Internal Auditor or Inspection of regulatory body.					
	Our security system identifies and safeguards internal Asset.					
	Departments and Branches have budget review system where actual expenditure is compared with budgeted expenditure and explanation for the variance is adequately given.					

DECLARATION

I, the undersigned, declare that this thesis is my original work, prepare under the guidance of _____. All source of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted either in part or in full to any other higher learning institution for purpose of earning any degree.

_____   _____

Name   **Signature**

St. Mary's University Addis Ababa

May 2016

ENDORSEMENT

This thesis has been submitted to St. Mary's University School of Graduate Studies for examination with my approval as a university advisor.

_____   _____

      Advisor   Signature

St. Mary's University Addis Ababa

May 2016