



---

## **A STUDY TO EXAMINE THE IMPACT OF INTERNAL CONTROL SYSTEM ON FINANCIAL PERFORMANCE OF MANUFACTURING FIRMS LOCATED IN AMHARA REGION.**

**Sefiwsew Zeleke Belay**

Lecturer in the department of Accounting and Finance Debre Tabor University,

Amhara region Ethiopia

### ***ABSTRACT***

The study investigated and sought to establish the relationship between internal control systems and financial performance in manufacturing firms in Amhara region Metropolitan cities. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, profitable and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls. The research was conducted using both quantitative and qualitative approaches using Survey, Correlation and multiple liner regressions as Research and Designs Data was collected using Questionnaires and Interview guide as well as review of available documents and records targeting basically Finance Departments, supply department and prosperity Administration department Management and staff as respondents from a population of 281 which are located in Amhara region Metropolitan cities. Data was analyzed using the Statistical Package for Social Scientists (SPSS) where conclusions were drawn from tables, graphs from the Package.

The study found that management of the company is committed to the control systems, actively participates in monitoring and supervision of the all operation of the organizations, all the activities are initiated by the top level management, that the internal audit department is efficient, well-staffed, conduct regular audit activities and produce regular audit reports although the reports produced by the internal audit department address weaknesses in the system. It was further revealed that there is a clear separation of roles and weaknesses in the system are addressed, organization. However, the study also found out that there is good of information



sharing and adequate security to safeguard the assets of organizations. It was also noted that there is enough cash to meet intended organization goals.

The Study therefore concludes that internal control systems that there is a significant relationship between internal control systems and financial performance in manufacturing firms in Amhara region Metropolitan cities.

The study established a significant relationship between internal control system and financial performance. The investigation recommends there should be strategies improve the organization of additional continual improvement.

**Keywords:** Financial Performance Internal control, , Manufacturing firms in Amhara,

### **Introduction:**

#### **Introduction about topic,**

Modern manufacturing had begun in Ethiopia in the early 20th century, mainly following the construction of the Ethio-Djibouti railways. Growing demand for manufactured imported goods on the one hand and rising cost of transportation for the imported goods on the other were believed to have necessitated domestic manufacturing. The expansion of manufacturing in Ethiopia is believed to have benefited from the entrepreneurial skills of foreigners (from America, Italy, Greece and India) who had begun settling in the country at the time (Befekadu et. al., 2000). The contribution of manufacturing industries to the real GDP of the Amhara region was found to be less than 3% for the same period. This implies that the manufacturing industry has not yet contributed considerably as the sector is at its infant stage. Several studies and policy documents revealed that for an economy to be fast growing and able to absorb large segment of the labor force and eliminate poverty, one of the major factors that lead to better performance of the manufacturing industry is to understand how this sector has linked with other economic sectors (Fentahun Tesafa, NMRJORS&T).

This study examined the impact of internal control on financial performance of manufacturing firms which are found in Amhara region. Internal control is an accounting procedure or system designed to promote efficiency or assure the implementation of a policy or safeguard assets or avoid fraud and error. Internal Control is a major part of managing an organization. It comprises



the plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, support performance based management (Arad and Navid, 2009).

### **Statement of problem**

The intended result of internal control on financial performance should be regarded most crucial in every organization, because the responsibility of internal control is to prevent and detect fraud and also guiding how activities must be performed at all levels of the organization. The code of corporate governance highlights that the organization need good internal control system to manage the business risk that faces it. Therefore internal control is needed to achieve business's objectives through preparation of reliable financial accounts which comply with relevant laws and regulations. To achieve organization's objective more emphasis is given to strengthen an internal audit services which in turn contribute to the implementation of the internal control system.

Related studies that have been conducted by (Simiyu, 2011) internal control systems clearly indicate that organizational internal control and financial performance is understudied area. Some of the challenges experienced with regard to internal control include; struggles with Liquidity problems, financial reports are not made timely, accountability for the financial resources is still wanting, frauds and misuse of institutional resources have been unearthed and a number of decisions made have not yielded the expected results. Even though manufacturing firm's audited their accounts and records using professionally trained and recognized auditors, the organizations are still engaged in a fight with Liquidity problems, dalliance of financial reporting (FS), frauds and misuse of organization's resources have been searching and a number of decisions made have not produced the anticipated solution.

As per researcher understanding All the above discussed inherent limitations and problems about the internal control and the financial performance along with the gap in the literature with respect to the assessment of internal control related to financial performance in Amhara region manufacturing firms, call for undertaking such types of extensive research to tackle the financial performance and improve internal control system.



---

## **General Objective**

This paper focuses to examine the impact of internal control systems on financial performance of manufacturing industries located in Amhara region.

### **Specific objective :**

1. To examine the role of Internal Control systems in Amhara region manufacturing firms.
2. To examine financial performance of Amhara region manufacturing firms.
3. To examine the relationship between internal control systems and financial performance in Amhara region manufacturing firms.

### **Research questions:**

The study will try to answer the following questions:

1. What is the role of Internal Control Systems in Amhara region manufacturing firms?
2. What is the financial performance of Amhara region manufacturing firms?
3. What is the relationship between internal control systems' role and financial performance in the Amhara region manufacturing firms?

**Scope-**The scope of the study covers the conceptual, geographical and the time scope.

**Conceptual Scope** - the study was focus on examining issues related to identify on impact of the internal control on financial performance of manufacturing firms in Amhara.

**Geographical Scope** -the research was carried out geographically Amhara region.

**Time Scope** -The study used the most recent year data from the fiscal year of 2009 up to 2010 e.c

### **Methodology,**

This paper focuses on to examine the impact of internal control on financial performance in manufacturing firms in Amhara region.

### **Research Design**

The study was employed by using both descriptive and explanatory research design with quantitative and qualitative methods. The quantitative aspect of the data focused on description of the state of affairs related with the impact of internal control on financial performance in manufacturing firms in Amhara region as it exists currently and analysis of a relationship among the dependent and explanatory variables of the region manufacturing firms.



## Population and Sampling Technique;

The population considered in this study was the total manufacturing firms which operate in Amhara region metropolitan cities, As per Amhara National Regional State Bureau of Industry and Urban Development (ANRS BoIUD 2011), there are 80 medium and large manufacturing firms in the region, and out of 80 medium and large manufacturing firms 25 manufacturing firms are large. The sampling design for this population was 12 large manufacturing firms were selected by simple random sampling and this is above 30% of the total population of the sample which is 25(Dr, Assefa Admassie "*research methodology*"). Large companies included in the sample because large organizations assumed to have internal audit function and they may use sophisticated auditing activities (Allegrini and D'Onza, 2003) and internal control system. Thus, the researcher is better to use large manufacturing firms to this study. Large manufacturing firms in Ethiopia context, (large manufacturing enterprises have been classified as establishments with more than 50 employees using automated machinery, capital investment above 500,000. **Central statistical agency**)

The Selected 12 big manufacturing firms and the number of employees listed as part of this population in these organizations are 458 (89 managers and 369 non-managers). The target population of the study all manufacturing comprises, all finance departments, internal audit service and supply department employees (managers as well as non managers) currently working in manufacturing firms located in Amhara region. The researcher wants to include only this employee in above department, because they believe to have direct relationship with internal control system and its impact on financial performance of their organization.

The study used both stratified and simple random sampling techniques in selecting the research subjects. Stratified sampling technique used to stratify employees who are currently working in these 12 manufacturing firms into managers and non managers. Since the tasks of managers directly allaying with planning and implementation of internal controlling strategies which help them to have enough exposure to the internal control system of their manufacturing firms the researcher used a census inquiry to address all managerial staffs. As a result all of managers (89) are considered in this study. In relation to non-managerial respondents, the researcher uses the

following Taro Yamane's formula to determine the number of samples that were drawn from strata of non-managers but proportionate to the size of each manufacturing firms.

$$n = N / [1 + N(e)^2], \text{ where } e = \text{sampling error (0.05)}$$

$$n = 369 / [1 + 369(0.05)^2] = 192 \text{ employees}$$

Therefore, samples of 192 non-managerial respondents were selected using simple random sampling technique from those 12 manufacturing firms located in Amhara region. As a result a total of 281 respondents (192 non-managerial staffs and 89 managerial leaders) are selected for the study.

To sum up, a combination of sampling techniques (stratified and systematic random sampling) are used to select sample respondents.

**Table 3.2.1 sample design**

No	Selected manufacturing firms	Employees			Sample size		
		Manager D/manager	Non-manager	Total	Manager	Non-manager	Total
1	Dashen beer factory	15	38	53	15	33	48
2	Tana communication S.C	5	26	31	5	8	13
3	Sheba Industries Plc	7	32	39	7	19	26
4	Gonder Soft drink factory (MOHA)	6	35	41	6	22	28
5	Bahir Dar Textile Factory plc	7	28	35	7	10	17
6	Dess cotton mill factory	6	25	31	6	12	18
7	Gondar meat factory	6	27	33	6	10	16
8	Combolcha (Bati) Brewery	13	37	50	13	18	31
9	Gondar Malt factory	7	35	42	7	27	34
10	Ethiopian steel plc	5	26	31	5	9	14
11	Bahir Dar Tannery Factory	7	36	43	7	8	15
12	Gonder printing enterprise	5	24	29	5	16	21
	Total	89	369	458	89	192	281



---

### **3.3 Methods of Data Collection**

Data were collected using primary data gathering tools of questionnaire and the researcher's onsite observation. Questionnaires that contain both open and closed ended questions are prepared and distributed to all staff members. The researcher ratings summarized by likert with a five point scale from strongly agree to neutral to obtain information on attitudes and to examine the impact of internal control on financial performance.

#### **3.3.1 Primary data**

This is system of data collection tool that was got directly from the field. It was collected using questionnaires.

#### **3.3.2 Secondary data**

The researcher was read related literature relevant to the subject before and during the study in manufacturing firms, obtained from previous studies, text books, internet, journals and reports from the firms itself.

### **3.4. Methods of data collection and instruments**

Administered questionnaires were given to a selected finance employees, internal auditors and managers who are currently working in the manufacturing firms, the questionnaire investigates opinions on the implementation of internal control based on factors and how the procedures were carried out as experienced and perceived by respondents.

### **3.5 Data Analysis Method:**

The responses of the respondents that have been collected using the above methods were organized, analyzed, and interpreted in a sensible way. To meet the objectives of the research correlation analysis and regression analysis as well as descriptive statistics have been used to analyze findings

Regression analysis was used to come up with the model expressing relationship between the independent variables (Control environment, Internal Audit, Control Activities) and the dependent variable (financial performance of manufacturing firms in Amhara region).

Specifically the regression model is this form.





$$FP(Y) = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \epsilon_i$$

Where,

$\beta_0, \beta_1, \beta_2, \beta_3$ , and  $\beta_n$  are the regression co-efficient

FP(Y) – financial Performance of manufacturing firms in Amhara region.

$X_1$  – Control environment

$X_2$  – Internal audit

$X_3$  – Control activities

Regression analyses are carried out to find out the significant impact of independent variables ( $X_1, X_2, X_3$ , and  $X_n$ ) on dependent variables (Financial Performance of manufacturing firms in Amhara region).

### 3.5.1. Multiple linear regression models

Regression analysis is a statistical tool for the investigation of relationships between dependent and independent variables. Usually, the investigator seeks to ascertain the causal effect of one variable upon another. To explore such issues, the investigator assembles data on the underlying variables of interest and employs regression to estimate the quantitative effect of the causal variables upon the variable that they influence. The investigator also typically assesses the “statistical significance” of the estimated relationships, that is, the degree of confidence that the true relationship is close to the estimated relationship.

In multiple linear regressions, there are  $p$  explanatory variables, and the relationship between the dependent variable and the explanatory variables is represented by the following equation:

$$Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \cdots \dots \dots + \beta_p X_{pi} + \epsilon_i$$

Where:

$Y_i$  is the dependent variable and  $X_1, X_2 \dots X_p$  are the independent variables





$\beta_0$  Is the constant term and  $\beta_1$  to  $\beta_p$  are the coefficients relating the p explanatory variables to the variables of interest. The term ‘linear’ is used because in multiple linear regressions we assume that y is directly related to a linear combination of the explanatory variables.

### 3.5.2. Model assumptions

Dependent variables (Y)

Independent (explanatory) variables:  $X_1, X_2 \dots X_n$

Assumptions

- The true model is  $Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \dots + \beta_p X_{pi} + \varepsilon_i, i = 1, 2, \dots, n$
- Homoscedasticity:  $Var(\varepsilon_i) = E(\varepsilon_i^2) = \sigma^2$  for all i
- No error autocorrelation:  $cov(\varepsilon_i, \varepsilon_j) = E(\varepsilon_i \varepsilon_j) = 0$  for all  $i \neq j$
- Each of the explanatory variables  $X_1, X_2 \dots X_n$  is non-stochastic.
- No multicollinearity: No exact linear relationship exists between any of the explanatory variables.
- Normality:  $\varepsilon_i$  are normally distributed with mean zero and variance  $\sigma^2$  for all i ( $\varepsilon_i \sim N(0, \sigma^2)$ )

### **Body of the paper: analysis, findings**

This chapter first presents the data collected by using the questionnaire, then analyzes the data by using SPSS and MS-Excel finally interprets the implications of the result. The presentations are in form of tables and statements according to the objectives of the study. Questionnaire results showed that, 12 companies have filled the questionnaire. They all have arranged internal control system on financial performance. Totally 300 questionnaires were distributed, but 291 questionnaires were collected out of which 281 were usable responses, which were response rate of 93%.

The study examines and describes the age groups details of respondents in this study and details of their respective age groups are presented in table 4.1.1 below



**4.1.1. Description of age groups of respondents:-** it is clearly evident that the majority of the respondents are in the age bracket of between 31-40, followed by 21-30, 41-50, above 50 and 21-30 in the orders of 38.1%, 49.5%, 10.7%, and 1.8% respectively. It can therefore be concluded that the majority of the respondents are in the most productive age brackets of their life and are reasonably experienced

**4.1.2 Gender characteristics of respondents:-** in relation to gender that 55.9% of the respondents were males and 44.1% were female. This could indicate that there are still low levels of employment of females in manufacturing firms located in Amhara region. The findings represent the views of the two sex groups about internal control systems and financial performance in manufacturing firms located in Amhara region. This was necessary for the study to get a balanced picture of the respondents' views. (The researcher was collected data supportive staffs only i.e. finance, supply and property administration department.)

**4.1.3 Education characteristics of respondent:-**In table 4.2.3 above, it can be disclosed that majority of respondents who are also the employees show that they hold Bachelor degree, followed by Diploma, Masters degree, and PHD in the orders of 70.8%, 18.5%, 10.3%, and .4% respectively. This means that the respondents are adequately qualified persons academically.

**4.1.4 Year of experience in the organization:-**In table 4.2.4 above, it can be disclosed that majority of respondents have worked in the manufacturing firms for the period 3-6 years, followed by above 6 years, 1-3 years and below one year. These represent 39.9%, 33.8%, 18.1%, and 8.2% respectively. This could also show that majority of the respondents have worked in the manufacturing firms for 3 -6 years, as per the data representative.

**4.1.5. Evaluation of controlling environment Internal control System.**

It can be disclosed that majority of respondents in the manufacturing firm regarding whether the organization structure of the company clearly defined in terms of lines of authority and responsibility 48.4% (136) of respondents strongly agree that the office has organization structure that clearly define in terms of authority and responsibility. Also 42.0% (118) of



respondents agree, 6.0% (17) of respondents disagree, 2.5% (7) of respondents neutral and 1.1% (3) of respondents are strongly disagree respectively.

According to Business Dictionary.com the organizational structure of the organization is defined as the framework, typically hierarchical, within which an organization arranges its lines of authority and communications, and allocates rights and duties. Organizational structure, determines the manner and extent to which roles, power, and responsibilities are delegated, controlled, and coordinated, and how information flows between levels of management.

In relation to Management is committed to the operation of the system majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, disagree, neutral and strongly disagree in the orders of 65.08%(185), 20.6%(58), 6.8%(19), 4.3%(12) and 2.5%(7) respectively. This means that the manufacturing managements are committed on the internal controlling (environment) system in their organization.

Management closely monitors implementation of Internal control systems in company majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 69.8%(196), 12.8%(36), 8.9%(25), 5.3%(15) and 3.2%(9) respectively. This means that the manufacturing managements are monitors and control the implementation of controlling environment/systems within the organization.

management provides feedback to the junior officers about the operation of the system majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 63.7%(179), 15.7%(44), 9.3%(26), 8.5%(24) and 2.8%(8) respectively. This means that the manufacturing firms' managements are give feedback to the concerned body its environment/systems within the organization.

managements are actively involved in supervising the accounting and finance department majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 44.8%(126),



36.7%(103), 8.5%(24), 7.8%(22) and 2.1%(6) respectively. This means that the manufacturing firms' managements are actively involved on every recording and posting system on its environment/systems within the organization.

management acts with a great degree of integrity in execution of their roles majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 60.5%(170), 22.4%(63), 8.9%(25), 6.8%(19) and 1.4%(4) respectively. This means that the manufacturing firms' managements have a great effort towards its role and commitment on its environment/systems within the organization.

management support and promote a control environment that is conducive to financial accountability majority of respondents who are also the manufacturing firms employees show that strongly agree, followed by Agree, disagree, neutral, and strongly disagree in the orders of 47.7%(134), 44.5%(125), 3.9%(11), 3.6%(10) and .4%(1) respectively. This means that the manufacturing firms' management support and promote a control environment that is more contributive to financial responsibility and its environment/systems within the organization.

#### **4.1.6. Evaluation of internal audit on perspective of Internal control System.**

internal audit staff conduct regular audit activities in company majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 68.0%(191), 18.1%(51), 8.5%(24), 3.2%(9) and 2.1%(6) respectively. This means that the manufacturing firms' internal audit staffs the importance its activity of an internal audit department to helping an organization achieve its objectives.

internal audit report address weaknesses in your internal control system majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 73.3%(206), 13.5%(38), 8.2%(23), 4.3%(12) and .7%(2) respectively. This means that the manufacturing firms' internal audit report address weaknesses in your internal control system to helping an organization achieve its objectives.



internal audit reports are produced regularly majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 75.4%(212), 10.3%(29), 9.3%(27), 3.9%(11) and .7%(2) respectively. This means that the manufacturing firms' internal audit reports are produced regularly at any condition if there is good or bad thing within the organization.

management discusses internal audit reports frequently majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 65.5%(184), 11.0%(31), 11.7%(33), 11.0%(31) and .7%(2) respectively. This means that the manufacturing firms' management discusses internal audit reports frequently and did corrective measure if it was necessary.

Internal auditor performs his duties with a greater degree of autonomy and independence from management majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 43.8%(123), 37.7%(106), 10.0%(28), 6.0%(17) and 2.5%(7) respectively. This means that the manufacturing firms' internal auditor performs his duties with a greater degree of autonomy and independence from management within the organization.

internal auditor makes appropriate recommendations for management to improve internal audit majority of respondents who are also the manufacturing firms employees show that strongly agree, followed by Agree, neutral, disagree, and strongly disagree in the orders of 46.6%(131), 37.4%(105), 10.0%(28), 3.9%(11) and 2.1%(6) respectively. This means that the manufacturing firms' internal auditor makes appropriate recommendations for management to improve internal auditing within the organization.

Independent appraisal of internal control measured by an external auditor would improve financial performance and management of your organization majority of respondents who are also the manufacturing firms employees show that strongly agree, followed by Agree, neutral, disagree, and strongly disagree in the orders of 45.9%(129), 39.9%(112), 10.0%(28), 3.2%(9) and 1.1%(3) respectively. This means that the manufacturing firms' Independent appraisal of



internal control measured by an external auditor would improve financial performance and management within the organization.

#### **4.1.7. Evaluation of controlling activities on perspective of Internal control System.**

Segregation of duties among the employees of an organization could improve financial management majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 58.0%(163), 32.7%(92), 5.7%(16), 3.2%(9) and .4%(1) respectively. This means that the manufacturing firms' Segregation of duties among the employees of an organization could improve financial management within the organization.

There is appropriate supervision by senior staff on the work of their juniors majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, disagree, neutral, and strongly disagree in the orders of 68.3%(192), 19.2%(54), 6.8%(19), 4.6%(13) and .7 % (2) respectively. In addition to this there was 1(.4%) missed. This means that the manufacturing firms' There is appropriate supervision by senior staff on the work of their juniors within the organization.

Corrective action is taken to address weaknesses majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 63.3%(178), 22.1%(62), 7.1%(20), 5.7%(16) and 1.8%(5) respectively. This means that the manufacturing firms' Corrective action is taken to address weaknesses within the organization.

departments have budget reviews where actual expenditure is compared with budgeted expenditure and explanations for the variances given majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 45.6%(128), 40.6%(114), 9.5%(26), 4.3%(12) and .4%(1) respectively. This means that the manufacturing firms' departments have budget reviews where actual expenditure is compared with budgeted expenditure and explanations for the variances given within the organization.



organization system identifies and safeguards company Assets majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 68.0%(191), 20.6%(58), 7.5%(21), 3.2%(9) and .7%(2) respectively. This means that the manufacturing firms' system identifies and safeguards company Assets within the organization.

#### **4.1.8. Evaluation of financial performance**

Perpetration of fraud and losses of revenue and weakness of financial performance in your company are as a result of weakness in the internal control system majority of respondents who are also the manufacturing firms employees show that strongly agree, followed by Agree, disagree, neutral, and strongly disagree in the orders of 44.8%(126), 41.3%(116), 6.8%(19), 5.7%(16) and 1.4%(4) respectively. This means that the manufacturing firms' Perpetration of fraud and losses of revenue and weakness of financial performance are as a result of weakness in the internal control system within the organization.

A true reflection of company activities are presented in financial statement through the performance of internal control majority of respondents who are also the manufacturing firms employees show that strongly agree followed by, Agree, neutral, disagree, and strongly disagree in the orders of 47.7%(134), 40.9%(115), 6.8%(19), 3.6%(10) and 1.1%(3) respectively. This means that the manufacturing firms' a true reflection of company activities is presented in financial statement through the performance of internal control within the organization.

It can be disclosed that in relation to Segregation of duties among the employees of company could improve financial performance majority of respondents who are also the manufacturing firms employees show that strongly agree followed by, Agree, disagree, neutral, and strongly disagree in the orders of 48.4%(136), 42.7%(115), 4.6%(13), 3.9%(11) and .4%(1) respectively. This means that the manufacturing firms' Segregation of duties among the employees of company could improve financial performance within the organization.

company all revenue and any other income are recorded and report on time majority of respondents who are also the manufacturing firms employees show that Agree, followed by





strongly agree, neutral, and disagree in the orders of 62.6%(176), 26.7%(75), 5.7%(16), and 5.0%(14) respectively. This means that the manufacturing firms' all revenue and any other income are recorded and report on time within the organization.

company has enough cash to meet its obligations effectively majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 68.0%(191), 21.0%(59), 5.7 % (16), 5.0 % (14) and .4 %(1) respectively. This means that the manufacturing firms' has enough cash to meet its obligations effectively within the organization.

Company has a well-developed Chart of Account and financial system majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 70.8%(199), 17.8%(50), 6.4%(18), 4.6 %(13) and .4 %(1) respectively. This means that the manufacturing firms' company has a well-developed Chart of Account and financial system within the organization.

Company has dalliance of financial report and any financial information majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, disagree, neutral, and strongly disagree in the orders of 61.9%(174), 14.9%(42), 15.7%(44), 6.4 %(18) and 1.1 %(3) respectively. This means that the manufacturing firms' company has dalliance of financial report and any financial information within the organization.

Organization ledgers maintained to record all financial transaction majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 58.4%(164), 26.0%(73), 8.5%(24), 6.4 %(18) and .7 %(2) respectively. This means that the manufacturing firms' ledgers maintained to record all financial transaction within the organization.

a relationship between internal control systems Operated by your organization and financial performance majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, disagree, neutral, and strongly disagree in the orders of 52.3%(147), 34.9%(98), 7.1%(20), 4.3%(12) and 1.4 %(4) respectively. This means that the



manufacturing firms' a relationship between internal control systems Operated by your organization and financial performance within the organization.

organization financial reports are reviewed and approved by the appropriate finance manager majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, disagree, neutral, and strongly disagree in the orders of 51.2%(144), 37.0%(104), 6.8%(19), 4.3%(12) and .7 %(2) respectively. This means that the manufacturing firms' financial reports are reviewed and approved by the appropriate finance manager within the organization.

It can be disclosed that in relation to organization all financial reports are prepared based on the accounting ledgers majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, disagree, neutral, and strongly disagree in the orders of 64.4%(181), 24.6%(69), 5.3%(15), 5.0%(14) and .7 %(2) respectively. This means that the manufacturing firms' all financial reports are prepared based on the accounting ledgers within the organization.

In relation to organization the usefulness of internal financial reports periodically evaluated majority of respondents who are also the manufacturing firms employees show that Agree, followed by strongly agree, neutral, disagree, and strongly disagree in the orders of 71.5%(201), 16.4%(46), 6.8%(19), 5.0%(14) and .4 %(1) respectively. This means that the manufacturing firms' the usefulness of internal financial reports periodically evaluated within the organization.

## **4.2. Correlation and Regression Analysis Output**

### **4.2.1 Correlation Analysis in internal control system and financial performance**

The aim of the present study is to identify the relationship between internal control and financial performance. Here we have the dependent variable (financial performance) and independent variables (control activities, internal auditing and control of environment). With respect to this, we have to do a correlation and regression analysis on this variable. Let us start with correlation analysis or to test the correlation/ association between financial performance with control activities, internal auditing and control of environment.

Table 4.2.1: Correlation output of the financial performance with selected variable.

Variable	Pearson Correlation	P value
Control activities	0.506	0.000
Internal auditing	0.487	0.000
Control of environment	0.255	0.000

As we have seen in the above table, all P values are less than the 5% level of significance. Therefore all are significant meaning that the Pearson correlation are positive and shows an association between financial performance with control activities, internal auditing and control of environment.

#### **Control activities is related with financial performance**

The Pearson correlation coefficient of financial performance and control activity is 0.506 this implies that there is somewhat strong positive or direct relationship exist between these variable because Control activities the core part of any organization such as operating review and reporting, authorization, verifications, approvals and division of duties should be implemented in order to try and avoid risks materializing that is why great relationship with the dependent variable 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.

#### **Internal audit and financial performance**

The Pearson correlation coefficient of financial performance and internal audit is 0.487 it is slight positive relationship exist between financial performance and internal auditing, These results seem to agree with Sebbowa (2009) where he notes that "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance processes". This is also in line with Whittington and Pany assertion that "internal auditing is performed as part of the monitoring activity of an organization". Since there is a positive relationship between the internal audit function and financial performance"



### Control environment is related with financial performance

The Pearson correlation coefficient almost weak positive relationship exist between financial performance and control of environment what DeZoort *et al.*, (2002) referred to as “protecting the owners’ interests by monitoring management’s actions, in terms of financial reporting, risk management and internal control”. Owners’ interests can only be protected through accountability and reporting. This suggests that the Control environment is related with financial performance and therefore, there is a relationship between the control environment and financial performance of manufacturing firms is accepted.

#### 4.2.2. Regression Analysis

In this topic we are going to describe the relationship between financial performance and control activities, internal auditing and control of environment in mathematical equation. To do this, let us start with the overall significance of the regression model test.

Table 4.7.2.1: ANOVA table

	Sum of Squares	df	Mean Square	F	Sig.
<b>Regression</b>	<b>24.324</b>	<b>3</b>	<b>8.108</b>	<b>46.152</b>	<b>.000</b>
<b>Residual</b>	<b>48.486</b>	<b>276</b>	<b>.176</b>		
<b>Total</b>	<b>72.810</b>	<b>279</b>			

As we see from the above ANOVA table the P value is 0.00 which is less than the level of significance or 0.05. Therefore the overall regression model is significant. The value of  $R^2$  (in table 3) is 0.988 which implies that about 98.8% of variation in financial performance is expressed by the variation in control activities, internal auditing and control of environment. But the remaining around 1.2 % is unexplained variation this is due to the non inclusion of other variables.

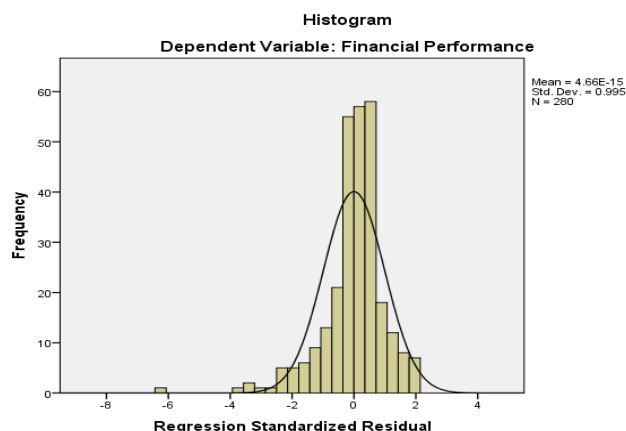
Table 4.2.1.2: Model summary

<b>R</b>	<b>R Square</b>	<b>Adjusted R Square</b>	<b>Std. Error of the Estimate</b>
<b>.994</b>	<b>.988</b>	<b>.988</b>	<b>.45746</b>

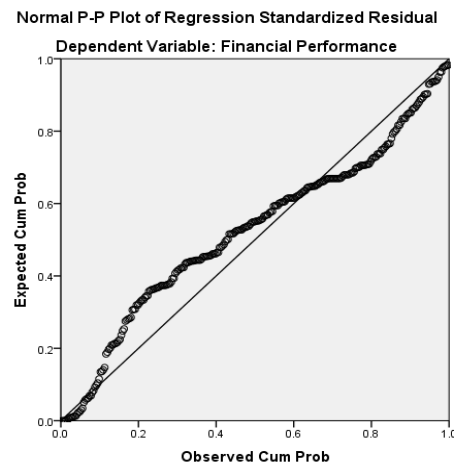
Before we come to the individual variable, first we should check the assumption of multiple linear regression models that is, the assumptions of multicollinearity, normality, heteroscedasticity, linearity and autocorrelation.

The assumption of multicollinearity is checked by VIF (variance inflated factor). As we see from table 4.2.1.2: all the VIF is less than 10. Therefore there is no multicollinearity problem. In Graph 1, the histogram all the spike of histogram lies under the normal curve. Therefore this shows the normality of error term and in Graph 2, the p-p plot shows the linear relation between finance performance and the independent variables because as we see from the normal P-P plot the points are lies on the straight line.

Graph 1: Histogram

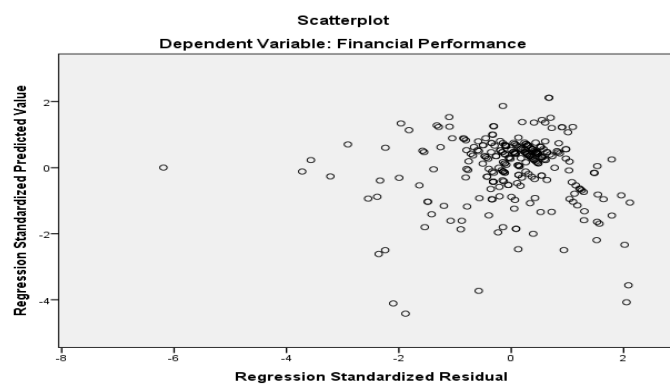


Graph 2: Normal P-P plot

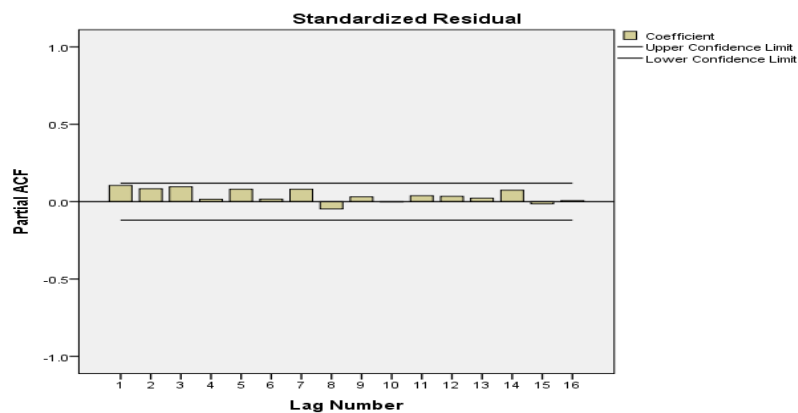


From the plot of standardize fitted values against the standardized residuals (Graph 1) we observed that the spread of the residuals are the same throughout the plot (i.e. there is no any systematic patterns). This non systematic of random pattern indicates the non existence of hetroscedastic problems. And in Graph 4: the PACF of the error term there is no spike outside the confidence interval meaning that the error terms are not correlated with each other or no autocorrelation problem.

Graph 3: Scatter plot



Graph 4: Partial Autocorrelation function (PACF)



As we have seen the assumption of multicollinearity, normality, heteroscedastic, linearity and autocorrelation, there is no any kind of problem or all assumptions are full field. Then after let us come to the individual variable coefficient that is whether it is significant or not on the basis of P value. The following Table 4.7.1.3 shows the coefficient of individual independent variables with corresponding to its P value.

Table 4.2.1.3 Coefficients of the selected variable

		Unstandardized Coefficients		t	Sig.	Co linearity Statistics	
		B	Std. Error			Tolerance	VIF
	(Constant)	1.662	.226	7.347	.000		
	Control Activities	.363	.057	6.320	.000	.717	1.394
	Internal Auditing	.320	.057	5.586	.000	.588	1.700
	Control of Environment	-.084	.051	-1.662	.098	.656	1.525

The P value of all variables except the control of environment is less than 0.05. That is the variable control activities and internal auditing has significant effect on financial performance. But control of environment has not any effect on the financial performance. The collected data





was not to indicated the controlling environment have direct or positive relationship with financial performance.

The coefficient of control activity and internal auditing is positive. That implies that there is direct or positive relationship between financial performance and control activity as well as between financial performance and internal auditing. But the variable control of environment has not any contribution to the financial performance.

**The coefficient of control activity is positive.** That implies that there is direct or positive relationship between financial performance control activities are policies and procedures that help ensure that management directives are carried out”. Therefore, internal control activities affect financial performance, Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities, whether automated or manual, have various objectives and are applied at various organizational and functional levels. Generally, control activities that may be relevant to an audit may be categorized as policies and procedures

**The coefficient of internal auditing is positive.** That implies that there is direct or positive relationship between financial performances. Therefore Whittington and Pany (2001) rightly stipulate that an important aspect of the organization’s monitoring system is the internal audit function. He further argues that as representative of top management, internal auditors are interested in determine whether each branch or department has a clear understanding of its assignment, adequately staffed, maintains good records, properly safeguards cash, inventories and other assets, and cooperates harmoniously with other departments. According to Stettler (1977), the growing recognition by management of the benefits of good internal controls and the complexities of an adequate system of internal control in a large organization have led to the development of internal auditing as a form of control over all other internal controls. The emergence of the internal auditor as a specialist in internal control is the result of evolutionary process that is similar in some ways to the evolution of independent auditing. The Institute of Internal Auditors (IIA), define internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an



organization to accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Due to this the internal audit great impact in an organizational financial performance. All the writers (reviewed) underscore the importance of an internal audit department in helping an organization achieve its objectives and performance. Notable among these are Subramaniam, (2006), Reid & Ashelby, (2002) and Millichamp (1993) among others. Therefore the finding is in tandem with the reviewed literature.

As we stated in the methodology part  $Y$ =financial performance,  $X_1$ = control activities,  $X_2$ = internal auditing and  $X_3$ = control of environment and the general relationship between financial performance and control activities, internal auditing and control of environment is mathematically written as follow:

$$Y_i = 1.662 + .363X_{1i} + .320X_{2i}$$

From the above regression model we do not include the variable control of environment because this variable is insignificant or it do not have any contribution to the financial performance.

### **CONCLUSION AND RECOMMENDATION**

This chapter presents summaries of the study findings as per the study objective, conclusions based on those findings and recommendations which are based on both the study findings and other relevant literature considered necessary and vital to be used in future to improve the study situation.

### **CONCLUSION**

The study found out that the impact of internal control on financial performance of the manufacturing firms located in Amhara region. It is apparent that the perceived internal control has a significant impact on financial performance. Control environment negatively influences the financial performance. However the control activities and internal audit positively influences the financial performance. Since the work performed by the organizations have been implemented in the past and work schedules take in to consideration the goals of internal control, therefore this will lead to lower control environment of the financial performance. This is because; the necessary proper procedures are already applied in managing the internal control. However, the



better the performance of control activities and internal audit lead to better financial performance.

The organizational structure provides the decision-making framework of an organization. This structure groups, divides, and coordinates the tasks required to achieve identified goals. To be effective, the structure must make the best use of available resources while maintaining adequate internal controls to ensure compliance with organization performance and other applicable requirements. In this respect the organizational structure of those of surveyed manufacturing firms are clearly defined in terms of line of authority and responsibility.

The study also discloses that all the activities of the organization are originated by the top level management, the study found out the internal audit department is efficient, effective, conduct regular audit activities and produce regular audit reports. Agreed that reports are produced in the department address the weaknesses in the internal control system. The study also found that the internal audit department is fully staffed manpower and worked it is work at proper manner this could be one of the reasons for producing audit reports as regularly.

This study is internal control system in Amhara region manufacturing firms' authorization and approval, segregation of duties, physical controls, arithmetical and accounting, management, organization, supervision, personnel, and acknowledgement of performance controls. For example, the organizational structure defines the formal relationship among groups and individuals in the organization.

The study found out that the organization has enough cash to meet its planned goals; the study further disclosed that; the liquidity of Amhara region manufacturing firms has provide an indication of the business' ability to repay all obligations if all of the assets were sold. Also provide an indication of the business' ability to unaffected risks by providing information about the organization ability to continue its operating, the study disclosed that the true reflection of organizational activities is presented in financial statement through the performance of internal control system, there is segregation of duties among the employees which is improve the financial performance of the organization , the company revenue are recorded and reports are produced on time, the organization has a well developed Chart of Account and financial system, the company financial report and any financial information has no dalliance and ledgers are



maintained to record all financial transaction and finally this study found out there is relationship between internal control systems and financial performance each of the organization.

Therefore in this conclusion, it will be said that the financial performance of any organization cannot do without internal control as true and fair presentation of financial statement may never be possible if the board and senior management are not committed to providing a well planned internal control system.

The study proved and established a significant relationship between internal control system and financial performance. This relationship was examined through the proportion of internal control systems and that of the financial performance selected for this particular study. The proportion of internal control systems (there is strong relationship with control activities and internal audit, and also sight relationship with the control environment) were linked to the proportion of financial performance.

## **RECOMMENDATION**

The role, responsibilities and procedures to be adopted by the management to improve the internal control system within the organization, internal audit department as well as in this study included department and service heads are to overall management of an organization should be focused on ensuring the internal control system of financial performance and soundness of their operations.

- Management should ensure that there are adequate organizational internal controls and that each staff knows his duties and equally ensures effective segregation of duties within the organization for the improvement of its performance.
- The internal control system should be reshaped and strengthened if it is necessary to the position of staff in carrying out their duties efficiently and effectively and at the same time evaluated periodically to strengthen its weaknesses in the organization continual improvement..
- The management of each manufacturing firms should be responsible for establishing and maintaining an effective internal control structure. To fulfill this responsibility, estimates and judgments by management are required to assess the expected benefits and related



costs for internal control policies and procedures. The objectives of an internal control structure are to assist management in meeting objectives by providing reasonable assurance that assets are safeguarded against loss from unauthorized use or disposition. The internal control structure also ensures that financial transactions are executed in accordance with management's authorization and are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles (GAAP).

- Management of the organization should take appropriate disciplinary action in response to departures from approved policies and procedures or violations of the code of conduct and the organization should arrange training and counseling services in order to help employees maintain and improve their competence for their jobs to improve operational performance. According to the first internal control standard, which relates to control environment, management and employees of the manufacturing firms should establish and maintain an environment throughout the organization that sets a positive and supportive attitude toward internal control. There are several key factors that affect the accomplishment of this goal. Top Managers and division managers should consider each of these control environment factors when determining whether a positive control environment has been achieved.
- The manufacturing firms have establish and uses a formal code or codes of conduct and other policies communicating appropriate ethical and moral behavioral standards and addressing acceptable operational practices and conflicts of interest within the organization. The organization management must clearly specify the lines of Authority and responsibility; if they are clearly stated and assigned throughout the organization and there is clear communication between all employees across the organizations. A well-designed internal control structure will reduce improper activity. The responsibility of designing and implementing internal controls is a continuous process. As conditions change, control procedures may become outdated and inadequate. Management should anticipate that certain procedures will become obsolete and modify the internal control structure in response to these changes.



Finally, the management of each manufacturing firms should be reviewed periodically so as to cope with modern trends in organizational internal control system, safeguarding of organization asset and best financial performance within the organization continual improvement.

## Reference

- BoFED, 2008. *“Bureau of Finance and Economic Development”*
- Arad and Navid, 2009. *“A Clear Look at Internal Controls: Theory and Concepts”*
- David Mwindi (2008) *“ Auditing”*
- WILLIAM ODEI AFFUM 211G.C *“evaluation of internal control”*
- Coso, 1992 *“Committee of Sponsoring Organizations of the Tread way Commission”*
- O. Ray Whittington & Kurt Pany (2001). *“Principles of Auditing and Other Assurance Services. Irwin/McGraw- Hill. New York”*
- Panday; 1996 and Paper 8;1998; *“ACCA- Managerial Finance”*
- IBIMA *“Publishing Journal of Eastern Europe Research in Business & Economics,(USA &EU)”*
- 1992, 1994 *“COCO Committee of Sponsoring Organizations of the Tread way Commission”*
- Millichamp, A. H. (2002). *“Auditing the Bath Press, Bath Eighth edition. Pg80-150,349 - 355. Auditing Standards and Guidelines (AS and G) 7.2.4”*
- Attwood, F. A. and Stein, N. D. (1986). *“Auditing, pitman Publishing Ltd. Seventeenth edition”*
- Howard (1984), *“internal control – integrated framework”*
- Stephen Emasu (2007) *“public financial management – Concepts & Practices”*
- Mugo Jeremiah Munene 2013G.c *“internal control systems and financial performance”*
- Paul D. Leedy (1989, Paperback *“A Basic Text for all Courses in Research Methodology”*
- Allegrini, M. and D’Onza, G. (2003), *“Internal auditing and risk assessment in large Italian companies: an empirical survey”, International Journal of Auditing, Vol. 7 No.3, pp.191-208”*



- Anne Deladem Siayor *“Risk Management and Internal Control Systems in the Financial Sector”*
- MOHAMMEED SEID ALI *“internal audit and risk assessment in ethiopian public enterprises”*
- Kotey, B. and G. G. Meredith (1997), *“Relationship among Owner/Manager Personal Values, Business Strategies, and Enterprise Performance, Journal of Small Business Management, April, 35(2), 37-61”*
- Tekalign Negash Kebede *“Impact of internal control over accounting frauds in public enterprises”*
- Rick Hayes et al. (2005) *“Principles of Auditing Pearson Education Limited”*
- Fentahun Tesafa *“Forward and backward linkage analysis of manufacturing industries in Amhara region”*
- Firezer Million 2013G.C *“Assessment of internal control and Accounting fraud in the case of Adama revenue office ”*
- Gupta (2001) *“drawing from Statements of Standard Auditing Practices No. 6 (SAP 6”*
- ACCA- *“Association of charter certified Accountant”*
- Sssuuna Pius Mawanda 2008 G.C *“Effects of Internal Control Systems on Financial Performance”*
- UNIDO (1996, 2000, 2003 &2004), *“Industrial Development Review Series Ethiopian, New Direction of Industrial Policy, Addis Ababa, Ethiopia ”*