ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

SCHOOL OF COMMERCE

MSC IN CORPORATE FINANCE: SPECIALTY IN INVESTMENT MANAGEMENT

THE EFFECT OF INTERNAL CONTROL SYSTEM ON FINANCIAL PERFORMANCE OF SELECTED COMMERCIAL BANKS IN ETHIOPIA

A THESIS RESEARCH SUBMITTED TO ADDIS ABABA UNIVERSITY SCHOOL OF COMMERCE IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE MSC IN CORPORATE FINANCE

BY

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June, 2025

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AUTHOR'S DECLARATION

I the undersigned, declare that this thesis is entitled the effect of internal control system on financial performance in the selected Commercial Banks in Ethiopia. It is my original work that it has not been submitted to any other institution anywhere for the award of any other academic degree. I followed all ethical and technical principles of scholarship in the data collection, data analysis and preparation of this report and all the sources that I have used or quoted have been indicated and acknowledged.

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THESIS SUBMISSION APPROVAL FORM

This is to certify that the thesis entitled the effect of internal control system on financial performance in the selected Commercial Banks in Ethiopia has been carried out by Bezawit Worku under my supervision. This thesis is submitted for the fulfillment of the requirements for the Master of Science in Corporate Finance (With Specialty in Investment Management) program at Addis Ababa University. I confirm that the candidate has met the necessary academic requirements and recommend the thesis for submission and defense.

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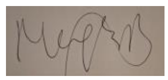
Signature: 

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EXAMINERS' APPROVAL ABABA UNIVERSITY COLLEGE OF BUSINESS AND ECONOMICS SCHOOL OF COMMERCE

We the undersigned certify that the thesis prepared by Bezawit Worku entitled the effect of internal control system on financial performance in the selected Commercial Banks in Ethiopia and submitted in partial fulfillment of the requirements for the Master of Science in Corporate Finance (With Specialty in Investment Management) program with the regulations of the University and meets the accepted standards with respect to originality and quality.

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List of Abbreviations

CONACT =control activities

FNPERFC = Financial performance

INTAUD = Internal Audit

INTCOSY = Internal controls system

RSASMT = Risk assessment

Abstract

The main objective of the study is the effect of internal control system on financial performance in the selected Commercial Banks in Ethiopia. The researcher used a quantitative research approach and explanatory research design. The sample size of the study is 133 employees who are currently working in Selected Commercial Banks in Ethiopia. Responses of the subjects were collected through closed ended structured questionnaires. The study examined four factors that influence financial performance. The descriptive analysis of the mean and standard deviation result indicated that; it is high which is above the mean score of point 3.0 of the standard. The result of correlation coefficients indicated that there is a positive relationship between Control activities, internal control system, risk assessment and Internal Audit on financial performance. The researcher used Ordinary Least Square (OLS) multiple regression model to identify determinants of financial performance. According to this study, all the predictors (control activities, monitoring, and risk assessment, Information and Communication and Internal Audit) have positive coefficient values indicating that positive influence on financial performance under the study. It is enormously essential that the management in the Selected Commercial Banks in Ethiopia conduct an assessment on these determinants factors which enables the Banks to collect valuable facts that makes available insights for financial performance in the study area. The study recommended by suggesting on further studies that need to be done that the work of employees should be performed with modern technology such as the use of computerized data tools and specific financial performance software and it had better to maintain current established databases management system and new competitive information technology that all employees are expected to perceive in the organization. The staffs need to collectively develop their knowledge or skills through appropriate professional training and development program.

***Key words**: internal controls system, Internal Audit, financial performance, Control activities, risk assessment*

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

An important topic of research in organizational management is how internal control systems affect financial performance, especially when it comes to improving operational effectiveness and guaranteeing the accuracy of financial reporting. The goals of internal control systems are to protect resources, guarantee the integrity of financial records, and encourage adherence to legal requirements. Because they reduce the risk of fraud, mistakes, and inefficiencies, their efficacy can have a big impact on an organization's financial success. The entire network of procedures put in place within an organization to give a reasonable level of assurance that its goals will be met is known as an internal control system. Effective and efficient operations, dependable financial reporting, and adherence to relevant laws and regulations are all advantages of an internal control system (Nyakundi, 2014)

Effective management of businesses depends on internal control systems, especially when it comes to guaranteeing operational and financial performance. In order to protect assets, guarantee the accuracy of financial reporting, and encourage adherence to relevant rules and regulations, these systems comprise a collection of processes and procedures. Due to the increased complexity of corporate processes and the increasing demand for accountability and transparency, the importance of internal control systems has garnered attention in recent years.

The corporation's internal control system is designed to increase the efficacy and efficiency of operations, ensure that operations comply with legal requirements, and enhance the accuracy of financial reporting. For the organization to achieve its ultimate goals, an internal control system is essential. For the organization to achieve its ultimate goals, an internal control system is essential. Banks can prevent or reduce future losses by using internal control systems to anticipate possible issues that could result in financial losses. An effective internal control system may be able to prevent financial costs, according to research on the reasons behind bank failures (Hayalli, 2012)Information and communication, monitoring, control actions, and risk assessment are all parts of internal control (Akisiki, 2017).The framework for the effective operation of the internal control system is provided by the control environment, which also influences how decisions are made, how the organization functions, and how people perceive the control system. By doing a risk assessment, business owners may address risks that keep them from achieving their goals. Finding and controlling risks that could negatively impact financial performance requires efficient internal control systems. They offer a framework for evaluating risks and putting controls in place to lessen them, which is especially important in sectors like banking that are vulnerable to financial irregularities. Internal control inefficiencies are one problem facing the banking industry, which might enable dishonest traders to lead these banks to incur large financial losses (Ayagree, 2014). Large amounts of non-performing loans, a lack of transparency, inadequate capitalization, and ineffective internal controls are some of the main causes of the financial sector's problems. In particular, during the crises that struck this industry in the early 1990s and mid-2004, compromised external audits were essential (Adeymi, 2011)the purpose of this study is to determine how internal control systems impact a subset of Ethiopian banks' financial performance.

1.2 Statement of the problem

The measures implemented by an organization to guarantee the achievement of its aims, missions, and objectives are referred to as internal controls. They are a set of policies and procedures that a company has implemented to ensure that its transactions are conducted correctly and to stop waste, theft, and resource misappropriation. To provide a reasonable level of assurance regarding the achievement of an organization's goals regarding the accuracy of financial reporting, operational efficacy and efficiency, and adherence to pertinent laws and regulations, internal controls are procedures developed and influenced by those in charge of management, governance, and other staff members (Ejom, 2014).

Its unintended consequence is to promote accountability. Interest in internal control and its continuous nature grew as a result of research into the factors that led to the massive losses suffered by a number of African banks (Amudo, 2008)Removing these obstacles is essential to advancing the banking sector's mission and objectives. Thus, this study's main goal is to strengthen internal controls and highlight the significance of keeping a close eye on their effectiveness. Organizations implement internal control systems to assist them meet their goals and objectives by boosting productivity, lowering the risk of loss, guaranteeing the accuracy of financial statements, and abiding by the law. One important element affecting an organization's financial success is the efficiency of its internal control systems. Even with the acknowledged significance of these systems, fraud, inefficiency, and financial mismanagement remain major problems for many firms.

The absence of strong internal control systems in many firms creates weaknesses that may lead to monetary losses. The financial health of a business can be significantly impacted by fraud and financial reporting errors, which are frequently linked to weak internal controls (Frank Nana, Manpreet Kaur, & Nissar Ahmed, 2023).Inaccurate financial information presented by organizations with inadequate internal controls may mislead stakeholders and lead to subpar decision-making (Mawanda, 2008). Operational inefficiencies brought on by inefficient internal control systems might result in resource waste and decreased profitability. If an organization's internal controls do not sufficiently support its operational procedures, it may find it difficult to meet its financial goals (Owizy, 2013)

An organization's financial management is vulnerable to risks like inaccurate financial statements and/or asset loss when proper internal control mechanisms are not in place. Inaccurate and untrustworthy financial records that could compromise the integrity of the business; theft and improper handling of important organizational documents that an employee might do to gain unfair advantage. Although theoretical frameworks indicate a close relationship between internal control systems and financial performance, empirical research is required to support these assertions in various organizational contexts and industries. The knowledge of how particular internal control procedures can improve financial results is limited by this study gap (Frank Nana, Manpreet Kaur, & Nissar Ahmed, 2023).

There are international studies in this area of study; very limited studies have been conducted in commercial banks in Addis Ababa on the effects of internal control on the financial performance. Because the effects of internal control on the financial performance of selected commercial banks in Ethiopia were not clearly defined and documented, this research was started. In order to solve the aforementioned issues, the study was carried out. Internal control systems and fraud detection and prevention were found to be significantly positively correlated by the study. This study was unable to prove the existence of preventative mechanisms and did not examine or consider the efficacy of the internal control system.

1.3 Research Questions

1. To achieve the above desired objectives the following research questions will be used:
2. What is the Effect of internal control system in selected commercial banks in Ethiopia?
3. What is the Effect of Control Activities in selected commercial banks in Ethiopia?
4. What is the Effect of risk Assessment in selected commercial banks in Ethiopia?
5. What is the Effect of information and technology in selected commercial banks in Ethiopia?
6. What is the Effect of Monitoring in selected commercial banks in Ethiopia?
7. What is the Effect of internal Audit in selected commercial banks in Ethiopia?

1.4 Objective of the study

1.4.1 General objective

The general objective of the study is to investigate the effect of internal control on financial performance in the selected Commercial Banks in Ethiopia.

1.4.2 Specific objective

1. To examine the effect of control activities on financial performance of selected Commercial Banks in Ethiopia.
2. To examine the effect of Internal Audit on financial performance in the selected Commercial Banks in Ethiopia.
3. To examine the effect of risk assessment on financial performance in selected Commercial Banks in Ethiopia.
4. To examine the effect of information and communication on financial performance in selected Commercial Banks in Ethiopia.
5. To examine the effect of Monitoring on financial performance in selected Commercial Banks in Ethiopia.

1.5 Significance of the study

The effect of the internal control system on the financial performance of selected Ethiopian commercial banks is the main subject of the study. It will serve as a model for other banks to follow, helping senior leaders to close gaps and give their subordinates better service. The research will add to our understanding of the function of internal control systems and the results may also add to the body of literature that scholars may find useful in conducting additional research in this area. Lastly, it is devoted to offering managers references that they may utilize as guidance when making decisions regarding the determinants that impact successful financial performance.

1.6 Scope of the study

The research will focus on the effect of internal control systems on financial performance of selected commercial banks in Ethiopia. Includes the influence of internal control system on financial performance and the relationship between internal control and financial performance.

- **Geographical Scope**: Only private commercial banks operate in Ethiopia, are included in the study, which offers insights unique to the banking industry.
- **Thematic Scope**: The study examines the connection between internal control system and financial performance.
- **Methodological Scope**: The study uses quantitative research approach to examine internal control system and their effects on financial performance.

1.7 Limitation of the Study

The study concentrated on the relationships that exist between financial performance and internal auditing, risk assessment, control activities, control environment, and information exchange.

This study's main goal was to ascertain how the financial performance of a few chosen banks was impacted by their internal control systems. This study concentrated on the internal control systems that influence the financial performance of a certain bank and the advantages that the bank offers due to its intricate and wide-ranging structure. The title's emphases on examining a particular bank and potential issues with data access were the primary research limits.

1.8 Definition of Terms

- **Financial performance -** is measuring the results of a firm's policies and operations in monetary terms. These results are reflected in the firm's return on investment, return on assets, value added, etc.
- **Control activities -** is the data application system applied in monitoring and controlling in internal administration system (Brutus, 2015).
- **Internal controls system: -** are a system that encompasses all aspects of managing a company's inventories; purchasing, shipping, receiving, tracking, warehousing and storage, turnover, and reordering (Ondiek, 2009).
- **Internal Audit:** is the critical appraisal of materials, items, or systems involving examination, testing, and estimating to determine whether it conforms to the company's, industries, local or national rules and regulations (Girma, 2015)
- **Risk assessment -**is estimating whether your organization can meet its business demands, such as a large order for goods or services that depend on whether your company's employees have the capabilities to produce the work (Young, 2001).

1.9 Organization of the study

There are five chapters in the study. The first chapter covers the introductory section, which includes the study's background, statement of the problem, objectives of the study, significance of the study, scope of the study and limitations of the study, The review of relevant theoretical literature and empirical findings is covered in the second chapter, while research methods and methodology are covered in the third. The results and discussions are presented in the fourth chapter. Lastly, findings and suggestions are sent forth on fifth chapter based on the study and interpretation.

CHAPTER TWO

LITERATURE REVIEW

2.1 Theoretical back ground

2.1.1 Role of internal control system

The purpose and objective of an internal control system are justified since internal control includes an organization's policies, procedures, and strategies that are primarily concerned with asset protection and ensuring that financial records are accurate and reliable. Systems for internal control are essential for maintaining the effectiveness and integrity of an organization's activities. The following are the main purposes they fulfill:

1. **Risk Management**: Internal controls help identify, assess, and mitigate risks that could adversely affect an organization's financial performance and operational efficiency. By proactively managing risks, organizations can prevent potential losses.
2. **Financial Reporting Accuracy**: A robust internal control system ensures the reliability and accuracy of financial reporting. This is crucial for stakeholders, including investors, regulators, and management, who rely on accurate financial information for decision-making.
3. **Fraud Prevention and Detection**: Internal controls are essential in preventing and detecting fraudulent activities. Effective controls create a deterrent against fraud and establish mechanisms for identifying irregularities when they occur.
4. **Operational Efficiency**: By streamlining processes and ensuring compliance with policies, internal controls enhance operational efficiency. This can lead to better resource allocation, cost savings, and improved productivity.
5. **Compliance with Laws and Regulations**: Internal control systems ensure that organizations comply with relevant laws, regulations, and standards. This compliance protects the organization from legal penalties and reputational damage.

6. **Safeguarding Assets**: Internal controls protect an organization's assets from theft, loss, or misuse. This includes physical assets as well as financial resources, ensuring that they are used appropriately.
7. **Enhancing Accountability**: Internal controls foster a culture of accountability within the organization. By clearly defining roles and responsibilities, they ensure that individuals are held accountable for their actions and decisions.
8. **Continuous Improvement**: Internal control systems promote a process of continuous evaluation and improvement. Regular assessments help identify weaknesses and areas for enhancement, ensuring that controls remain effective over time.

2.1.2 Internal control theory

Numerous theoretical stances can be used to frame the investigation of internal control systems and how they affect financial performance. While contingency theory contends that the effectiveness of internal controls is impacted by the particular organizational context and environment, agency theory contends that efficient internal controls align the interests of management and shareholders by lowering agency costs (Frank Nana, 2023) a theory is a collection of related ideas, definitions, and claims that offer a methodical perspective on events or circumstances by outlining the relationships between variables in an effort to explain and forecast the events or situations. Theoretical literature prioritizes theories or hypotheses over real-world applications. Two theories were examined in the study: the theory of the firm and the theory of agency. The goal of agency theory, a management and economic theory is to clarify business dealings and self-interest. It describes control delegation and the relationship between principals and agents.

It describes the most effective way to set up partnerships where the principle decides what has to be done and the agent does it or takes decisions on the principal's behalf (Jensen, 1976)How to effectively manage partnerships where one party assigns the task and another party completes it is explained by agency theory. In this arrangement, the principal employs an agent to carry out the work or complete a task that the principle is incapable or unwilling to complete. For instance, in businesses, the principles are the stockholders who assign tasks to the agent, which is the management of the business. Self-interest drives both the principal and the agent, according to agency theory. Agency theory is doomed to inherent conflicts because of this self-interest assumption. Agents are therefore more likely to pursue self-interested goals that deviate from and even conflict with the principal's objectives if both sides are driven by self-interest. Agents, however, are only supposed to operate in their principals' best interests. Research has demonstrated that the need for monitoring controls has been explained by agency theory (Watts, 1983) To accomplish their stated goals, organizations have integrated internal control systems into their policies, rules, and laws. This notion was crucial to the current investigation because it clarified the ways in which the agency and principal work together for the organization's good. According to the neoclassical economic theory of the company, businesses, including companies and enterprises, exist and make decisions in order to maximize profits. Before distributing resources according to models that aim to maximize net profits, businesses interact with the market to determine pricing and demand. According to firm theory, maximizing profits is what motivates a particular business entity's actions. This theory influences choices in a number of areas, including as the distribution of resources, the production process, price modifications, and output levels. The minimal stock ownership of many decision makers is one issue that is taken into consideration by modern theories of the business. According to some, CEOs of publicly traded companies have goals focused on market share, sales maximization, and public relations in addition to profit maximization. Just maximizing profits poses some risk in terms of public perception and a decline in the company's goodwill with other people or organizations. A business exposes itself to more danger when it just uses one approach in the marketplace. A company or department within a company may go bankrupt if its total performance depends on the sale of a single product, and that product fails in the market.

2.1.3 Types of internal Control

According to the internal control guidelines, an organization should have access to the following eight (8) types of internal control systems:

2.1.3.1 Organizational Control

Every function of an organization should be overseen by a designated individual, known as the "responsible officer," who will be accountable for defining and allocating responsibilities. It is important to clearly define the delegation of power and responsibility as well as to have adequate lines of reporting for all aspects of the organization's activities, including controls (Amaka, 2012).

2.1.3.2 Segregation of Duties

The division of labor is one of the main methods of control. This raises the factor of checking and lowers the chance of internal manipulation and unintentional error. Initiation (the officer or person who decides to give out the loan), execution (the person who keeps the money to be loaned out), and recording (the person who records the entire procedure in the book) are functions that should be separated in an organization's financial management. To make the internal control system completely impenetrable to fraud, system development and day-to-day operations must be taken into account (Amaka, 2012).

2.1.3.3 Physical Control

This relates to asset physical custody and includes protocols and security measures intended to restrict access to only authorized persons. These consist of documentation-based direct and indirect access. When it comes to valuable, portable, exchangeable, or desirable assets, these controls are crucial. In a computerized setting, physical control can also be accomplished electronically, for instance, by using electronic ID cards, passwords, and other measures to limit access to specific files (Amaka, 2012).

2.1.3.4 Arithmetical and Accounting Control

These are the controls in the recording function that make sure the transactions that need to be recorded and processed are allowed and executed accurately. These controls include accounting for documents, maintaining and verifying totals, reconciling, controlling accounts and trial balances, and verifying the arithmetic accuracy of the records (Amaka, 2012).

2.1.3.5 Personnel Control

Procedures should be in place to guarantee that staff members has the skills necessary for their roles. Any stem's ability to work properly is inevitably dependent on the skill and moral character of its operators. When establishing any control system, particularly in financial management, it is crucial to take into account the credentials, hiring, training, and personal traits of the staff members engaged (Amaka, 2012).

2.1.3.6 Supervision Control

Daily transactions should be monitored and recorded by competent officials as part of any internal control system. Every action taken by employees at every level of financial management should be documented in detail and shared with the supervisor (Amaka, 2012).

2.1.3.7 Management

These are the controls that management implements outside of the regular operations of the system. These consist of the internal audit function, the assessment of management accounts and their comparison with the budget, the general supervisory controls that management exercises, and other special review procedures. It is also the management's duty to evaluate internal control on a regular basis in order to adjust to changes in financial management operations (Amaka, 2012).

2.1.3.8 Authorization and Approval

Every transaction needs to be approved by a suitable, accountable individual. This is crucial for an organization's financial system, which handles a lot of money. As a result, it is acceptable that the money used for different transactions be approved by a competent and trustworthy individual (Amaka, 2012)

2.2 Internal Controls Systems and Financial Performance

The procedure that management implements to give reasonable certainty about the attainment of effective and efficient operations, trustworthy financial reporting, and adherence to legal and regulatory requirements is known as internal control. "The plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving management objectives 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 accounting records, and the timely preparation of reliable financial information" is how (Gupta,2001) defines internal control, drawing from Statements of Standard Auditing Practices No. 6 (SAP 6).Therefore, it is important to note that properly implemented internal control systems will guarantee the following: that all transactions carried out by an entity are complete; that the entity's assets are protected from theft and misuse; that transactions in the financial statements are stated at the appropriate amounts; that all assets in the company's financial statements do exist; that all assets reported in the company's financial statements are recoverable; and that the entity's transactions are presented appropriately in accordance with the applicable reporting framework. The phrase "internal control" refers to the way management ensures that a firm achieves its financial and other goals. In addition to improving managerial efficacy, internal control systems are a crucial responsibility of corporate boards.

In addition to helping managers be more effective, internal control systems are a crucial responsibility of corporate boards of directors (Verschoor, 1999). Corporate managers must possess a thorough understanding of business-level operations and markets in order to implement strategic controls. A broad information exchange between divisional and corporate managers is also necessary for these controls (Hoskisson, Hitt, & Ireland, 1994). Financial controls, on the other hand, use objective standards like return on investment (ROI) to assess the performance of business-level management. As a result, senior managers set financial goals for every company and evaluate the performance of managers at the business level in relation to those goals. When there is a high level of interconnectedness between business units, this method may be troublesome. The performance of each division must therefore be mainly independent in order to emphasize financial controls. A company's complexity and the number of divisions that corporate leaders must supervise and manage increase as it expands, particularly through acquisitions. This increases the executives' spans of control. It is obvious that business managers' requirement for information processing rises with each purchase, often significantly.

Effective operations, financial reporting, and compliance are the three main categories of management objectives. Protecting the organization's assets is the foundation of efficient operations. Without proper controls, the company's nonphysical assets, such as receivables, cash, and essential papers and records, could be lost, stolen, or destroyed by accident. Since management has a professional and legal obligation to make sure that information is presented fairly in compliance with applicable accounting standards, the objective of financial control necessitates correct information for internal decision-making. The company's annual report to shareholders includes these management statements on internal control. Performance, according to (Mawanda, 2008), is the capacity to function profitably, survive, expand, and respond to environmental opportunities and dangers. They contend that an organization's effectiveness is determined by how effectively it uses its resources to accomplish its goals.

2.2.1 Control Environment

The control environment encompasses the organization's ideology, style, and supporting attitude in addition to the personnel's competency, morale, integrity, and ethical ideals. An organization's tone is established by its control environment, which also affects its members' control consciousness. It provides structure and discipline and serves as the cornerstone for all other internal control components. The board of directors' attention and guidance, management's philosophy and operating style, the way management allocates authority and responsibility, and the organization and development of its personnel are all examples of control environment factors (University of California, Berkeley, 2012). An organization's entire control awareness is referred to as the "control environment," and it is influenced by regulations, moral principles, procedures, and oversight mechanisms. Examples of the organization's management philosophy, which is a component of the control environment, include the organization's goal and mission as well as its battle to maintain proper financial accountability. It is important to keep in mind that general direction is determined by the control environment, which affects employee awareness. The efficacy of management and the board of directors significantly affect the control environment. Personnel consciousness is influenced by the control environment (Aldridge and Colbert, 1994). In addition to operational success, it represents management's views and stances on the significance of internal controls in banks.

The company's history and culture are also influenced by the control environment, which leads to a positive attitude toward internal control and management. Examples of massive bank losses show how management disregards and is negligent with the control culture of the financial institution. The contempt of the directors and high management has resulted in further losses. These banking-related occurrences also demonstrate that managers are not incentivized to exercise effective line supervision and uphold a high degree of control consciousness. Boards of directors and upper management must emphasize the value of internal control both verbally and physically.

2.2.2 Control Activities

The rules and practices that assist guarantee that management directions are followed are known as control activities. They assist in making sure that the appropriate steps are taken to mitigate risks to the accomplishment of the entity's goals. According to the University of California, (Berkley, 2012)they cover a wide range of tasks, including as authorizations, approvals, verifications, reconciliations, operating performance assessments, asset security, and segregation of jobs.

The foundation of the business's efforts to mitigate the risks it encounters, such fraud, are control activities. Depending on how management evaluates the risks, a company's specific control measures will change. The company's size and nature have a significant impact on this evaluation.

The six principles of control activities are as follows.

- Establishment of responsibility
- Segregation of duties
- Documentation procedures
- Physical controls
- Independent internal verification
- Human resource controls

There are procedures and policies in place to help ensure that management effectiveness is carried out accurately and on time. Examples of control tasks include information processing, physical controls, work segregation, and performance evaluations (Walker, 1999)It According to this argument, control actions are applicable across all entity levels and functionalities. Authorizations, approvals, verifications, reconciliations, reviews, security, and the creation and preservation of pertinent records are all part of an institution's financial performance operations, which are the procedures and policies that facilitate the execution of management directives. Role separation is one of the most important control jobs. Assigning different employees to manage the responsibilities of authorizing and recording transactions, maintaining asset custody, and doing comparisons and reconciliations is the best course of action.

2.2.3 Internal Audit

The Latin word "AUDIRE," which means to hear, is the source of the word "audit," which refers to the formal review of accounts and records. According to Whittington and Pany (2001), internal auditing is carried out as a component of an organization's monitoring activities. It entails examining and evaluating internal controls as well as how well the organization's various divisions carry out their designated tasks. An internal auditor typically wants to know if a department understands its job, has enough employees, keeps accurate records, protects money and other assets, and works well with other departments. Typically, the top management receives the internal auditor's reports.

Instead, "internal audit is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization," according to (Gupta, 2001)Assisting members of the organization in carrying out their duties effectively is the aim of internal audit. "Management determines the scope of internal audit," claims Gupta. "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations," according to (Bamweyana, 2009)

By providing a methodical, disciplined strategy to assess and enhance the efficacy of risk management control and governance procedures, it aids a company in achieving its goals. He goes on to list the following internal auditing principles: competence, objectivity, confidentiality, and integrity. However, internal auditors' neutrality is typically severely undermined because they are employees of an organization, are appointed by management, and report to management. The Institute of Internal Auditors states that independence applies to all types of auditors.

2.2.4 Internal Control in Banking

Internal control systems include all financial, operational, and other control systems implemented by internal controllers, according to the Banking Regulation and Supervision Board (BRSB). To ensure that all bank operations are conducted by management levels in accordance with the most recent policies, procedures, directives, and constraints, these systems involve routine monitoring, objective evaluation, and timely reporting to management levels. In a broader sense, the idea examines how important independent internal control is for detecting and assessing compliance with industry rules. In their work, (Bayou, 2015)highlighted the importance of independence as a fundamental component of internal control.

They argued that without independence, internal controls could not be deemed effective or successful. Both the overall operations of the organization and the acts of management must be overseen by an impartial controller. This framework for evaluating internal control systems was published by the Basel Committee on Banking Supervision as part of its ongoing efforts to address supervisory issues with banks and improve supervision by making recommendations that promote effective risk management techniques. Internal controls are the cornerstone of safe and reliable financial institution operations and an essential part of bank management.

A strong internal control system can ensure accurate financial and managerial reporting, the achievement of long-term profitability targets, and the accomplishment of a bank's goals and objectives. Such a system can reduce the risk of unanticipated losses or harm to the bank's reputation in addition to assisting the bank in adhering to laws and regulations, plans, strategies, and internal rules and processes. Supervisory authorities should consider these fundamental concepts when evaluating their approaches and processes for analyzing how banks set up their internal control systems.

2.2.5 Risk assessment

Risk assessment, according to (Coso, 2013)is a dynamic and iterative process for identifying And analyzing risks to fulfill the entity's objectives, and it serves as a foundation for establishing How risks should be managed. Additionally, it was stated that management evaluates potential Changes in the company's internal business model as well as the external environment that may Impede its capacity to fulfill its goals.

2.2.6 Information and communication

According to COSO, information is necessary for the entity to fulfill its internal control requirements in support of the achievement of its goals. Internal and external Communication provide the organization with the information it requires to carry out ordinary Internal control activities. It teaches employees about internal control responsibilities and the necessity of such functions in achieving goals. It also states that auditors must learn about the information system and business procedures relevant to financial reporting, such as transaction classes, manual and IT system procedures, accounting records, and how information systems record events and conditions, as well as the financial reporting process.

2.3 Financial Performance

Performance is defined as the capacity to function effectively, generate profits, endure, expand, and respond to environmental opportunities and dangers (Stoner, 2003) performance is determined by how effectively an organization uses its resources to accomplish its goals. It is the gauge of success attained by a person, group, institution, or procedure .underperforming assets (companies) are the cause of many enterprises' bad performance. Strategic mistakes committed throughout the acquisition process in previous years are frequently linked to low performance from underperforming assets. For example; some firms acquire businesses with unrealistic expectations of achieving synergy between the acquired assets and their current sets of assets. A common reason for such errors is managerial hubris (Roll, 1986)or overvaluation of managerial capability in the acquisition process. In a research published in September 2013, the European Central Bank looked at bank performance in terms of its capacity to provide long-term profitability. Since profitability strengthens a bank's capital position and boosts future profitability through retained earnings investments, it serves as its first line of defense against unforeseen losses. A business that continuously loses money will eventually run out of funds, endangering the interests of its stockholders and debt holders. Furthermore, as protecting and increasing wealth for shareholders is the ultimate purpose of any profit-seeking organization.

2.3.1 Measures of Financial Performance

(Dixon et, 1990) Defined acceptable performance metrics as those that allow companies to focus their efforts on accomplishing their strategic goals. According to(Kotey& Meredith,1997) performance can be evaluated using either subjective or objective criteria. One argument in favor of subjective measures is the challenge of gathering qualitative performance data from small businesses and the issues with data reliability brought on by variations in accounting practices among businesses. (Kent, 1994) discovered that metrics like return on capital employed, revenue growth, and profit growth are examples of objective performance measures. Market Value Added (MVA), a metric developed by financial advisors Stern Stewart & Co., quantifies the extra value that a business has delivered to its shareholders over the sum of their investments.

Eight more conventional measures of financial success are used to determine this ranking, including net margin, return on equity, sales growth for one and three years, profit growth for one and three years, and total return for one and three years. Verschoor does, however, list additional financial metrics, such as the utilization of company assets, financial soundness, and the value of long-term investments. He also discusses non-financial performance metrics, such as creativity, the capacity to draw in, nurture, and retain skilled personnel, management caliber, product or service caliber, and environmental and community responsibility. Use the three metrics of return on equity (ROE), return on assets (ROA), and return on sales (ROS) to discuss accounting-based success.

2.3.1.1 Liquidity

The current ratio, or current assets divided by current liabilities, is a common indicator of an organization's liquidity. The significance of the current ratio as a gauge of an organization's liquidity was further underlined by Baysinger (1989). According to ACCA and (Panday, 1996) the acid test ratio—which is calculated by subtracting inventory from current liabilities—is another indicator of liquidity.

2.3.1.2 Accountability

State that managers require regular financial reports in order to make well-informed decisions. One method managers use to hold themselves accountable for the resources entrusted to them are through reporting, especially financial reports. Accountability might take the form of financial, social, or political responsibility.

2.3.1.3 Reporting

(Whittngton, 2001)Discuss how thorough internal controls are in addressing the accomplishment of goals in the areas of operations, financial reporting, and legal and regulatory compliance. They add, "The program for creating, confirming, and disseminating to the different levels of management those current reports and analyses that enable executives to maintain control over the variety of activities and functions that are performed in a large organization is also included in internal control." They list internal control tools such as time and motion studies, internal audit labs, production standards, personnel training, and the application of budgetary methodologies.

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

2.3.1.4 Survival

High-performing businesses can stay in business for a long period. Furthermore, the ability of a business to continue operating is a measure of great financial performance.

2.4 Empirical Literature Review

2.4.1 Foreign Literature

Numerous studies on the relationship between internal control and financial success have produced contradictory findings. The financial performance of Nairobi City's higher education institutions is significantly impacted by indicators of internal control systems, including information and communication, risk assessment, control activities, and the control environment (Benson, 2015).The organization implemented internal control systems, mechanisms, and procedures in response to the unfavorable environment, insufficient risk and control activity assessment, careful use of information and communication systems to continuously improve accountability, and prudent use of organizational resources.

While internal control systems were described as the information system, control activities, risk assessment process, and control environment, financial performance was defined as cost per unit, objective achievement, profitability, or excess. The findings of the regression analysis demonstrate that internal control systems contribute to the enhancement of sugarcane out-grower companies' financial performance. The following suggestions were offered in light of the study's findings and conclusions: Strengthening the internal control system is necessary because it was discovered to have a statistically positive effect on the performance of sugarcane out-grower enterprises. Although the study yielded useful data, it had some flaws that made further research possible. The purpose of the study was to look into how the internal control environment affected the financial performance of companies listed on the Nairobi Securities Exchange. The findings supported (Mawanda, 2008)claim that organizations with strong internal control systems consistently provide better financial results by demonstrating a significant positive correlation between internal control environment and financial performance.

2.4.2 Local Literature

Overall, (Tsedal, 2015)study shows that colleges implement internal control, which is beneficial from the standpoints of experience and academic competency. Nevertheless, each element of internal control has a significant impact; for example, the control environment of the internal control system is not enough to be deemed effective. An outdated asset register and documentation, significant problems with role separation, and ineffective asset acquisition and disposal are only a few of the organization's control measures' shortcomings. Furthermore, despite the ineffectiveness of risk assessment, information, and monitoring, action is nevertheless taken. (Endeshaw, 2021) reports that the study's conclusions show that internal control components have improved privately held manufacturing share companies' performance, despite the fact that some of them only slightly affected the business's financial results.

Therefore, the performance of privately held manufacturing sharing enterprises in Addis Ababa was impacted by the internal control system. High levels of financial performance in privately held manufacturing share companies seem to be associated with stronger internal control systems. Since all internal control systems are somewhat complex, they can be used to ensure the administration, accuracy, and completeness of records as well as to prevent fraud and collusion, especially by those in positions of authority or trust. Internal control systems are therefore comparatively effective and significantly affect the performance of organizations. For any organization to function well, internal control measures must be sufficient.

2.5 Identified Literature Gap

Gap 1: There is no theoretical debate regarding the connection or relationship between financial Performance and internal control. It turns out that the impact of internal control on financial performance in Ethiopia has not been studied theoretically or experimentally.

Gap 2: There is no empirical support for financial performance as an intervention variable for organizational performance. It studies the relationship between financial performance and internal control, and it almost investigates the relationship between financial performance and organizational performance. However, no empirical evidence exists to support the concept that internal control capacity financial performance.

2.6 Conceptual Framework

To accomplish the study's goals, the framework provides information on the elements that affect financial performance. Internal audit, risk assessment, and control activities and internal control system are the main factors of financial performance (Seppala, 2015)The four main criteria have already been covered in this study.

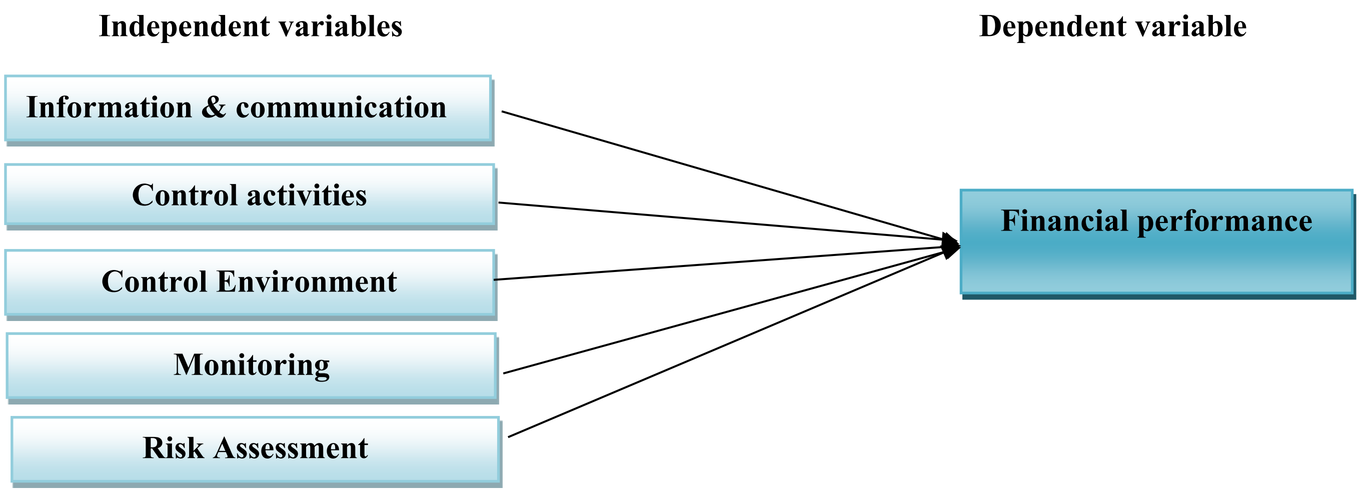

Figure 1 Conceptual framework

2.7 Hypothesis of the study

Based on the background and statement of the problem explained so far, the following hypotheses have been formulated.

H1. Internal controls system has a significant and positive effect on financial performance in selected Commercial Banks in Ethiopia.

H2. Control activities have a significant and positive influence on financial performance in selected Commercial Banks in Ethiopia.

H3. Internal Audit has a significant and positive effect on financial performance in selected Commercial Banks in Ethiopia.

H4. Risk assessment has a significant and positive effect on financial performance in selected Commercial Banks in Ethiopia.

CHAPTER THREE

RESEARCH METHODOLOGY

This part describes the methodology that are used in the study; it includes the research approach, Research design, the target population, the sampling strategy, data collection Procedure and data analysis techniques along with appropriate justification associated with each approach.

3.1. Research Approach

According to Creswell (2009), it provides a more comprehensive understanding of the research problem than either qualitative or quantitative research methodologies. The phenomenon of collecting numerical data that can be analyzed using mathematical methods is described by quantitative research, according to Creswell (2009), because the developed propositions should be examined with the relationship between varieties of variables using numerical techniques that are appropriate to test the strength of relationships.

In order to improve overall understanding of the perceived fundamental issues influencing respondents' assessments of the financial performance of particular Ethiopian commercial banks, this study aims to collect pertinent data and evaluate theoretical frameworks.

This work's quantitative research approach makes it possible to gather numerical data, measure variables, make predictions, analyze data, and draw conclusions using statistical procedures (Cooper, 2003)

3.2. Description of the study area

The study concentrated on Ethiopia's commercial banks, which are main financial organizations that are vital to the nation's economic growth. Selected Ethiopian commercial banks with at least ten years of operational experience made up the main study area.

3.3 Research Design

To investigate the cause-and-effect relationship between the independent and dependent variables under investigation, the researcher employed the explanatory research approach. This research aims to direct the cause-and-effect relationship of variables and it serves as linkage between the theoretical and empirical research (Zikmund, 2003).

In an empirical research study, the research design is a detailed plan for gathering data (Kothari, 2003). It creates the guidelines for data collection, measurement, and analysis. It is a collection of techniques and steps that characterize the variables under study.

To comprehend cause-and-effect links between the explanatory factors (control activities, internal controls system, risk assessment, and internal audit) and the explained (financial performance), the researcher employed a field survey study design.

3.4 Sources and Data collection Tools

Creswell (2009) asserts that primary data makes it simple to evaluate sample information and allows the researcher to make inferences about extrapolating the findings from a sample of replies to the full population.

The researcher used primary data sources for the study in order to meet the research objectives. Structured questionnaires were the main tool used to collect the necessary data from study participants in order to examine the quantitative data. In other words, surveys with five-point Likert scale questions ranging from highly agreed (5) to strongly disagree (1) were given out and gathered from personnel who are now employed by a few private commercial banks in Ethiopia.

3.5 Population and Sampling Technique

(Creswell, 2009) Defines a population as all individuals or objects that possess the qualities that are being studied. The target population is defined as a specific group of people or objects for which observations or questions can be performed in order to provide the required data structures and information.

The study's target population was Managers, Customer Service Manager (CSM), Senior Customer Service Officer, Senior Branch Controller, Customer Service Officer (CSO), Branch Controller and Customer Relation Officer (CRO).

The study has selected 8 Banks randomly based on their establishment as shown in table 1 below. The study also used simple random sampling techniques to select respondents. Therefore, the total population of the study is 200 employees.

Table 1 Population and Sample Size

No.	Selected Private Banks	Total Population	Proportional Sample size
1	Awash International Bank	45	27
2	Dashen Bank	32	21
3	Bank of Abyssinia	28	18
4	Wegagen Bank	29	19
5	United Bank	15	11
6	Nib International Bank	18	13
7	Cooperative Bank of Oromia	17	13
8	Bunna Bank	16	11
	Sum	200	133

Source: Selected Commercial Banks in Ethiopia

3.6 sample size

The studies focused on top level management of selected banks. The Study will use basic random sampling to select respondents. The, method of purposive sampling is also to select the respondents based on their experience.

The study's sample size was determined using the formula taken from (Yemane, 1967)Therefore, n= N/ (1+N (e)) is the formula used to determine the sample size.

$$\mathbf{n = \frac{N}{1+Ne^2} = \frac{200}{1+200\,(.05)^2} = 133}$$

Where n is the minimum sample size to be drawn

N is the total population from which the required sample population has been drown

e is error term (0.05).

3.7 Measurement of Variables

3.7.1 Measurement of Independent Variables

According to this study, the independent variables of the study are determinant factors that influence the financial performance. Therefore, in order to assess the full representation of independent variables, the researcher adopted from different authors of standardized questionnaires. The independent variable consists of four dimensions of determinants such as control activities, internal controls system, risk assessment and Internal Audit. Therefore, the study used The Likert scale five points: 5 for strongly agree, 4 for agree, 3 for neutral, 2 for disagree, and 1 for strongly disagree.

3.7.1.1 Internal Audit

Internal Audit is the critical appraisal of materials, items, or systems involving examination, testing, and gauging. Inspectors take measurements and make comparisons. Internal Audit is formal evaluations or organized examination exercises. The inspectors determine whether the item or material is in proper condition and of the right quantity. They also determine whether it conforms to the company's, industries, local or national rules and regulations.

Therefore, to measure the Internal Audit 4 items were prepared by adopting the Likert scale five points: 5 for strongly agree, 4 for agree, 3 for neutral, 2 for disagree, and 1 for strongly disagree.

3.7.1.2 Risk assessment

Risk assessment is estimating whether your organization can meet its business demands, such as a large order for goods or services that depend on whether your company's employees have the capabilities to produce the work (Young, 2001).

To measure it, 5 items were prepared by adopting (Young, 2001)using The Likert scale five points: 5 for strongly agree, 4 for agree, 3 for neutral, 2 for disagree, and 1 for strongly disagree.

3.7.1.3. Internal controls system

Internal controls system is a system that encompasses all aspects of managing a company's inventories; purchasing, shipping, receiving, tracking, warehousing and storage, turnover, and reordering (Ondiek, 2009).

To measure it, 5 items were prepared by adopting (Ondiek, 2009)using The Likert scale five points: 5 for strongly agree, 4 for agree, 3 for neutral, 2 for disagree, and 1 for strongly disagree.

3.7.1.4. Control activities

Is the data application system applied in monitoring and controlling for banking administration system (Brutus, 2015)**.**To measure it 6 items were prepared by using The Likert scale five points: 5 for strongly agree, 4 for agree, 3 for neutral, 2 for disagree, and 1 for strongly disagree.

3.7.2 Measurement of Dependent Variable

In this study, the dependent variable is the financial performance. Financial performance is the act of keeping track of a bank's effectiveness and monitoring their weight, dimensions, amounts, and location. The goal of financial performance is to minimize the cost of holding by helping business owners know (Godana, 2014)To measure the dependent variable of this study, 7 items were prepared by adopting using The Likert scale five points: 5 for strongly agree, 4 for agree, 3 for neutral, 2 for disagree, and 1 for strongly disagree. Thus, the respondents were requested to select their own choice of the five point Likert scale alternatives in order to specify their level of agreement or disagreement on each statement.

3.8 Method of Data Analysis

Survey questionnaires were utilized to gather quantitative data, which was then presented and analyzed using relevant tables and graphs using the Statistical Package for Social Sciences (SPSS Version 27). After being gathered from the field, the data was coded, saved, and input into the computer.

Descriptive analysis

To assess respondents' comprehension, the descriptive statistical data was shown using a table, frequency distribution, and percentage. The distribution of observations, degree of consistency, and similarity among respondent replies with each independent and dependent variable under research were observed using the statistics of mean score and standard (Zikmund, 2003).

Relationship Analysis

The association between the independent variables of risk assessment, internal audit, internal controls system, and control activities was determined using the Pearson correlation coefficient.

Multiple Regression Analysis

In the study region, the Ordinary Least Square (OLS) model is used. The findings were tested to see if they met fundamental assumptions using the results of linear multiple regression analysis. The impact of determinant factors, risk assessment, internal audit, and control actions was also examined using multiple regression analysis (Kothari, 2004).

Regression functions

The variables of control activities, internal controls system, risk assessment, and internal audit were used to construct the multiple regression equation (Kothari, 2004)

The regression model presented as follows:

FNPERFC =ß0+ß1 (CONACT) +ß2 (INTCOSY) +ß3 (RSASMT) + B4 (INTAUD) + e

Where

Bo= constant term

B1, B2, B3, and B4 = slopes or coefficients of independent variables

RSASMT= risk assessment

INTAUD = Internal Audit

FNPERFC= Financial performance

CONACT =control activities

INTCOSY = internal controls system

E = error term

3.9 Validity and Reliability

Validity and reliability must be taken into account in order to lower the possibility of receiving an incorrect response. The ability of a scale to gauge the planning that has to be decided upon and taken into consideration is known as validity. A greater fit between the conceptual and operational definitions would result in a more accurate assessment of validity. It illustrates how the construct and its indicators are related (Zikumund, 2003)

Gujarati (2004) defines dependability as the degree to which a measure is devoid of random error and produces a consistent outcome. It serves as a gauge for the internal reliability of the measure. Although a measure may be valid, it is not always the case that it is dependable. External and internal validity, demonstrate how accurate a measure is or how accurately a score captures an idea. The study's strengths and weaknesses are determined by the questionnaires' preparation, which draws on the work of earlier researchers in the field and data gathered from trustworthy sources of respondents employed by certain commercial banks in Ethiopia. To ensure the format, relevance, language, clarity, and arrangement of the questions, the researcher runs a pilot test. Fifteen respondents were given the pre-test survey questionnaires. The researcher made significant changes based on the results of the pilot test, including rewriting repetitious questions and avoiding questions that were pointless and improving order, clarity, and sentence structure.

The most common practical assessment of a separate item scale's reliability is the standard of all potential split-half reliabilities given a construct. Although a suitable result should be greater than 0.7 on the scale to be dependable or acceptable, the coefficient Alpha (also known as the Cranach Alpha result) is suggested to imply that the higher the coefficients, the better the measurement device.

According to this study, the lowest coefficient Cronbach Alpha value for each pre-test variant is 734, and the highest is 832, as indicated in table 2 below. According to the findings, the association between the independent factors and the measurement of the dependent variable is generally reliable when the alphas are rationally high. Table 2 below shows the instrument's Cronbach alpha coefficient reliability.

Table 2 Summery of reliability test

Variables	Pre test	
	No.of samples	Cronbanch's alpha
Control activities	125	.734
Internal Audit	125	.821
risk assessment	125	.832
Internal controls system	125	.756
Financial performance	125	.785

Source – Own survey 2025

3.10 Ethical Considerations

The confidentiality of the information obtained from the respondents was maintained, and their identities were not revealed. Additionally, no information was altered or adapted; instead, it was provided as gathered, and the reference list acknowledges all of the literature gathered for this study. To protect respondents' privacy and safety, ethical considerations must be taken into account. Consent and confidentiality are two important ethical considerations in the study process.

CHAPTER FOUR

Result and Discussions

This chapter used multiple regression analysis, correlation, and descriptive statistics to manipulate empirical results. The demographic details of the participants, data analysis of descriptive results, correlation results, regression results, hypothesis testing, and discussion are all covered..

4.1 Response Rate

The result shows that 125 questionnaires were properly filled and returned and used for analysis purpose which accounted 93.98 % response rate, but the remaining 8 questionnaires were not returned which accounted only 6.02%.

4.2 Demographic Characteristics of Respondents

The demographic factors in this survey constitute gender, age, qualification, and years of experience of respondents in Selected Commercial Banks in Ethiopia.

Table 3 Demographic Characteristics of Respondents

Characteristics	Items	Frequency	Percent
Gender	Male	104	83.2
	Female	21	16.8
	Total	**125**	**100.00**
Education Level	Certificate	0	0
	Diploma	0	0
	Bachelor Degree	79	63.2
	Master and above	46	36.8
	Total	**125**	**100.00**
Work Experience	1-5 Years	35	28.0
	6-10 Years	54	43.2
	11-15 years	22	17.6
	Above 15 years	14	11.2
	Total	**125**	**100.00**

Source – field survey 2025

There are 125 respondents in all, with 104 (83.2%) men and 21 (16.2%) female respondents. Table3 illustrates that the respondents' sex distribution is not balanced.

According to table 3 above, out of the 125 respondents, 0 (0%) have a certificate, 0 (0%) have a diploma, 79 (63.2%) have a degree, and the remaining 46 (36.2%) have a master's degree or higher. Therefore, it makes sense that the vast majority of responders have a first degree.

According to Table 3 above, 35 (28%) of the respondents have between one and five years of work experience, 54 (43.2%) have between six and ten years of experience, 22 (17.6%) have between eleven and fifteen years of experience, and 14 (11.2%) have more than fifteen years of experience. We can infer that over 50% of the participants possess significant professional experience, expertise, and understanding.

4.3 Descriptive Analysis of the Results

The investigation's respondents' mean, standard deviation, and valid number of observations was all examined using descriptive statistics.

Descriptive statistics are useful for assessing the features of data based on the distribution of two categories: measures of dispersion and spreading (standard deviation, variance, and range); and measures of central tendency or placement (mean, media, and mode). The interpretation of mean and standard deviation values in accordance with general notions was the main emphasis of this study. The simple average of every value in a distribution is the mean score. Response disagreement is indicated by a low mean score, whereas agreement is indicated by a high mean score.

According to Field (2009), the following evaluation has been formulated.

- The mean score from 1.00-1.80 is considered as Strongly disagree
- The mean score from 1.81-2.60 is considered as Disagree
- The mean score from 2.61-3.40 is considered as Neutral
- The mean score from 3.41-4.20 is considered as Agree
- The mean score from 4.21-5.00 is considered as Strongly agree

The degree of consistency and similarity among respondent responses is represented by the standard deviation, which shows the distribution of observations around the mean.

Table 4 Descriptive Statistics of risk assessment

Items	N	Mean	Std. Deviation
The bank develops action plans for implementing decisions and management plans for identified risks	125	4.08	1.036
The bank uses numerical methods to assess credit risks	125	3.82	.916
The bank undertake a credit worthiness analysis before executing transaction	125	3.94	.855
The bank‘s risk management process is well documented to provide guidance to staff about the management of risk	125	3.93	.834
The bank has a computer based support system to estimate the earnings and risk management variability	125	3.99	.798
Grand mean and Standard deviation	**125**	3.95	.645

Source – Researcher's Computation through SPSS 2025

As shown in the above table 4, the mean score and standard deviation of risk assessment ranges from 3.82 to 4.08 and 0.798 to 1.036 respectively. The highest mean score is that The bank develops action plans for implementing decisions and management plans for identified risks with (M=4.08, SD= 1.036) while the lowest mean score is that The bank uses numerical methods to assess credit risks (M=3.82, SD=.916). The grand mean and Standard deviation is 3.95 and .645 which is similar to individual items. According to Field (2009), the mean result is Strongly Agree which is above the average.

Table 5 Descriptive Statistics of Internal Audit

Items	N	Mean	Std. Deviation
Internal auditors examine the accuracy and reliability of accounting Records.	125	3.91	.780
The bank's financial statements are audited regularly by external.	125	3.67	.689
Organizational internal auditing complies with professional standards.	125	3.65	.687
The internal auditors check compliance with establish police and Accounting procedures.	125	3.78	.903
Grand mean and Standard deviation	**125**	**3.76**	**.649**

Source – Researcher's Computation through SPSS 2025

The mean score and standard deviation of Internal Audit as shown in table 5 above ranges from 3.65 to 3.91 and 0.780 to 0.903 respectively. The highest mean score is Internal auditors examine the accuracy and reliability of accounting Records (M=3.91, SD= .780) while the lowest mean score is Organizational internal auditing complies with professional standards (M=3.65, SD=.687). The grand mean and Standard deviation is 3.76 and .649. According to Field (2009), the mean result is Agree which is above the average and the standard deviation indicates the variation of respondents' response for Internal Audit is low.

Table 6. Descriptive Statistics of Control activities

Items	N	Mean	Std. Deviation
Your Bank has clear Separation Duties.	125	3.66	.983
Staffs are Trained to discharge their responsibilities diligently.	125	3.81	.784
There are adequate controls over access to resources belonging to the bank.	125	3.82	.968
There are adequate controls over information systems.	125	3.42	1.079
Internal audit is able to detect illegal activities from within the Bank.	125	3.63	.980
All changes to employee status or pay rate are duly approved by an Appropriate official.	125	3.57	1.095
Grand mean and Standard deviation	**125**	**3.65**	**.685**

Source – Researcher's Computation through SPSS 2025

As shown in the above table 6, the mean score and standard deviation of control activities ranges from 3.42 to 3.82 and .784 to 1.095 respectively. The highest mean score is there are adequate controls over access to resources belonging to the bank with (M=3.82, SD= .968) while the lowest mean score there are adequate controls over information systems (M=3.42, SD= 1.079). The grand mean and Standard deviation is 3.65 and 0.685. According to Field (2009), the mean result is Agree which is above the average.

Table 7. Descriptive Statistics of Internal controls system

Items	N	Mean	Std. Deviation
Problems of outstanding cheques are solved in time to reconcile the Bank balance of an account and book balance of the customer.	125	3.85	.981
Financial performance is the measurement of the results of a firm's Policies and operations in monetary terms.	125	3.97	.718
The bank has enough cash to meet its obligations effectively (as and when they fall due).	125	3.74	.960
No single measure of financial performance is adequate for evaluating a firm.	125	3.69	.945
Accountability process is adequate in your organization	125	3.86	.956
Grand mean and Standard deviation	**125**	**3.82**	**.649**

Source – Researcher's Computation through SPSS 2025

Based on table 7 above, financial performance is the measurement of the results of a firm's Policies and operations in monetary terms (M=3.97, SD= .718) which is the highest score followed by Accountability process is adequate in your organization (M=3.86, SD=0.956) while the lowest mean score is the bank has enough cash to meet its obligations effectively (M=3.74, SD= 0.960). The grand mean and Standard deviation (M=3.82, SD =.649) is Agree, according to (Field, 2009).

Table 8 results of financial performance

Items	N	Mean	Std. Deviation
Management review financial transactions regularly.	125	3.69	.984
The bank has a clear organizational structure.	125	3.73	.919
All employees are aware of the guidelines.	125	3.68	.689
The policies, procedures and guidelines are documented.	125	3.98	.701
All staffs perform their responsibilities as per the regulation and guidelines.	125	3.91	.780
Compliance to bank guidelines can lead to reliable financial reporting.	125	3.67	.689
The internal control guidelines are able to detect irregularities.	125	3.97	.709
Grand mean and Standard deviation	**125**	**3.80**	**.570**

Source – Researcher's Computation through SPSS 2025

As can be seen in Table 8 above, the grand mean and standard deviation values were M=3.80 and SD=.570, respectively. Each response to the seven items response range from mean score of 3.67 to 3.98 and a standard deviation of 0.689 to 0.98. According to this outcome, respondents are generally getting closer to agreeing with their assessment of the financial performance. Field (2009) states that all item mean scores are above 3.0, which is regarded as agree, and that the standard deviation likewise indicates a low degree of response variance.

4.4 Regression Test

4.4.1 Multi-Co linearity Diagnostics

Multiple linear regressions must not show a strong connection or relationship between the predictor variables. Multi-Co linearity is the term for the model's difficulty that arises when the predictor variables are highly correlated. (Gujarati, 2004)demonstrated that by examining the values of substantial correlation (R>.9) and zero correlation between independent variables, tolerance below 0.1, and Variance Inflation Factors (VIF) over 10, multi-Co linearity can be identified.

The study's VIF and tolerance values, as shown in table 9 below, ranges from 1.246 to 8.343 and.120 to.802 respectively. Every number is within the acceptable range (VIF = 1–10, tolerance = 0.1–1.0), indicating that the regression model utilized for this investigation is sufficient and well-fitted and does not have a Multi-Co linearity issue. Thus, the researcher came to the conclusion that this study does not have a Multi-Co linearity problem.

Table 9 Multi-Co linearity Test

Model		Co linearity Statistics	
		Tolerance	VIF
1	Control activities	.255	3.927
	Internal Audit	.120	8.343
	risk assessment	.253	3.954
	Internal controls system	.802	1.246

Dependent Variable: FNPERFC
Source – Researcher's Computation through SPSS 2025

4.4.2 Normality Test

According to Brooks (2008), normalcy has a bell-shaped, symmetrical curve with decreased frequencies toward the extreme and the maximum frequency of scores in the middle. It explains symmetrical data distribution. Regression analysis would yield few points if the dependent variable was not normally distributed, and it would yield few points if the dependent variable of internal audit effectiveness was not normally distributed, as this would violate the model's central premise. The shape of the histogram in this study, as seen in Figure 2 below, resembles a bell curve, suggesting that the data used was normally distributed.

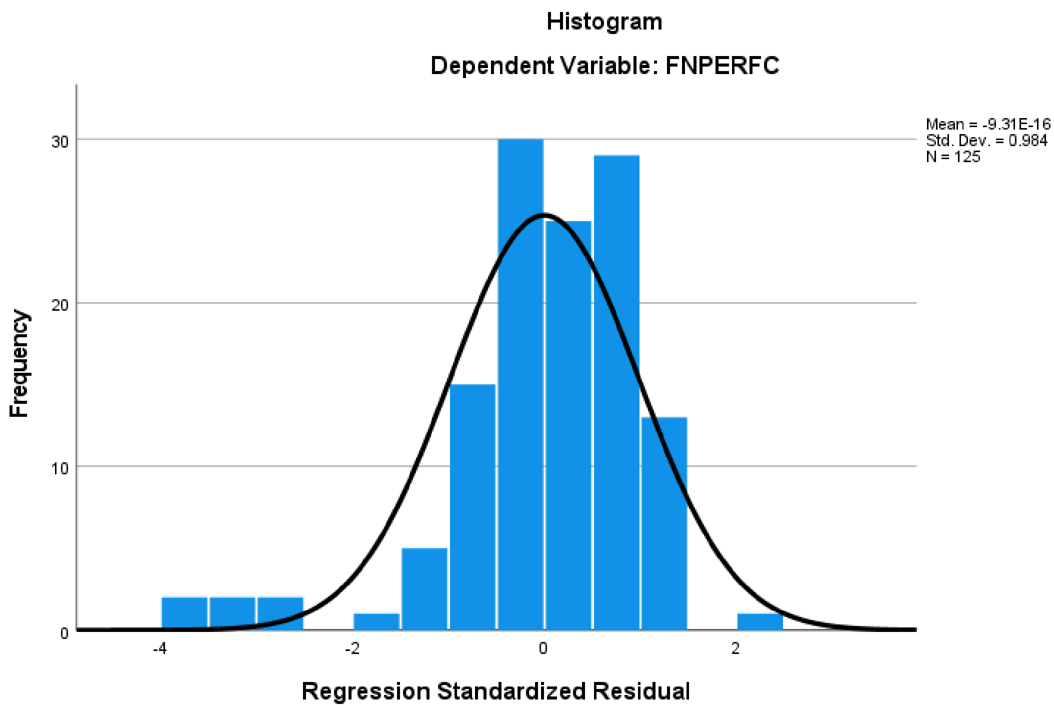

Figure 2 Normality Test
Source – Researcher's Computation through SPSS 2025

4.4.3 Linearity Test

According to (Sounders, 2003)linearity is the degree to which changes in the dependent variable are correlated with changes in the predicted variables. To test this assumption, a normal probability plot is employed. In other words, the points on a plot should be near the diagonal reference line if the distribution is normal. The assumption of linearity is satisfied in this study since the independent variables and the dependent variable have a linear relationship, as shown in Figure 3 below.

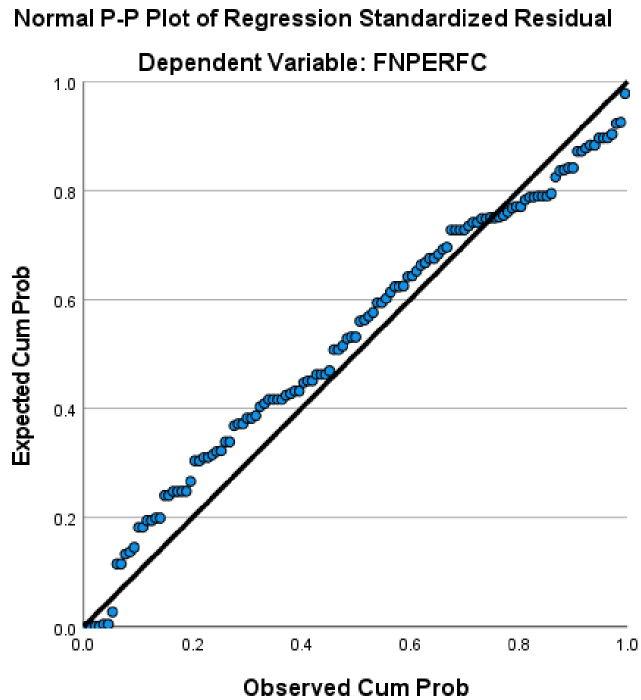

Figure 3 Linearity Test

Source – Researcher's Computation through SPSS 2025

4.4.4 Homoscedasticity Test

A scatter plot is one way to visualize the relationship result of a phenomenon because, according to Field (2009), the variance of the residual term must be constant and the assumption has been measured by the plot of standardized residuals compared to standardized predicted values. As can be seen from figure 4 below, the scatter plot's points form an almost straight line and are evenly concentrated in the scattered diagram; there is no indication of a funnel-like shape of points in one side than the other side is looked at, indicating that the data confirmed under the study is homoscedastic.

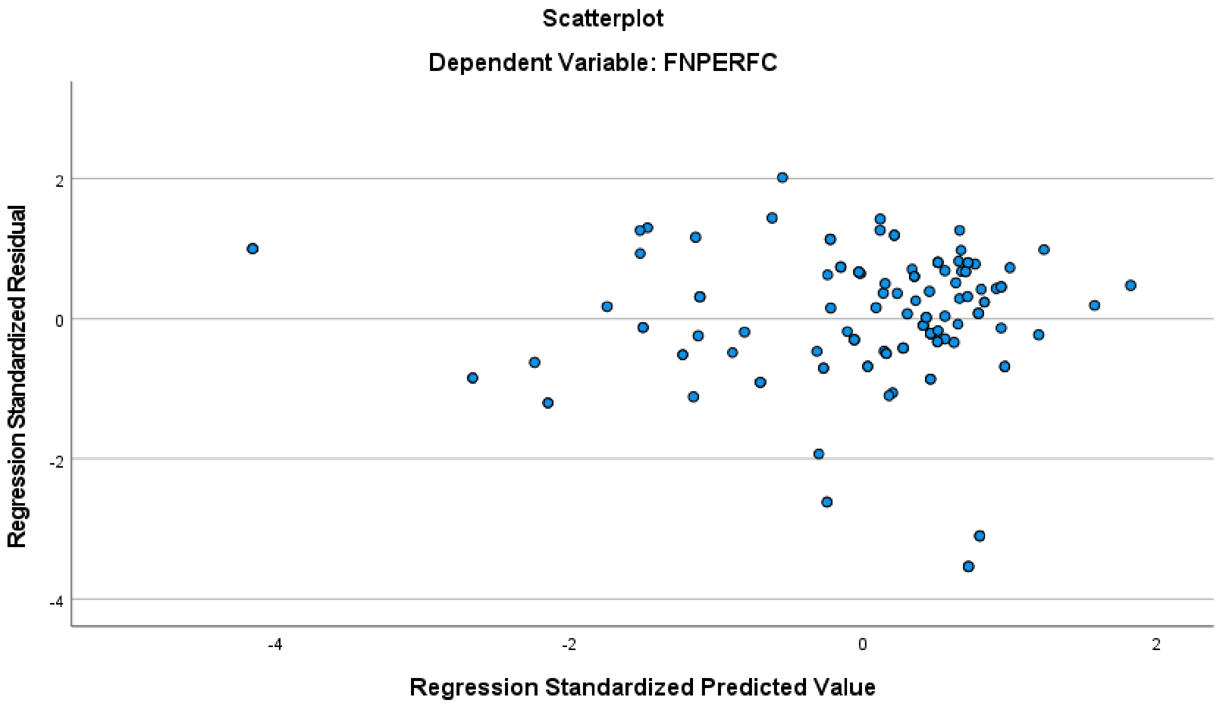

Figure 4 Homoscedasticity Test
Source – Researcher's Computation through SPSS 2025

4.5 Analysis of Correlation Results

According to Field (2009), correlation quantifies the relationship between two items. This is how you indicate how closely two or more variables are related to one another. The Pearson product moment correlation, one of the most used bi-variant correlation statistics, was employed by the researcher. The Pearson correlation ranges from +1 to -1, if +1 or -1 meaning a perfectly positive or negative Relation and 0 denoting no relationship, according to Cohen (2008).

Correlation (r) between -.3 to .3 --- weak relationship
Between -.5 to -.3 or .3 to .5 --- Moderate relationship
Between -.9 to -.5 or .5 to .9--- strong relationship
Between -1.0 to -.9 or .9 to 1.0 --- very strong relationship

4.5.1 The Relationship between Control activities and financial performance

Table 10 indicates that there is significant, strong and positive relationship ($r = .828$, $P < .01$) between the variables of control activities and financial performance with 99% level of confidence. This relation clearly shows that as the control activities increases, the financial performance also moves in the same direction. The reverse is true that as the control activities decreases, the financial performance also moves in the same reverse direction.

Table 10 Correlation Coefficients

		CONACT	INTAUD	RSASMT	INTCOSY	FNPERFC
CONACT	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	125				
INTAUD	Pearson Correlation	.829**	1			
	Sig. (2-tailed)	.000				
	N	125	125			
RSASMT	Pearson Correlation	.544**	.819**	1		
	Sig. (2-tailed)	.000	.000			
	N	125	125	125		
INTCOSY	Pearson Correlation	.300**	.374**	.436**	1	
	Sig. (2-tailed)	.001	.000	.000		
	N	125	125	125	125	
FNPERFC	Pearson Correlation	**.828****	**.895****	**.761****	**.478****	**1**
	Sig. (2-tailed)	.000	.000	.000	.000	
	N	125	125	125	125	125

**. Correlation is significant at the 0.01 level (2-tailed).

Source – Researcher's Computation through SPSS 2025.

4.5.2 The Relationship between Internal Audit and Financial performance

The above table 10 shows the relationship between Internal Audit and financial performance ($r = .895$, $p < .01$) is positive and has strong relationship as explained in section 4.5 with 99 % level of confidence. This relation indicates that as the Internal Audit increases, the financial performance also moves in the same direction. The reverse is true that as the Internal Audit decreases, financial performance also moves in the same direction.

4.5.3 The Relationship between Risk assessment and financial performance

Table 10 indicates that there is significant, strong and positive ($r = .761$, $P < .01$) between the variables of risk assessment and financial performance with 99% level of confidence. This relation clearly shows that as the risk assessment increases, the financial performance also moves in the same direction. The reverse is true that as the risk assessment decreases, the financial performance also moves in the same direction.

4.5.4 The Relationship between Internal controls system and financial performance

As indicated in the study above in table 10, it shows that there is moderate and positive ($r=.478$, $p < .01$) between the variables of Internal controls system and financial performance with 99 % level of confidence. This relationship clearly shows that as the Internal controls system increases the financial performance also moves in the same direction. The reverse is true that as Internal controls system decreases, the financial performance also moves in the same direction.

4.6 Analysis of Multiple Regression

In order to forecast values of the dependent variable from one or more independent variables, researchers created a predictive model to suit the data (Brooks, 2008)The purpose of this study was to examine the mutual effects of independent variables (control activities, internal controls system, risk assessment, and internal audit) on the dependent variable of financial performance through the use of multiple regression analysis.

Table 11 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.926[a]	.857	.852	.21948	.857	179.441	4	120	.000	1.838

a. Predictors: (Constant), INTCOSY, CONACT, RSASMT, INTAUD

b. Dependent Variable: FNPERFC

Source – Researcher's Computation through SPSS 2025

Table 11 shows that the combined effect of the independent variables observed on the dependent variable. The adjusted R squared was found to be .852 which means that 85.2% of variation in the dependent variable of financial performance can be explained by the four independent variables (control activities, internal controls system, risk assessment and Internal Audit). That means, of the major determinants of the dependent variable, 85.2% can be recognized to the four independent variables under the study and the remaining 14.8 % of determinants are not explained in this study.

Table 12 ANOVA for Regression

Model		Sum of Squares	Df	Mean Square	F	Sig.
	Regression	34.575	4	8.644	179.441	.000[b]
1	Residual	5.781	120	.048		
	Total	40.356	124			

a. Dependent Variable: FNPERFC

b. Predictors: (Constant), INTCOSY , CONACT , RSASMT, INTAUD

Source – Researcher's Computation through SPSS 2025

The model tests whether the complete regression model is a good fit for the data (Field, 2009). Table 12 represents the report of ANOVA on the general significance of the model. The result of the model gives a significant result $F (4, 120) = 179.441$, $p < .001$ by which it indicates that the independent variables under the study can significantly influence the dependent variable of financial performance. Therefore, the combined effects of independent variables (control activities, internal controls system, risk assessment and Internal Audit) significantly predict the dependent variable (financial performance) under the study.

Table 13 Coefficients of the Four Determinants

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.296	.148		2.001	.048
	Control activities	.293	.057	.352	5.147	.001
	Internal Audit	.359	.088	.408	4.091	.001
	risk assessment	.151	.061	.171	2.492	.014
	Internal controls system	.128	.034	.145	3.770	.001

a. Dependent Variable: FNPERFC

Source – Researcher's Computation through SPSS 2025

If the study's beta value is positive, it indicates that the predictor variables and the dependent variable have a positive relation; if the coefficient is negative, it indicates a negative relation (Field, 2009). According to this study, all the predictors (control activities, internal controls system, risk assessment and Internal Audit) have positive coefficient values indicating that positive influence on financial performance under the study area.

The standardized coefficients of the regression model revealed that the independent variables under the study, control activities (Beta =.352, $p<.05$), Internal Audit, (Beta = 0.408, $p < 0.01$), risk assessment (Beta = 0.171, $p <0.05$) and internal controls system (Beta = 0 .145, $p < 0.05$)

are significant and positive predictors of over all the financial performance in Selected Private Commercial Banks in Ethiopia.

4.7 Hypothesis Testing and Discussions

Four theories have been developed by the researcher and will be put to the test. The following assumptions have been examined in light of the multiple regression analysis's standardized coefficients:

H1. Control activities has a significant and positive influence on financial performance in Selected Commercial Banks in Ethiopia

With a standardized coefficient of (Beta=.352, $p < .05$), the multiple linear regression analysis model in table 13 shows that control efforts have significantly impacted the financial performance. This figure indicates that, assuming all other predictors stay the same, financial performance increases by.352 units for every unit improvement in control activities. indicated that technical accessibility may also involve infrastructure for control operations and human resources, which is in line with the findings of Kasim (2012). Additionally, as control operations have advanced, they have become more closely linked to financial performance, which has raised the need for internal control using Enterprise Resource Planning expertise.

The results further corroborate the idea that control activities significantly improve the study's financial performance. As a result, the researcher accepts the alternative hypothesis and rejects the null hypothesis.

H2. Internal Audit has a significant and positive influence on financial performance in Selected Commercial Banks in Ethiopia

With a standardized coefficient of (Beta=.408, $p<.01$), the multiple linear regression analysis model in table 13 shows that Internal Audit has significantly improved the financial performance. If all other variables stay the same, this value indicates that if Internal Audit improves by one unit, the financial performance increases by.408 units.

In order to reduce the cost of holding to ensure the continuity of supply at the same time shows, how the management of internal control within operational works would be effective and bring a lot of cost savings to the organization.

The results Support the conclusion that internal audit has a positive effect on financial Performance. As a result, the researcher accepts the alternative hypothesis and rejects the null hypothesis.

H3. Risk assessment has a significant and positive influence on financial performance in Selected Commercial Banks in Ethiopia

With a standardized coefficient of (Beta=.171, $p<.05$), the multiple linear regression analysis model in Table 13 demonstrates that risk assessment has significantly impacted financial performance. This figure indicates that, under the assumption that the impacts of all other predictors stay constant, financial performance increases by.171 units for every unit improvement in risk assessment. This outcome supports the findings of Kasim (2012), that employees need a broad range of competencies expressed in various aspects as related competence to an individual's ability to perform a job or task properly based on professional experience, educational attainment, and staff members' efforts for ongoing professional development.

As the result, the researcher rejects the null hypothesis and agrees to take the alternative hypothesis.

H4. Internal controls system has a significant and positive influence on financial performance in Selected Commercial Banks in Ethiopia

The multiple regression analysis as shown in table 13, the standardized coefficient (beta = .145, P <. 05) has a significant and positive effect on the dependent variable of effectiveness of material resource management under the study. This result supports the previous findings of (Uloma, 2011) that improving internal controls system has a benefit of cost reduction improving sales effectiveness , reduction of waste, transparency and accountability, easy storage and high internal control utilization .In order to achieve all these, organization have to maintain flexible internal control services.

As the result, the researcher rejects the null hypothesis and agrees to take the alternative hypothesis.

Chapter Five

Summary, Conclusions and Recommendations

5.1 Summary

The study's main goal is to assess how the internal control system affects the financial performance of a few Ethiopian commercial banks. The dependent variable, financial performance, was used to alter regression analysis and descriptive statistics. The following findings are a summary of the analysis conducted in Chapter 4.

- The means and standard deviations of determinant factors independence of control activities, internal controls system, risk assessment and Internal Audit result indicate that they are high according to (Field, 2009)which is above 3.0 and the variation of respondent's response is low.
- The results of this study show that each independent variable and the dependent variable have a positive association.
- The four independent variables (control activities, internal controls system, risk assessment, and internal audit) can account for 85.2% of the variation in the dependent variable of financial performance, according to the adjusted R squared of.852.
- According to the report of ANOVA on the general significance of the model, the result of the model gives a significant result $F(4, 120) = 179.441$, $p < .001$ by which it indicates that the independent variables under the study can significantly influence the dependent variable of financial performance. Therefore, the combined effects of independent variables (control activities, internal controls system, risk assessment and Internal Audit) significantly predict the dependent variable (financial performance) under the study.
- This study found that all of the predictors—control activities, internal controls system, risk assessment, and internal audit—had positive coefficient values, meaning they had a positive impact on the study area's financial performance.

5.2 Conclusion

Based on the objectives and findings of the study, the following conclusions have been made.

- **Control activities**: have a significant and positive impact on the financial performance dependent variable, and it is shown to be the determinant variable that affects financial performance in Selected Commercial Banks in Ethiopia. This result supports the findings of (Kasim,2012).
- **Internal Audit**: The finding of this study shows that Internal Audit is a significant and positive effect on the financial performance. This result supports the findings that Internal Audit has a significant positive effect on the financial performance in Selected Commercial Banks in Ethiopia.
- **Risk assessment**: The findings of the study showed that Risk assessment has a positive and statistically significant effect on the financial performance in Selected Commercial Banks in Ethiopia which supports the findings of (Kasim, 2012)
- **Internal controls system:** The study's conclusions show that the internal control system has a favorable and statistically significant impact on financial performance and is a key determinant of financial success in a selected Ethiopia's commercial banks. This outcome validates the conclusions of (Uloma, 2011)

5.3 Recommendations

Based on the findings and the results indicated in chapter four, the researcher suggested the following recommendations.

- **Internal Audit:** has a major impact on the study's financial performance. Employees should therefore give internal audit top priority at the contract agreement level. In addition to adjusting the Internal Audit that impedes the free flow of information, harmonization, and employee teamwork, it must be free from management interference in incorporating and reporting all of the important findings.

- **Risk assessment** is discovered to be a key factor in raising the research area's financial performance and quality. Therefore, through proper professional training and development programs, the staff members must collectively possess or develop their knowledge of abilities. Effective credit policies must be disseminated across all Bank branches, put into practice using the proper protocols, tracked, and updated on a regular basis to account for the previously mentioned shifting internal and external circumstances.

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Appendix

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

SCHOOL OF COMMERCE

A Questionnaire distributed to selected commercial banks in Ethiopia

Dear Respondents

My name is Bezawit Worku. I am a graduate student at Addis Ababa University School of commerce in the field MSC in Corporate Finance: Specialty in Investment Management. I am conducting a research on "The effect of internal control system on financial performance of selected Commercial Banks in Ethiopia in partial fulfillment of my study.

I respectfully ask that you take a few minutes to complete the questionnaire. I want to reassure you that any information you give will be kept private and that your name is not required.
Regarding the project's outcome, your sincere response is greatly appreciated.
Thank you for your cooperation in completing the survey.

Section 1 – Demographic Information

Please complete the following biographical information by circling from the alternative that is the most applicable answer to you in respect of each of the following items.

1. Name of the Bank -----------------------------------
2. Please indicate your sex? A. Male B. Female
3. What is your education level?
A. Certificate B. Diploma C. Degree D. Masters and above
4. What is your work experience?
A.1-5 Years B. 6-10 Years C. 10-15 Years D. above 15 years

Part II: Survey on Management

Please thick in the appropriate box to indicate the extent to which you agree or disagree with each statement Please tick (√) and indicate your agreement with each statement based on the 5-point of liker scale 1/ strongly disagree 2/ Disagree 3/ Not sure 4/ Agree 5/ strongly agree

S.No	Details	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	Control Activities:					
1	Your Bank has clear Separation Duties.					
2	Staffs are Trained to discharge their responsibilities diligently.					
3	There are adequate controls over access to resources belonging to the bank.					
4	There are adequate controls over information systems.					
5	All changes to employee status or pay rate are duly approved by an Appropriate official.					
S.No	**Details**	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**
	Internal Auditing:					
6	Internal auditors examine the accuracy and reliability of accounting Records.					
7	The bank's financial statements are audited regularly by external.					
8	Organizational internal auditing complies with professional standards.					
9	Internal audit is able to detect illegal activities from within the Bank.					
10	Independence of internal auditor assured, based upon review of Documentation.					
11	The internal auditors check compliance with establish police and Accounting procedures.					
S.No	**Details**	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**

	Internal controls system					
12	Problems of outstanding cheques are solved in time to reconcile the Bank balance of an account and book balance of the customer.					
13	Financial performance is the measurement of the results of a firm's Policies and operations in monetary terms.					
14	Your bank has enough cash to meet its obligations effectively (as and when they fall due).					
15	No single measure of financial performance is adequate for evaluating a firm..					
16	Accountability process is adequate in your organization					
S.No	**Details**	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**
	risk assessment					
17	The bank develops action plans for implementing decisions and management plans for identified risks					
18	The bank uses numerical methods to assess credit risks					
19	The bank effectively assesses the likelihood of different risks occurring					
20	The bank undertake a credit worthiness analysis before executing transaction					
21	The bank's risk management process is well documented to provide guidance to staff about the management of risk					
22	The bank has a computer based support system to estimate the earnings and risk management variability					
	To examine financial performance					
23	Management review financial transactions regularly.					
24	The bank has a clear organizational structure.					
25	All employees are aware of the guidelines.					
26	The policies, procedures and guidelines are documented.					
27	All staffs perform their responsibilities as per the regulation and guidelines.					
28	Compliance to bank guidelines can lead to reliable financial reporting.					
29	The internal control guidelines are able to detect					

	irregularities.					
30	The control environment in the bank is enough to reach its objectives.					