



**ST. MARY'S UNIVERSITY  
SCHOOL OF GRADUATE STUDIES**

**INTERNAL CONTROL AND ITS CONTRIBUTIONS TO  
ORGANIZATIONAL EFFICIENCY AND EFFECTIVENESS: A CASE  
STUDY OF YES BRANDS FOOD AND BEVERAGE PLC.**

**BY**

**ENDASHAW ZELEKE**

**JUNE, 2015**

**ADDIS ABABA, ETHIOPIA**

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## **DECLARATION**

I hereby declare that this thesis is the result of my own original research and that no part of it has been presented for another Degree in the university or elsewhere.

However, works by other authors which served as sources of information, have been acknowledged by references to the authors thereafter.

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**June, 2015**

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## LIST OF ACRONYMS

MOI	Ministry of Industry
EEPCO	Ethiopian Electric Power Corporation (EEPCO),
JV	Joint Venture
FMCG	Food Manufacturing Company Group
EA	East Africa
CAPEX	Capital Expenditure
YBFB	Yes Brands Food Beverage
CSD	Carbonated Soft Drink
CSR	Community Social Responsibility
COSO	Committee of Sponsoring Organization
CR	Control Risk
AR	Audit Risk
IR	Inherent Risk
DR	Detection Risk

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## **ABSTRACT**

*Current business trends have made it imperative for almost all large organizations to maintain an internal control system. The Ethiopian manufacturing industry has evolved from a highly regulated sector into a largely market driven one. The regulatory and institutional framework has improved considerably yet still manufacturing industries in Ethiopia are facing some challenges as the world globalization rivalry, technology competence, skilled manpower and etc. Among the objective of the study to examine the measure adapted to enhance the effectiveness of internal controls in yes brands management .The current study was done as objective data was collected and analyzed on a case information by the help of primary data from interview schedules. The purposive type of sampling was used in sampling. All in five respondents were sampled from the thirty (30) respondents under review. The data gathered was analyzed and interpreted by the help of percentages and frequency tables. The findings of the study revealed that there are measures put in place by the Yes Brands Food and Beverage PLC to enhance compliance. The measurement put in place is management oversight responsibility for internal control whereby control policies and procedures are being followed to. It came to light that, the internal audit unit was responsible for monitoring internal control policy compliance whiles management assesses risk but the internal audit unit is not part of site operations, they only visit the sites on monthly bases. The recommendations drawn from the study was that the Yes Brands Food and Beverage PLC should set internal audit units at their various sites(phases) across the region, so that there shall always be internal audit personnel to ensure compliance to the internal controls that exist in the organization. In view of this, the internal audit personnel's should also be rotated at regular intervals to avoid any form of misconducts.*

**Keywords /Phrases:** *Effectiveness, efficiency internal control, Internal audit COSO framework.*

# CHAPTER ONE

## INTRODUCTIN

### 1.1Background of the study

Yes Brands Food and Beverages PLC domiciled in Oromiya region, Alemgena town. It was established under Ethiopian commercial registration and business license proc. No. 67/1997 and Federal Regulation No.13/1997 with paid up capital of 60 million Birr. Yes Brands foods & Beverages PLC started as Alemayehu Mineral water factory founded in 2010 with production of bottled water starting in the back end of 2010. Within two years of operation, the company became a major player in the bottled water sector commanding substantial market share in the category. In May of 2013 Alemayehu Mineral Water factory went into a 50/50 joint venture with Catalyst Principal Partners, an Equity fund company registered in Mauritius. A new foods and beverages company under Yes Brands foods & beverages PLC was formed. The JV partner brings into the business a wealth of experience in fast moving consumer goods business gained from their other FMCG businesses within the EA region.

The expansion project is going to be undertaken by Yes Brands Food and Beverage PLC established in 2013 with a paid up capital of Birr 444,540,000,000 (Four hundred forty four million five hundred forty thousand Birr) to manufacture bottled water both for the local and the export market. The Company has been operational for the last two year and registered remarkable result. The shareholders are Ato Alemayehu Negussie Tefera and Catalyst Ethiopia FMCG Holdings Plc. **Catalyst Principal Partners LLC** ([www.catalysprincipal.com](http://www.catalysprincipal.com)) manages Catalyst Fund I LLC, a US\$125m private equity fund that invests in mid-sized companies across Eastern Africa, including Ethiopia, Kenya, Uganda, Tanzania, Rwanda, Zambia and Democratic Republic of Congo. The Fund's sector focus includes consumer goods and retail, financial and business services, industrials, manufacturing and value-add processing, technology and telecommunications, with the Fund making strategic minority and controlling equity investments ranging from between US\$5m and US\$20m. The company invested Birr 222,240,000.00, that is, 50% of

the shareholding in Yes Brands Food and Beverages PLC in the name of Catalyst Ethiopia FMCG Holdings LLC.

The promoters have since been joined by a joint venture company that has other fast moving consumer goods business in the East Africa region. The JV partner brings a wealth of experience into the already very well established business. It is therefore expected that the business will make the expansion of capacity a success in the market.

The company increased its capital to Birr 444,540,000.00 as per the written resolutions of the shareholders on May 13, 2013. It is engaged in the business of processing and bottling water for sale to local and export markets. Yes Brands is currently the market leader in the category. The location of the project, which is 20 Km from the center of Addis Ababa is strategic as it is situated in an area where the basic utilities such as electricity, water and telephone lines are already in place.

### **Performance of the Company**

Yes water has grown progressively since launch to become the leading Brand in the market. The total value of sales for the last six months (sep.2013 up to Feb.2014 birr 167,257,109.60 million. The company is already exporting to markets in Sudan, Somaliland, Djibouti and Kuwait. The export market will be extended to Saudi Arabia, Israel and UAE in the near future.

### **Market study**

The product has extremely high local and export demand particularly from East African and the Middle East countries. The present local demand for the proposed product is estimated at 511,688 hectoliters per annum. The demand is expected to reach at 697,551 hectoliters by the year 2020. The unsatisfied demand in 2010 was 223,961 hectoliters whereas the demand in the international market was 1.6 billion hectoliters in the same year.

Given the scarcity of potable water and the nature of the surface water and aquifer in the Middle East, it is likely that these countries will remain net importers of water to satisfy their increasing demand. Though there are many alternative suppliers of bottled water to the Middle East, the geographic proximity of the countries to east Africa gives spatial

advantage to the project under consideration over European and American suppliers. These conditions are deemed to create a promising market potential for the envisaged bottled water manufacturing project.

### **Technical study**

The expected capacity from existing production facility has already been reached. The demand has continued to grow to a level where the business has been unable to meet it with the current equipment. With a projected market growth in excess of 40%, this demand is expected to continue and if the business will not invest to match this growth, then it will be making the market attractive for other players to come in and eat into Yes brands market share. With the entry of a JV partner, the business has put together a capacity expansion program that will see the capacity of the current plant doubled once the project is completed.

The project involves a full re-organization of the current packing hall to take more equipment and creation of a finished goods warehouse to take the increased capacity of the plant.

### **Organization, Management and manpower**

The project will be organized in a way that it operates successfully. The top organ in the organizational structure is the managing director who will be assisted by the project manager and six divisions. The divisions are Administrative and Finance, Sales & Marketing, Human Resources, Production, Technical and Quality control. Upon the completion of the expansion, there will be additional resource required and will be recruited as necessary. We expect the expansion to create job opportunities equivalent to 450 people.

### **Environment Impact Assessment**

The project does not cause any hazard to the environment and the workers engaged in the production process.



## **Financial study**

The investment cost estimated at Birr 619,540,000.00. The project cost will be financed from two sources: Shareholder accounts the lion's share of birr 444,540,000.00 and the remaining balance of Birr 175,000,000.00 will be financed from the Bank loan. The projected profit and loss statement shows that a net profit at initial will be Birr 91.9 million which will increase to Birr 104 million at the 5<sup>th</sup> year.

The cash flow projection also shows a positive incremental cumulative cash balance throughout the project's life. The cash balance at the first year is estimated at Birr 64.3 million and this steadily rises to cumulative balance of Birr 340 million at the 5<sup>th</sup> year. The after tax internal rate of return of the project is 57% which is greater than the lending rate. Likewise, sensitivity test is carried out by reducing revenue at 38%, increasing operating costs at 45% and investment cost at 51%. Such adverse circumstances will not significantly affect the project. The analysis shows that the project is profitable venture with minimum risk. This has been proven for the last four years. Based on this consideration the business has invested heavily in expanding the production capability. Assistance of the banks will be required to fund the working capital of the expanded business.

## **Product Description and Application**

According to Quality and Standard Authority of Ethiopia (QSAE), industrially processed and bottled water can be classified into two major groups: bottled drinking water (ES 597:2001) and mineral water (ES 621:2001). The former is further classified into carbonated "sparkling" natural water and non-carbonated "still" natural water. If water has been made after possible treatment, effervescent by addition of carbon dioxide then it is called carbonated natural water. Non-carbonated water is by nature and after possible treatment does not contain free CO<sub>2</sub>, in excess of the amount necessary to keep dissolved the hydrogen carbonates salts that are present in the water. In this study, both types of water have been considered.

Globalization and the advancement in technology has become the assurance for businesses today and the manufacturing sector is no exception. Manufacturing companies have been expanding their operations and activities beyond the domestic borders as a result of globalization and improved technology. The expansion of business, globalization and the advanced technology also exposes business to increased risk, fraud, altercations and other irregularities. This has made internal controls an imperative system to maintain by every business and for that matter the manufacturing sector. Globalization of businesses, technological advancements, increasing risk of business failures, the fraud and altercations that emerged in the manufacturing sector in Africa call for the proper maintenance of an effective internal control systems.

The United States of America and governments, regulators and nations have encouraged nations and corporate organizations to place more emphasis on their internal control systems and internal auditing functions and risk management (Mercer University, 2010: Online). The internal control critical that has hit the world's most developed economies recently is a clear indication of the failure of the system to hold in check some of the excesses in our haste to satisfy our profit making agenda and to outdo one another in competition. These internal control problem which affected the mainly the developed countries manufacturing industries results are being felt by the developing countries of which Yes Brands Food and Beverage is no exception.

National industrial policy frameworks and implementation capacities, infrastructure development, institutional capacity and the overall commitment and efforts of the private manufacturing enterprises are considered as key for industrial sector development and structural transformation. Acknowledging this, the Ethiopian government is creating a business-enabling environment, through developing the required infrastructures and providing generous investment incentives, including; the provision of bank loans at preferential rates and tax holidays.

Besides to infrastructure development, the government has also undertaken various macro-economic reforms that support industrial expansion and structural transformation.

At a micro level, international development partners have been providing considerable support, both technical and financial, for the manufacturing enterprises, in improving firm-level productivity and enhancing international competitiveness.

The Ministry of Industry (MoI) has also implemented various activities to strengthen its regulatory capacity and the capacities of the institutes under it. Over the past decade, it has implemented various institutional restructuring and capacity building activities.

However, the capacity building activities that the MoI has implemented have been insufficient and disconnected. The MoI's capacity for developing sectoral and sub- sectoral strategies and regulatory laws is still inadequate. For instance, the long awaited investment and export promotion law of the country has yet to be put into practice, largely due to the inability of the Ministry to develop the implementation strategy. The MoI's institutional capacity gaps have varying aspects. One key gap relates to the skills base. The technical, marketing and industrial management skills of existing employees of the federal and regional bureaus of industry are low. Employees have no access to periodic or regular training and their general skill level is very low.

Internal controls and risk managements, the purpose to ensure effectiveness and efficiency of operational activities, reliability of financial information, compliance with applicable rules and regulations and sustainable business growth have been incorporated into the ordinary activities of manufacturing industries in Ethiopia.

Internal controls are to be an integral part of any organization's financial and business policies and procedures. Internal controls consist of all the measures taken by the organization for the purpose of;

- 1 Protecting its resources against waste, fraud, and inefficiency;
- 2 Ensuring accuracy and reliability in accounting and operating data;
- 3 Securing compliance with the policies of the organization; and
- 4 Evaluating the level of performance in all organizational units of the organization.

Internal controls are simply good business practices. (Kansas State University - USA June 30, 2003)

For some time now, risk management in general and internal control more specifically; have been considered as fundamental elements of organizational governance. As a consequence, risk management is beginning to be perceived as a new means of strategic business management, linking business strategy to daily risks and then optimizing those risks in order to realize value (Saarens and de Beelde 2006.) In the United States for instance in 1992, a group of companies sponsored the formation of the treadway commission to study and report on how to improve on the effectiveness of internal control systems, and more recently in 2002 the US congress passed the Sarbanes Oxley act giving new directives on how companies are to report on the effectiveness or otherwise of their internal control systems. (Circular 123 spring 2005, KPMG LLP).

The ministry of industry Ethiopia in playing the regulatory role has come out with measures to help regulate the functioning of the manufacturing industries to improve on the effectiveness of their internal control systems and risk management. The Ethiopian government developed an export-led industrial development strategy in 2002. It even tried to incorporate import substitution into the policy, later on. However, the supporting rules, regulations and procedures are either insufficient or inconsistent with the ruling development strategy.

In addition to the need for refinement and updating, the strategy lacks supportive legislations and policies. At present, most development policy analysts, regulatory agencies and industry actors are in favor of developing a rather balanced industrial development strategy, which provides equal emphasis on both import substitution and export promotion. Therefore, there is a need for a revision of the existing policy framework.

In spite of the government's initiative of building industrial zones, the MoI has not yet developed the management framework of these potential development districts. Such a framework includes, among others, the eligibility criteria for land acquisition, land lease

and other service fee rates, as well as mode of payment, and security, social and environmental management guidelines.

The MoI and the regional industry and investment bureaus have not yet developed an integrated approach that enables them to proactively solve problems that may be faced by the manufacturing enterprises. For instance, the absence of pre-planned power request and regular follow-up, to comply with the requirements of the Ethiopian Electric Power Corporation (EEPCO), has had a huge impact on the project implementation performance of individual manufacturing industries.

To redress all these problems, the MoI ought to implement a comprehensive capacity building program. And this program ought to rightly correspond to the key institutional gaps of the sector.

Implementing regular staff training and skills development programs, at both the federal and regional levels, is one essential area of intervention. Such an intervention will enhance the staff's working attitude and motivation in their respective duties.

As part of improving their internal control systems, internal auditing function, and reducing risk, most manufacturing industries in the country have put in place mechanisms to ensure internal control and compliance in the regulatory role. These include setting up an internal audit unit, a monitoring unit and issuing the Accounting, Treasury and Financial Reporting Rules. It is therefore in this light that this project work is being carried out to assess the effectiveness of internal control system and how the internal auditor perceives his or her role in risk management in the manufacturing sector.

## **1.2 Statement of the Research Problem**

The growth and the development of the private manufacturing companies are highly dependent on the effective and efficient internal control of its own performance . Under the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework, the objective setting is considered a precondition to internal control. By setting objectives, management can then identify risks to the achievement of those

objectives. To address these risks, management of organizations may implement specific internal controls. The effectiveness of internal control then be measured by how well the objectives are achieved can how effectively the risks are addressed.

More generally, setting objectives, budgets, plans and other expectations establish criteria for control. Control itself exists to keep performance or a state of affairs within what is expected, allowed or accepted. Control built within a combination of interrelated components such as a social environment affecting behavior of employees, information, necessary internal control, and policies and procedures. Internal control structure is a plan determining how internal control consists of these elements. The concepts of corporate governance also heavily rely on the necessity of internal controls. Internal controls help to ensure that processes operate as a designed and that risk responses (risk treatments) in risk management are carried out. In addition, there needs to be in place circumstances ensuring that the aforementioned procedures will be performed as intended: right attitudes, integrity and competence, and monitoring by managers.

To ensure the effective and efficient managements of private manufacturing industry, internal controls are normally put in place. In the manufacturing sector to enhance the effectiveness and efficiency on internal control systems various rule and procedure have been put in place by the private manufacturing company and the government instution. These legislations include the Financial Regulations of the Council of Ministers (No 17/1997) and Article 68 of the Proclamation on Financial Administration (No. 57/1996) establishes the basis for internal audit and internal control of the Government of Ethiopia.

Notwithstanding, internal controls only provide reasonable assurance, not absolute assurance. This is because it is people who operate the internal controls, breakdowns can occur, human error, deliberate circumvention, management override, and improper collusion among people who are suppose to act independently can cause failures of the internal control to achieve objectives.

This case study is to assess the extent of failures caused by humans to the internal controls and effectiveness of internal controls in risk management in the manufacturing industries with a particular reference to Yes Brands Food and Beverage plc.

### **1.3 Research Questions**

Related to the problem, the research seeks to address the following questions

- 1 How does the internal control systems at Yes Brands Food and Beverage PLC look like?
- 2 How conscious are employees or staff about internal control in Yes Brands?
- 3 How effective are the internal control systems in Yes Brands Food and Beverage PLC?
- 4 What measures need to be adopted to enhance the effectiveness of internal control systems in Yes Brands Food and Beverage PLC?

### **1.4 The Objectives of the Study**

In an attempt to address the above research questions, on the basis this following specific objective were set

- 1 To study if there is an appropriate internal control in Yes Brands Food and Beverage plc.
- 2 To examine the consciousness of employees of Yes Brands Food and Beverage plc.
- 3 To examine the measures adopted to enhance the effectiveness of internal Controls in Yes Brands Food and Beverage PLC management.
- 4 To recommend appropriate policy measures that will improve the effectiveness of internal controls in managing risk.

### **1.5 Significance of the Research**

This research work provides a basis or a conceptual framework and standard against which companies could assess their internal control system and judge their effectiveness. In other words, the study is to provide common language, understanding and a practical way for companies to assess and improve their internal control systems.

To the researcher studying on the same subject, it will provide way of delving into what this research could not cover considering its limitations. The results of this study will help the manufacturing industries to sit up in following the control measures in their day to day management of their activities internal control system.

Though this research is to partially fulfill an academic requirement for the award of MBA in accounting and finance, it is expected that recommendations will be provided to complement the policies by the regulatory bodies and the efforts of the manufacturing industries in addressing problems of default and the unnecessary legal struggles that characterizes internal control system in private manufacturing business.

### **1.6 Limitations of the Study**

Even though this research is to find the effect of internal control on the performance of manufacturing business in Ethiopia the scope of the research does not give findings that can be generalized. There are also resource constraints, in terms of time and logistics as well as the difficulties in accessing data.

### **1.7 Organization of the Study**

The study is presented in five Chapters. Chapter one includes background of the study, the profile of Yes Brands Food and Beverage Private Limited Company, the problem statement, research question, objectives of the research, the significant of the study, and the limitation of the study. Chapter two is the literature review which includes the definitions of internal control, internal controls objectives, types of internal controls, components of internal control, internal control evaluation, parties responsible for internal controls, internal control limitations and what can happen when internal controls are weak.

Chapter three consist of the research design, population under study, sampling techniques, sources of data, research instruments and method of data analysis. Chapter four focuses on data presentation and data analysis. Chapter five is the summary of findings, conclusion and recommendations.



# CHAPTER TWO

## LITERATURE REVIEW

This chapter presents the view of other authorities and theories on the topic. It also tries to unfold the key terms that have been used in this project work.

### 2.1 Definition of Terms

In accounting and auditing, internal control is defined as a process affected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives. (COSO Definition of Internal Control) It is a means by which an organization's resources are directed, monitored, and measured. It plays an important role in preventing and detecting fraud and protecting the organization's resources, both physical (e.g., machinery and property) and intangible (e.g., reputation or intellectual property such as trademarks). At the organizational level, internal control objectives relate to the reliability of financial reporting, timely feedback on the achievement of operational or strategic goals, and compliance with laws and regulations. At the specific transaction level, internal control refers to the actions taken to achieve a specific objective (e.g., how to ensure the organization's payments to third parties are for valid services rendered.) internal control procedures reduce process variation, leading to more predictable outcomes. Internal control is a key element of the Foreign Corrupt Practices Act (FCPA) of 1977 and the Sarbanes-Oxley Act of 2002, which required improvements in internal control in United States public corporations. Internal controls within business entities are also referred to as operational controls.

Internal controls have existed from ancient times. In Hellenistic Egypt there was a dual administration, with one set of bureaucrats charged with collecting taxes and another with supervising them. Martin Van Creveld 1999. *The Rise and Decline of the State*. Cambridge University Press. pp. 49.)

There are many definitions of internal control, as it affects the various constituencies (stakeholders) of an organization in various ways and at different levels of aggregation.

Under the Committee of Sponsoring Organizations of the Treadway Commission (COSO) internal control -Integrated Framework, a widely-used framework in the United States, internal control is broadly defined as a process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting;
- Compliance with laws and regulations.

The COSO definition relates to the aggregate control system of the organization, which is composed of many individual control procedures.

Discrete control procedures or *controls* are defined by the SEC as: "...a specific set of policies, procedures, and activities designed to meet an objective. A control may exist within a designated function or activity in a process. A control's impact may be entity-wide or specific to an account balance, class of transactions or application. Controls have unique characteristics - for example, they can be: automated or manual; reconciliations; segregation of duties; review and approval authorizations; safeguarding and accountability of assets; preventing or detecting error or fraud. Controls within a process may consist of financial reporting controls and operational controls (that is, those designed to achieve operational objectives)."(SEC Interpretive Guidance)

According to A. H. Millichamp (2002), Internal Control System is defined as the whole system of controls, financial and otherwise, established by the management in order to carry on the business of safeguard the assets and secure as far as possible the completeness and accuracy of the records. He further analyzed the redefinition as follows;

- 1 The whole system: internal control can be seen as a whole or single system. The whole is more than the sum of parts.
- 2 Financial and otherwise: the distinction is not important. Perhaps the financial would include the use of control accounts and otherwise may include physical access restrictions to computer terminals.
- 3 Established by Management: internal controls are established by management, either through consultant (external) or internal through internal audit.
- 4 Ensure Adherence to Management Policies: management has express policies such as budget and the adherence of budget can be achieved through the procedures such as variance analysis.
- 5 Safeguard Assets: allowing assets to be stolen or broken is unacceptable and procedures are always put in place to safeguard assets.
- 6 Secure completeness: to check that transactions are duly recorded, checking that all goods leaving the factory must have a delivery not attached to it.

Besides, Alan G. Hevesi (2005) also defined internal control as the integration of the activities, plans, attitudes, policies, and efforts of the people of an organization working together to provide reasonable assurance that the organization will achieve its objectives and mission.

All the above definitions of internal control systems have identified the main objectives of internal controls to be the assurance that organizational resources will be put to economic, efficient and effective use in order to achieve the objectives for which the organization was set up.

The term internal control encompasses all the methods, procedures and arrangements adopted within an organization to ensure as far as possible the safeguarding of assets, the completeness, accuracy and liability of the accounting records and the promotion of operational efficiency and adherence to management policies (Okai, 1996).

However, in the context of this project work internal control shall be defined as recommended by COSO that is a process affected by an entity's board of directors, management and other personal, designed to provide reasonable assurance regarding the achievement of objectives in the following categories.

- Effectiveness and efficiency of operations in Yes Brands Food and Beverage PLC
- Reliability and accuracy of financial reporting
- Compliance with applicable laws and regulation

## **2.2 Internal Control Objectives**

Internal Control objectives are desired goals or conditions for a specific event cycle which, if achieved, minimize the potential that waste, loss, unauthorized use or misappropriation will occur. They are conditions which we want the system of internal control to satisfy. For a control objective to be effective, compliance with it must be measurable and observable. (Mercers University).

Internal Audit evaluates Mercer's system of internal control by accessing the ability of individual process controls to achieve seven pre-defined control objectives. The control objectives include authorization, completeness, accuracy, validity, physical safeguards and security, error handling and segregation of duties.

### **Authorization**

The objective is to ensure that all transactions are approved by responsible personnel in accordance with specific or general authority before the transaction is recorded.

### **Completeness**

The objective is to ensure that no valid transactions have been omitted from the accounting records.

## **Accuracy**

The objective is to ensure that all valid transactions are accurate, consistent with the originating transaction data and information is recorded in a timely manner.

## **Validity**

The objective is to ensure that all recorded transactions fairly represent the economic events that actually occurred, are lawful in nature, and have been executed in accordance with management's general authorization.

## **Physical Safeguards & Security**

The objective is to ensure that access to physical assets and information systems are controlled and properly restricted to authorized personnel.

## **Error handling**

The objective is to ensure that errors detected at any stage of processing receive prompt corrective action and are reported to the appropriate level of management.

## **Segregation of Duties**

The objective is to ensure that duties are assigned to individuals in a manner that ensures that no one individual can control both the recording function and the procedures relative to processing the transaction.

A well designed process with appropriate internal controls should meet most, if not all of these control objectives.

## **2.3 Types of Internal Control Systems**

Different writers have come with different types of internal control systems. Milichamp (2002) puts the types of internal controls as; Safeguarding assets, Separation of duties, supervision, Verification, Approval and authorization, Documentation, Safeguarding Assets, and Reporting.

However, many other authors such as Dr Lousteau (2006), the state university of New York and diNapoli (2005) have agreed that the types of internal controls includes directive controls, preventive controls, compensating controls, detective controls, and corrective actions. These types of internal controls are explained below.

### **2.3.1 Directive Controls**

Directive Controls relate to policies and put in place by top management to promote compliance with independence rules. To ensure compliance with directive controls, a clear, consistent message from management that policies and procedures are important must permeate the organization. They provide evidence that a loss has occurred but do not prevent a loss from occurring. Examples of detective controls are reviews, analyses, variance analyses, reconciliation, physical inventories, and audits. However, detective controls play critical role providing evidence that the preventive controls are functioning and preventing losses. Control activities include approvals, authorizations, verifications, reconciliation, and reviews of performance, security of assets, segregation of duties, and controls over information systems. (Di Napoli 1999).

### **2.3.2 Preventive Control**

Preventive controls relate to measures taken by a firm to deter noncompliance with policies and procedures. They are proactive controls that help to prevent a loss. Examples of preventive controls are separation of duties, proper authorization, adequate documentation and physical control over assets, Dr Lousteau (2006)

### 2.3.3 Compensating Controls

Compensating controls are intended to make up for a lack of controls elsewhere in the system. For example, firms with an electronic database could maintain a hard copy of the client list in the office library. Such a list would compensate for downtime in electronic systems and difficulties in locating client names in an electronic system. While the list would have to be reprinted from time to time to add new clients would mitigate some of the obsolescence that exists with hard copies. University of New York (200%).

### 2.3.4 Detective Controls

Directive controls are aimed at uncovering problems after they have occurred. Although necessary in a good internal control system, detection of an independence violation after the fact is less desirable than prevention in the first place. Detective controls rarely work well as a deterrent in the absence of severe penalties Dr Lousteau (2006).

## 2.4 Components of Internal Control

COSO defines internal control as having five components:

- **Control Environment**-sets the tone for the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control.
- **Risk Assessment**-the identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed
- **Information and Communication**-systems or processes that support the identification, capture, and exchange of information in a form and time frame that enables people to carry out their responsibilities
- **Control Activities**-the policies and procedures that help ensure management directives are carried out.

- **Monitoring**-processes used to assess the quality of internal control performance over time.

These components are explained further in detail;

### **2.4.1 Control Environment**

This sets the tone for the organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control. The control environment reflects the board of directors' and management's commitment to internal control. It provides discipline and structure to the control system. Elements of the control environment include the organization structure of the institution, management's philosophy and operating style, the integrity, ethics, and competence of personnel, the external influences that effect the organization's operations and risk management practices, the attention and direction provided by the board of directors and its committees and the effectiveness of human resources policies and procedures. (Administrator of National Banks, Comptroller's Hand Book 2001), Hevesi (2005) however considers the Control environment to be the attitude toward internal control and control consciousness established and maintained by the management and employees of an organization. It is a product of management's governance that is its philosophy, Style and supportive attitude, as well as the competence, ethical values, integrity and morale of the people of the organization. The control environment encompasses the attitudes and actions regarding control.

This environment sets the organizational tone, influences control consciousness, and provides and foundation for an effective system of internal control. The control environment also provides the discipline and structure for achieving the primary objectives of internal control. (Lannoye 1999). Flowing from the above the board of directors should show concern for integrity and ethical values. There must be a code of conduct and/or ethics policy and this must be adequately communicated to all levels of organization. Also there must be a structure appropriate, which is not dominated by one or a few individuals and an effective oversight by the board of directors or audit committee.



Management also needs to put a mechanism in place to regularly educate and communicate to management and employee the importance on internal controls, and to raise their level of understanding of controls.

### **2.4.2 Risk Assessment**

This is the identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed. According to Lannoye (1999) this component of internal control highlights the importance of management carefully identifying and evaluating factors that can preclude it from achieving its mission. Risk assessment is a systematic process for integrating professional judgment about probable adverse conditions and events, and assessing the likelihood of possible losses (financial and non-financial) resulting from their occurrence. The second internal control standard addresses risk assessment. A precondition to risk assessment is the establishment of clear, consistent agency goals and objectives have been set, the agency needs to identify the risks that could impede the efficient and effective achievement of those objectives at the entity level and the activity level. Internal control should provide for an assessment of the risks the agency faces from both internal and external sources. Once risks have been identified, they should be analyzed for their possible effect. Management then has to formulate an approach for risk management and decide upon the internal control activities required to mitigate those risks and achieve the internal control objectives of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations.

### **Risk Identification**

Management should perform a comprehensive analysis of identifiable risk, including all risks associated with department-wide and activity level objective (derived from the organization's mission). The activities analyzed should include those that support both financial and non-financial objectives. Management must consider the significant interactions with external organizations as well as those internal to their organization at both the department-wide and activity levels. Several means of risk identification can be

used, including; management planning conferences, strategic planning, periodic reviews of factors effecting department's activities, changing needs or expectations of agency officials or the public and natural catastrophes. (Lannoye, 1999)

## **Risk Analysis**

After identifying department-wide and activity level risk, management should perform a risk analysis. The methodology may vary since risks are difficult to quantify; however, the process generally includes the following:

- Estimating risk significance
- assessing likelihood/frequency of occurrence
- Considering how to manage risk

Risk with little significance and low probability of occurrence may require special attention. After assessing the significance and likelihood of risk, management must determine how to control it. Approaches may differ among agencies, but they must be designed to maintain risk within levels deemed appropriate by management, considering the concepts of reasonable assurance and cost-benefit. Once implemented, the approach should be continually monitored for effectiveness. (Lannoye, 1996)

## **Managing Risk during Change**

When change occurs in an organization it often affects the control activities that were designed to prevent or reduce risk. In order to properly manage risk, management should monitor any change to ensure that each risk continues to be managed as change occurs. Management should inform employees responsible for managing the organization's most critical risks about any proposed changes that may affect their ability to manage those risks. Managers should continually monitor the factors that can affect the risks they have already identified as well as other factor that could create new risks. (Walker 1999).

### **2.4.3 Information and Communication**

According to the fourth internal control standard, for an agency to run and control its operations, it must have relevant, reliable information, both financial and non-financial, relating to external as well as internal events. That information should be recorded and communicated to management and others within the agency who need it and in a form and within a time frame that enables them to carry out their internal control and operational responsibilities. (Steihoff 2001) Hevesi (@0050 information and communication are essential to effective control. Information about an organization's plans, control environment, risks, control activities, and performance must be communicated up, down, and across an organization. Reliable and relevant information from both internal and external sources must be identified, captured, processed, and communicated to the people who need it in a form and timeframe that are useful.

According to the comptroller's Handbook (2001), accounting, information, and communication systems capture and impart pertinent and timely information in a form that enables the board, management, and employees to carry out their responsibilities. Accounting systems are the methods and records that identify, assemble, analyze, classify, record, and report on transaction. Information and communication systems enable all personnel to understand their roles in the control system, how their roles relate to others, and their accountability. The entity must be able to prepare accurate and timely financial report including interim reports. The board of directors and management must ensure that they receive accurate and timely information to allow them to fulfill their responsibilities. Management must also provide written job descriptions and reference manuals that describe the duties of personnel.

### **2.4.4 Control Activities**

The policies and procedures that help ensure management directives are carried out. According to the Administrator of National Banks, (2001), control activities are the policies, procedures, and practices established to help ensure that an organization's personnel carry out board and management directives at every business level through the

organization. These activities help ensure that the board and management act to control risks that could prevent an organization from attaining its objectives. The New York State comptroller (1999) defined control activities as tools - both manual and automated - that help identify, prevent or reduce the risks that can impede accomplishment of the organization's objectives. Management should establish control activities that are effective and efficient. According to Walker (1999) control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. He provided the following as example of control activities

- 1 Top level reviews of actual performance,
- 2 Reviews by management at the functional or activity level,
- 3 Management of human capital,
- 4 Controls over information processing,
- 5 Physical controls over vulnerable assets,
- 6 Establishment and review of performance measures and indicators,
- 7 Segregation of duties,
- 8 Proper executions of transaction and events,
- 9 Accurate and timely recording of transactions and events,
- 10 Access restrictions to and accountability for resources and records, and
- 11 Appropriate documentation of transactions

## **2.4.5 Monitoring**

Monitoring is the assessment of internal control performance over time; it is accomplished by ongoing monitoring activities and by separate evaluations of internal control such as self-assessments, peer reviews, and internal audits. The purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Internal control is adequately designed and properly executed if all five internal control components (Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring) are present and functioning as designed. Springer (2004). Periodic evaluations of internal control are made and personnel, in carrying out their regular duties, obtain evidence as to whether the system of internal control continues to function. Management should implement internal control recommendations made by internal and independent auditors, correct known deficiencies on a timely basis, and respond appropriately to reports and recommendations from regulators. There must also be an internal audit function that management uses to assist in their monitoring activities. In Yes Brands Food and Beverage PLC there is the internal audit and monitoring units that carry out the functions of monitoring internal controls.

## **2.5 Internal Control Evaluation**

DiNapoli (1999) defined evaluation as the process management uses to assess whether an organization's operations are effective in achieving its mission. The purposes of evaluation are to provide management with a reasonable assurance that; the organization's systems of internal control. According to Louwers (2002) the five components of internal control are considered to be the criteria for evaluating a financial reporting control and the bases for the auditors' assessment of control risks in terms of;

- Understanding a client's financial reporting controls and documenting that understanding,
- Preliminarily assessing the control risk, and
- Testing the controls, reassessing control risk, and using that assessment to plan the remainder of the audit work.

## **2.5.1 Effectiveness of Internal Control**

A judgment as to whether an entity's internal control is effective is based on considering the extent to which the components are present and operating effectively. Effective functioning of all the components provides reasonable assurance as to achievement of one or more of the three categories of objectives.

Internal control may be judged effective for each of the three categories of internal control objectives if the board of directors and management have reasonable assurance that;

12 They understand the extent to which they entity's operations objectives are being achieved.

13 Published financial statements are being prepared reliably,

14 Applicable laws and regulations are being complies with.

Effectiveness of internal control depends on the presence of all the components of internal control working together. No two entities are likely to have the same internal control system.

Nevertheless, even though entities may not respond to similar risks in the same way, the basic components contributing to an entity's being in control need to be satisfied.

For the financial reporting objective there is a more detailed criterion, namely, the material weakness concept. A material weakness is defined as follows:

A condition in which the design or operation of one or more components of internal control does not reduce to a relatively low level the risk that errors or irregularities in amount that would be material to the financial statements may occur and not be detected and corrected within a timely period by employees the normal course of performing their assigned duties.

## **2.5.2 Understand and document the client's Internal Control**

A major goal on audits is to be efficient. This means performing the work in minimum time and with minimum cost while still doing high-quality work to obtain sufficient, competent avoidance.

The allocation of work times between control-evaluation and year-end audit work is a lost-benefit trade-off. Generally, the more auditors know about good controls, the less substantive test year-end work they need to do. However, auditors do not necessarily need to determine the actual quality of a company's internal control. They only need to know enough to plan the other work. They can obtain only a minimum understanding of a client's control, assess a high control risk, and perform extensive substantive balance-audit work.

## **2.5.3 Obtaining an Understanding**

This gives auditors an overall acquaintance with the control environment and management's risk assessment, the flow of transactions through the accounting system, and the design of the client's activities. After the audit team gains an understanding of the control environment of the accounting system. That is the flow of transaction. This review should produce general knowledge along the following lines.

15 The various classes of significant accounting transaction.

16 The types of material errors and fraud that could occur

17 Methods, by which each significant class of transactions is; authorized and initiated, documented and recorded, Processed in the accounting system and places in financial reports and disclosures.

Auditors obtain an understanding of internal controls from several sources of information. Minimum requirements for a good control oriented accounting system include a chart of accounts and some written detritions and instructions about measuring and classifying transactions.

## **2.5.4 Document the Internal Control Understanding**

Working papers documentation of a decision to assess risk can consist only of a memorandum of that fact. However for future reference in next year's audit, the memorandum should contain an explanation of the effectiveness-related or efficiency-related reasons. Working paper documentation is required and should include records showing the audit team's understanding of the control. This can be summarized in the form of questionnaires, narratives and flowcharts.

Internal Control Questionnaires. The most efficient means of gathering evidence about the control structure is to conduct a formal interview with knowledgeable managers, using the checklist type of internal control questionnaire. The questionnaire is organized under headings that identify the control environment questions and the questions related to each of the seven control objectives. All questionnaires are not organized like this, so auditors need to know the general transaction control objectives in order to know whether the questionnaire is complete. Internal control questionnaires are designed to help the audit team obtain evidence about the control environment and about the accounting and control activities that are considered good error checking routines. Answers to the questions, however should not be taken as final and definitive evidence about how well control actually functions.

Do native descriptions. One way to tailor these inequity procedures to a particular company is to write a narrative description of each important control subsystem. Such a narrative would simply describe all the environmental elements, the accounting system, and the control activities. The narrative description may efficient in audits of very small businesses.

## **2.5.5 Assess the control risk**

After obtaining an understanding of control and designing a preliminary audit program, the audit team should be able to make a preliminary assessment of the control risk. One way to make the assessment is to analyze the control strengths and weaknesses. Strengths are specific features of good general and application controls. Weaknesses are the lack of controls in particular areas. The auditor's findings and preliminary conclusions should be



written up for the working papers files. Strengths and weaknesses should be documented in a working paper sometimes called a bridge working paper, so called because it corrects the control evaluation to subsequent and its procedures.

### **2.5.6 Perform Test of Controls audit Procedures and Reassess Control Risk**

When auditors reach third phase of an evaluation of internal control, they will have identified specific controls on which risk could be assessed very low. To reduce the final risk assessment to a low level, auditors must determine

- The required degree of company compliance with the control policies and procedures and
- The actual degree of company compliance. The required degree of compliance is the auditor decision criterion for good control performance. Knowing that compliance cannot realistically be expected to be perfect, auditors might decide, for example that evidence of using bills of lading to validate sales invoices is sufficient to assess a low control risk for the audit of accounts receivable

### **2.5.7 Perform Test of controls audits procedures**

At this stage the auditors can perform test of controls procedures to determine how well the company's controls actually functioned during the period under audit. A test of controls audit procedure is a two part statement. Part one is an identification of the data population from which a sample of items will be selected for audit. Part two is an expression of an action taken to produce relevant evidence. In general, the action is to determine whether the selected item correspond to a standard and determine whether the selected items agree with information in another data population. Some test of control procedures involves re-performance. The auditors perform again the arithmetic calculations and the comparisons the company people were supposed to have performed. Test of controls procedures, when performed should be applied to samples of transactions and control activities executed throughout the period under audit. The reason for this requirement is that the conclusions about controls will be generalized at the whole period under audit.

### **2.5.8 Reassess the Control Risk**

Final control risk assessment is complicated. In the sampling modules you will find explanations of sampling methods for performing test of controls procedures. However for an advanced peace at the result, recognized that the final evaluation of a company's internal control is the assessment of the control risk (CR) related to each assertion. Control risk is the element in the audit risk model.  $AR = IR * CR * DR$ , where AR is defined as audit Risk, IR as Inherent risk and DR as detection risk. These assessments are an auditors expression for the effectiveness of internal control for preventing, detecting and of internal control for preventing, detecting and correcting specific errors and gauds in management's final statement assertions. Each of these final control risk assessments can be qualitative or quantitative.

An assessment of control risk should be coordinated with the final audit plan. The final account balance audit plan includes the specification of substantive audit procedures to detect material misstatements in account balances and foot notes disclosures.

### **2.6 Parties Responsible for and Affected by Internal Controls**

While all of an organization's people are an integral part of internal control, certain parties merit special mention. These include management, the board of directors (including the audit committee), internal auditors, and external auditors.

The primary responsibility for the development and maintenance of internal control rests with an organization's management. With increased significance placed on the control environment, the focus of internal control has changed from policies and procedures to an overriding philosophy and operating style within the organization. Emphasis on these intangible aspects highlights the importance of top management's involvement in the internal control system. If internal control is not a priority for management, then it will not be one for people within the organization either. As an indication of management's responsibility, top management at a publicly owned organization will include in the organization's annual financial report to the shareholders a statement indicating that management has established a system of internal control that management believes is

effective. The statement may also provide specific details about the organization's internal control system. Internal control must be evaluated in order to provide management with some assurance regarding its effectiveness. Internal control evaluation involves everything management does to control the organization in the effort to achieve its objectives.

Internal control would be judged as effective if its components are present and function effectively for operations, financial reporting, and compliance. The boards of directors and its audit committee have responsibility for making sure the internal control system within the organization is adequate. This responsibility includes determining the extent to which internal controls are evaluated. Two parties involved in the evaluation of internal control are the organization's internal auditors and their external auditors.

Internal auditors' responsibilities typically include ensuring the adequacy of the system of internal control, the reliability of data, and the efficient use of the organization's resources. Internal auditors identify control problems and develop solutions for improving and strengthening internal controls. Internal auditors are concerned with the entire range of an organization's internal controls, including operational, financial, and compliance controls.

Internal control will also be evaluated by the external auditors. External auditors assess the effectiveness of internal control within an organization to plan the financial statement audit. In contrast to internal auditors, external auditors focus primarily on controls that affect financial reporting. External auditors have a responsibility to internal control weaknesses (as well as reportable conditions about internal control) to the audit committee of the board of directors.

## **2.7 Limitations of Internal Controls**

No matter how well internal controls are designed, they can only provide reasonable assurance that objectives have been achieved. Some limitations are inherent in all internal control systems (Mercer University - United States of America (Georgia)). These include:

### **2.7.1 Judgment**

The effectiveness of controls will be limited by decisions made with human judgment under pressures to conduct business based on the information at hand. According to Lannoye (1999) Effective internal control may be limited by the realities of human judgment. Decisions are often made within a limited time frame, without the benefit of complete information, and under time pressures of conducting agency business.

These judgment decisions may affect achievement of objectives, with or without good internal control. Internal control may become ineffective with management fails to minimize the occurrence of errors for example misunderstanding instructions, carelessness, distraction, fatigue, or mistakes

### **2.7.2 Breakdowns**

Even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes. Errors may also result from new technology and the complexity of computerized information systems.

### **2.7.3 Management Override**

High level personnel may be able to override prescribed policies and procedures for personal gain or advantage. This should not be confused with management intervention, which represents management actions to depart from prescribed policies and procedures for legitimate purposes. With Lannoye, management may override or disregard prescribed policies, procedures, and controls for improper purposes. Override practices include misrepresentations to state officials, staff from the central control agencies, auditors or others. Management override must not be confused with management intervention (i.e. the departure from prescribed policies and procedures for legitimate purposes). Intervention may be required in order to process non-standard transactions that otherwise would be handled inappropriately by the internal control system. A provision for intervention is needed in all internal control systems since no system anticipates every condition.

### **2.7.4 Collusion**

Control systems can be circumvented by employee collusion. Individuals acting collectively can alter financial data or other management information in a manner that cannot be identified by control systems. The effectiveness of segregation of duties lies in individuals' performing only their assigned tasks or in the performance of one person being checked by another.

There is always a risk that collusion between individuals will destroy the effectiveness of segregation of duties. For example an individual received cash receipts from customer can collude with the one who records these receipts in the customers' records in order to steal cash from the entity (Williams 2000).

### **2.8 What Can Happen When Internal Controls Are Weak Or Non-Existent?**

When we recommend improving controls within a department, we often hear three basic arguments for not implementing our recommendations:

- There is not enough staff to have adequate segregation of duties.
- It is too expensive.
- The employees are trusted and controls are not necessary.

These arguments represent pitfalls to unsuspecting management. Each argument is in itself a problem that needs to be resolved.

- The problem of not having enough staff or other resources should be discussed with your supervisor. In most cases, compensating controls can be implemented in situations where one person has to do all of the business-related transactions for a department.
- If implementing a recommended control seems too expensive, be sure to consider the full cost of a fraud that could occur because of the missing control. In addition to any funds that may be lost, consider the cost of time that would have been spent by the

department during the time of an investigation of the matter, and the cost of hiring a new employee. Fraud is always expensive and the prevention of fraud is worth the cost.

- Finally consider the issue of trust. Most employees are trustworthy and responsible, which is an important factor in employee relations and departmental operations.

However, it is also the responsibility of administrators to remain objective. Experience shows that it is often the most trusted employees who are involved in committing frauds.

# **CHAPTER THREE**

## **RESEARCH DESIGN AND METHODOLOGY**

This chapter presents the activities and processes that were undertaken to gather data for the research work. It gives full details of how data are collected and processed for this research work. The discussion was centered on the following: Research design, Population under study, sampling techniques, sources of data, research instruments, and method of data analysis.

### **3.1 Research Design**

The research is intended to find out how effective internal control systems in the manufacturing sector of Ethiopia are in reducing risks and ensuring effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws. This is a fact finding exercise, thus a case study is used and as such the survey method of data collection was employed to collect data of qualitative nature.

A survey is a means of questioning a respondent via a collection of questions and instruction for both the respondent and the interviewers. (Cooper and Schindler, 2001) A structured questionnaire was therefore designed to collect the data.

### **3.2 Population under Study**

The target population of the study is manufacturing industries in the Oromia Region. However, the study used Yes Brands Food and Beverage PLC Oromia Region as the case study.

According to Mr. Peter Karatu Joint manager of Yes Brands Food and Beverage PLC, there are four phases (4) phases in the Oromia Region. The target population for this study is the four (4) phases in the region.

### **3.3 Sample Size**

A sample size of 3 phases was drawn from a target population of 4 phases. This sample size has been arrived at by taking 75 % of the target population. Therefore, a purposive sampling technique was used to arrive at the figure. In all, thirty (30) interview schedules were used to interview thirty (30) respondents.

### **3.4 Sources of Data**

Primary and secondary data were employed in the study. Primary data was sourced from the staff of Yes Brands Food and Beverage PLC Oromia Regional that is Phase I , Phase II, Phase III and Phase IV. Secondary data was sourced from textbooks, particularly in Auditing and Assurance services, journals and other publications on internal controls, internal auditing and risk management.

### **3.5 Research Instruments**

Questionnaire and interview schedules were administered to the staff of Yes Brands Food and Beverage PLC. Oromia Region. In addition to that a review of related literature on internal auditing risk management and internal control systems were also used to gather information for the research work.

### **3.6 Methods of Data Analysis**

In analyzing the data, frequency tables were used as the analytical techniques. Qualitative explanations were made of quantitative data to give meaning to them as well as explain their implications.

From these appropriate recommendations was made on the findings of the research. The results are presented in chapter four of the study.



## CHAPTER FOUR

### DATA ANALYSIS AND DISCUSSION OF RESULTS

This chapter provides information on the data collection procedure adopted, analysis of the data and findings. The responses from the respondents are described, analyses, and inferences made to established relationships.

#### 4.1 Background Information on Respondents

With a questionnaire as the main research tool to gather data from the respondents, the first section was intended to gather data on the background of the respondents. Frequency tables are used in analyzing the data gathered from the respondents.

##### 4.1.1 Gender Distribution of Respondents

Out of 30 respondents interviewed 30% were male and 70% female as indicated on table 4.1 .The gender distribution showed that both male and female were represented in the study as shown below.

**Table 4.1 Gender Distribution of Respondents**

Category	Frequency	Percentage (%)	Cum percent (%)
Male	9	30%	30%
Female	21	70%	100%
Total	30	100%	100%

Source: from the field data April 2015

### 4.1.2 Educational Attainment of respondents

The analysis of this variable revealed that the majority of respondents (53.33%) have both first degree and second degree, 20% had first degree only, 16.67% had Advanced Diploma, and 10% had both Diploma and COC Qualification.

**Table 4.2 Educational Attainment of Respondents**

Category	Frequency	Percentage (%)	Cum percent (%)
First Degree & Second Degree	16	53%	53%
First Degree	6	20%	73%
Advanced Diploma	5	17%	90%
Diploma and COC Qualification	3	10%	100%
Others	-	-	100%
Total	30	100%	100%

Source: from the field data April 2015

### 4.1.3 Marital status of respondents

The study also took interest of the marital status of the respondents. Of the 30 respondents interviewed, 63% of them were married and 37% are single. This is indicated in table 4.3 below

**Table 4.3 marital status of respondents**

Category	Frequency	Percentage (%)	Cum percent (%)
Married	19	63%	63%
Single	11	37%	100%
Total	30	100%	100%

Source: from the field data April 2015

#### **4.1.4 Job types of respondents**

This variable seeks to identify the types of jobs performed by the respondents. In terms of type of jobs performed, majority of the respondents (73%) are performing accounting duties, 20% perform administrative duties and 7% perform auditing tasks.

This is shown below in table 4.4

**Table 4.4 Types of Job Performed By Respondents**

Category	Frequency	Percentage (%)	Cum percent (%)
Accounting duties	22	73%	73%
Administrative duties	2	7%	80%
Auditing tasks	6	20%	100%
Total	30	100	100%

Source: from the field data April 2015

### 4.1.5 Grade/position of respondents

This variable was analyzed to reveal the positions being held by the respondents in their various departments. It revealed that most of the respondents (67%) work at the operation, 10% marketing department while 23% managers. The table (4.5) below represents the situation.

**Table 4.5 grade of respondents**

Category	Frequency	Percentage (%)	Cum percent (%)
Operation	20	67%	67%
Marketing	3	10%	77%
Manager	7	23%	100%
Others	-	-	100%
Total	30	100%	100%

Source: from the field data April 2015

## 4.2 Data Analysis

### 4.2.1 Control Environment of Internal Control Systems

This variable was to test the respondent's knowledge of the existence of internal control systems, the type of internal control systems and the people responsible for setting those internal control systems in the organization. All the respondents to the questionnaire acknowledged the existence of internal control systems. This means that information about the existence of internal controls has been well disseminated by the management. Table 4.6 represents a 100% agreement that all the respondents agreed that there an internal control system at Yes Brands Food and Beverage PLC. Also the acknowledged the existence of internal control systems enables: Achieving orderly conduct of business, ensure the organization's operations are conducted

effectively and efficiently and in particular they should enable the organization to respond appropriately to **business**, operational, financial, compliance and other risks to achieving its objectives, ensure that the organization and its staff comply with applicable laws and regulations, and that staff comply with internal policies with respect to the conduct of the business, ensure that assets are optimally utilized and stop assets being used inappropriately. They should prevent the organization losing assets through theft or poor maintenance. Table 4.7 represents that the majority (53%) of the respondents responded that the existence of internal control is preventive, 33% directive and 14% detective control. indicated that the internal control systems are set by Head office Management Team. The existence of internal control preventive important to measures taken by a yes brands to deter non noncompliance with policies and procedures .They are proactive controls that help to prevent a loss such as separation of duties, proper authorization ,adequate documentation and physical control over assets. The existence of internal control directive To ensure compliance with directive controls, a clear, consistent message from management that policies and procedures are important must permeate the organization. Also the existence of internal control detective 14% it shows uncovering problems after they have occurred and although necessary in a good internal control system, detection of an independence violation after the fact is less desirable than prevention in the first place. For table 4.8 all the respondents indicated that the internal control systems are set by Head office Management Team.

**Table 4.6 Existence of Internal control**

Category	Frequency	Percentage (%)	Cum percent (%)
Yes	30	100%	100%
No	0	0	100%
Total	30	100%	100%

Source: from the field data April 2015

**Table 4.7 types of internal controls**

Category	Frequency	Percentage (%)	Cum percent (%)
Preventive Control	16	53%	53%
Directive control	10	33%	86%
Detective Control	4	14%	100%
Others	-	-	100%
Totals	30	100%	100%

Source: from the field data April 2015

**Table 4.8 responsibility for setting up internal control**

Category	Frequency	Percentage (%)	Cum percent (%)
Phases Management Team	0	0	0
Head Office Management Team	30	100%	100%
Department Management Team	0	0	100%
Others	-	-	100%
Total	30	100%	100%

Source: from the field data April 2015

#### **4.2.2 Risk Assessment of Internal Control Systems**

This variable was investigated to find out how the manufacturing industry sector identify, analyses and manage risk that are related to the preparation of financial statements. This covered whether the organization document its objective, whether employees are represented in setting organizational objectives, and whether the organization have establish overall strategies for managing risk. All the respondents said yes, but for the employees representation at the setting of the organizational objectives, majority of the respondents did not respond to that section, indicating that they are not aware whether employees are represented or not. Out of 30 responses, 11 (37%) responded yes to the fact

that employees are represented in the setting of the Yes Brands Food and Beverage objective while 19 (63%) gave no response, that is they have no idea as to whether they are represented or not. This is shown in table 4.9.

**Table 4.9 Employees representation in objective setting**

Category	Frequency	Percentage (%)	Cum percent (%)
Yes	11	37%	37%
No	-	-	37%
No Response	19	63%	100%
Total	30	100%	100%

Source: from the field data April 2015

### 4.2.3 Control Activities of Internal Controls Systems

This variable was investigated to see the adequacy of physical security for cash and other assets, the tracking of the organization's equipments to their location. It was also investigated to check whether those who control assets are prohibited from recording them and whether key managers review and approve all financial transactions. This is shown in table 4.10 below.

**Table 4.10 Control Activities**

Category	Frequency	Percentage (%)	Cum percent (%)
Yes	30	100%	100%
No	-	-	100%
Total	30	100%	100%

Source: from the field data April 2015

#### **4.2.4 Information and Communication of Internal Control Systems**

Table 4.11 shows that 100% of the respondents agreed that they receive relevant information regarding legislation, regulatory developments economic changes, or external factors that may affect the organization. They also agreed that key information about the organization's operations are identified and regularly reported. Customers complaints are taking seriously and investigated upon.

**Table 4.11 Information and Communication of Internal Control Systems**

Category	Frequency	Percentage (%)	Cum percent (%)
Yes	30	100%	100%
No	0	0	100%
Total	30	100%	100%

Source: from the field data April 2015

#### **4.2.5 Monitoring of Internal Control Systems**

This was investigated to check the effectiveness of internal control systems that exist in Yes Brands Food and Beverage plc. All the respondents agreed that the organization's internal control systems are evaluated routinely, that Phases management have complete access to records and the organization has an internal audit unit which visits the phases every month. They also agreed that the internal audit unit report to the head office management team and board of directors. This is illustrated in table 4.12.



**Table 4.12 Monitoring of Internal Control System**

Category	Frequency	Percentage (%)	Cum percent (%)
Yes	30	100%	100%
No	-	-	100%
Total	30	100%	100%

Source: from the field data April 2015

In addition to mentioned before periodic evaluations of internal control are made and personnel, in carrying out their regular duties, obtain evidence as to whether the system of internal control continues to function. Management in Yes Brands Food and Beverage PLC should implement internal control recommendations made by internal and independent (external) auditors, correct known deficiencies on a timely basis, and respond appropriately to reports and recommendations regulators.

## **CHAPTER FIVE**

### **SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

This chapter gives a summary of the findings, conclusions and recommendations of the study.

#### **5.1 Summary of Findings**

The study revealed the following findings.

Internal control systems do exist at Yes Brands Food and Beverage PLC and they are the responsibilities of head office management team. Majority of the respondents said the control systems are preventive. The Yes Brands Food and Beverage PLC has well defined organizational structure. Expectations and policies are communicated to staff members.

Employees of Yes Brands Food and Beverage PLC are conscious of the internal control system at the work place and relevant information regarding legislation, regulatory developments, economic changes, changes in operation and other external factors that may affect the organization are communicated and explained.

In terms of the measures put in place to enhance compliance, majority of the respondents responded that management oversight responsibility for internal control was the main measure applied for the enhancement of compliance in the sector. Nonetheless, it was revealed that it is the management's responsibility to ensure that control policies and procedures are adhered to.

Most of the respondents saw the internal auditor as the one responsible for monitoring internal control policy compliance.

Demographically it was made known that it is the responsibility of management to assess risk.

Strategies are established for managing risk but employees are unaware whether they are represented in the setting of organizational objectives. There are adequate physical securities for cash and other assets and all equipments can be tracking to their location.

Management was seen as being solely responsible for setting up internal control and that no one particular person was in control of decision or activities. Further, respondent indicated the existence of an internal audit unit but majority of the respondent again said the unit visits their outfit every month.

## 5.2 Conclusions

The findings confirmed the assertion of the Treadway commission of the committee of sponsoring organizations (COSO), that it is management responsibility to set up the internal control system and that the internal auditor's role is to evaluate the effectiveness or otherwise of the system. Therefore the internal auditor often plays a significant monitoring role, but their offices are at the head office and visit the phases on monthly bases. This in a way makes the influence of the internal control systems rest mostly on the internal audit unit. But for a control system to be described as effective, control policies and procedures must not be under the influence of one person. When such a thing happens that individual can easily override the controls. The objective of the study was to determine whether internal controls and its contribution lead to organizational efficiency and effectiveness. It came out that the effectiveness and efficiency of the internal controls rest on the internal audit unit, which visits the phases on the monthly basis. It also came out that no one individual has influence over control activities/decisions in the Yes Brands Food and Beverage PLC and this confirmed the assertion of the COSO that it is management's responsibility to set up the internal control system and that the internal auditor's role is only to advice.

The research revealed that there are internal control systems in Yes Brands Food and Beverages PLC in particular and the manufacturing sector in general. However, the effectiveness of the internal controls could not be described very effective since monitoring is less effective. In that the internal audit unit whose responsibility is to ensure compliance only visits the phases once a month.

The final conclusion of this study is periodic review internal control system in the organization that provides relevant and credible information that can use to target assistance and inform future assessments. Periodic review activities were conceived to have significant effects on the objectives of the organization.

### **5.3 Recommendations**

The following recommendations are offered to assist in improving on the effectiveness of internal control systems in Yes Brands Food and Beverage plc. Should set internal audit units for each phases across the Oromia region, so that there shall always be the availability of internal audit personnel's to ensure compliance to the internal controls that exist in their organization.

This is to make the internal audit part of the daily activities of the organization to ensure daily compliance to the internal controls but not wait till month. In as much as possible, this office should be part of the phases management team. In doing so, they will report directly to the head office management team. The internal audit personnel should also be rotated at regular intervals to avoid any form of malpractices.

Regarding to the organizational internal control system: Yes Brands determined the various roles and responsibilities with respect to internal controls, including the governing body; management at all levels, employees ,as well as coordinate the collaboration among departments. However there is deed for improvement in the organizational control and management should ensure that no delay occurs while the organizational internal control systems implemented specifically in the financial matters.

Finally the researcher suggests areas for further studies on challenges faced by manufacturing industries in implementing internal control systems

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## **APPENDIX**

### **ST. MARY'S UNIVERSITY SCHOOL OF GRADUATE STUDIES**

### **QUESTIONNAIRE FOR MASTERS (MBA) IN ACCOUNTING AND**

### **FINANCE**

This questionnaire is on the research topic, internal control and its contribution to organizational efficiency and effectiveness, the case of Yes Brands Food and Beverage limited, Oromia Region, and is in partial fulfillment of a Master Degree in Accounting and Finance. I would be very grateful if you could provide appropriate response to the questions below. The information you provide will be treated with strict confidence as expected. Thank you

## **BACKGROUND OF RESPONDENTS**

### (1) Gender

Male [ ]

Female [ ]

### (2) Educational attainment

Have both 1<sup>st</sup> and 2<sup>nd</sup> degree [ ]

Had first Degree only [ ]

Had Advanced Diploma [ ]

Had both Diploma and COC Qualification [ ]

Others (specify) .....

### (3) Marital status

Married [ ]

Single [ ]

### (4) Job Type

Accounting Duties [ ]

Administrative Duties [ ]

Auditing Tasks [ ]

(5) Grade/position

Operations [ ]

Marketing [ ]

Manager [ ]

Others (specify) .....

## **Section B**

### **CONTROL ENVIRONMENT OF INTERNAL CONTROL SYSTEMS**

(6) Are there any internal control systems in Yes Brands Food and Beverage Private Limited Company?

a. Yes [ ]                      b. No [ ]

(7) If yes, what are they?

a. Preventive [ ]

b. Directive [ ]

c. Detective [ ]

d. Other.....

(8) Who is responsible for setting them up?

a. Phases management team [ ]

b. Head office management team [ ]

c. Department management team [ ]

c. Other .....

(9) Is the organizational structure in Yes Brands Food and Beverage Private Limited Company clearly defined?

- a. Yes [     ]    b. No [     ]

(10) Have all important expectations or "policies" been formalized and communicated to your personnel?

- a. Yes [     ]    b. No [     ]

### **Section C**

#### **RISK ASSESSMENT OF INTERNAL CONTROL SYSTEMS**

(11) Are there documented objectives for all key activities of the organization?

- a. Yes [     ]    b. No [     ]

(12) Were all employee levels in the organization represented in establishing the objectives?

- a. Yes [     ]    b. No [     ]

(13) Have overall strategies for managing important risks been established?

- a. Yes [     ]    b. No [     ]

(14) Have specific assignments and activities necessary to implement the strategies been identified and communicated to the responsible employees?

- a. Yes [     ]    b. No [     ]

### **Section D**

#### **CONTROL ACTIVITIES OF INTERNAL CONTROL SYSTEMS**

(15) Do you provide adequate physical security for cash and other assets subject to theft?

- a. Yes [     ]    b. No [     ]

(16) Do you track the location and use of all equipment?

a. Yes [  ]

b. No [  ]

(17) Are individuals who control assets prohibited from also recording transactions related to those assets?

a. Yes [  ]

b. No [  ]

(18) Do you or your key managers review and approve all financial transactions?

a. Yes [  ]

b. No [  ]

## **Section E**

### **INFORMATION AND COMMUNICATION OF INTERNAL CONTROL SYSTEMS**

(19) Do you receive relevant information regarding legislation, regulatory developments, economic changes, or similar external factors that may affect your organization?

a. Yes [  ]

b. No [  ]

(20) Is key information about your organization's operations identified and regularly reported?

a. Yes [  ]

b. No [  ]

(21) Have you communicated your organization's standards and expectations to key outside groups or individuals?

a. Yes [  ]

b. No [  ]

(22) Are client complaints taken seriously, investigated, and acted upon?

a. Yes [  ]

b. No [  ]

**Section F**

**MONITORING OF INTERNAL CONTROL SYSTEMS**

(23) Do you routinely evaluate the overall effectiveness of your internal control system?

a. Yes [  ]

b. No [  ]

(24) Do the phase management and its representatives have complete access to records?

a. Yes [  ]

b. No [  ]

(25) How often do you normally prepare reports and other returns to management?

a. Monthly [  ]

b. Quarterly [  ]

c. Half-Yearly [  ]

d. Other .....

(26) Does the Yes Brands have an internal audit unit?

a. Yes [  ]

b. No [  ]

(27) How many times did the internal audit visit your management accounts last year?

a. Once [  ]

b. Twice [  ]

c. Quarterly [  ]

d. Other.....

(28) What kind of report does the internal audit unit issue anytime they visit?

- a. Compliance
- b. Detective
- c. Preventive
- d. Other .....

(29) To whom does the internal auditor report?

- a. Audit report implementation committee
- b. Phases Management Team
- c. Head Office Management Team
- d. Department Management Team
- e. Other .....

(30) Who is chiefly responsible for ensuring that internal control measures are adhered to?

- a. Phases Management Team [ ]
- b. Head Office Management Team [ ]
- c. Department Management Team [ ]
- d. Other .....

**THANK YOU A LOT FOR YOUR TIME!!!**