# INFLUENCE OF INTERNAL CONTROL SYSTEMS ON FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVES IN RWANDA: A CASE OF SACCOs IN GASABO DISTRICT

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*Abstract:* **Despite of the achievements of Umurenge SACCO, challenges remain, such as small loan high Non Performing Loan (NPL) ratio of 12.5%, no connection to payment systems, a number of fraud, and high interest rate on the loan in Umurenge SACCO (24%).The purpose of this study is to study the role of internal control systems on financial performance of savings and credit cooperatives in Rwanda: a case of SACCOs in Gasabo District. The study will test three objectives which are to analyse the functionality of internal control system of Umurenge SACOO in Gasabo District, to examine the level of financial performance of Umurenge SACCO in Gasabo District and to assess the relationship between ICS and financial performance of Umurenge SACCO in Gasabo District. The study design of this research is descriptive using quantitative and qualitative approaches. The target population of this study is made of the employees of SACCO who are aware of the financial information. These employees are Managers, Accountants, loan officer and Cashiers who are 60 employees. The researcher used purposive and census sampling techniques as the target population is small the sample size was equal to the population 60 respondents. To collect primary data the questionnaire was used as research instruments. After collecting data they were edited, coded, recorded and tabulated and then analyzed using SPSS. Descriptive statistical was used such as frequency, percentage, mean and standard deviation to analyse the level of functionality of internal control. Correlation and regression analysis was used to test relationship between internal control and financial performance of Umurenge SACCO in Gasabo District. Spearman coefficient correlation between Control environment and financial performance was 0.315 and the p-value of 0.01. This implies that there is a significant weak correlation between Control environment and financial performance. The spearman rho correlation between Risk assessment and financial performance was 0 .409. This implies that the relationship is Weak correlation between Risk assessment and financial performance. The spearman rho correlation between Control activities and financial was 0.379. This implies that the relationship was weak. As all P-values are less than 0.05 all the relationship are significant.The coefficient of the correlation (R) was 0.473 and the coefficient of determination (R square) was 0. 224. This implies that the predictors of internal control system contributed 22.4% % on the financial performance of SACCOs in Gasabo District.Findings showed a p-value of (0.003) which is less than the level of significance (0.05).This implies that internal control system indicators have a causal effect on the financial performance of SACCOs in Gasabo District. However, the researcher found that each coefficients of internal control separately doesn't statistically affect the financial performance because P-values of all indictors are greater than the 0.05 level of significance. This implied that all predictors should be applied together to get influence on the financial performance. The management of SACCOs in Gasabo District should continue to apply internal control system in their management in order to maintain the rules of regulation in the management. As these institutions are among the core factors of economic development of the country, they should show a transparency in their working. Also they should strive to increase the profitability of their SACCOs, because**

findings showed that it was at a moderate level. A moderate level is not satisfactory. This is necessary because the profitability is the main indicator of financial performance. A firm which has a high profitability is a firm which a high chance to survive.

*Keywords:* Internal Control Systems on Financial Performance of Savings and Credit Cooperatives.

# 1. INTRODUCTION

Internal control in financial management has been acknowledged worldwide for instance Enron, Worldcom, Ahold, Parmalat and others determined to issue in 2002 the Law of Sarbanes–Oxley in the USA Amongst others collapsed as a result of poor internal financial controls (CPA Australia, 2008). A study by Goodwin-Stewart & Kent (2006), using a sample of Australian listed companies, shows that the existence of an Internal Control System is positively associated with firm size and commitment to risk management. In 1992, the COSO model appeared; its analysis distinguished the concepts of risk and internal control. Now, the concept of internal control involved not only accounting mistakes and implementing means of their prevention, but also a modern attitude that might identify the spheres of control management and processes, and also a motivated development of their detailed analysis. The Worldwide known collapses of such companies as Enron, Worldcom, Ahold, Parmalat and others determined to issue in 2002 the Law of Sarbanes–Oxley in the USA, in which attention is focused on the effectiveness of the enterprise internal control system and its assessment.

# 2. STATEMENT OF THE PROBLEM

Umurenge SACCO was established in 2009 with the aim of boosting up rural savings through prudent financial control systems (AMIR, 2016). To help SACCOs achieving their mission of ensuring healthy and viable financial institutions and for the purpose of establishing an internal control system strong and reliable enough to prevent fraud, embezzlement and misappropriation of depositors' funds; the National Bank of Rwanda released internal control guideline to help SACCOs to be efficient and effective in their daily operations (BNR, 2013). However, over the last five years the financial performance of the Umurenge SACCO has been noted to be very poor (AMIR, 2016). Moreover, some Umurenge SACCOs' have incurred massive losses from none performing loans. Some imirenge SACCO have been accumulated a loss from NPL. For example Umurenge SACCO Kimironko lost Rfw 275,200,000 from NPL between2010 and 2016(AMIR, 2017).This raises the question on internal financial control systems of Umurenge SACCO. Many studies have been conducted in various areas of financial control systems for instance antifraud (Jones and Smith, 2014), financial performance (Mishkin, 2007), risk assessment ((Doyle et al., 2007; Doyle et al., 2007; Siyanbola, 2013). None of them focused on the internal control systems and SACCOs. This provides an opportunity for the current study.

# 3. OBJECTIVES OF THE STUDY

### 3.1 General objective:

The research attempts to investigate the effect of internal control system on financial performance of Umurenge SACCO in Gasabo District.
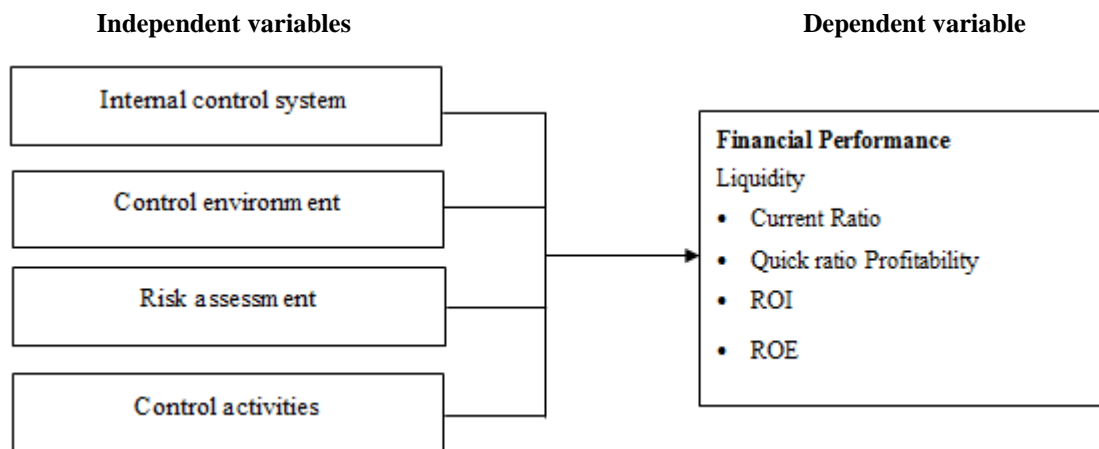
### 3.2 Specific Objectives:

1. To analyse the effect of Control Environment on Financial performance of Umurenge SACCO in Gasabo District.

2. To analyse the effect of Risk Assessment on Financial performance of Umurenge SACCO in Gasabo District.

3. To analyse the effect of Control Activities on Financial performance of Umurenge SACCO in Gasabo District.

4. To assess the multiple correlation between ICS and financial performance of Umurenge SACCO in Gasabo District.

### 3.3 Research questions

1. What is the effect of Control Environment on Financial performance of Umurenge SACCOs in Gasabo District?

2. What is the the effect of Risk Assessment on Financial performance of Umurenge SACCOs in Gasabo District?

3. What is the the effect of Control Activities on Financial performance of Umurenge SACCOs in Gasabo District?

4. What is the multiple correlation between ICS and financial performance of Umurenge SACCOs in Gasabo District?

## 4. CONCEPTUAL FRAME WORK

Diagrammatically the conceptual framework is represented below:

**Independent variables**                                    **Dependent variable**

| Internal control system |

| Control environment |

| Risk assessment |

| Control activities |

**Financial Performance**
Liquidity
- Current Ratio
- Quick ratio Profitability
- ROI
- ROE

## 5. RESEARCH METHODOLOGY

### 5.1 Research design:

This study is based on a descriptive design using both quantitative and qualitative approaches. Quantitative approach was used in the sense that the study involved systematic empirical investigation via statistical, mathematical or computational techniques.

### 5.2 Population;

The population of this study was all agents of Umurenge SACCO who are aware of the financial information in Gasabo District. The agents of each SACCO are 4 including one Manager, one accountant, Loan Officer, a cashier. The total number of the population is $4 \times 15 = 60$ employees.

### 5.3 Sample size:

The sample is a part of population, which is deliberately selected for the purpose of investigating the properties of the total population (Sounders, Philip and Adrian, 2000). For this study, the researcher used the total population as sample frame as a sample size because it was very small.

### 5.4 Data Collection Instruments:

In this study self-administered questionnaire was used. The questionnaire contained closed scaled questions to gather data from research participants. The questionnaire contained three sections; A, B, C. and D. Section A relating to demographic characteristic of the respondents. Section B relating to the functionality of internal control system. Section C relating to financial performance of SACCOs in Gasabo District. The measurement was based on the 5-point Likert scale.

### 5.5 Data analysis:

The methods were used to analyze the data in this research, are as follows: Descriptive Statistics: It is in that case descriptive statistical was used such as frequency, percentage, mean and standard deviation to analyze the level of functionality of Internal control and the level of financial performance of imirenge SACCO. The correlation and regression analysis were used to show relationship between internal control and financial performance of Imirenge SACCO in Gasabo District. Spearman correlation coefficient was used because the data of the study are in the form of ordinal data. The researcher used the following regression model in analysis: $Y = b + a_1X_1a_2X_2 + a_3X_3 + e$.

## 6. RESEARCH FINDINGS

### 6.1 Demographic Data:

### 6.1.1 Age of the respondents:

In this study the researcher assessed the age of the respondents, in order to see youth are present in working in SACCOs.
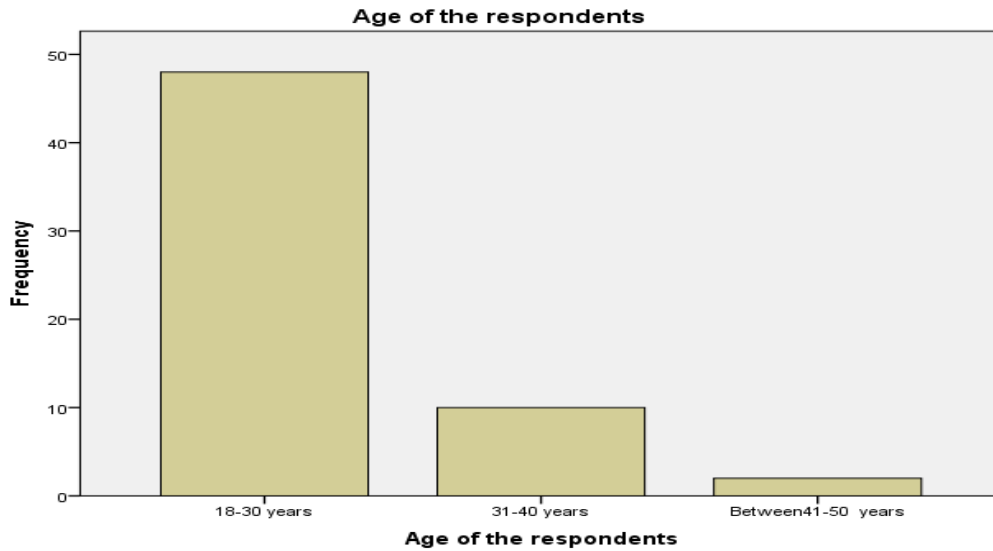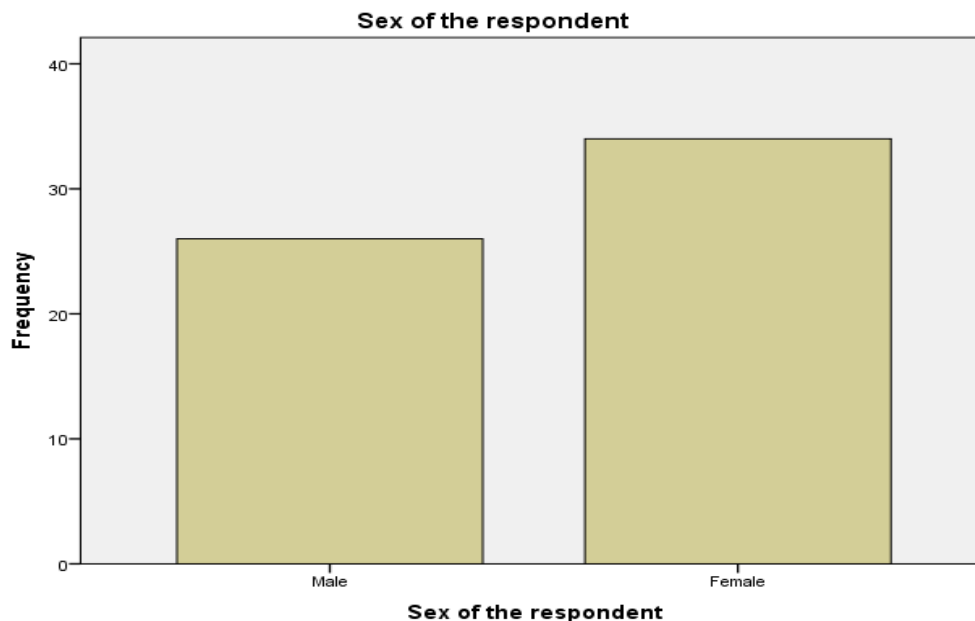
**Figure 1: Age of the respondents**

Findings about age shows that the big number of respondents are in the age between 18-30 years containing 49(81.7%), followed by those who are in the age between 31-40 years containing 9 (15.0%), followed by those in the age Between41-50 years who are 2 (3.3 %). This shows that more young are employed in SACCOs in Gasabo District. This is good news because the policy of Rwanda is job creation especially youth.

**6.1.2 Sex of the respondents:**

Gender has been analyzed in order to assess if gender balance is respected in SACCOs. Findings are found in figure.2



**Figure 1: Gender of the respondents**

Findings from figure 2 showed that female occupies a big number than male 34(56.7%) and 26 (43.3%) respectively among respondents. Gender balance is respected in the SACCOS of Gasabo District.

**6.1.3 Assessment of Education level:**

Education level has been assessed in order to see if the employees of SACCOs in Gasabo District have enough skills for fulfilling their management tasks.
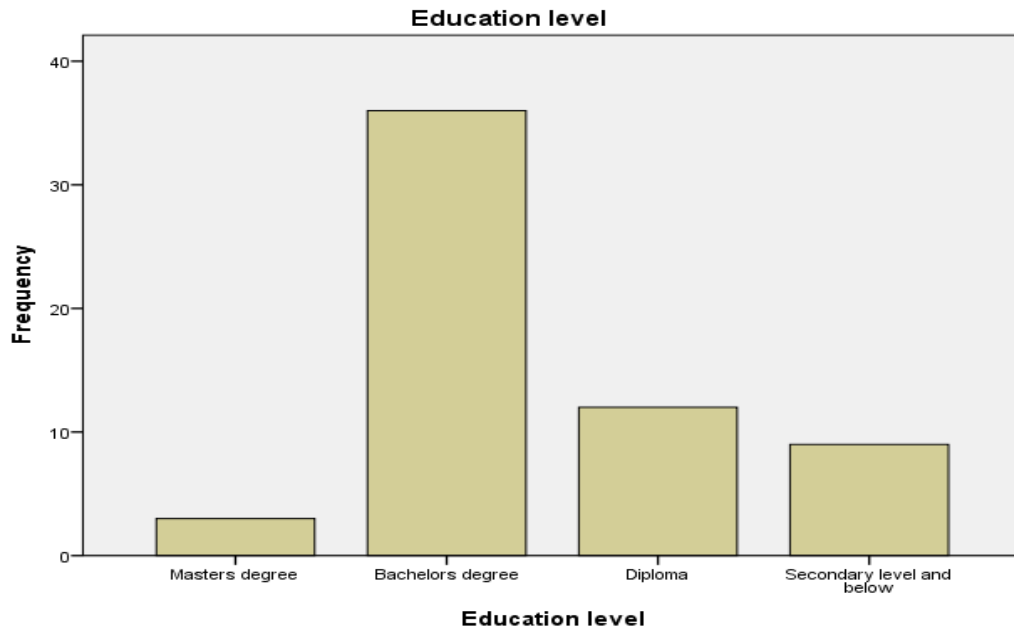
**Figure 3: Education level**

The analysis of education level showed that many respondents have a Bachelors degree 36(60%) followed by those which have diploma 12 (20%), flowed by those who have secondary school9 (15%), and those who have Masters degree 3(5.0%), from these findings, the researcher can conclude that the staffs have sufficient education background, to give better to services.

**6.2 Assessment of internal control system:**

To assess the internal control system, the researcher used three indicators of internal control systems which are control environment, risk assessment and control Activities.

**6.2.1 Assessment of Control environment:**

To assess the level of control environment, the researcher used five assertions. Findings are presented in the table 1

**Table 1: Level of control environment practices**

| Assertions | Mean | Std. Dev | Interpretation |
|---|---|---|---|
| Monitoring compliance with policies and procedures and noncompliance report | 4.3333 | .68064 | Very High |
| Board's access to bank records | 4.3667 | .66298 | Very High |
| Board receives adequate information about the internal risk assessment process | 4.1833 | .81286 | High |
| The board takes appropriate follow-up and ensures effective action of noncompliance | 4.6500 | .54695 | Very High |
| The board periodically reviews policies and procedures for proper controls | 4.4167 | .56122 | Very High |
| **General mean** | **4.39** | **0.65** | **Very High** |

*Source: Primary data, 2017.*

Monitoring compliance with policies and procedures and noncompliance report was done at a very high level (mean=4.33; Std. Dev =0.68),Board's access to bank records was at a very high level (mean=4.36; Std. Dev =0.66), Board receives adequate information about the internal risk assessment process at a high level (mean=4.18; Std. Dev =0.81), The board takes appropriate follow-up and ensures effective action of noncompliance at a very high level (mean=4.65; Std. Dev =0.54)and the board periodically reviews policies and procedures for proper controls at a very high level (mean=4.41; Std. Dev =0.56). The general level of control environment practices was at a very high level (mean=4.39; Std. Dev =0.65).

**6.2.2 Analysis of Risk assessment practices:**

**Table 2: Level of risk assessment**

| Assertions | Mean | Std.Dev | Interpretation |
|---|---|---|---|
| Material risks are identified, analyzed, evaluated, treated, continually monitored and reviewed. | 4.2833 | .71525 | Very High |
| Risk management systems meet minimum requirements | 4.0333 | .80183 | High |
| Insurance coverage | 4.0333 | 1.23462 | High |
| There is sufficient, competent and knowledgeable staff, and have adequate resources | 3.100 | .84020 | Moderate |
| Management and the board involve audit personnel or other internal control experts in the risk assessment process | 4.4000 | .66892 | Very High |
| Board and management appropriately evaluate risks when planning for new products or activities | 4.2833 | .76117 | Very High |
| The board and management discuss and appropriately when planning for new products and activities | 4.2833 | .61318 | Very High |
| **General mean** | **4.09** | **0.80** | **High** |

*Source: Primary data, 2017.*

Material risks are identified, analyzed, evaluated, treated, continually monitored and reviewed at a very high level (mean=4.28; Std. Dev =0.71), Risk management systems meet minimum requirements at a high level (mean=4.03; Std. Dev =0.80), insurance coverage at a high level (mean=4.03; Std. Dev =1.23), there is sufficient, competent and knowledgeable staff, and have adequate resources at a moderate level (mean=3.10; Std. Dev =0.84), Management and the board involve audit personnel or other internal control experts in the risk assessment process at a high level (mean=4.40; Std. Dev =66), Board and management appropriately evaluate risks when planning for new products or activities at a high level (mean=4.28; Std. Dev =0.76), the board and management discuss and appropriately when planning for new products and activities at a high level (mean=4.28; Std. Dev =0.61). The general level of Risk assessment practices was at a high level (mean=4.09; Std. Dev =0.80).

**6.2.3 Assessment of control activities:**

**Table 3: Level of control activities**

| Assertions | Mean | Std.Dev | Interpretation |
|---|---|---|---|
| There is independent verification of transactions to ensure integrity. | 4.5167 | .70089 | Very High |
| Transactions are done by more than one person | 4.4667 | .56648 | Very High |
| Key risk-taking activities are appropriately managed from reconciliation activities | 3.9667 | .82270 | High |
| Critical decisions are made with appropriate approval | 4.40 | .69380 | Very High |
| **General mean** | **4.33** | **0.69** | **Very High** |

*Source: Primary data, 2017.*

There is independent verification of transactions to ensure integrity at a very high level (mean=4.45; Std. Dev =0.70), transactions are done by more than one person at a very high level (mean=4.46; Std. Dev =0.56), Key risk-taking activities are appropriately managed from reconciliation activities at a high level (mean=3.96; Std. Dev =0.82), critical decisions are made with appropriate approval at a very high level (mean=4.40; Std. Dev =0.69).The general level of control activities was very high (mean=4.33; Std. Dev =0.69).

**6.3 Analysis of Financial performance:**

To assess financial performance, two indicators which are liquidity and profitability were used. Mean and standard deviation were used to interpret findings.

**6.3.1 Assessment of Liquidity:**

**Table 4: Level of Liquidity**

| Assertions | Mean | Std. Dev | Interpretation |
|---|---|---|---|
| Umurenge SACCO current assets are more than current liability in the last four years | 3.63 | 1.19273 | High |

| | | | |
|---|---|---|---|
| Umurenge SACCO was able to meet its every day cash obligation in the last four years | 4.23 | .90884 | Very High |
| The cash flow of Umurenge SACCO met the company financial obligation in the last four years | 4.23 | .94540 | Very High |
| Umurenge SACCO current ratio and quick ratio were sufficient in the last four years. | 3.76 | .87074 | High |
| **General mean** | **3.96** | **0.97** | **High** |

*Source: Primary data, 2017.*

Findings showed that in the last four years, current assets were more than current liability at high level (mean=3.63; Std. Dev =1.19), SACCOs were able to meet their everyday cash obligation at high level (mean=4.23; Std. Dev =0.90). The cash flow met the company financial obligation high level (mean=4.23; Std. Dev =0.94) , current ratio and quick ratio were sufficient at a high level (mean=3.76; Std. Dev =0.87).The general level of liquidity was high (mean=3.96; Std. Dev =0.97).

**6.3.2 Assessment of profitability:**

**Table 5: Level of profitability**

| Assertions | Mean | Std. Dev | Interpretation |
|---|---|---|---|
| Net profit of Umurenge SACCO has been appreciable during last four years | 3.3167 | 1.04948 | Moderate |
| Operating profit margin has been sufficient during last fouryears | 3.5500 | .85222 | High |
| Net profit margin has been sufficient during last four years | 3.5333 | .94719 | High |
| The profit of Umurenge SACCO was high comparing to the assets during last four years. | 3.3000 | .69624 | Moderate |
| The profit of Umurenge SACCO was high comparing to the Equity during last four years. | 3.1833 | .74769 | Moderate |
| **General mean** | **3.37** | **0.85** | **Moderate** |

*Source: Primary data, 2017.*

During the last four years, Net profit has been appreciable at a moderate level (mean=3.31; Std. Dev =1.04), Operating profit margin has been sufficient at a high level (mean=3.55; Std. Dev =0.85), Net profit margin has been sufficient at a high level (mean=3.53; Std. Dev =0.94), The profit was high comparing to the assets at a moderate level (mean=3.30; Std. Dev =0.69), The profit was high comparing to the Equity at a moderate level (mean=3.18; Std. Dev =0.74). The general level of profitability was moderate level (mean=3.37; Std. Dev =0.85).

**6.4 Relationship between Internal control system and financial performance**

To analyze the relationship between internal control system and financial performance, the researcher analyzed first the relationship between Control environment and financial performance, the relationship between Risk assessment and financial performance and the relationship between Control activities and financial performance. The researcher analyzed the combined correlation between internal control systems under Control environment, Control activities, Risk assessment and financial performance.

**Table 6: Spearman's rho Correlations between independent variables and dependent variable**

| | | | Financial performance |
|---|---|---|---|
| Spearman's rho | Control environment | Correlation Coefficient | .315[*] |
| | | Sig. (2-tailed) | .014 |
| | | N | 60 |
| | Risk assessment | Correlation Coefficient | .409[**] |
| | | Sig. (2-tailed) | .001 |
| | | N | 60 |
| | Control activities | Correlation Coefficient | .379[**] |
| | | Sig. (2-tailed) | .003 |
| | | N | 60 |
| **. Correlation is significant at the 0.01 level (2-tailed). | | | |
| *. Correlation is significant at the 0.05 level (2-tailed). | | | |

*Source: Primary data, 2017.*

The table6 showed that the spearman rho correlation between Control environment and financial performance was 0.315 and the p-value of 0.01.This implies that there is a significant weak correlation between Control environment and financial performance. The spearman rho correlation between Risk assessment and financial performance was 0 .409. This implies that the relationship is Weak correlation between Risk assessment and financial performance. The spearman rho correlation between Control activities and financial was 0.379.this implies that the relationship was weak. As all P-values are less than 0.05 all the relationship are significant.

### 6.5 Effect of Internal control system on financial performance:

To study the effect of internal control system on financial performance, multiple regressions was used. Findings are in the table 7.

**Table 7: Model Summary**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .473[a] | .224 | .182 | .62436 |
| a. Predictors: (Constant), Control activities, Control environment, Risk assessment | | | | |

*Source: Primary data, 2017.*

The table7 shows that the coefficient of the correlation (R) was 0.473 and the coefficient of determination (R square) was 0.224.This implies that the predictors of internal control system contributed 22.4% % on the financial performance.

**Table 8: ANOVA[a]**

| Model | | Sum of Squares | Df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 6.185 | 3 | 2.062 | 5.288 | .003[b] |
| | Residual | 21.441 | 55 | .390 | | |
| | Total | 27.625 | 58 | | | |
| a. Dependent Variable: Financial performance | | | | | | |
| b. Predictors: (Constant), Control activities, Control environment, Risk assessment | | | | | | |

*Source: Primary data, 2017.*

Findings on table8 showed that the p-value (0.003) is less than the level of significance (0.05).This implies that internal control system indicators have a causal effect on the financial performance of SACCOs in Gasabo District.

**Table 9: Coefficients[a]**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .122 | .889 | | .137 | .891 |
| | Control environment | .392 | .218 | .262 | 1.795 | .078 |
| | Risk assessment | .288 | .281 | .190 | 1.026 | .309 |
| | Control activities | .140 | .189 | .118 | .739 | .463 |
| a. Dependent Variable: Financial performance | | | | | | |

*Source: Primary data, 2017.*

From the table9 the researcher found that each coefficients of internal control separately doesn't statistically affect the financial performance because P-values of all indictors are greater than the 0.05 level of significance. As findings in table9 showed that the combined internal control system indicators have a causal effect on the financial performance of SACCOs, the researcher can conclude that to get influence on financial performance, all indicators of internal control system should be jointly applied. Otherwise a single indicator cannot play any significant influence. From these findings, it is not easy to verify the model of linear equation which predicts the causal effect of internal control system on the financial performance of SACCOs in Gasabo District.

## 7. CONCLUSIONS

The focus of the study was to establish the Influence of Internal Control Systems on the Financial Performance of Savings and Credit Cooperatives in Rwanda: A Case of SACCOs in Gasabo District. Data collected are analyzed through both descriptive and inferential statistics established that internal control system had significant effects on SACCOs' financial performance. The spearman correlation between Control environment and financial performance was 0.315 and the p-

value of 0.01.This implies that there is a significant weak correlation between them. The spearman correlation between Risk assessment and financial performance was 0 .409 with the P-value of 0.001. This implies Weak significant correlation. The spearman correlation between Control activities and financial was 0.379 with the P-value of 0.003.this implies significant weak relationship. The Grand coefficient correlation (R) was .473 and the coefficient of determination ($R^2$ = 0.224) showing that there was a weak significant relationship between Internal control system and financial performance of SACCOs in Gasabo District. Therefore, it can be concluded that the predictors of financial performance were statistically significant in explaining the financial performance of SACCOs.

## 8. RECOMMENDATIONS

From the findings of the study the researcher formulated the recommendations to the management of SACCOs

The management of SACCOs in Gasabo District should continue to apply internal control systems in their management in order to maintain the rules of regulation in the management. As these institutions are among the core factors of economic development of the country, they should show a transparency in their working.  Also they should strive to increase the profitability of their SACCOs, because findings showed that it was at a moderate level. A moderate level is not satisfactory. This is necessary because the profitability is the main indicator of financial performance. A firm which has a high profitability is a firm which a high chance to survive.

**Areas for further research:**

Another study should collect information on other measures of internal control Monitoring Information & Communication which have not been assessed in this study. The researchers should not use the secondary data to assess financial performance of the SACCOs which has not used because of lack of time. Another study should be conducted to see other factors which contribute to the financial performance because findings showed that internal control systems contributed only 22.4% % on the financial performance of SACCOs in Gasabo District. Other factors which contribute 77.6% should be determined.

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