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**EFFECT OF INTERNAL CONTROL PRACTICES ON LOAN  
PERFORMANCE OF HANA MICROFINANCE**

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**EFFECT OF INTERNAL CONTROL PRACTICES ON LOAN  
PERFORMANCE OF HANA MICROFINANCE**

A thesis submitted as a partial fulfilment of the requirement for the degree of  
Master of Banking and Finance (MBF)

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## **ABSTRACT**

The purpose of the study was to evaluate whether or not there is a correlation between the effectiveness of internal control mechanisms and the performance of Hana microfinance loans. Internal controls were evaluated from a number of different angles, including the control environment, risk assessment, control activities, information and communications, and monitoring. This was done as a method for determining how effectively loans were being managed. In addition, the approach of descriptive research is utilized during the course of this investigation. Data were collected from twenty-five percent of the employees who work in the operation, risk management, and internal audit departments at Hana microfinance. This was done in order to guarantee that the internal control processes used by Hana microfinance are effective. Using multiple regression analysis, we were able to establish the extent to which Hana Microfinance's internal control system contributed to the company's overall loan performance. Monitoring, information sharing, risk assessment, control actions, and information sharing are all part of Hana's robust internal control system, which also includes risk assessment. Control environment and monitoring make up the majority of the procedures that fall under the category of internal control among them. Hana has a firm grasp of the concepts of integrity and ethical beliefs, and she is aware that she must continually advocate for these principles. Management ensures that a culture exists and actively promotes a productive working environment. Hana is well aware of the benefits that can accrue from keeping an efficient monitoring mechanism in place between individuals on the ground who put the strategies that are decided upon into action and those who directly benefit from those strategies. The findings revealed a statistically substantial and favorably skewed positive Pearson correlation coefficient between loan performance and internal control systems. The results of the statistical analysis of the regression study indicate that the control environment, the flow of information and communication, as well as monitoring, are the primary factors that have the greatest impact on the relationship between internal control procedures and loan performance. According to the findings of this study, there is a direct connection between effective internal control and loan performance. There is always alignment with the essential components of the internal control system whenever there is an effort to improve loan performance. In addition, there should be regular reviews of the efficiency of important components of the company's internal control system, which will hopefully put the company on the right track and lead to the best possible loan performance.

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# TABLE OF CONTENTS

	<b>Page</b>
<b>ABSTRACT</b>	<b>i</b>
<b>ACKNOWLEDGEMENTS</b>	<b>ii</b>
<b>TABLE OF CONTENTS</b>	<b>iii</b>
<b>LIST OF TABLES</b>	<b>v</b>
<b>LIST OF FIGURES</b>	<b>vi</b>
<b>LIST OF ABBREVIATIONS</b>	<b>vii</b>

## **CHAPTER I INTRODUCTION**

1.1	Rationale of the Study	2
1.2	Objective of the Study	3
1.3	Scope and Method of the Study	3
1.4	Organization of the Study	4

## **CHAPTER II THEORETICAL BACKGROUND OF THE STUDY**

2.1	Internal Control Theory and COSO Framework	5
2.2	Components of COSO Framework	6
2.3	Principle of COSO Framework	14
2.4	Loan Performance in Microfinance	15
2.5	Previous Studies	16
2.6	Conceptual Framework of the Study	19

## **CHAPTER III Internal Control Practices of Hana Microfinance in Myanmar**

3.1	Overview of Microfinance in Myanmar	21
3.2	Profile of Hana Microfinance	24
3.3	Internal Control Practices of Hana Microfinance	26
3.4	Loan Performance	28

<b>CHAPTER IV</b>	<b>Effect of Internal Control Practices on Loan Performance</b>	
4.1	Research Design	29
4.2	Demographic Profile of Respondents	31
4.3	Employee Perception of Internal Control Practices	33
4.4	Loan Performance of Hana Microfinance	40
4.5	Relationship between Internal Control Practices and Loan Performance	41
4.6	Effect of Internal Control Practices on Loan Performance	42
<b>CHAPTER V</b>	<b>CONCLUSION</b>	
5.1	Findings and Discussions	44
5.2	Suggestions and Recommendations	46
5.3	Need of Further Study	47
<b>REFERENCES</b>		
<b>APPENDIX</b>		

## **LIST OF TABLES**

<b>Table No.</b>		<b>Page</b>
Table (2.1)	Seventeen principle of internal control components in COSO framework	14
Table (2.2)	Working Definition of Key Terms	20
Table (3.1)	Loan Amount of Microfinance in 2022	22
Table (3.2)	Saving Amount of Microfinance 2022	23
Table (3.3)	Number of Employee in Microfinance Industry	23
Table (4.1)	Total Number of Employees Involved in Internal Control Practices	30
Table (4.2)	Number of Sample Employees	31
Table (4.3)	Respondents' Demographic Profile	32
Table (4.4)	Rating scale	33
Table (4.5)	Employee Perception of Control Environment	34
Table (4.6)	Employee Perception of Risk Assessment	35
Table (4.7)	Employee Perception of Control Activities	37
Table (4.8)	Employee Perception of Information and Communication	38
Table (4.9)	Employee Perception of Monitoring	39
Table (4.10)	Overall Mean Score of Internal Control Practices	40
Table (4.11)	Loan Performance	41
Table (4.12)	Relationship of Internal Control Practices to Loan Performance	42
Table (4.13)	Effect of Internal Control Practices on Loan Performance	43

## LIST OF FIGURES

<b>Figure No.</b>		<b>Page</b>
Figure (2.1)	The Impact of Internal Control on the Profitability of Microfinance Institutions in Senegal	16
Figure (2.2)	Effect of Internal Control on Financial Performance of Micro-finance Institutions in Kisumu Constituency, Kenya	17
Figure (2.3)	Effect of Internal Control Systems on Financial Performance in an Institution of Higher Learning in Uganda	18
Figure (2.4)	Effect of Internal Control Practices on Loan Performance	19
Figure (3.1)	Organization Chart of Hana Microfinance	25

## **LIST OF ABBREVIATIONS**

COSO - Committee of Sponsoring Organizations of the Treadway Commission

COVID - Coronavirus Disease

ERM - Enterprise Risk Management

## **CHAPTER (I)**

### **INTRODUCTION**

A class of financial services known as microfinance caters to people and small enterprises without access to traditional banking and related services. Microfinance has a long history that dates back to the middle of the 1800s. The pioneer of the microcredit movement in the 1970s was Muhammad Yunus. In 1983, Muhammad Yunus founded the Grameen Bank, which offers so-called microcredit—small loans with simple terms. The 2006 Nobel Peace Prize was given to Muhammad Yunus and Grameen Bank. The informal sector is primarily targeted through microfinance. There is historical evidence that suggests microfinance has aided the economically disadvantaged in building workable enterprises, increasing income, and lessening their sensitivity to shocks from the outside world. It has also been a powerful tool for empowering the economically underprivileged groups, particularly women, to achieve economic independence. This money made by businesses goes toward expanding business operations, raising household incomes, and supporting things like food security, children's education, healthcare, etc. Since women have traditionally been kept out of public spaces, encounters with such formal institutions may help them develop self-confidence and a sense of empowerment.

Myanmar by the Human Development Initiative of the UNDP in 1997. The government passed the new Microfinance Law in November 2011, opening the door for the development of microfinance services by enabling domestic and international investors to set up entirely privately owned MFIs in the nation. As of February 2020, there were slightly over 180 MFIs functioning in Myanmar. The second-largest microfinance company in Myanmar is one of them, and its name is Hana. One of the biggest bank holding corporations in South Korea, Hana Financial Group, has a subsidiary company called Hana Microfinance. Hana has locations in 14 States/Divisions and the Nay Pyi Taw Union Territory in Myanmar. It employs more than 1,400 people overall, serves more than 200,000 clients, and has loans outstanding totaling more than \$200 billion.

Microfinance companies were allowed to run successfully and routinely prior to the COVID 19 timeframe. Employee loans are easily disbursed while the member's economy is struggling during COVID 19, with no proper checking. Staff from the head office are unable to check owing to transportation issues. There are a lot of bad debts and a lot of fraud cases. These

are brought on by the internal control system's shortcomings. An organization's goals can be more clearly defined with the aid of internal controls, allowing personnel and resources to be allocated to them. They protect against resource misuse and make corrective action easier. Good records help management understand what happened in the past and where change might be most effective, but if internal controls aren't operating effectively, the outcome could be negative. Loan repayments will decline if internal control procedures are poor, and a fraud case will develop.

Microloans are the primary asset of the industry, and a lucrative and long-lasting firm depends on high-quality loans. They will mostly have an impact on loan performance. The time is here for effective internal control in the microfinance industry. Additional losses could occur if internal control is not completed on time. The purpose of this study is to examine internal control procedures and demonstrate how they affect loan performance.

## **1.1 Rationale of the Study**

This investigation on loan performance attempts to learn how to determine the effectiveness of internal controls, including their strong and weak points. If internal control can be implemented effectively, the company will be very successful. An accounting technique or system known as internal control was created to increase productivity, protect assets, and prevent fraud and error. Effective internal controls support loan performance that is efficient and effective. Unsuccessful internal controls lower production. Microfinance productivity must be improved by control over loan performance. Before COVID 19, microfinance in Myanmar had good loan performance, but it has been discovered that since COVID 19, loan performance has dramatically declined. The lack of effective internal control during COVID 19 is the primary cause of the deterioration in loan performance. Because the loan begins late, it is possible to determine this by looking at the dates on which the financial fraud began. Hana's loan performance has considerably declined even after the COVID 19 period, and the number of fraud cases has rapidly increased as well. Traveling normally after COVID 19; To control the situation, intense inspections were initiated as a result of the sharp fall in loan performance. Since the start of this control, the primary issues of poor loan performance and instances of financial fraud have occurred. The unethical behavior of every employee, the flaws in the loan approval procedure, the need to update the company's rules and producers, insufficient communication, and a lack of monitoring are all related to these. Internal control is intimately tied to each of the aforementioned procedures. It is certain that the loan performance will increase if these factors are well under

control. Hana is now performing well on her loans. However, management is actually seeking improvements. Previously, management placed a higher priority on strengthening the loan portfolio; currently, management is attempting to strengthen loan performance. This study was conducted as a result because it is the best examination of internal control procedures for enhancing loan performance, which accounts for the biggest proportion of assets in microfinance.

## **1.2 Objective of the Study**

The main objectives of the study are as follows:

- To identify internal control practices of Hana microfinance
- To analyze the effect of internal control practices on loan performance of Hana microfinance

## **1.3 Scope and Method of the Study**

This study focuses on Hana Microfinance's internal control procedures. Hana should be chosen because it is among the microfinance organizations with the fastest rate of growth. Therefore, how to establish internal control and how to control loan performance should be researched in a fast expanding firm. This study examined the impact of internal control procedures on Hana Microfinance's loan performance. This study used both descriptive and quantitative methods. 1,078 personnel from three departments, including internal audit, operations, and risk management, who are involved in Hana Microfinance's internal control procedures across the nation, make up the study's entire population. 25 percent was computed based on the sum of each area and the head office when sampling the entirety of Hana. A quarter of the population was surveyed for primary data.  $(1,0007 * 25\%)$  equals 270 workers. The 270 employees in the sample were distributed proportionally by areas. Following that, the number of employees in each department was divided proportionally among the sample employees from each area. In this investigation, proportional random sampling was employed. The Hana website, newsletter, journals, publications, and earlier research papers were used to gather secondary data. the five components of the questionnaire—control environment, risk assessment, control actions, information and communications, and monitoring—were each given a separate section to create.

#### **1.4 Organization of the Study**

There are five chapters in this work. The study's justification, objectives, scope, technique, and organization are all covered in Chapter 1, which serves as the study's introduction. The background theory of the study is presented in Chapter 2, along with the COSO framework, its components, principles, loan performance in microfinance, prior research, and the conceptual foundation for the current study. The investigation of how internal control procedures affect loan performance is found in Chapter 3. Presents a study of how internal control procedures affect loan performance in Chapter 4. Conclusions are presented in Chapter (5) along with conclusions and suggestions for additional research..

## **CHAPTER (II)**

### **THEORETICAL BACKGROUND OF THE STUDY**

This chapter includes the definition and types of internal control system and internal control theory of COSO framework. The components of COSO framework and the previous study of internal control system and conceptual framework of the study are expressed.

#### **2.1 Internal Control Theory and COSO Framework**

According to the definitions of accounting and auditing, internal control is a procedure that ensures an organization satisfies its objectives in terms of operational effectiveness and efficiency, accurate financial reporting, and compliance with laws, rules, and policies. This includes ensuring that the organization complies with laws, rules, and policies. The phrase "internal control" is a catch-all phrase that can be used to refer to anything that an organization undertakes in order to manage risk. It is a strategy for the management, monitoring, and assessment of an organization's available resources. It is essential for the organization's efforts to detect and prevent fraud, as well as to protect both its tangible (such as its property and equipment) and intangible (such as its human capital) resources (e.g., reputation or intellectual property such as trademarks).

Internal control is defined by the COSO framework as a continuous process that is overseen and influenced by management and a company's board of directors. When utilized appropriately, internal control can assist ensure operational success, improve efficiency, and even help a company maintain legal and regulatory compliance. To make COSO more manageable to implement and to make sure nothing is missing, it is divided into five distinct categories. The elements listed below work together to support an organization in fulfilling its mission and goals and assist it more effectively accomplish its set objectives. The Committee of Sponsoring Organizations is referred to as COSO. In 1992, the committee collaborated with a number of businesses to develop the framework, including the following:

1. American Accounting Association
2. Financial Executives International

3. The Institute of Internal Auditors
4. American Institute of Certified Public Accountants
5. The Institute of Management Accountants (formerly the National Association of Cost Accountants)

## **2.2 Components of the COSO Framework**

There are five components of COSO framework are as follow.

- (a) Control environment.
- (b) Risk assessment.
- (c) Control activities.
- (d) Information and Communications.
- (e) Monitoring.

### **(a) Control Environment**

This element includes the direction, purpose, objectives, and desired results. This crucial element includes the hierarchy's structure, the ethics policy, the commitment to excellence, and the commitment to integrity. The company has a dedication to moral principles and decency. This principle ultimately starts at the top, when the board of directors and management communicate the significance of an ethical workplace and its role in accomplishing organizational goals through both directives and their own behavior. All levels of the business should be aware of the specific standards of conduct, and procedures should be in place to assess performance and act rapidly when standards are not being met.

The board of directors oversees the creation and operation of internal controls and exhibits independence from management. In addition to remaining objectively separate from management, the board of directors should also possess the requisite knowledge to carry out each duty. For instance, having a Treasurer who is knowledgeable in accounting and financial accounts is essential. If not, board-level financial analyses would be subject to poor controls that could compromise the organization's goals. The board of directors should also supervise management's design and implementation of internal controls.

In order to achieve its goals, management creates the necessary structures, reporting lines, and authority with the help of the board. At all levels of the organization, management

must clearly define roles and assign authority to those roles. To facilitate authority, responsibility, and information flow, reporting lines are firstly established. Major decisions should continue to be made by the board of directors. They should also go over the management's responsibilities and authority restrictions.

The company has a dedication to finding, nurturing, and keeping qualified workers who are in line with its goals. Monitoring employee competency is crucial to keeping an internal control system in place, and evaluation should go beyond the hiring stage. Instead, competence should be fostered and maintained through a continuous plan for staff training and development.

In order to achieve its goals, the company holds individuals accountable for their internal control duties. By defining clear objectives, performance metrics, and rewards that take into account the stresses of accomplishing the linked goals, accountability is strengthened. By taking proper corrective action when necessary, it is further strengthened.

## **(b) Risk Assessment**

This essential component of COSO ensures a comprehensive understanding of risks while also tackling both threats and weaknesses head-on. The process of assessing risk entails doing an in-depth analysis of a variety of factors, including company objectives, operational procedures, and, most crucially, potential weak spots in the system.

There may be risks from external sources, such as data theft, cyberattacks, and the loss of secret data, formulas, and methods, although these may vary depending on the type of firm and the industry in which it operates. Brands in the healthcare industry, the manufacturing industry, and the software development industry are all susceptible to risks associated with their particular businesses. These also present a major danger of not complying with regulations and laws.

Finding hazards is just the first stage in this process; it also involves conducting an analysis, coming up with solutions, and putting changes into place that will decrease risk and prevent losses. When it comes to a company's overall success, risk management is one of the most important factors.

2 Within the context of the COSO Enterprise Risk Management framework, event detection comes first, followed by risk assessment, and then risk response. The scale of the risks, both individually and collectively, is measured in order to lay the groundwork for a response to risk

and to direct management's attention toward the most significant opportunities and threats. In addition, this step lays the groundwork for mitigating risk. The primary objective of risk assessment is to measure and prioritize potential dangers, with the intention of bringing risk levels down to acceptable levels while maintaining certain levels of openness and not missing out on any opportunities that may be advantageous. Beginning a new project, regularly upgrading an enterprise risk management program, combining with another firm, purchasing another company, selling a company, or undergoing a big reorganization are all examples of situations that could trigger a risk assessment. Certain dangers, including some that are associated with the market and production, are ever-changing and require consistent monitoring and evaluation. Other dangers are less dynamic and just require periodic reevaluation; nonetheless, continuous monitoring should trigger an alarm to reevaluate the situation sooner if the circumstances change.

**Identify risks.** Prior to risk assessment, the process of risk (or event) identification generates a thorough list of risks (and frequently opportunities as well), organized by risk category (financial, operational, strategic, compliance) and sub-category (market, credit, liquidity, etc.) for business units, corporate functions, and capital projects. To understand the universe of hazards that make up the enterprise's risk profile, a wide net is being cast. The list needs to be prioritized in order to draw senior management and the board's attention to the most essential risks, even though each risk may be significant to management at the function and business unit levels. The risk assessment is used to achieve this prioritizing.

**Develop assessment criteria.** The creation of a standard set of assessment criteria to be used by business units, corporate departments, and significant capital projects is the first step in the risk assessment process. The impact and possibility of risks and opportunities are often considered while evaluating them. Many businesses understand the value of considering risk along other dimensions like vulnerability and onset speed.

**Assess risks.** Using the established criteria, values are assigned to each risk and opportunity as part of the risk assessment process. This can be done in two steps, with the first step being a qualitative risk screening and the second step being a more quantitative examination of the key risks..

**Assess risk interactions.** Risks don't exist by themselves. Businesses now understand how crucial it is to manage risk interactions. Even risks that seem modest on their own have the capacity to provide big opportunities or great harm when they interact with other circumstances

and events. Because of this, businesses are inclining toward a holistic or integrated view of risks utilizing tools like risk interaction matrices, bow-tie diagrams, and aggregated probability distributions..

**Prioritize risks.** By comparing the degree of risk to predetermined target risk levels and tolerance limits, risk prioritization establishes the priorities for risk management. Risk is considered in terms of subjective factors including the effect on health and safety, reputational damage, vulnerability, and speed of onset, in addition to the financial impact and probability.

**Respond to risks.** The outcomes of the risk assessment process are then used as the main input for risk responses, which involve examining the available options (accept, decrease, share, or avoid), performing cost-benefit assessments, formulating a response strategy, and developing risk response plans..

### (c) **Control Activities**

This component of the COSO Framework investigates organizational policies and practices, as well as security implementation and even continuity management plans. Control operations are in alignment with your mission and goals when you have a solid plan in place to guarantee company continuity in the event of an emergency and when you have a proactive attitude toward security and upgrades. A corporation will have a better chance of successfully governing its operations if regulations spell out their requirements and the behavior that is required of them in as clear a manner as possible.

Control actions are made up of several policies, procedures, strategies, and mechanisms that all work together to ensure that the management's reaction to lowering dangers that were detected during the risk assessment process is really carried out. To put it another way, risk reduction activities are also known as control activities. The demand for a control activity can be established through the process of risk assessment. When it is determined that there is a significant risk that the purpose of an organization will not be realized, a matching control activity or sequence of actions will be selected and put into action. Control actions are carried out by the agency on every level and in every function. Measures of control that are both effective and efficient ought to be devised by management. While planning and carrying out control activities, management ought to make it a priority to deliver the maximum possible benefit at the lowest possible cost. The cost of the control attempt shouldn't be higher than what the agency would spend if the undesirable occurrence actually occurred in order for it to be

considered effective. Control activities should be incorporated by management at the beginning of the design phase of business processes and systems. Adding control activities later, after a process or system has already been built, typically results in increased costs. When deciding how many resources to allocate to each of the many control activities, it is important to take into account both the likelihood of the risk and its impact. There may be various suitable control measures that can be implemented for each specific risk, either alone or in combination with other measures of control. These controls may be performed either separately or jointly.

Authorization and control operations that fall under this category are intended to provide reasonable confidence that all transactions take place within the boundaries established by policy or that exceptions to policy have been allowed by the appropriate officials.

Control activities in this category are designed to provide reasonable assurance that transactions have been reviewed for accuracy and completeness by appropriate personnel. These activities include review and approval. Review and approval control activities are designed to provide reasonable assurance that transactions have been reviewed for accuracy and completeness. Verification and control operations fall under this type of controls. These controls comprise a variety of computer and manual procedures meant to provide a reasonable assurance that all accounting information has been appropriately captured. Control operations that fall under this category are aimed to offer reasonable assurance of the accuracy of financial records through the periodic comparison of source data. This is accomplished through the process of reconciliation.

**Authorization**, control activities in this category are designed to provide reasonable assurance that all transactions are within the limits set by policy or that exceptions to policy have been granted by the appropriate officials.

**Review and approval**, control activities in this category are designed to provide reasonable assurance that transactions have been reviewed for accuracy and completeness by appropriate personnel. Verification, control activities in this category include a variety of computer and manual controls designed to provide reasonable assurance that all accounting information has been correctly captured. Reconciliation, control activities in this category are designed to provide reasonable assurance of the accuracy of financial records through the periodic comparison of source.

**(d) Information and Communications**

Information is required for the entity in order to meet the duties of its internal control system and to assist the achievement of its goals. In order to ensure the smooth running of the internal control system, management must get, produce, and make use of relevant information gleaned from both internal and external sources. Communication is necessary for the constant provision of information, the exchange of information, and the acquisition of new knowledge. The process by which information travels up, down, and all throughout an organization is referred to as internal communication. It is beneficial for top management to communicate to personnel that control duties should be taken seriously at all times. Inbound communication of pertinent external information is made possible by external communication, which also serves to deliver information to external parties in response to demands and expectations. Inbound communication of pertinent external information is a two-way street.

An organization needs information in order to satisfy the requirements of its internal control system and to assist in the achievement of the goals it has set for itself. The management team gathers relevant information from both internal and external sources, analyzes it, and makes use of it in order to confirm that all of the organization's internal controls are performing as expected. Communication, as defined by COSO, is the ongoing and iterative process of giving, sharing, and receiving significant information. The process through which information is disseminated horizontally, vertically, and all within a company is referred to as internal communication. It makes it feasible for staff to hear from senior management in a clear manner that control obligations need to be taken seriously, which makes it possible for staff to take control duties seriously. Communication with the outside world not only makes it possible to receive relevant information from the outside world, but it also provides information to the outside world in response to their requests and expectations.

Despite the fact that its core concepts haven't changed all that much since the original COSO internal control framework, the revised COSO information and communications standards are organized differently and have a somewhat different appearance in this upgraded COSO internal control framework. This is due to the fact that this upgraded COSO internal control framework has been upgraded. Additionally, ideas concerning information and communication have developed in today's society as a result of the utilization of third-party service providers in the Internet-driven global economy.

**(e) Monitoring**

Setting up the conditions, the environment that you want to operate in, and the team policies that you need to employ is a great place to start, but you won't be able to keep up with the changes if you don't build on two key ideas from COSO's 2006 Guidance, which are to monitor and evaluate processes. Continuous observation can be helpful in locating deficiencies and failings, which makes it possible to take corrective action and helps structure remain intact. The COSO monitoring guidance ongoing and/or separate evaluations allow management to assess whether the other internal control elements continue to work over time and whether internal control flaws are discovered and promptly reported to the parties responsible for taking corrective action, as well as to management and the board as necessary. This allows management to determine whether the other internal control elements continue to work over time and whether internal control flaws are discovered and promptly reported to the parties responsible for taking corrective action. The monitoring guidance also suggests that these principles are best achieved by monitoring that is based on three major components: establishing a foundation for monitoring that includes a suitable tone at the top; an effective organizational structure that assigns monitoring roles to people with the necessary capabilities, objectivity, and authority; and a starting point or baseline of known effective internal control from which ongoing monitoring and separate evaluations can be derived. These three major components are as follows: establishing a foundation for monitoring that includes a suitable tone at the top; an efficient

Evaluating and reporting results, which includes determining the seriousness of any flaws that are found and reporting the monitoring results to the appropriate staff and the board for prompt action and follow-up, as necessary. Creating and implementing monitoring procedures that are centered on providing convincing evidence about the performance of important controls that address material risks to organizational goals. Both management and the board of directors should be familiar with the fundamentals of effective supervision as well as the ways in which it serves to further the objectives of each respective party.

As the board gains greater expertise in monitoring, it will also develop the skills necessary to question management over any big risk area. The purpose of the Monitoring Guidance provided by COSO is to provide assistance to organizations in responding to these and other queries within the context of their own specific circumstances, which will change over the course of time. It is likely that businesses will have the opportunity to further improve the process as they progress in becoming more effective in monitoring. This can be accomplished through the utilization of tools such as continuous monitoring software and exception reports that are

tailored to the businesses' operations. The guidelines also cover additional concepts that are essential for effective and efficient monitoring, such as the characteristics of an evaluator's objectivity, the duration and conditions during which an organization can draw the conclusion that internal control is still effective by utilizing appropriately prepared indirect information in conjunction with continuous or periodic compelling direct information. These concepts are covered because they are essential for effective and efficient monitoring.

finding a way to make monitoring more efficient without compromising its efficacy; ensuring that the data used is acceptable and enough; and ensuring that the results can be used to support conclusions about internal control. The recommendations for monitoring from COSO are presented in three separate volumes. In Volume I, the fundamental principles of effective monitoring are laid out, and a connection to the COSO Framework is formed. The concepts presented in Volume I are elaborated upon and discussed further in Volume II, which also provides guidance to persons who are in charge of effectively monitoring the situation. In Volume III, we look at some examples of effective monitoring. Many businesses should be able to improve the effectiveness and efficiency of their internal control systems by applying the principles that are detailed in the advise that was provided. COSO's Monitoring Guidance is designed to assist companies in two different ways so that they can achieve this goal: (1) identifying effective monitoring where it already exists and utilizing it to the fullest potential; and (2) identifying less effective or efficient monitoring, which will ultimately lead to changes. In either scenario, improving the effectiveness of the company's internal control system might make it more likely that the organization will achieve its objectives.

## 2.3 Principles of COSO Framework

There are seventeen principles of COSO framework are as follows.

**Table-2.1 Seventeen Principle of Internal Control Components in COSO framework.**

<b>Internal Control Component</b>	<b>Principles</b>
Control environment	<ol style="list-style-type: none"><li>1. Demonstrates commitment to integrity and values</li><li>2. Demonstrates independence and exercises oversight responsibility</li><li>3. Establishes structure, authority, and responsibility</li><li>4. Demonstrates commitment to attracting, developing, and retaining competent staff</li><li>5. Enforces accountability</li></ol>
Risk assessment	<ol style="list-style-type: none"><li>6. Specifies suitable, specific objectives</li><li>7. Identifies and analyzes risks</li><li>8. Assesses fraud risk</li><li>9. Identifies and analyzes significant changes</li></ol>
Control activities	<ol style="list-style-type: none"><li>10. Selects and develops control activities that help mitigate risks</li><li>11. Selects and develops general controls over technology</li><li>12. Bases controls on thorough policies and procedures</li></ol>

Information and communication	13. Uses relevant, high-quality information 14. Communicates internally to support controls 15. Communicates externally
Monitoring	16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies

Source, COSO principle, 2013

## 2.4 Loan Performance in Microfinance

Loan performance is a measurement of the stability of a financial organization based on how well the institution's spread loans have performed across a variety of industries. In addition to this, it relates to the behavior that is anticipated for the loans as well as how well they are performing in terms of meeting their payment schedules as opposed to their actual payment performance. It is directly connected to making timely and consistent payments toward the principal as well as the interest on a loan. A default on a loan is possible if the borrower is put in an unfavorable situation that makes it difficult for them to repay the debt (Hull, 2007). The most common causes of default on loans are the borrower's refusal to repay the loan, the financial institution's lack of commitment to the repayment of the loan, the staff's lack of accountability to shareholders to make a profit, the fact that clients' lives are frequently filled with unforeseeable crises such as illness or death in the family, the fact that loans are too large for the cash needs of the business, the possibility that extra funds will be used for personal purposes, and the fact that loans are guaranteed (Norell, 2001).

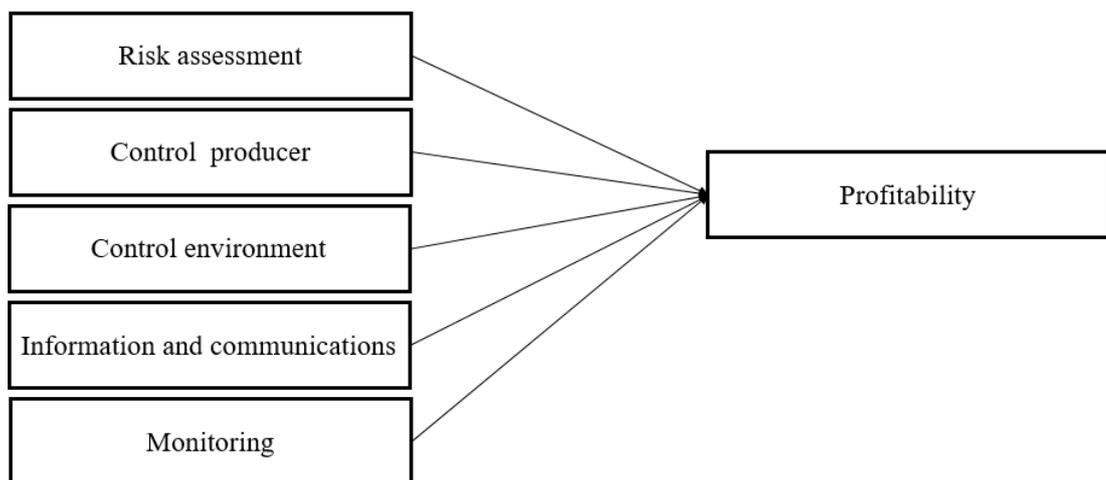
According to Wakuloba, the most common causes of loan default include inadequate performance in business, improper management of financial resources, and personal problems (2005). According to Breth, the rates of loan repayment are affected by a wide range of socioeconomic and institutional factors. [Citation needed] (1999). On the lender's side, the most important factors to take into consideration are a high frequency of collections, stringent controls, efficient administration of the information system, loan officer incentives, and appropriate follow-ups. How soon loans are returned is impacted by a number of factors,

including the amount borrowed, how long the loan is for, the interest rate charged by the lender, and the time of loan disbursement (Okorie & Andrew, 2007). The borrower's own socioeconomic characteristics, such as gender, level of education, marital status, and household income, as well as the influence of their peers in group-based lending arrangements, are the key factors that determine their behavior when it comes to borrowing money.

## 2.5 Previous Studies

This section describes the related previous studies of internal control practices by researchers. Gnilane Ndiaye (2019) explored the impact of internal control on the profitability of microfinance institutions in Senegal which is shown in Figure (2.1).

**Figure (2.1) The Impact of Internal Control on the Profitability**



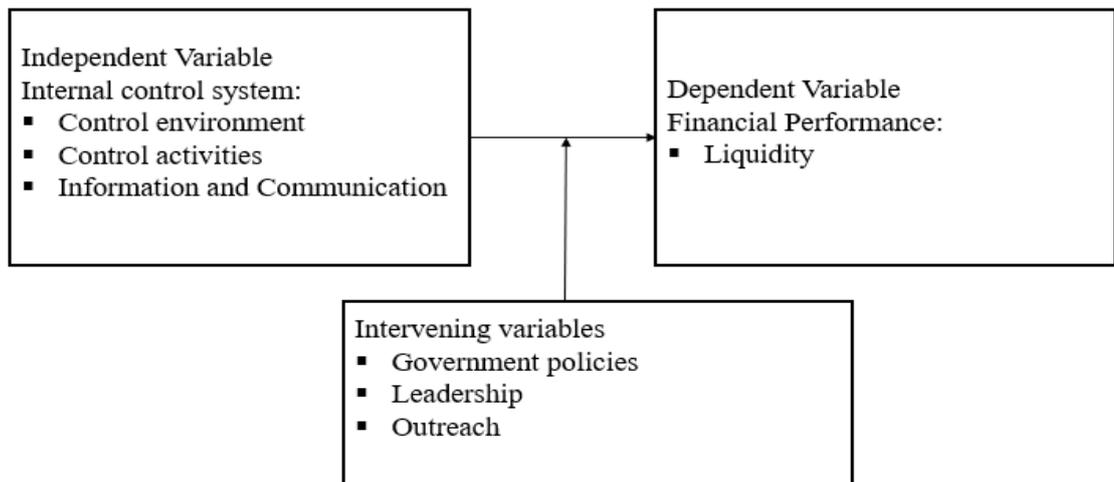
Source: Gnilane Ndiaye, 2019

Examining the influence of internal control systems on the performance of Senegalese microfinance organizations was the study's main goal. The profitability of MFIs served as the primary performance metric. In addition to macro considerations, the effect of internal control on an organization's performance may vary based on organization-specific characteristics, such as size and the type of its operations. In order to boost their profitability, this report advises

MFIs in Senegal to upgrade their internal control systems, particularly those on risk management and control environment.

Figure from Gnillance Ndiaye's (2019) description of the impact of internal control on the financial performance of microfinance firms in Kenya's Kisumu Central Constituency (2.2) According to the report, management at the institutions is dedicated to maintaining controls over the micro-finance institutions, and they actively take part in monitoring and supervising the staff's daily actions. The study also demonstrates that top-level management is responsible for initiating all of the Institution's actions. According to the research, the majority of institutions' internal audit departments are effective, carry out routine audit activities, and generate routine audit reports.

**Figure (2.2) Effect of Internal Control on Financial Performance**

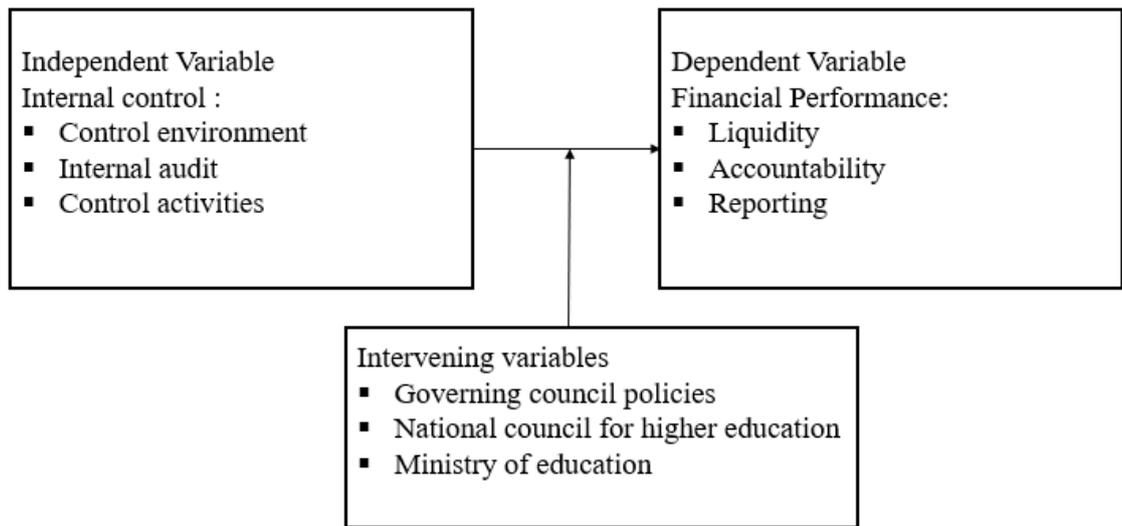


Source: Ssuuna Pius Mawanda, 2018

The study's findings support the assertion that Kisumu's microfinance institutions have an efficient internal control mechanism. The study's findings indicate that there is a considerable positive association between financial performance and internal control system (control environment, control activities, information, and communication) (liquidity).

Ssuuna Pius Mawanda (2018) researched the effect of internal control systems on financial performance in an institution of higher learning in Uganda which is displayed in Figure (2.3).

**Figure (2.3)-Effect of Internal Control System on Financial Performance**



Source: Sssuuna Pius Mawanda,2018

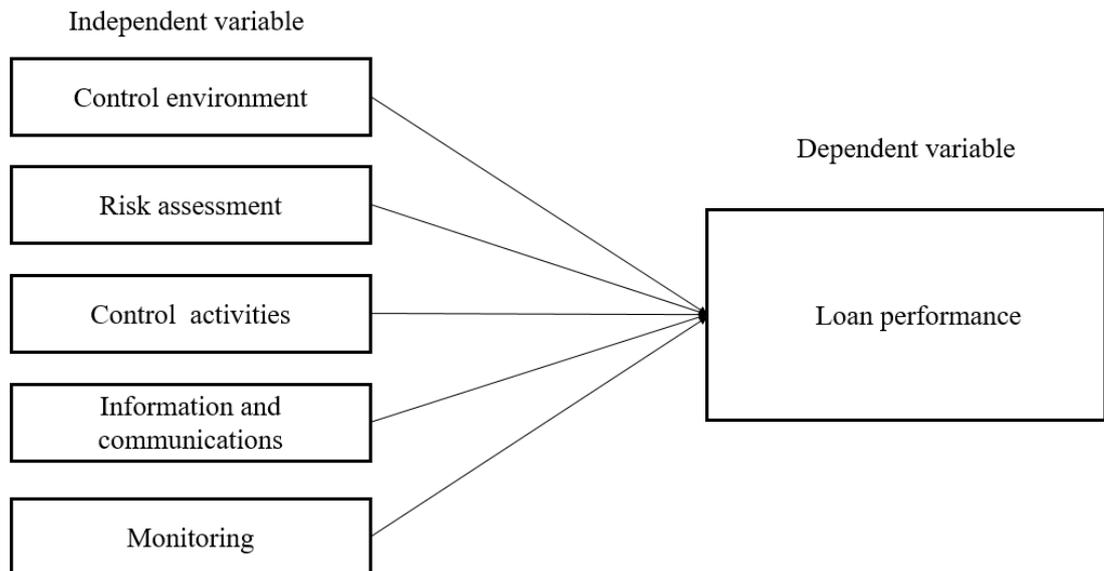
The goal of this study is to determine how internal control systems and financial performance relate in a higher education institution in Uganda. Internal controls are typically implemented in an organization to offer a reasonable level of assurance regarding the accomplishment of the entity's goals regarding the accuracy and dependability of financial reporting, the effectiveness and efficiency of operations, and compliance with relevant laws and regulations.

According to the study's findings, the institution has an efficient internal control system, which is supported by the findings of the study's clear role separation, supervision, training, and management commitment. However, there are difficulties in putting controls in place, particularly given that the audit function is not properly extended to upcountry locations, which obviously has harmed their effectiveness as this study reveals. In order to allow all parties within the organization to freely access and use the official information, the study also suggests that the institution create and administer a knowledge information management system. The report suggests that the organization create a plan for enhancing the development of additional funds for the University's activities.

## 2.6 Conceptual Framework of the Study

The conceptual framework of this study was developed based on the COSO framework components which is shown in the following Figure 2.4 constructed with independent variables (Internal Control Practices) and dependent variable (Loan Performance).

**Figure (2.4) Conceptual Framework of the Study**



Source: Adopted from COSO framework, 2023

The study's objective, as stated in the conceptual framework above, is to determine the relationship between loan performance and control environment, risk assessment, control activities, information and communications, and monitoring, which serve as independent variables. The conceptual framework of this study attempts to determine the impact of internal control techniques on loan performance and the relationship between those practices and loan performance. Working definitions of the variables are defined based on the literature. Working definitions of important terminology utilized in this investigation are shown in Table (2.1).

**Table (2.2) Working Definition of Key Terms**

<b>No</b>	<b>Variable</b>	<b>Working Definition</b>
1	Control Environment	The control environment reflects the values of an organization, ethical commitment, committed to doing what is right
2	Risk Assessment	A risk assessment is the process of identifying what risk currently exist or may appear in the workplace.
3	Control Activities	Control activities are the policies and procedures that help ensure management directives are carried out.
4	Information and Communications	Information is circulated throughout the company, flowing up, down, and across the entity
5	Monitoring	Monitoring includes the continuous assessment of programs based on early detailed information on the progress or delay of the ongoing assessed activities.
6	Loan Performance	Loan performance essentially refers to the probably that the microfinance will be repaid the money it regular partially on a given loan.

## **CHAPTER (III)**

### **Internal Control Practices of Hana Microfinance in Myanmar**

This chapter presents role and overview of microfinance industry in Myanmar. In addition, the profile of Hana microfinance is also presented including the history of microfinance, background of Hana microfinance and microfinance in Myanmar.

#### **3.1 Overview of Microfinance in Myanmar**

Microfinance in Myanmar has had phenomenal growth ever since the country's law regulating the industry was enacted in 2011. It is believed that there are 33 million people living in this country who do not have a bank account, and there are a rising number of MFIs competing for their business. It is now widely acknowledged in Myanmar that microfinance is the single most important tool for eradicating cultures that are afflicted with poverty. If given the opportunity, low-income people who currently pay extremely high interest rates to unregulated money lenders would switch to using microfinance if given the choice. More than 99 percent of all businesses in Myanmar are classified as either small or medium-sized enterprises (SMEs), with the majority of these establishments being microbusinesses.

Microfinance programs usually target females in an effort to help them climb out of poverty. This is done with the understanding that if they are successful, they would be able to improve the quality of life for their families, as well as the educational opportunities available to their children. Microfinance is presently being provided for a diverse assortment of purposes, thanks to the incorporation of more than 250 authorized microfinance institutions (MFIs) based in both domestic and international locations. With the commercialization of the microfinance business, Myanmar will be able to entice investors. These investors will supply microfinance institutions (MFIs) with a variety of funding sources, allowing for tailored loans that may cater to a variety of needs.

Microfinance has experienced substantial growth in Myanmar over the past several years, becoming a large sector of financial service providers focused at the low-income population that is excluded from the regular banking system. In Myanmar, the majority of the population lives in poverty. The government recognizes the importance of inclusive finance as a tool in its fight against poverty and gives it a substantial role.

In November 2011, the law governing microfinance was approved by the Microfinance Supervisory Enterprise (MMSE), which has since been renamed the Financial Regulatory Department (FRD) and falls under the authority of the Ministry of Finance. In order to compete with foreign MFIs managed by INGOs that are already established in the nation, local MFIs have begun to form. The information regarding microfinance loans, savings, and staff that is detailed in the following paragraphs is the most up-to-date information available as of the year 2022.

## 1. Loan

Microfinance is a banking service that gives unemployed or low-income people or group's access to financial services that they would not otherwise have. People can obtain acceptable small business loans through microfinance in a secure manner that adheres to moral lending principles. There have been several loans made throughout Myanmar, and as of the third quarter of 2022, the total amount of loans that have been repaid nationwide is 2,253,236 million which includes in tables 3.1.

**Table (3.1) Loan Amount of Microfinance in 2022**

Year	Quarter	No. of MFI	Credit	
			Active Borrower	Loan Outstanding
2022	1 <sup>st</sup>	91	4,825,738	2,305,655
	2 <sup>nd</sup>	94	4,773,048	2,301,333
	3 <sup>rd</sup>	91	4,797,659	2,253,236
	4 <sup>th</sup>	-	-	-

Source: Myanmar microfinance association, 2022

## 2. Saving

Organizations and financial institutions encourage people to save money as a type of microfinance. Similar to typical savings accounts, savings accounts are made for small deposits. Savings have been collected from clients throughout Myanmar, and as of the third quarter of 2022, there are 317,909 million in outstanding savings nationwide which includes in table 3.2

**Table (3.2) Saving Amount of Microfinance in 2022**

Year	Quarter	No. of MFI	Saving	
			Active Client	Saving Amount
2022	1 <sup>st</sup>	91	5,507,700	312,395
	2 <sup>nd</sup>	94	5,452,012	307,014
	3 <sup>rd</sup>	91	5,409,611	317,909
	4 <sup>th</sup>	-	-	-

Source: Myanmar microfinance association, 2022

### 3. No. of Employee at Microfinance Industry

The following Table (3.3) shows the number of employees who are working in the microfinance industry. The highest number of employees in the microfinance sector is field officer. They are the main role and front line of the business and the rest number might be played in the supporting role of the industry.

**Table (3.3) Number of Employee in Microfinance Industry.**

Year	Quarter	No. of MFI	Staff information	
			No. of loan officer	No. of staff
2022	1 <sup>st</sup>	91	13,349	23,529
	2 <sup>nd</sup>	94	12,346	23,303
	3 <sup>rd</sup>	91	12,369	22,534
	4 <sup>th</sup>	-	-	-

Source: Myanmar microfinance association, 2022

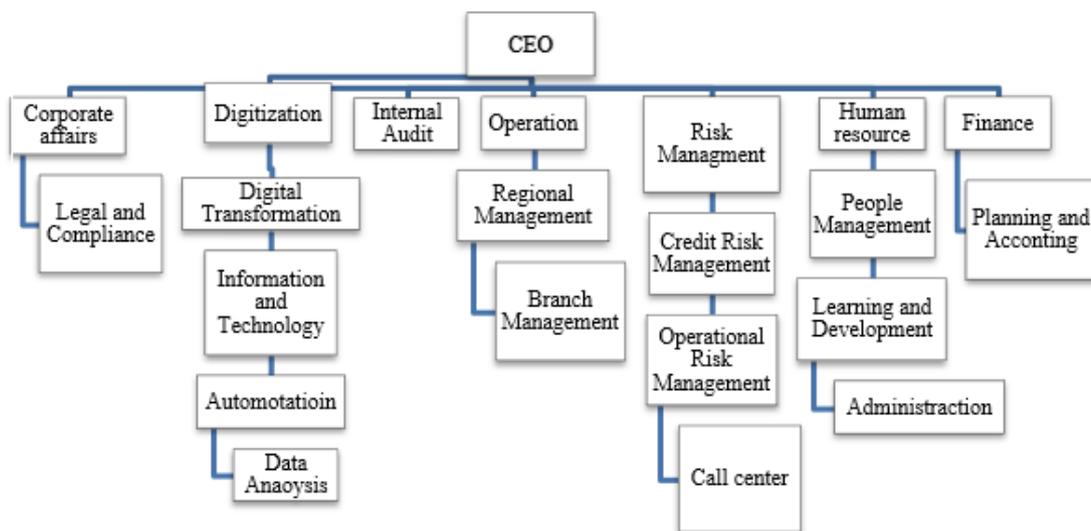
### **3.2 Profile of Hana Microfinance**

Hana Financial Group, which is one of the most significant bank holding organizations in South Korea, has a subsidiary that is referred to as Hana Microfinance Limited. It first opened its doors in August of 2013. The Hana Financial Group is working to build a name for itself as a financial institution that goes above and beyond to contribute to the development of a thriving society and to enhance the value of its shares for shareholders. It offers a wealth of options for all employees to realize their ambitions and assists customers in expanding both their assets and their companies. Hana Financial Group is well positioned to become one of the most successful financial organizations in the world as a result of its enormous global network, which is the most extensive in the Korean financial business.

Hana, which is one of the most significant microfinance organizations in Myanmar, makes available loans to satisfy the requirements of business owners who want to start up or expand their operations. Hana has around one thousand and five hundred workers working across its branches, which are located in fourteen states/divisions and Myanmar's Nay Pyi Taw Union Territory. Hana Microfinance allows individuals and small businesses that do not have access to traditional banking institutions to apply for microloans through their organization (individual and group). With the capital that we make available to them, our customers can either establish brand-new companies or grow the ones they already have. Additionally, Hana Microfinance provides clients with savings services that encourage them to develop a savings habit, have investment funds available when needed, have cash on hand for emergency situations, and transition from being borrowers to investors as their savings grow. These services include having investment funds available when needed, having cash on hand for emergency situations, and having investment funds available when needed.

Within the Hana microfinance organization, there are various departments. Due to the size of the company, a huge number of employees have been appointed. Each of them is striving to develop the company in a variety of ways, each inside the department that they are assigned to within the organization. The talents of a variety of employees were pooled together to build the foundation of the Hana microfinance enterprise. The organizational structure of Hana Microfinance can be found below in the following format:

**Figure (3.1) Organization Chart of Hana Microfinance**



Source: Hana microfinance, 2023

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### **3.3 Internal Control Practices of Hana Microfinance**

At Hana, the information pertaining to loans is processed by the operations department, the risk management department, and the internal audit department. The procedure for financing is handled by the operation. The department of risk management is responsible for approving loans and granting approvals that are directly related to loans, while the department of internal audit is responsible for analyzing the rules that were set by the departments that were tied to the loan.

**Control Environment-** Management at Hana makes it a point to remind each and every worker there to maintain their dignity at all times. The management ensures that there is no financial fraud in the workplace by not engaging in it themselves and taking severe disciplinary action against employees who commit fraud.

**Risk Assessment-** Getting hold of the necessary documentation for loan applications, ensuring that the data is accurate and comprehensive, and conducting research on the business that will stand as a guarantee. The department of risk management is responsible for approving loans and granting approvals that are directly related to loans

**Control Activities-** Sharing of responsibilities, efficient mechanisms for monitoring, and delegation of authority were all made possible because to Hana. The proper degrees of

inspections are carried out in line with the size of the loan, and the company is managed effectively with regard to its particular business manuals, regulations, and goods.

**Information and Communication-** Important information can also be evaluated based on the degree of position. Discussions and the exchange of information through the use of technology are encouraged at all times.

**Monitoring-** By carefully considering the perspectives of all of its workers, Hana makes it a priority to continuously improve. It is kept up to date by performing random inspections as well as making any necessary changes. Examination of producer compliance and adherence to predetermined policies on a stringent and routine basis. Monitoring of internal control mechanisms is done on a regular basis in order to improve the overall quality of loans and methodically deal with daily late loan repayments.

Hana is a client-focused micro lender that operates with integrity and always takes into account both the client's profitability and the client's benefits. Each procedure includes a variety of different internal control measures that are either directly or indirectly related to the amount of money that is being made from loans. If a client's monthly repayment amount is greater than 25 percent of their net income, the loan amount and loan term may be subject to change in order to prevent the client from becoming over-indebted. Hana Microfinance is required to keep a close eye on the financial flow of its clients in order to prevent over-indebtedness. If the loan amount requested by clients is higher than their monthly repayment amount and clients are confident that the requested amount is appropriate for the purpose of maximizing the profit of clients' businesses, then clients may choose to extend the load repayment period in order to lower the monthly repayment amount. This option is available to clients when the loan amount requested by clients is also higher than the monthly repayment amount. The client's cash flow as well as the information that was obtained are utilized in the process of carrying out the subsequent loan review while the loan contract is still in effect.

It is Hana's responsibility to provide both written and verbal explanations of its policies, rights, and procedures in the interest of maintaining open communication. Prior to the client registering, there must have been at least two meetings, the first of which must have been a group meeting (at the Village level), and the second of which must have been an individual meeting. Both of these meetings are required. In the event that customers lack financial awareness, Hana is obligated to provide a concise explanation of percentage computation. On the day that the customer is to sign the loan contract, which is also the day that the money will

be disbursed, Hana needs to read through each document in great detail. It is important that the signed contract as well as the original signed contract be kept at the branch office. One should be given to the customer as a presentation. Hana makes the necessary changes to the information and signs both the loan contract and the savings book for the client.

It is required of Hana to maintain the confidentiality of the personal information of each customer. Only for the purposes of conducting internal operations and determining credit should information about customers be used. Because Hana disclosed confidential information about her customers to a third party, she will be held accountable for her actions. No employee of Hana is permitted to disclose any personal information regarding a customer to a third party (non-Hana employees). It is against company policy for employees of Hana to disclose confidential business information to other Hana customers who live in the same township, ward, or village as those customers with whom they do business. Hana conducts her business with the goal of establishing connections with and effectively managing her clientele, which are the aspects that she cherishes and over which she exercises control.

### **3.4 Loan Performance**

Hana conducts ongoing analysis of the status of the loans and oversees their performance. Since the expansion of the company is inextricably linked to the success of the loans, the management closely tracks and assesses their status on an ongoing basis. Before the Covid period, loan performance was typically positive; but, after the Covid period, it significantly deteriorated as a result of members failing to return their loans and employees engaging in fraudulent activity. The organization's loan assessment process has a significant bearing on how well loans are performed, how quickly loans are repaid by the company, how well its internal control system works to cut down on bad debt, and how well its control system works to cut down on fraud when evaluating loan performance. The main indicator of loan performance is portfolio at risk, yield on loan portfolio, the amount of bad debt and rate of loan written off. The effect of internal control practices is directly effect to the loan performance. If the company can control the process of loan organization to the disbursement, loan performance must be good. Loan performance is the big asset of the microfinance industry which is directly proportional to the profit. The data is analyzed in the chapter four.

## **CHAPTER (IV)**

### **The Effect of Internal Control Practices on Loan Performance**

This chapter includes five sections. These are research design, profile of respondents, internal control practices and loan performance of Hana Microfinance, relationship between internal control practices and loan performance and effect of internal control practices on loan performance.

#### **4.1 Research Design**

This study focuses on the impact of Hana Microfinance's internal control procedures. 1,078 personnel from three departments, including internal audit, operations, and risk management, who are involved in Hana Microfinance's internal control procedures across the nation, make up the study's entire population. 25% of the population is used as a sampling point for data collection. The 269 employees in the sample were distributed proportionally by areas. The region spans the entire nation. Area 1 includes Bago, Kayin, Naypyidaw, and Rakhine; Area 2 includes Kayah, Mandalay, and Shan; Area 3 includes Chin, Magway, Mon, and Thanintharyi; Area 4 includes Ayawaddy, Kachin, and Sagaing; And Area 5 is Yangon, which serves as the country's capital. Following that, a proportional distribution of sample employees from each area based on the number of workers in each department is as follows in table 4.1

**Table (4.1) Total Number of Employees involved in the internal control practices**

<b>Department</b>	<b>Area 1</b>	<b>Area 2</b>	<b>Area 3</b>	<b>Area 4</b>	<b>Head Office</b>	<b>Grand Total</b>
Internal Audit Department	6	6	6	6	8	32
Operation Department	206	260	234	136	9	845
Risk Management Department	45	58	49	28	21	201
<b>Grand Total</b>	<b>257</b>	<b>324</b>	<b>289</b>	<b>170</b>	<b>38</b>	<b>1,078</b>

Sampling data is collected from the 25% of the population. Sample 269 employees was assigned proportionately by areas in the internal audit, operation and risk management department as follow.

**Table (4.2) Number of sample employees**

<b>Department</b>	<b>Area 1</b>	<b>Area 2</b>	<b>Area 3</b>	<b>Area 4</b>	<b>Head Office</b>	<b>Grand Total</b>
Internal Audit Department	2	2	1	1	2	8
Operation Department	52	65	59	34	2	212
Risk Managemen t Department	11	15	12	6	5	49
<b>Grand Total</b>	<b>65</b>	<b>82</b>	<b>72</b>	<b>41</b>	<b>9</b>	<b>269</b>

The control environment, risk assessment, control activities, information and communication, and monitoring are the five primary independent variables included in this study. Hana Microfinance's loan performance as an independent variable. There are three sections to the questionnaire survey. The questions about the respondents' backgrounds are in the first section. The second section contains of questions to measure independent variables that are practices of internal control techniques of Hana microfinance. Questions measuring the dependent variables, specifically loan performance, make up the third section. A 5-point Likert scale with the following values is utilized in this study: 1 (Strongly Disagree), 2 (Disagree), 3 (Neutral), 4 (Agree), and 5 (Strongly Agree). The Statistical Package for Social Sciences (SPSS) Version 22.0 application was used to analyze the data.

## **4.2 Demographic Profile of Respondents**

This part includes the personal profile of respondents which are gender, age level, and level of education, job position and year of experience in Hana. They are shown as in Table (4.3).

**Table (4.3) Demographic Profile**

Description		Frequency	Percent
Gender	Male	138	47.1
	Female	155	52.9
Age (Years)	Between 20-25	47	16.0
	Between 26-30	161	54.9
	Between 31-35	54	18.4
	Between 36-40	21	7.2
	Between 41-45	10	3.4
Level of Education (Degree)	Bachelor	284	96.9
	Master	9	3.1
Job Position	Area Operation Support Officer	1	.3
	Auditor	2	.7
	Customer Consultant Officer	4	1.4
	Field Officer	150	51.2

Year of Experience (Year)	1-3	121	41.3
	4-6	113	38.6
	7-10	20	6.8
	Below one year	39	13.3

Source: Survey Result, 2023

According to the data above, 138 respondents, or 52.9 percent, are men, while 155 respondents, or 47.1 percent, are women. There is a small discrepancy in the percentage of male and female respondents overall. The survey's largest group, consisting of 161 respondents, was between the ages of 26 and 30. The remaining respondents are ranked by their percentage age: 10 respondents aged 41–45, representing 3.4, 21 respondents aged 36–40, representing 7.2, and 54 respondents aged 31–35, representing 18.4. Most respondents, according to the data, are between the ages of 26 and 30. The largest group of survey participants—284 respondents with bachelor's degrees—represents 96.9 percent of all respondents. The remaining 9 responders, or 3.1 percent, were master's degree holders.

In the field officer job, which was the largest group in the study, there were 150 respondents, or 51.2 percent. 1 respondent served as the remaining group. 2 respondents, or 3% of area operation support officers, were surveyed. 7 percent of auditors, 4 respondents, 1.4% of customer consultant officers, and 2 respondents, respectively, were surveyed. 60 respondents, or 7% of internal auditors, were surveyed. 2,7% of regional auditors were represented by 2 respondents, and 8% of managers were represented by 7 respondents. 7 % of the regional junior internal auditor, 9.6 % of the regional officer, and 12.3 % of the supervisor were represented by 36 respondents, who made up the remaining 28 respondents.

According to the data, managers were the second-largest group of respondents, followed by filing offices. 39 respondents, or 13.3 percent, have less than one year of experience, 121 respondents, or 41.3 percent, have one to three years of experience, 113 respondents, or 38.6 percent, have four to six years of experience, and 20 respondents, or 6.8 percent, have seven to ten years of experience. According to the data, this survey's most common employment experience range was one to three years.

### 4.3 Employee Perception of Internal Control Practices

Internal control procedures, including the control environment, risk assessment, control activities, information and communication, and monitoring, are the main emphasis of this study. Based on a five-point Likert scale, the survey's data were divided into five categories: strongly disagree, disagree, neutral, agree, and highly agree. Each statement's mean value and standard deviation have been described as factors. If the mean values are greater than 3, it may be assumed that Hana Microfinance will firmly implement internal control measures inside the organization, and if the mean values are lower than 3, Hana will implement weak internal control measures.

**Table 4.4 Rating Scale**

<b>Score</b>	<b>Opinion</b>
1.00-1.80	Lowest

1.81-2.60	Low
2.61-3.40	Moderate
3.41-4.20	High
4.21-5.00	Very High

Source, Best, 2023

According the best 1977 on a five Likert scale, the mean score from 1 to 1.8 is lowest, from 1.81 to 2.60 is low, from 2.61 to 3.40 is moderate, from 3.41 to 4.20 is high and from 4.21 to 5 is considered as very high. In additional, standard deviation is less than 1 is considered to have no significant variation in the responses while the standard deviation is greater than 1 indicates that there are significant variations in the response.

### **4.3.1 Control Environment**

This variable was shown the existence of internal control environment in the Hana, The mean value and standard deviation for each statement related control environment in the following table.

Table (4.5) Employee Perception of Control Environment

No.	Control Environment	Mean	Standard Deviation
1	Top management at the Hana is committed to integrity and ethical values in the operations of the Hana.	4.12	0.840
2	Senior management in the risk management department is actively involved in supervising the credit risk.	4.21	0.769
3	Top management strictly adheres to existing policies, regulations, and procedure at the Hana.	4.17	0.744
4	Establishment of staff code of conduct has enhanced performance as they adhere to desired integrity levels fearing consequences of misconduct.	4.13	0.773
5	Company provides training on ethical compliance to improve employee morale.	4.20	0.782
<b>Overall Mean Value</b>		<b>4.16</b>	

Source: Survey data, 2023

The Hana microfinance environment's region of control is demonstrated. According to the aforementioned findings, senior management in the risk management division actively supervises the credit risk mean value. 4.21, the business offers ethical compliance training to raise employee morale imply value At the Hana mean value of 4.20, senior management strictly follows to the current rules, laws, and procedures. 4.17, the implementation of a staff code of conduct has improved performance because employees maintain the appropriate integrity levels out of fear of the negative effects of misconduct. 4.13 and upper management at Hana are dedicated to honesty and moral principles in conducting business 4.12. Hana Microfinance's total control environment has a mean rating of 4.16, which indicates that it has a solid control environment.

### 4.3.2 Risk Assessment

This variable was shown the existence of risk assessment in the Hana, The mean value and standard deviation for each statement related risk assessment in the following Table (4.6)

Table (4.6) Employee Perception of Risk Assessment

No.	Risk Assessment	Mean	Standard Deviation
1	Risk management department has effective credit risk assessment tools in place.	4.08	0.815
2	Risk management department has defined clear goals and objectives on the credit risk control.	4.09	0.823
3	All employees in risk management department are well trained on credit risk assessment.	4.02	0.829
4	Risk management department has communication channels in place to notify staff of changes in operational practices.	4.01	0.832
5	Hana handles risks appropriately and efficiently, with internal controls in place to reduce known credit risks.	4.10	0.798
<b>Overall Mean Value</b>		<b>4.06</b>	

Source: Survey data, 2023

The results demonstrate that Hana manages risks effectively and correctly, and internal controls are in place to decrease known credit risks. 4.10, the department of risk management has established specific aims and objectives for the mean value of credit risk control. 4.09, the risk management division has efficient instruments for evaluating credit risk in situ mean value All risk management department workers have received adequate training in credit risk assessment (mean value: 4.02), and the risk management department has established mechanisms for informing personnel of changes to operational procedures (mean value: 4.01) Hana has solid practices for producing risk assessments as part of its internal control system, as evidenced by the risk assessment's overall mean value of 4.06.

### 4.3.3 Control Activities

This variable was shown the existence of control activities in the Hana, The mean value and standard deviation for each statement related control activities in the following table.

Table (4.7) Employee Perception of Control Activities

No.	Control Activities	Mean	Standard Deviation
1	Top management closely supervises carrying out of internal controls.	3.99	0.763
2	Online information system tracks the status of loan performance of the client and supports adequate management reporting.	3.95	0.828
3	There is adequate segregation of duties in risk management department.	3.97	0.814
4	Loan assessment is approved by responsible authorized employees.	4.02	0.836
5	It is impossible for one staff to have access to valuable data information without the consent of a senior staff	4.09	0.862
<b>Overall Mean Value</b>		<b>4.00</b>	

Source:

Survey data, 2023

The results, as shown in Table (4.7), indicate that the mean value of Without the approval of a senior staff member, it is difficult for one employee to get access to important data. 4.09, authorized workers with responsibility approve the loan assessment; mean value 4.02, top management actively monitors internal control implementation mean value The impact of proper duty separation in the risk management department's mean value is =3.99 3.97 and an online information system that allows proper management reporting mean value tracks the client's loan performance. 3.95. Han reportedly paid attention to the internal control system's control activities, as indicated by the total mean value for control activities of 4.0.

#### 4.3.4 Information and Communication

This variable was shown the existence of information and communication in the Hana, The mean value and standard deviation for each statement related information and communication in Table (4.8).

**Table (4.8) Employee Perception of Information and Communication**

<b>No.</b>	<b>Information and communication</b>	<b>Mean</b>	<b>Standard Deviation</b>
1	Management has identified individuals responsible for coordinating appropriate communication on implementation of internal controls.	4.09	0.741
2	Hana has a process in place to communicate relevant and timely information to external parties.	3.99	0.752
3	Whistleblowing policy exist for reporting suspected irregularities regarding fraud and other improper use of cash.	4.07	0.869
4	There is free flow of information between top management and other levels of management at operational level	4.01	0.846
5	There is a clear procedure on how financial reports are submitted to the external auditors, government's staff and lenders.	4.03	0.762
<b>Overall Mean Value</b>		<b>4.03</b>	

Source: Survey data, 2023

The mean value of a statement pertaining to the Hana microfinance information and communication channel and process is displayed in Table (4.8). The results show that management has designated personnel in charge of coordinating adequate communication on internal controls implementation mean value 4.09 There is a whistleblower policy communication route available for reporting fraud and other alleged unlawful uses of cash mean value. 4.07, state the precise process by which financial reports are delivered to the employees of the government, external auditors, and lenders signify value 4.03, 4.01 for the operational level communication channel between top management and other levels of management, and 3.99 for the process of communicating pertinent and timely information to third parties. From the aforementioned facts, it can be shown that Hana has a free-flowing information channel of communication system inside the organization because the overall mean value is 4.03.

### 4.3.5 Monitoring

This variable was shown the existence of monitoring in the Hana, The mean value and standard deviation for each statement related information and communication in Table (4.9)

**Table (4.9) Employee Perception of Monitoring**

No.	Monitoring	Mean	Standard Deviation
1	Hana has put in place appropriate supervisory structures to support accountability of resources.	4.02	0.726
2	Regular credit committee meetings are held to evaluate the quality of loan performance.	4.20	0.715
3	The Internal Audit department in the Hana is independent and reports to top management.	4.11	0.762
4	Each department is responsible for the effective implementation and operation of the internal control procedures.	4.13	0.733
5	The internal control system efficiency is continuously assessed and monitored by the management.	4.08	0.748
<b>Overall Mean Value</b>		<b>4.10</b>	

Source: Survey data,2023

Regular credit committee meetings are held to assess the quality of loan performance, and the department supporting the other department responsible for the effective implementation and operation of the internal control procedures has a mean score of 4.13. The independent internal audit and its reporting to top management has a mean score of 4.20. Hana has the necessary supervision structures to promote resource accountability mean value 4.02, the management regularly evaluates and monitors the effectiveness of the internal control system mean value 4.08, and The average score is 4.10. Hana has an effective monitoring system in terms of internal control procedures, it may be said.

Table provides the overall mean value of Hana Microfinance's internal control procedure (4.10).

**Table (4.10) Overall Mean Value of Internal Control Practices**

No.	Particular	Mean
1	Control Environment	4.16
2	Risk Assessment	4.06
3	Control Activities	4.00
4	Information and Communication	4.03
5	Monitoring	4.10

The respondents are quite happy with the Hana's control environment, as shown by Table (4.10). According to the responders, Hana has a strong control environment and supports everyone's integrity. The respondents then favor Hana's strict monitoring procedure, which is also a highly important tool for achieving goals quickly. The reply then mentions that Hana is now continuously developing its risk assessment procedure. Hana attempts to create a communication system using technology this year as part of information and communication. Therefore, it will soon still be evolving. The respondents next answer the control activities question, which has the lowest mean score but a higher average. The respondents preferred not to use stringent internal control procedures since they could make the change process difficult to implement and strict.

#### **4.4 Loan Performance of Hana Microfinance**

This part can be presented loan performance of Hana microfinance. Loan performances are reviewed by the five-point Likert scale (1= strongly disagree, 2= disagree, 3= neutral, 4= agree, 5 = strongly agree). This variable was shown loan performance, The mean value and standard deviation for each statement related information and communication in Table (4.11).

**Table (4.11) Loan Performance**

<b>No.</b>	<b>Loan Performance</b>	<b>Mean</b>	<b>Standard Deviation</b>
1	Loan assessment process in the organization has a significant influence on its loan performance	4.19	0.731
2	On time repayment of the company is positive effected from its loan performance	4.33	0.724
3	The company's internal control system aids to reduce bad debt	4.07	0.788
4	The company's control system helps to reduce occurrence of frauds	4.13	0.793
5	The company's internal control system helps to improve loan performance	4.23	0.712
<b>Overall Mean Value</b>		<b>4.19</b>	

Source: Survey data,2023

According to the table, the study's findings showed that the internal control system aids in the company's timely repayment, which has a good impact on its loan performance mean value of 4.33. It also aids in raising the loan performance mean value. 4.19, the company's control system aids in lowering the incidence of fraud mean value 4.13, the management of internal control system aids in lowering bad debt mean value 4.07, and the loan assessment procedure in Hana has a significant impact on its loan performance mean value 4.23. The aggregate mean value result is 4.19, indicating a favorable impact on loan performance.

#### **4.5 Relationship between Internal Control Practices and Loan Performance**

This section explains the connection between Hana Microfinance's loan performance and internal control system components. The components of internal control procedures are the independent variables in this section, and Hana Microfinance's loan performance is the dependent variable. This study uses a questionnaire with a Likert scale to analyze the dependent and independent variables. Therefore, it is appropriate to apply Pearson's correlation to analyze those relationships.

**Table (4.12) Correlation of Internal Control Practices and Loan Performance**

No	Factors	Correlation Coefficient	P-Value
1	Control Environment	.869**	.000
2	Risk Assessment	.811**	.000
3	Control Activities	.790**	.000
4	Information & Communication	.804**	.000
5	Monitoring	.848**	.000

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

Source; Survey data, 2023

The correlation coefficient for dependent factors (Control Environment, Risk Assessment, Control Activities, Information & Communication, and Monitoring) and independent variables is displayed in Table (4.12) in accordance with Pearson's correlation (non-financial performance and financial performance).

The most direct association between loan performance and the survey's control environment is the correlation coefficient, which is close to 9.00. the section of the internal control process that is ranked in terms of monitoring, risk assessment, and information and communication. Control activities, which are correlated with internal control practices at the lowest level of 0.7 and 1% significance in this survey, had the least impact on loan performance..

#### **4.6 Analysis on the Effect of Internal Control Practices on Loan Performance**

This study evaluates the effect of internal control practices on loan performance in Hana microfinance. Multiple regression analysis was applied in this study.

**Table (4.13) Effect of Internal Control Practices on Loan Performance**

Independent factor	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	VIF
	B	Std.Error	B			
Constant	.386	.112		3.441	.001	
Control Enviroment	.373***	.058	.389	6.459	.000	5.476
Risk Assessment	.103*	.056	.118	1.841	.067	6.170
Control Activities	.024	.058	.025	.411	.681	5.591
Information and Communication	.188***	.047	.190	3.985	.000	3.435
Monitoring	.240***	.058	.242	4.138	.000	5.165
Adjusted R Square						.807
F Value						245.164

Source; Survey data, 2023

Notes: \*\*\* Significant at 1% level, \*\* Significant at 5% level \* Significant at 10% level

According to Table 4.10's multiple regression analysis, the independent variable contributed 80.7% of the variation in loan performance, which was explained by an adjusted R<sup>2</sup> of .807. The results demonstrate Hana's successful loan performance. The control environment, information and communication, and monitoring all have P values of 0.000, or less than 0.001. (1 percent level of significant). The risk assessment's P value was 0.067, which is less than 0.1. (10 percent level of significant). Thus, it demonstrates how internal control procedures for information & communication, monitoring, and risk assessment have a substantial impact on Hana Microfinance's loan performance.

## **CHAPTER (V)**

### **CONCLUSION**

This chapter concludes with a summary of the findings, recommendations, and need for additional research. The study's findings show a relationship between internal control procedures and Hana Microfinance's loan performance. This study makes recommendations based on its findings and urges more research..

#### **5.1 Findings and Discussions**

Identification of Hana Microfinance's internal control procedures and an analysis of how those procedures affect Hana Microfinance's loan performance are the study's two key goals. The primary conclusions of this study can be categorized into two categories. Hana Microfinance has internal control procedures, and these procedures have an impact on how well loans perform. A descriptive research approach was used, and a sample of employees from the operation, risk management, and internal audit departments—which play a big part in overseeing the internal control procedures for the company's first, second, and third lines of defense—were employed in the study. Of the 1078 individuals who work in the operation, risk management, and internal audit departments, 293 have responded, or more than 25%. The study used questionnaire-based primary data, which was then subjected to multiple regression analysis based on descriptive statistics.

This study examines certain demographic factors like gender, age, education level, work position, and length of employment with present business. A percentage analysis is performed on the data. According to the results, women make up the majority of the respondents. The majority of responders are between the ages of 26 and 30, and the majority have bachelor's degrees as their highest level of schooling. The positions of field officer and branch manager received the majority of responses. Regarding working experience, the majority of respondents had had jobs for 4-6 years.

The degree of Hana Microfinance's internal control practices' adherence is investigated in the other section. Hana has a good control environment and management at the Hana is dedicated to integrity and ethical values in the activities of the Hana, according to the highest mean value of the researched survey results. To boost employee morale, management

established a staff code of conduct, integrity levels that feared the consequences of misconduct, and encouraged ethical compliance.

Hana has a risk management system that is above average based on the risk assessment's mean results. Hana manages risks effectively by putting internal controls in place to lower known credit risks and by providing credit risk assessment training to all employees in the risk management department.

Control actions receive the mean value's lowest score. The outcome showed that the client's loan performance was not successfully tracked by the online information system, which also did not provide acceptable management reporting. The risk management department needs to increase proper job separation, and senior management must actively monitor the implementation of internal controls. The data indicates that control operations are not good, even though monitoring is intended to be good. Generally speaking, if the monitoring is effective, the personnel must adhere completely to the control measures. However, the results show that there is just a weak link. It's possible that the branch office only performs a cursory amount of some rules and producers set by the management. The loan information that was collected from online sources needs to be completed. The division of responsibilities by the risk management department could be biased.

Additionally, it can be demonstrated that management has designated individuals in charge of coordinating appropriate communication regarding the implementation of internal controls and that there is a policy in place to encourage reporting suspected irregularities involving fraud and other improper use of cash.

Hana uses a monitoring system that is aligned with company operations and follows best practices. The effectiveness of the internal control system is regularly evaluated and monitored by management. Hana's department is aware that it is in charge of successfully implementing and running the internal control procedures.

Regression analysis revealed that risk assessment came behind control environment, information and communication, and monitoring as the most important factors. The outcome showed that the least important level of internal control for loan performance is control activities.

Internal control, the internal control environment, and monitoring have the strongest mean values in this study, it can be said. These two actions make up the smallest portion of

internal control and play a significant influence in it. Internal control practices' remaining components, such as risk analysis and information and communication sharing, are at a modest level. The results of the correlation coefficient demonstrate a positive association between Hana Microfinance's internal control system and loan performance. The regression model's findings demonstrate that the performance of loans is significantly influenced by three primary factors: control environment, control actions, and monitoring..

## **5.2 Suggestions and Recommendations**

The management of the company should concentrate on improving control of the environment, information and communication, and monitoring in light of the findings, as these factors are directly related to getting good loan performance.

Hana has a clear understanding of integrity and ethical ideals, and she must always promote these values. Management upholds a culture and fosters a positive work environment. On the other hand, management established a solid action plan for breaking the law as well as clear guidelines to follow ethical standards.

The risk management department should have established mechanisms for informing personnel of modifications to operational procedures. We will be able to recognize the changes and carry out a better risk assessment thanks to risk management. The risk management department should make an effort to be aware of operational changes in advance and teach the staff to be able to analyze the risks associated with the changes.

The least significant and basic ways are control actives. This showed that the respondents did not really appreciate the question in this section, and the findings indicate that it is not significant. But in the risk management department, proper job segregation is crucial. It lessens the possibility of mistakes and inappropriate behavior. By preventing any employee from committing and covering up errors or fraud while performing their regular activities, segregation of roles is a crucial internal control that aims to reduce the likelihood of either happening. The ability to be accountable for work comes only with knowledge of responsibility. Therefore, further research should be done on the division of labor in control operations, and a Hana solution should be found. When checking on branches and ensuring the implementation of issued orders, management should be specific.

The results demonstrated the value of communication and information in the internal control system. By using digitization, information may freely move from the bottom to the top while also creating a strong communications infrastructure. The management promotes open

communication among all employees and believes that a productive workplace can only be established through efficient communication.

Monitoring offers a way to evaluate the critical connection between those who implement the strategy of the decision-makers and those who benefit from it on the ground. Hana has an effective monitoring system and advises people to keep up excellent habits, establish consistent monitoring, and carefully adhere to it.

To get the best loan performance, all of these recommendations should be carried out with the appropriate supervision. This study demonstrated the relationship between internal control procedures and loan performance. Hana's internal control procedures are generally well-developed, but Hana should continue to research, monitor, and implement new internal control systems to support a company's good effects..

### **5.3 Need of Further Study**

This study looked at how internal control procedures affected the performance of loans. Only Hana workers, who primarily manage the internal control system, responded to the poll. The department of digital and automation should receive the questions, examine the answers, and assess their comprehension. Then establish a system between the internal control department and digitization. Today, digitization is unavoidable. It is significantly more efficient to develop a solid internal control system through digitization. The digital platform's decision-making and monitoring systems are significantly more convenient, time- and money-saving. The impact and connection between internal control systems and digitization should therefore be the main areas of future research. The knowledge gap between management and employees about task segregation is discovered. Therefore, further research on the division of labor in control operations is necessary.

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## **Appendix**

### **Part-I**

#### **Name-**

#### **1. Location**

Area-1

Area-2

Area-3

Area-4

Head Office

#### **2. Gender**

Male

Female

#### **3. Age Level**

Age between 20-25

Age between 26-30

Age between 31-35

Age between 36-40

Age between 41-45

Age between 46-50

#### **4. Level of Education**

Bachelor's degree

Master's degree

#### **5. Job position**

Manager

Supervisor

Regional Officer

Field Officer

Auditor

- Regional Auditor
- Other (type position)

**6. Year of experience in current company**

- Below one year
- 1 - 3years
- 4 - 6years
- 7 - 10 years

**Part-II**

Please indicate the extent to which you agree or disagree with the following.

1 = strongly disagree, 2 = disagree, 3 = Neutral, 4 = agree, 5 = strongly agree.

Please tick (√) appropriately.

<b>Control Environment</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
1. Top management at the Hana is committed to integrity and ethical values in the operations of the Hana.					
2. Senior management in the risk management department is actively involved in supervising the credit risk.					
3. Top management strictly adheres to existing policies, regulations, and procedure at the Hana.					
4. Establishment of staff code of conduct has enhanced performance as they adhere to desired integrity levels fearing consequences of misconduct.					
5. Company provides training on ethical compliance to improve employee morale					

<b>Risk Assessment</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
6. Risk management department has effective credit risk assessment tools in place.					

7. Risk management department has defined clear goals and objectives on the credit risk control					
8. All employees in risk management department are well trained on credit risk assessment					
9. Risk management department has communication channels in place to notify staff of changes in operational practices.					
10. Hana handles risks appropriately and efficiently, with internal controls in place to reduce known credit risks.					

<b>Control Activities</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
11. Top management closely supervises carrying out of internal controls					
12. Online information system tracks the status of loan performance of the client and supports adequate management reporting.					
13. There is adequate segregation of duties in risk management department					
14. Loan assessment is approved by responsible authorized employees					
15. It is impossible for one staff to have access to valuable data information without the consent of a senior staff					

<b>Information and Communications</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
16. Management has identified individuals responsible for coordinating appropriate communication on implementation of internal controls					
17. Hana has a process in place to communicate relevant and timely information to external parties					
18. Whistleblowing policy exist for reporting suspected irregularities regarding fraud and other improper use of cash					

19. There is free flow of information between top management and other levels of management at operational level					
20. There is a clear procedure on how financial reports are submitted to the external auditors, governments staff and lenders					

<b>Monitoring</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
21. Hana has put in place appropriate supervisory structures to support accountability of resources.					
22. Regular credit committee meetings are held to evaluate the quality of loan performance					
23. The Internal Audit department in the Hana is independent and reports to top management.					
24. Each department is responsible for the effective implementation and operation of the internal control procedures					
25. The internal control system efficiency is continuously assessed and monitored by the management					

<b>Loan Performance</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>
26. Loan assessment process in the organization has a significant influence on its loan performance					
27. On time repayment of the company is positive effected from its loan performance					
28. The company's internal control system aids to reduce bad debt					
29. The company's control system helps to reduce occurrence of frauds					
30. The company's internal control system helps to improve loan performance					