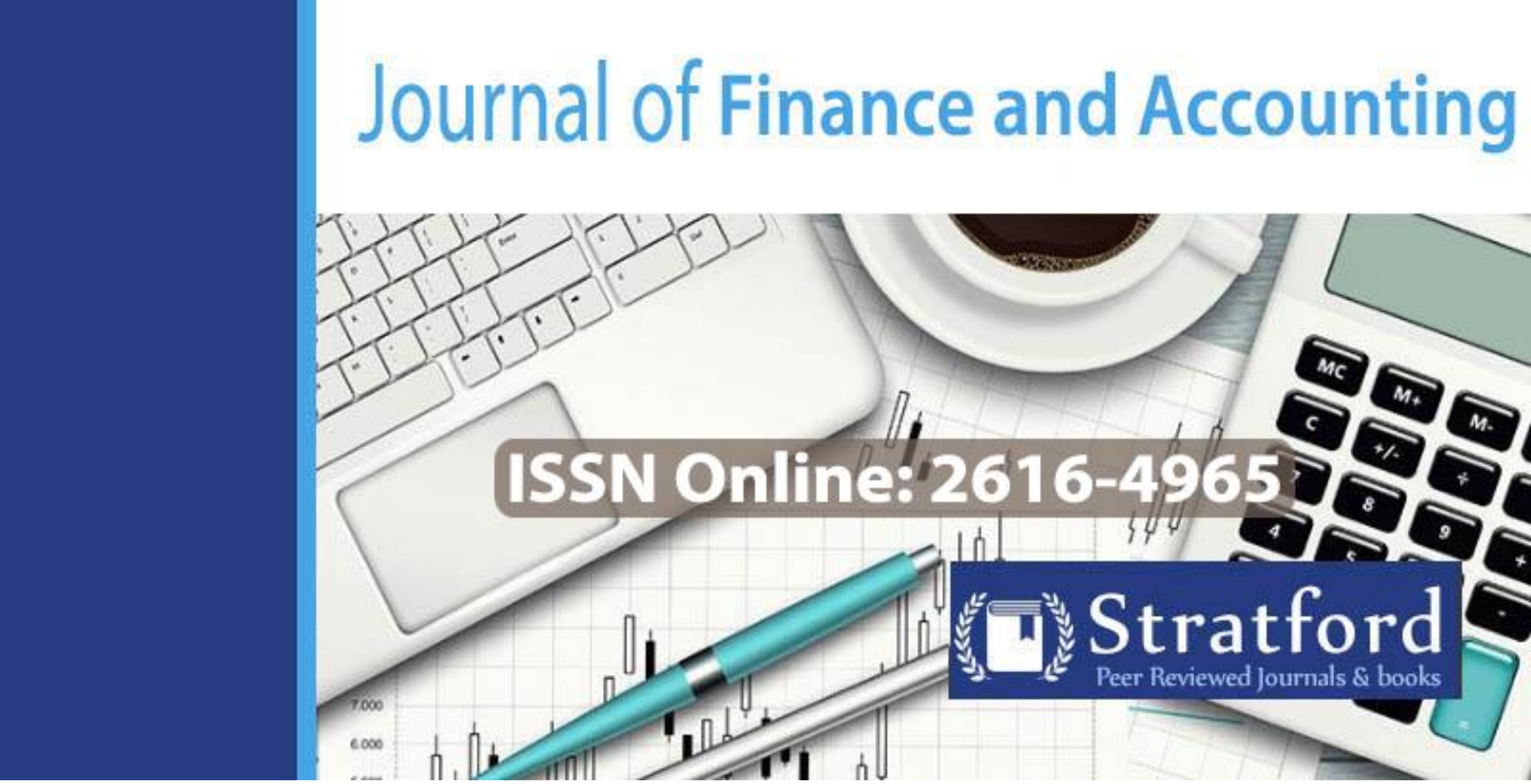

Effect of Internal Control System on Financial Performance of Transport Companies in Rwanda. A Case of Rwanda Interlink Transport Company Limited

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Abstract

The aim of this study was to establish the effect of internal control systems on financial performance of transport companies in Rwanda. The area scope of the study was Rwanda Interlink Transport Company Limited (Ritco Ltd). This study was guided by attribution theory, agency theory, and institutional theory. The study used mixed methods, both quantitative and qualitative. The nature of data was both primary and secondary data and were collected to enable the researcher to reach the conclusion. This study employed descriptive and correlational research design. The target population was the employees of Rwanda Interlink Transport Company Limited. The sample size was determined using stratified and simple random techniques. The total number of sampled respondents was 155 to represent the total population. Data was collected using questionnaire and interview guide as data collection instruments. The data was analyzed using SPSS software by determining descriptive statistics such as simple percentages, means and standard deviations. Regression analysis was also used to determine the relationship or correlation level between independent and dependent variables. The study found strong positive correlations between control environment ($r = 0.625^{**}$, $p = 0.000$) and control activities ($r = 0.946^{**}$, $p = 0.000$) with financial performance. Similarly, risk assessment ($r = 0.764^{**}$, $p = 0.000$), information and communication ($r = 0.605^{**}$, $p = 0.000$), and monitoring of controls ($r = 0.634^{**}$, $p = 0.000$) also showed strong positive correlations with financial performance. The overall prediction of these variables on financial performance was high ($r = 0.980$), with an R square of 0.961, indicating that 96.1% of the changes in financial performance could be explained by these predictors. The study concluded based on the findings that internal control system has significant effect on the financial performance of Rwanda Interlink Transport Company Limited. The study recommends the management of the company under review and government agencies to ensure improved efficiency in application of internal control system in their operations.

Keywords: *internal control system, transport companies, financial performance***.**

1.1 Introduction

Internal controls are those measures established and adopted by the firm/company to ensure the efficiency and effectiveness in its operations which lead to the achievement of its mission, goals, and objectives. The control environment, entity's risk assessment process, information system, control activities, and monitoring are the components of internal control. There are various controls or measures including policies and procedures established by the companies to ensure that their operations are carried out in appropriate and acceptable manner which prevent theft and misuse of the firm's resources.

Internal controls are procedures created and implemented by those responsible for management, governance, and other functions to offer a reasonable level of assurance regarding the accomplishment of an entity's goals with regard to the accuracy and dependability of financial reporting, the effectiveness and efficiency of operations, and compliance with applicable laws and regulations (Mwindi, 2008). It is important to keep in mind that internal controls only give a company's management and board of directors a fair amount of assurance and not an absolute guarantee that the organization's goals will be met. Limitations present in every system of internal control have an impact on the chances of performance (Hayes et al., 2005).

Globally, effective internal control processes are critical for ensuring the stability and performance of financial institutions. For example, Hayali et al. (2012) found that the Turkish banking system's robust internal control operations, aligned with international standards, significantly contribute to the sector's strong and stable outlook. Regionally, in Africa, the effectiveness of internal control systems varies widely. In Ghana, Inusah and Abdulai (2015) noted that the Lands Commission's insufficient internal controls and lack of oversight hinder its operations, while in Sudan, Ayom (2013) discovered that internal auditing in NGOs failed to ensure proper financial accountability and efficient use of donor funding despite compliance with operational rules. In Kenya, inadequate ICT and lax internal controls have led to fraud and embezzlement among county administrations (Musya, 2014), whereas manufacturing enterprises with strong internal controls showed better financial performance (Kamau, 2014).

Locally in Rwanda, studies emphasize the importance of robust internal control systems for financial performance. Bashaija (2022) highlighted that risk management and control environment are crucial for the financial performance of commercial banks. Similarly, Muyenzi (2016) found a positive correlation between the internal control systems and the financial performance of public institutions, indicating that enhancing internal controls positively impacts the success of these organizations. These findings collectively underscore the critical role of effective internal control systems in improving financial performance across various sectors and regions. Therefore, this study aimed to investigate the effect of internal control systems on the financial performance of transport companies in Rwanda. A case of Rwanda Interlink Transport Company Limited.

1.2 Statement of the problem

Businesses are failing, most of which might have been prevented. Despite the numerous rules and regulations that have been put in place by different regulatory organizations and governments, the world has recently seen frauds of all kinds. Business failures have an economic impact that is devastating to a country's economy (Ewa et al., 2012).

Transport industry is one of the challenging businesses not only in Rwanda but also across the world. Transport companies need strong internal control systems to ensure operational and financial efficiency. Many firms encounter inefficiencies in their operations resulting from the lack of internal control systems or ineffective internal control systems being applied. Such operational inefficiencies include cash theft, misuse of the firms' assets in personal interests, frauds and many others that could affect the financial performance of the firm.

During the second quarter 2022, fleet used by licensed public transport bus and minibus companies and cooperatives decrease by 6.5% from 2226 of quarter four 2021to 2090 of quarter two 2022. Fleet used by licensed public transport bus and minibus companies and cooperatives also decrease by 2.1% from 2135 of quarter one 2022 to 2090 of quarter two 2022 (RURA, 2022).

In addition, during the second quarter 2022, the seating capacity for public transport bus service decreased by 5% from 67,386 in quarter one 2022 to 63,934 in quarter two 2022. The total seating capacity for both intercity and city public transport service companies and cooperatives decreased. There was a decrease of 2.4% in the intercity total fleet while in the city the decrease was 29.9% of the total fleet (RURA, 2022).

This decline in the companies' fleets shows that resources are not efficiently managed as a result of lack or ineffective internal controls in place. Internal control systems need to be effective and operational to detect frauds that might arise and prevent any potential misuse of the company's resources. Effectiveness of the internal control systems prevents and detects frauds in the firm and enhance its financial performance.

Based on the above-mentioned statistics, this study aimed to investigate the effect of internal control systems on the financial performance of transport companies in Rwanda. A case of Rwanda Interlink Transport Company Limited.

1.3 Research hypotheses

Ho1: There is no significant effect of control environment on the financial performance of Rwanda Interlink Transport Company Limited.

Ho2: The control activities have no significant effect on the financial performance of Rwanda Interlink Transport Company Limited.

Ho3: The risk assessment has no significant effect on the financial performance of Rwanda Interlink Transport Company Limited.

Ho4: There is no significant effect of information and communication on the financial performance of Rwanda Interlink Transport Company Limited.

Ho5: Monitoring of controls have no significant effect on the financial performance of Rwanda Interlink Transport Company Limited.

2.0 Literature Review

This section contains the theoretical review that provides explanations on various theories that guided the study.

It also shows empirical review which shows the studies of other authors regarding internal control systems and financial performance.

2.1 Theoretical Review

According to Creswell (2006) a theory is a bundle of assertions or guiding ideas developed to explain a set of facts or events, particularly one that has undergone extensive testing or is generally accepted and that can be used to forecast natural phenomena. This study adopted three theories, namely: attribution, agency and institutional theories.

2.1.1 Attribution Theory

Attribution theory, developed by Fritz Heider in 1958, explains how behavior and events are interpreted and their causes determined (Schroth & Shah, 2000). Reffett (2007) asserted that differences in handling similar situations are often attributed to personality differences rather than situational behavior. Wilks and Zimbelman (2004) and Schroth & Shah (2000) echoed similar sentiments. Assessors frequently attribute internal control failures to auditors' negligence and revenue generation issues. Bonner et al. (1998) noted that auditors might be sued if they fail to detect fraud affecting financial performance, while Reffett (2007) emphasized that undetected fraud risk by auditors can be detrimental to an organization. Attribution theory posits that auditing determines the efficiency of an organization's internal control systems, requiring auditors to have a thorough understanding of these systems for proper revenue generation. This theory is relevant to the study as it highlights that control activities, like internal audits, are crucial elements of control systems that help prevent fraud.

2.1.2 Agency Theory

Jensen and Meckling (1976) created agency theory, which views a business as a network of agreements among stakeholders. This theory suggests conflicts between owners and executives regarding the company's best interests. An agency relationship arises when a principal delegates tasks to an agent, potentially leading to the agent exploiting the principal, creating an agency problem. Internal control is essential to address this issue (Jensen & Payne, 2003). Research shows that internal controls reduce agency costs and improve financial performance (Abdel-Khalik, 1993). Agency theory justifies the need for monitoring controls such as financial statement audits, external directors, audit committees, internal audits, and compensation plans (Arwinge, 2013). These controls mitigate knowledge asymmetries between principals and agents and are crucial for addressing agency problems, highlighting the theory's relevance to this study.

2.1.3 Institutional Theory

Institutional theory, rooted in the works of Meyer and Rowan (1977) and DiMaggio and Powell (1983), offers a sociological perspective on how control methods are adopted within organizations. According to Etengu and Nasieku (2015), businesses adopt management strategies and operating procedures deemed appropriate by their industry peers, reflecting or responding to the laws and

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structures in their environment. Arwinge (2013) adds that management often looks to industry standards, company traditions, and management fads when developing new control techniques, beyond just cost-benefit considerations. From this institutional perspective, controls are implemented to gain legitimacy and for other less rational reasons. Governance controls like risk assessments, pay committees, and regulations are often adopted to signal commitment to important issues, influenced by company traditions, industry standards, and mimicking other businesses. This theory is relevant to the study as it explains how management can internally develop control techniques to enhance the firm's financial performance.

2.2 Empirical Review

Generally, several studies have been done with respect internal control systems on the financial performance. This section shows related literature reviewed. According to Hayes *et al.* (2005), internal control is made up of five elements: the control environment, control activities, the entity's risk assessment, information and communication systems, and monitoring of controls.

2.2.1 Control Environment and Financial Performance

In order to determine the connection between internal controls and corporate governance in Kenyan commercial banks, Olumbe (2012) conducted a study. The 45 commercial banks in Kenya were all the subject of a survey by the researcher. It was determined that the majority of banks had implemented the various metrics for evaluating internal controls and corporate governance. This was demonstrated by the methods used to gather information about it, which revealed that the respondents agreed that their banks had implemented good corporate governance along with a robust system of internal controls and that there is a relationship between internal control and corporate governance. Ayagre, *et al.* (2020) researched the effectiveness of internal controls in Vietnamese Credit institutions. The results showed that all five components improve the effectiveness of the internal control system, and the internal control system plays a role in the safety of Vietnamese credit institutions.

2.2.2 Control Activities and Financial Performance

Internal control operations take place all throughout the organization, according to Rezae *et al.* (2001). They cover a wide range of procedures such approvals, authorizations, verifications, reconciliations, reviews of operational performance, asset security, and separation of roles. Control activities include a wide range of different tasks like authorizations, authorizations, verifications, reconciliations, performance reviews, security maintenance, and the creation and upkeep of related records that serve as appropriate documentation and proof that these tasks were completed (Steeves, 2004).

Ejoh and Ejom (2014) investigated the connection between internal control activities and financial performance in Nigerian tertiary institutions. The study's findings also demonstrate that there is no meaningful correlation between the financial performance of Cross River State College of Education and internal control operations.

A study on audit committee effectiveness, internal audit function, and sustainability reporting methods in Uganda was carried out by Tumwebaze *et al.* in 2022 using the case of Centenary Bank. The findings showed that the R correlation of 0.932 demonstrated a substantial positive

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association between predictors and return on equity. The predictors account for 86.8% of the variance in return on equity, according to the coefficient of determination of 0.868 R square. Accordingly, 86.8% of Centenary Bank's progress can be attributed to internal control system indicators as well as other metrics including return on equity, income generation, and long-term investment. According to Chang et al. (2019), management should regularly assess control actions to see whether they are still necessary and make any necessary adjustments. According to GamageLow and Keving (2018), control actions guarantee that all necessary procedures are performed to reduce risk and support companies in achieving their goals.

2.2.3 Risk Assessment and Financial Performance

The identification of pertinent risks that might have an impact on the accomplishment of management goals, according to Chen et al. (2020), is facilitated by risk assessment. According to Association of Chartered Certified Accountants, ACCA (2004), assessing risks entails looking at and building arrangements to mitigate risks related to the achievement of corporate goals. The management developed the policies and procedures that make up the control activities in order to ensure the efficiency of carrying out tasks in relation to the achievement of organizational objectives.

Kimenyi (2016) conducted a study on risk assessment, practices and financial performance of business companies in Rwanda. The study concluded that risk identification has a significant influence on financial performance of Business Companies. Eissa, O. M. S. (2022) studied the relationship between risk assessment and financial performance of the firms in Egypt during Covid19 and found that there is a significant relationship between risk assessment and financial performance.

The final step in the risk assessment process, risk monitoring, is the most crucial task performed by risk managers because it necessitates regular communication with clients who view managers as trusted advisors and issue solvers (Ndwiga & Ngugi, 2012). Through the final stage of the risk assessment process, it is the process that aids managers in identifying issues that have arisen in systems at an early stage.

Magara (2013) studied the effect of internal controls on savings and credit cooperative societies in Kenya demonstrated that the degree of internal controls put in place by the management of these institutions has a significant impact on the financial performance of savings and credit cooperative societies in Kenya. The financial performance of these savings and credit cooperative societies will significantly improve if they increase the efficiency of their internal controls. It was concluded that there was a significant positive relationship between internal controls and organizational financial performance to some extent, that the organizational performance level was adequate, and that the internal controls used in People Banks in Zanzbar were effective and satisfactory.

2.2.4 Information System and Financial Performance

Information and communication systems or procedures facilitate the identification, capture, and sharing of information in a manner and time frame that permits people to carry out their obligations, according to Walker, Shenkir, and Burton (2003).

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According to Chen (2004), information and communication systems produce reports with operational, financial, and compliance-related data that enable management of an organization.

To achieve the organization's financial reporting objective, information and communication are processes that are used to locate, collect, and appropriately disseminate critical information within the parameters defined by management (Vu & Nga, 2022). Wales (2005) emphasized the necessity to find, gather, process, and deliver reliable and pertinent information to those in need in a timely manner. This information must come from both internal and external sources.

Simon *et al*. (2020) conducted a study on Assessing the Impact of Monitoring, Information and Communication on Banks Performance in Ghana. The study result shows that Information and communication have a weak significant effect on financial performance. Both formal and informal information and communication systems are possible. Simple staff meetings and sophisticated computer technology are both examples of formal information and communication systems that collect input and feedback on the organization's operations, financial reporting, and compliance goals. The better performance of an organization depends on such mechanisms (Simon *et.al.*, 2020).

2.2.5 Monitoring of Controls and Financial Performance

Monitoring internal control systems is necessary since it determines how well the system performs over time. Regular managerial and supervisory tasks as well as other actions staff members conduct while carrying out their duties that evaluate the effectiveness of internal control system performance constitute ongoing monitoring (Colbert & Bowen, 1996).

According to Lary (2009), monitoring is necessary to guarantee that planned administrative, operational, and financial duties and activities are completed promptly and correctly, enabling the achievement of internal control goals and organizational performance. Monitoring also tries to ascertain whether organizational members have completed or are currently completing their jobs efficiently and effectively in accordance with the policies of the organization.

In their study "The impact of internal control systems on performance measures: empirical evidence in Spanish SMEs," Elena *et al.* (2011) discovered a link between better performance measures and SMEs that use internal control systems for bank and fiscal management. Based on empirical data, this research study aims to quantify the correlation between the usage of internal control systems by small and medium-sized businesses (SMEs) in Spain and increased productivity and performance metrics for those businesses. Njeri (2014) conducted a study entitled effect of internal controls on the financial performance of manufacturing firms in Kenya. The study concluded that there was a significant positive relationship between internal controls and organizational financial performance to some extent, that the organizational performance level was adequate, and that the internal controls used in PBZ were effective and satisfactory.

2.3 Conceptual Framework

This section discusses the conceptual framework, or set of factors, that guides the investigation and analysis of the connection between independent variables (internal control systems) and

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dependent variables (financial performance). The connection between those variables is shown clearly in this graphic below.

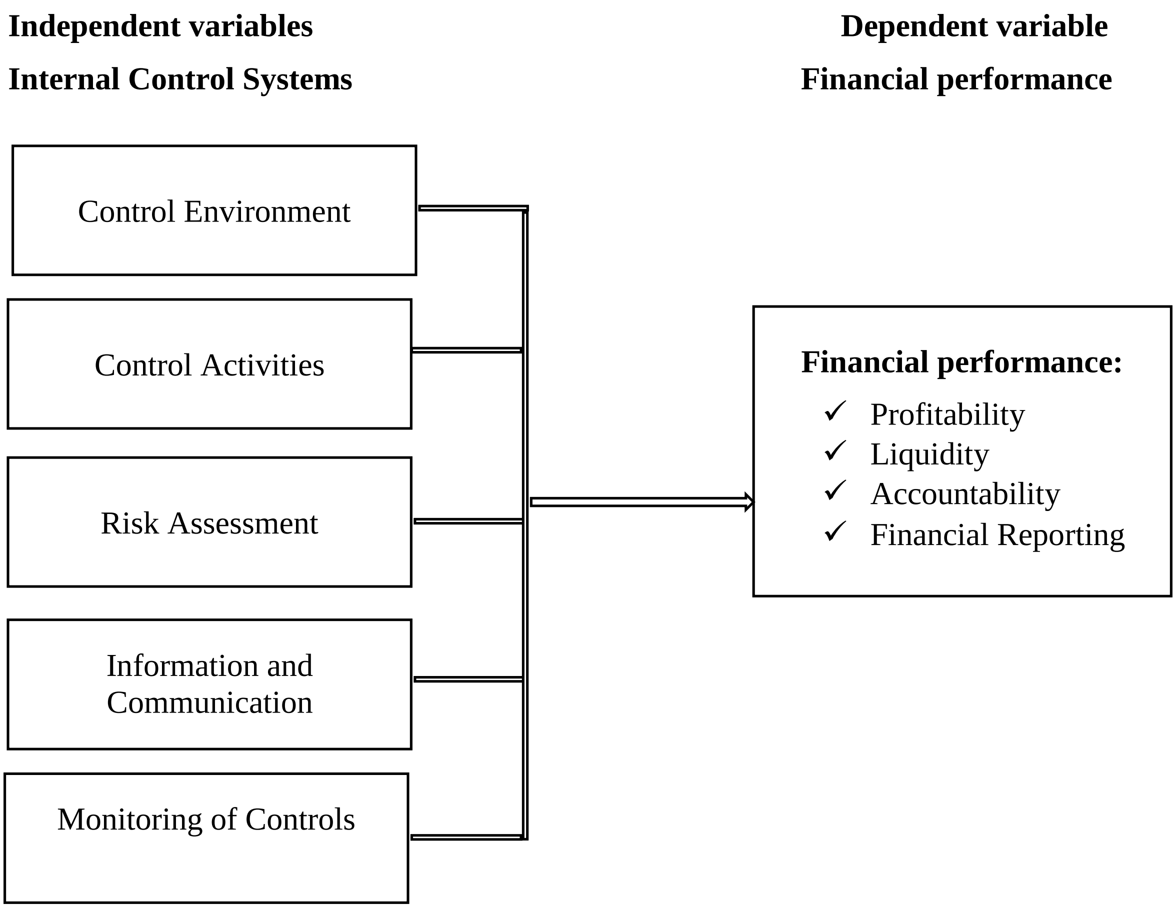

Figure 1: Conceptual Framework

3.0 Research Methodology

This study employed a descriptive and correlational research design using both quantitative and qualitative data. Mugenda and Mugenda (2007) confirmed that a descriptive research design is preferred for accurately reporting phenomena. The target population was 252 employees of Rwanda Interlink Transport Company Limited across various departments, with a sample size of 155 respondents determined through stratified and simple random sampling. Primary data was collected using questionnaires and interviews, and secondary data through documentary reviews. Data collection instruments included questionnaires, observation, and interviews, with validity and reliability tests conducted to ensure accuracy. Data analysis was performed using SPSS Version 21.0, with descriptive statistics, correlation, and regression analyses employed. Pearson correlation coefficient and ANOVA analysis determined the relationships between variables. Ethical considerations ensured confidentiality and respondent anonymity.

4.0 Research Findings

This section indicates the results obtained from respondents. The findings are presented in the form of tables and interpretations are provided to make results clearer and more understandable.

Table 1: Correlation coefficients between internal control systems and financial performance

		Control environment	Control activities	Risk assessment	Information and communication	Monitoring of controls	Financial performance
Control environment	Pearson Correlation	1	.640**	.486**	.661**	.930**	.625**
	Sig. (2-tailed)		.000	.000	.000	.000	.000
	N	155	155	155	155	155	155
Control activities	Pearson Correlation	.640**	1	.692**	.648**	.721**	.946**
	Sig. (2-tailed)	.000		.000	.000	.000	.000
	N	155	155	155	155	155	155
Risk assessment	Pearson Correlation	.486**	.692**	1	.634**	.511**	.764**
	Sig. (2-tailed)	.000	.000		.000	.000	.000
	N	155	155	155	155	155	155
Information and communication	Pearson Correlation	.661**	.648**	.634**	1	.638**	.605**
	Sig. (2-tailed)	.000	.000	.000		.000	.000
	N	155	155	155	155	155	155
Monitoring of controls	Pearson Correlation	.930**	.721**	.511**	.638**	1	.634**
	Sig. (2-tailed)	.000	.000	.000	.000		.000
	N	155	155	155	155	155	155
Financial performance	Pearson Correlation	.625**	.946**	.764**	.605**	.634**	1
	Sig. (2-tailed)	.000	.000	.000	.000	.000	
	N	155	155	155	155	155	155

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

The findings from Table 1 indicated a linear correlation between internal control systems and financial performance. Specifically, there was a strong positive correlation between the control environment and financial performance (r = 0.625**, p = 0.000). The results also showed a strong positive correlation between control activities and financial performance (r = 0.946**, p = 0.000). Additionally, there was a strong positive correlation between risk assessment and financial performance (r = 0.764**, p = 0.000). The findings revealed a strong positive correlation between information and communication and financial performance (r = 0.605**, p = 0.000). Moreover, there was a strong positive correlation between monitoring controls and financial performance (r = 0.634**, p = 0.000). These results imply that well-established internal control systems significantly influence financial performance.

Table 2: Model summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.980[a]	.961	.960	1.28267	.961	733.129	5	149	.000

a. Predictors: (Constant), Monitoring of controls, Risk assessment, Information and communication, Control activities, Control environment

Source: Primary data, 2023

The overall prediction of independent variables (control environment, control activities, risk assessment, information and communication and monitoring of controls) on the dependent variable (financial performance of Ritco Ltd) is 0.980 which is a positive and strong correlation. The coefficient of determination is indicated by R square of 0.961 indicating that the predictors considered in the model can explain 96.1% of the changes in financial performance. The study indicates that there are other factors that explain 3.9% of the change in financial performance.

Table 3: Analysis of Variance (ANOVA[a]) Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6030.835	5	1206.167	733.129	.000[b]
	Residual	245.140	149	1.645		
	Total	6275.974	154			

a. Dependent Variable: Financial performance of RITCO Ltd
b. Predictors: (Constant), Monitoring of controls, Risk assessment, Information and communication, Control activities, Control environment

Source: Primary data, 2023

Table 2 above illustrates the overall significance of the predictors on financial performance of Ritco Ltd. The results indicated that at 5% level of significance, the overall prediction of variables under consideration; control environment, control activities, risk assessment, information and communication and monitoring of controls are significant (F = 733.129, p = 000<.05). The results therefore indicated that there was a significant effect of internal control system on financial performance of Ritco Ltd.

Table 4: Regression Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.176	.860		.204	.838
	Control environment	.701	.061	.537	11.526	.000
	Control activities	.974	.029	.956	33.270	.000
	Risk assessment	.207	.021	.232	9.705	.000
	Information and communication	.151	.026	.148	5.915	.000
	Monitoring of controls	.736	.063	.580	11.662	.000

a. Dependent Variable: Financial performance of RITCO Ltd

Source: Primary data, 2023

The regression coefficients of the independent variables are presented in table 3 above. The results indicated that Control environment (β = 0.701, p = 000) and control activities (β = 0.974, p = 000) and monitoring of controls (β = 0.736, p = 000) significantly predict changes in financial performance of Ritco Ltd, while risk assessment (β = 0.207, p = 000) and information and communication (β = 0.151, p = 000) does not significantly predict changes in financial performance of Ritco Ltd.

Table 5: Summary of tested hypothesis

№	Hypotheses	P value	Verdict
1	There is no significant effect of control environment on the financial performance of Rwanda Interlink Transport Company Limited.	0.000	Rejected
2	The control activities have no significant effect on the financial performance of Rwanda Interlink Transport Company Limited.	0.000	Rejected
3	The risk assessment has no significant effect on the financial performance of Rwanda Interlink Transport Company Limited.	0.000	Rejected
4	There is no significant effect of information and communication on the financial performance of Rwanda Interlink Transport Company Limited.	0.000	Rejected
5	Monitoring of controls have no significant effect on the financial performance of Rwanda Interlink Transport Company Limited.	0.000	Rejected

Source: Primary data, 2023

5.0 Summary of the findings

The study found a strong positive correlation between the control environment and financial performance (r = 0.625**, p = 0.000). Similarly, there was a strong positive correlation between control activities and financial performance (r = 0.946**, p = 0.000). The findings also showed a strong positive correlation between risk assessment and financial performance (r = 0.764**, p = 0.000), and between information and communication and financial performance (r = 0.605**, p = 0.000). Furthermore, there was a strong positive correlation between monitoring controls and financial performance (r = 0.634**, p = 0.000). The overall prediction of the independent variables (control environment, control activities, risk assessment, information and communication, and monitoring controls) on the dependent variable (financial performance of Ritco Ltd) was 0.980, indicating a positive and strong correlation. The coefficient of determination, indicated by an R square of 0.961, shows that these predictors explain 96.1% of the changes in financial performance of Ritco Ltd.

6.0 Conclusions

The study concludes that the financial performance of Rwanda Interlink Transport Company Limited (Ritco Ltd.) is significantly influenced by the control environment, risk assessment, control activities, information and communication, and monitoring of controls, which are indicators of the internal control system. This conclusion is based on the finding that these independent variables explained 96.1% of the changes in the financial performance of Ritco Ltd.

7.0 Recommendations

The study recommends that the company enforce the application of its internal control system efficiently and effectively to prevent actions that might cause inefficiencies in its operations. It also advises managers to regularly establish and update the risk management plan to ensure the company's financial performance is not adversely affected by emerging risks. Additionally, government agencies should provide more incentives for establishing, operating, and maintaining effective and efficient internal control systems to ensure public funds are well spent. While this study investigated the effect of internal control systems on the financial performance of transport companies in Rwanda, further studies could examine the effect of internal control systems on the operational or financial performance of air and marine transport companies in Rwanda.

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