

**ST. MARY'S UNIVESITY  
BUSINESS FACULTY  
DEPARTMENT OF ACCOUNTING**

**EFFECT OF INTERNAL CONTROL OVER ACCOUNT  
RESCEIVABLE THE CASE OF COMMERCIAL BANK OF  
ETHIOPIA HABTE GEORGIS BRANCH**

**By**

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MUHAZEA NESRO**

**SMU  
JUNE 2014  
ADDIS ABABA**

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ETHIOPIA HABTE GEORGIS BRANCH**

**A SENIOR ESSAY SUBMITTED TO THE DEPARTMENT  
OF ACCOUNTING BUSINESS FACULTY  
ST. MARY'S UNIVESITY**

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**IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR  
THE DEGREE OF BACHELOR OF ARTS OF ACCOUNTING**

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## **Acknowledgements**

First of all we would like to thank and glorify the Almighty God who has been and will be the source of strength throughout our life.

We would like to acknowledge Accounting department for giving this opportunity for we to do this research. Our heartfelt thanks goes to Our advisor Mr. Ahmed Mohammed for his timely comment, advice and support by sacrificing his precious and golden time from selection of topics till the end of submission of the final research paper. We would also acknowledge CBE Habtegiyorges branch staffs for their cooperation during data collection.

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## **List of Abbreviation**

CBE	Commercial Bank of Ethiopia
ATM	Automated Teller Machine
SWIFT	Society for Worldwide Interbank Financial Telecommunication
AICPA	American Institution of Certified Public Accountants
COSO	Committee of Sponsoring Organization
NBE	National Bank of Ethiopia
ARTO	Account Receivable Turnover
ACP	Average Collection Period

## **Abstract**

**Background:** the internal control process which historical has been a mechanism for reducing instance of fraud, misappropriation and errors, has recently become more extensive, addressing all the various activities faced by organization. it is now recognized that assumed internal control process is critical to organization's ability to meet its established goals and objectives, and to maintain financial viability.

**Methods:** The study sample was selected based on simple random sampling technique and also the data was collected from a sample of 10 respondents.

**Result:** In this study it was found that from a total of 10 respondents, 5(50%) respondents said that the internal control system over receivable in the bank is good and the rest of the respondent said that there is fair internal control system over receivable in the bank. From the total respondents 8(80%) respondents said that the bank have independently collection departments and the rest of the respondent replied that no collection departments independently. All the respondents responded that it communicate with credit customers by phone or remind them the due date of two or three days. From those total respondents 7(70%) respondents said that it's giving of credit limit to the customer are good and the rest said it's fair. All the respondents said that it has credit term or agreement on the bank. From the total respondents 9(90%) respondents make known that statements of account receivable is prepared and sent to customers strictly on the bank and the rest said not. From the respondents 8(80%) respondents said that the bank prepare an aging report and the rest said no aging report on the bank.8( 80%) respondents said credit customer pay their agreement highly and rest respondents said that the credit customer pay their agreement lowly and very highly. All the respondents said the bank takes action for those customers who do not pay on due date by forbidding giving of credit and by taking legal action. As all the respondents said the bank does change an account receivable to promissory note receivable and also there is a procedure to write-off uncollectible.

**Conclusion:** In this research the researcher tries to assess that how the bank treats receivables, what control mechanisms are followed over receivables, reasons that made the collection difficult and what sort of action are taken for those customers who do not pay according to their agreement and due date and also tries to identify the problem that affects receivables to be outstanding for about more than one year and to solve those problem by the management and related body.

# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1. Background of the Study**

The internal control process which historical has been a mechanism for reducing instance of fraud, misappropriation and errors has recently become more extensive, addressing all the various activities faced by organization. It is now recognized that assumed internal control process is critical to organizations ability to meet its financial viability. (Batra and Bagradia, 1992)

Internal control is broadly defined as a process designed to provide reasonable assurance regarding the achievement of specific objectives in accountability, effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations. (Sexena, 1990)

As such it is an internal component of an organization overall governance structure, which is intended to direct and control its activities by promoting transparency, accountability, responsibility and fairness of all stake holders .(Meiss, 1989)

Practicing internal control over account receivable is one of the most important activities in all business organization. Internal control is necessary to promote the accuracy of accounting record and to discourage fraudulent manipulation of bank asset. Management is responsible for controlling over account receivable of the bank because of it is easily convert to cash and universal attractiveness of compare to other than non cash current asset, which needs strong internal control system.

So this study tries to assess the activity of the bank regarding internal control assessment and analyzing and examining in internal control over account receivable of the bank.

### **1.2. Background of the Organization**

Commercial bank of Ethiopia is the leading bank in Ethiopia established in 1943. The leading African bank with asset of birr 155 billion as on June 30<sup>th</sup> 2012, it has 830 branches stretched across the country. Commercial bank of Ethiopia combines a wide

capital base with more than 12,800 talented and committed employees. Currently the bank has more than million account holders.(www.cbe.gov.et)

It is the first bank of Ethiopia to introduce Automated teller machine service for local users. Commercial bank of Ethiopia has reliable and long-standing relationships with many internationally acclaimed banks throughout the world. Pioneer to introduce western union money transfer services in Ethiopia, it has strong correspondent relationship with more than 50 renowned foreign banks and a society for worldwide interbank financial telecommunication bilateral arrangement with 500 others.(www.cbe.gov.et)

In Ethiopia commercial bank of Ethiopia is one of the financial interline diaries in universal banking activity, which service as a channel for loanable funds from saver to borrower. The source of those loanable funds is demand deposit and saving deposits made by the customers. The bank proceed various types of loan to customers mainly over draft, short term loan, medium and long term loan, revolving export credit, micro finance institutions loan. Commercial bank of Ethiopia is required to function efficiently and effectively to meet the growing demand of credit so as to induce development.

### **1.3. Statement of the Problem**

The balance sheet of most business enterprise includes a variety of claims from other parties that generally provide a future in flow of cash these receivables arise from transaction and events such as sales goods or services, Loan made to others and so on. Receivable include all claims against people, organization or other debtors. Receivable from customer service in credit base represents substantial part of business enterprise current asset.

In CBE all receivables that are expected to be realized in cash within one year are presented in current asset section of the balance sheet. These receivable which are not currently collectible such as long term loans made to others, should be listed in the investment section of asset. Not all the time a receivable which resulted from the services, will be collected in cash value; part of the claim against a credit customer usually proves to be uncollectible. This is a common practice regardless of the care, protection and controls used in granting and collecting credits there is no one single general way of identifying uncollectible. Failure to pay at maturity or dishonoring a note

is not by itself and indicator of uncollectible. Nevertheless bankruptcy of the debtor, closing of debtors business, disappearance of the debtor, failure of repeated attempts to collect are significant indication of partial or complete worthlessness of a receivable.

In most business companies account receivable in various functional areas is not strong internal control to achieve the desired objective. at the bank absences of accountability, effectiveness and efficiency of operation, reliability of financial reporting.

From these and that problems stated, researchers will assess the control system of account receivable in Commercial Bank of Ethiopia by Comparing its actual controlling practice against the theoretical basis of internal control system over account receivable. In the way providing of this problem the researcher will seek answer for the following basic question

- Does the bank have responsible department for follow up the credit collections and has proper internal control system over receivables?
- Is statement of account receivable strictly prepared and sent or mail to debtors?
- Does all credit customers pay timely according to their agreement?
- Does the bank use or prepare an account receivable aging report?
- Does the bank use a write off mechanism for all its credit customers?
- Does the bank properly evaluate its customer liquidity and business efficiency?
- Does the bank handles documents in orderly manners?

## **1.4. Objective of the Study**

The objective of the study consists of general and specific objective.

### **1.4.1. General Objective**

The principal objective of this paper was investigate the effectiveness of internal control over account receivable in commercial bank of Ethiopia. In doing so the research has the following specific objectives.

### **1.4.2. Specific Objectives**

Specifically this study conducted to:

- ❖ Appraise whether the company has a well established department that follow-up account receivable internal control system.
- ❖ Evaluate that the application of credit policy to the credit customers and its affiliates.
- ❖ Assess that the company sent an account receivable statement to the customer monthly.
- ❖ Review that whether the company collects timely from its credit customers according to their agreement.
- ❖ Assess that the company uses the note to make the loan more formal enforceable.
- ❖ Identify a specific accounts receivable is removed from the accounting record at the time it is finally determined to be uncollectible.

### **1.5. Significance of the Study**

This study identifies source of the problem and recommends solution receivable.

- ❖ To create awareness to any business firms to maintain and implement effective internal control system over account receivable to achieve its goals.
- ❖ It would help and serve as a bench mark for the policy maker's to improve the policies. And Management for a better decision.
- ❖ To identify different measures taken to reduce banking insurance of fraud, misappropriation and errors

### **1.6. Scope of the Study**

The scope of this study concentrate on the system of internal control of receivable commercial bank of Ethiopia located in Addis Ababa particularly Habte Giorgis branch and this study will be from January 1, 2008 to December 31, 2013.

## **1.7. Research Methodology**

### **1.7.1. Research Design**

A descriptive approach method had used in carrying out this study because it pictures the current situation in the company and show accurately the characteristics of a particular situation. Moreover, the method enabled to examine relationship exit between years and account receivable.

### **1.7.2. Population and Sampling Techniques**

The population of the study had been used both employees and manager working in CBE Habtegeogis branch. The total number of employees are 38 out of this 3 of them are a managerial status and the rest 35 are employees. However the researcher team distributed the questionnaire only at the finance department and credit operation department .From the total population of the department 10 respondents are randomly selected.

### **1.7.3. Types of Data Collected**

Both primary and secondary data source had been used. The primary data collected from employees and employers through questionnaire. The secondary data obtain from different type of books, internet, company annual report profile and magazine.

### **1.7.4. Method of Data Analysis**

In order to analyze and interpret the finding, the student researcher used both quantitative and qualitative methods using tables and graphs. Finally both primary and secondary data tabulated, discussed interpreted and analyzed.

## **1.8. Limitation of the Study**

There were some factors that affected the study not be continued as expected. Among these factors the following are mentioned:

- Some of employees were not willing to fill the questionnaires
- Some of the questionnaires were filled negligently
- Open ended questions were not sufficiently answered.



- Lack of financial and time constraints.
- Lack of experience of the researcher.

## **1.9. Organization of the Study**

The study organized into four chapters, the first chapter deals with background of the study, statement of the problem, objective of the study, scope and significance of the study, limitation of the study, research design and methodology and organization of the study. The secondary chapter contained the review of the related literature. The third chapter focused on data presentation and analysis. Finally in chapter four conclusions and recommendation forwarded by the researcher based on the assessments.

# **CHAPTER TWO**

## **LITERATURE REVIEW**

### **2.1. Internal Control**

#### **2.1.1. Nature of Internal Control**

Differences of opinion have long existed about the meaning and objective of internal control. Many people interpreted the term internal control as the steps taken by a business to prevent fraud both misappropriation of assets and fraudulent financial reporting, while acknowledging the importance of internal control for fraud prevention, believed that internal control has an equal role in assuring control over manufacturing and other processes. Such differences in interpretation also existed in the professional publications issued by the American institution of certified public accountants. The institute of internal auditor's incorporation and the research foundation of the financial executives institute. (K.Cshekhar & Lekshmy Shekha, 2003)

It was not until the early 1990's that the various professional organizations worked together to develop a consensus on the nature and scope of internal control. As a result of a number of instances of fraudulent financial reporting in the 1970's and early 1980's, the major accounting organizations sponsor the national commission on fraudulent financial reporting (the trend way commission) to study the causal factors that are associated with fraudulent reporting and to make recommendation to reduce its incidence. The commission made a number of recommendations that directly addressed internal control, for example, it emphasized the importance of a competent, involved audit committee, and active, and objective internal audit function in preventing fraudulent practices. It also called on the sponsoring organizations to work together to integrate the various internal control concepts and definitions to develop common criteria to evaluate internal control. (ibid)

Accordingly, the committee of sponsoring organization commissioned a study to:

- Establish a common definition of internal control to serve the needs of different parties;

- Provide a standard against which business and other entities can assess their control system and determine how to improve them.

COSO'S definition of internal emphasizes that internal control is a process, or a means to all end in and of itself. The process is affected by individuals, not merely policy manuals, documents and forms. By including the concept of reasonable assurance, the definition recognizes that internal control cannot realistically provide absolute assurance that an organization objective will be achieved. Reasonable assurance recognizes that the cost of organizations internal control should not exceed the benefits expected to be obtained.

Internal control is defined by AICPA as all coordinate methods and measures within an organization or within a system adapted to safeguard assets, check accuracy and reliability of accounting data, promote operational efficiency and encourage adherence to prescribed managerial policy. (Arens and Leobbeck Ibid, 1989)

In accounting, control of financial information is involved in systems and producers of management information flow and documentation for various management decision cycles, which may require us to distinguish administrative control and accounting controls.

## **2.2. Types of Internal Control**

### **2.2.1. Administrative Controls**

Administrative control emphasizes on control for management decision concentrating on authority and responsibility for authorization of information as such includes plan of organization structure, producers and records related to the decision process.(Kamal Gupta & Ashok Arora, 1996)

### **2.2.2. Accounting Controls**

Accounting controls emphasize on reliability of financial records and safe guarding on of assets and records for providing reasonable assurance on transaction and financial information needed for appropriate action. In spite of the above however, it is important to note the point of interface between administrative controls and accounting controls. For the concern with authorization of transaction or action decision consequently leads to

the need for ensuring that the authorized action is actually taken and what results are achieved. (Mosich, 1989)

#### Purposes and Objectives of Internal Control

- To aid management information, protection and control.
- To protect asset from theft, loss, damage, spoilage, wastage.
- To prevent errors and fraud in advance before they occur.
- To assure accuracy and dependability of perusal and financial operation.
- To monitor operating efficiency
- To monitor adherence to prescribed policy.
- To provide evidence of responsibility (Aren and Leobbeck, 1998)

### **2.2.3. The Control Environment**

The control environment of an enterprise represents an overall attitude toward and awareness of the important of controls by both management and other employees. Factors influencing the control environment of an enterprise include management's philosophy and operating style includes management's attitude concerning controls. For example, if top management routinely violates established control policies and procedures, the control environment employees may view controls as unimportant. On the other hand, a top management that emphasizes the importance of controls in dealing with operating personnel and encourages adherence to control policies and procedures will create favorable control environment. (Yednekachew Tesma ,1989)

Personnel policies and procedures include the hiring, training, evaluation, promotion and compensation of employees to accomplish an enterprise's goals and objectives. Common personnel policies that impact on the control environment include the establishment of codes of ethics for employee conflict of interest policies. (ibid)

### **2.2.4. The Control Procedures**

Control procedures are those policies and procedures that management has established within the control environment in order to provide reasonable assurance that enterprise goals will be achieved. General control procedures which can be integrated throughout

the accounting system and which apply to all enterprises are briefly discussed in the following sections. (Yednekachew Tesma,1989)

### **2.2.5. Competent Personnel and Rotation of Duties**

Employees should possess the skills and knowledge essential to the performance of their job. If employees are lacking in skills or knowledge, they may be ineffective in performing their assigned duties. This is especially critical when the employees are involved in performing controls. Ideally, management should be committed to hiring employees with appropriate levels of education and experience, and providing them with adequate supervision and training. (William C, Boynton & Walter G, Kell)

### **2.2.6. Assignment of Responsibility**

If employees are to work efficiently their responsibilities must be clearly defined. Control procedures should exist to guarantee that no overlapping or undefined areas of responsibility exist. For example, if a certain cash register is to be used by two or more sales clerks, each one should be assigned a separate a drawer and register key. Thus a daily proof of cash can be obtained for each clerk, separation of responsibility, errors and fraud, control procedures should exist to guarantee that the responsibility for a sequence of related operations is divided among two or more persons.

When the responsibility for purchasing, receiving and paying are divided among three persons or departments, the possibilities of such abuses are minimized.

The “checks and balances” provided by distributing responsibilities among various departments requires no duplication of effort. The business documents prepared as a result of the work of each department must “fit” with those prepared by other departments. (William C, Boynton & Walter G, Kell)

### **2.2.7. Separation of Operation and Accounting**

Control procedures should exist to ensure that responsibilities for maintaining the accounting records are separated from the responsibility for engaging in business transactions and for the custody of the bank assets. By such separations, the accounting records serve as an independent check on the business operations. For example, the employees entrusted with handling cash receipts from credit customers should not have

access to the journal or ledger. Separation of the functions reduces the possibilities of errors and embezzlement. (KIESO,etal 2005)

### **2.2.8 Proofs and Security Measure**

Proofs and security measures should be used to safeguard business assets and assure reliable accounting data. This control procedure applies to many different techniques, such as the use of reserve fund in international bank in Ethiopia and other safekeeping measures for cash other valuable documents. Cash registers are widely used in making the initial record of cash sales. The conditioning of the public to observe the amount recorded as the sale or to accept a printed receipt from the sales clerk increases the machines effectiveness as a part of the internal control structure. The use of fidelity insurance is also an aid to developing an effective internal control structure. It insures against losses caused by fraud on the part of employees who are entrusted with company assets. (KIESO,etal 2005)

### **2.2.9. Independent Review**

To determine whether internal control procedures are being effectively applied, the control structure should be periodically reviewed and evaluated by internal auditors. These auditors must be independent of the employees responsible for operations. (Fees Warren, Ibid 2001)

## **2.3. Receivable**

### **2.3.1. Definition and Classification of Receivables**

### **2.3.2. Definition and Receivables**

The term receivables include all money claims against people, organizations or other debtors. Receivables are acquired by a business enterprise in various kinds of transactions the most common being the sale of merchandise or services on a credit basis.

Credit may be granted on open account or on the basis of a formal instrument of credit, such as a promissory note. A promissory note, frequently referred to as a note is a written promise to pay a sum of money on demand or at a definite time. Notes are usually used for credit periods of more than sixty days, as in sales of equipment on the installment

plan, and for transactions of relatively large dollar amounts. Notes may also be used in settlement of an open account and in borrowing lending money.

Customers often owe a company amounts for goods brought or services rendered. A company may sub classify the trade receivables, usually the most significant item it possess, into account receivable and note receivable. (Fess Warren ibid,2001)

## **2.4. Accounts Receivable**

Account receivable is an written promise of the borrower to pay for principal and interest sold; they represent “open account” resulting from short term extension of credit. A bank collects them within one year.

The balance sheet of every business enterprise includes a variety of claims from other parties that generally provide a future inflow of cash. These receivables arise from transaction and events such as services, loans made, subscriptions obtained from investors for capital stock or bonds, claims for income tax refunds, claims resulting from litigation and amounts due from leasing of assets.

Receivables from customers frequently represent a substantial part of a business enterprise’s current assets. Poor screening of applicants for credit or an inefficient collection policy may result in large losses. Consequently, strong accounting controls and effective management of receivables are typical characteristics of most profitable enterprise. (KISEO, etal, ibid 2005)

## **2.5. Controls over Receivable**

As is the case for all assets, the broad principles of internal control discussed used to establish procedures to safeguard receivables. These controls would include the separation of the business operations and the accounting for receivables, so that the accounting records can serve as an independent check on operations. Thus the employee who handles the accounting for notes and accounts receivable should not be involved with credit approvals or collections of receivables. Separation of these functions reduces the possibility of errors and embezzlement. The controls would also include the separation of responsibility for related functions, so that the work of one employee can serve as a check on the work of another employee.

For most businesses, the principle receivables are notes receivable and accounts receivable. Generally, notes receivable are recorded in a single general ledger account. If there are a numerous notes, the general ledger account can be supported by a notes receivable register. The register would contain details of each note, such as the name of the maker, pace of payment, amount, term interest rate, and due date. Frequent reference to the due date section directs attention to those notes that are due for payment. In this way, the maker of the note can be notified when the note is due, and the risk that the maker will over look the due date can be minimized.

Adequate control over accounts receivable begins with the approval of the sale by a responsible bank official or the credit department, after the customer's credit rating has been reviewed. Likewise, adjustments of accounts should be authorized or reviewed by a responsible party. Effective collection procedures should also be established to ensure timely collection of accounts receivable and to minimize losses from uncollectable accounts. The proper use of the controlling account and the accounts receivable ledger, as discussed increases the effectiveness of the control over accounts receivable. (Acca text book *ibid*, 1995)

### **2.5.1. Monitoring the Receivables Position**

Accounts receivable depends on the banks own unique operating condition however even through optimal credit policies vary among banks or even for a single bank over time, it is still useful to analyze the effectiveness of the bank credit policy in an overall aggregate sense inventors both stockholders and bank loan officers should pay close attention to accounts receivable management because, as we shall see one can be misled by reported financial statements and later suffer serious losses on an investment.

When a credit service is made, the following events occurs

1. Cash are reduced by the cost of collection of loan
2. Accounts receivable are increased by the loan interest and
3. The difference is profit, which is added retained earnings.

The profit is not actually earned unless and until the account is collected banks have been known to encourage loan to very weak customers in order to report high profits this could boost the bank's stock price, at least until credit losses begin to lower earnings. At which



time the stock price will fall analyzes along the lines suggested in the following section will detect any such questionable practice as well as any unconscious deterioration in the quality of accounts receivables. Such early detection could help both investors and bankers avoid losses. (A.Rose,5<sup>th</sup> edition ibid,1999)

### **2.5.2. Aging Schedules**

An aging schedule breaks down a bank's receivables by age of account. The number of different age classes to be used depends on actual experience and the terms of loan. An estimate of the average collection the experience for each age class provides a base for estimating the portion of outstanding trade accounts receivables that may prove to be uncollectable.

In the process of aging trade accounts receivable, management should evaluate current financial statements of major customers to make a better assessment of the probability of collection. The credit department of a business enterprise is assigned responsibility for continuing analysis of the financial statements of existing and prospective customers so that loans are not made to those who represent excessive risk of nonpayment. (Mosich Ibid, 1989)

### **2.5.3. The Payment Pattern Approach**

The primary point in analyzing the aggregate accounts receivable situation is to see if customer, on average is slowing down their payments. If so, the bank will have to increase its receivable financing, which will increase its dollar cost of carrying receivables. Further, the payment slowdown may signal a decrease in the quality of the bank receivables and hence an increase in bad debt losses down the road. The aging schedules are useful in monitoring credit operations, but both are affected by increases and decreases in a bank's level of loan. Thus, changes in loan, including normal seasonal or cyclical changes can change a firm's aging schedule even though its customer's payment behavior has not changed at all. For this reason a procedure called the payments pattern approach has been developed to measure any changes that might be occurring in customers' payment behavior. (A.Rose,5<sup>th</sup> edition,1999)

## **2.6. Credit Policy**

Even if the structure of credit operation of commercial bank varies greatly from bank to bank depending on the size of bank and economic environment in which the bank operates. Some lending procedures are accepted universally by at most commercial bank. Some of them are the following:

### **2.6.1. The Interview**

It is the first contract with the borrower and provides an opportunity for the bankers to explore about application beyond the loan application. It should be friendly discussion in which the banker tries to see through the loan request .He should touch on points like: the purpose of loan, the applicant's commitments elsewhere .the applicant's deposit account of other branch or banks. The applicant's business experience, how he intends to pay of the loan and the business plan etc... (Takele; 2003)

### **2.6.2. Loan Application**

The loan application should state details of the requested loan clearly and it includes: amount of loan requested. The purpose of the loan, the collateral offered. The duration of the loan in which the borrower intend to pay off the debt and the installment if monthly, quarterly, in one lump sum etc... (Takele; 2003)

### **2.6.3. Relevant Documents**

The applicant should fulfill the following document

- trading license-preferably renewed for current year
- power of attorney, if applicable
- feasibility study, in case of new project
- original security certificates-like land holding certificate, car booklet
- financial statement audited or provisional including cash flow statement in case of
- Manufacturing and performance invoice, receipts, sales or purchase agreement, work
- order etc... (Takele 2003)

#### **2.6.4. Financial Statement and Property Estimation**

The financial statements like balance sheet, income statement, cash flow statements etc. it should be carefully analyzed to determine the financial soundness of the applicant and assess the repayment capacity.

Ratio and percentages to measure the liquidity and profitability of the business need revised carefully to assist in the decision making of the amount and type of loan granted. (Takele 2003)

#### **2.6.5. Credit Information**

The most commonly used inquiries in obtaining credit information are based on the five c's. i.e capital, capacity, characters, credit worthiness and collateral.

All available sources of internal and external should be used to obtain credit information before deciding on the financing of the applicant.

Internal source of information are the customers accounts in the bank itself, the frequently and magnitudes of the transaction as well as the cheque bounced for lack of funds are good indicators of his business activity and credit worthiness. Other branches where is he likely to have had a loan or deposit account have to be approached for credit information. Past records of settled loans should also be taken in to accounts to verify his repayment habits. (Takele, 2003)

#### **2.6.6. Setting the Collection Policy**

Collection policy refers to the procedures the bank follows to collect past due accounts. The collection process can expensive in terms of both out of pocket expenditures and lost goodwill but at least some bank's in needed to prevent an undue lengthening of the Colleton period and to minimize outright losses. Again a balance must be struck between the costs and benefits of deficient collection policies. Changes in collection policy influence loan, the collection period the bad debt loss parentage, and the percentage of customers who take discounts. The effects able will be analyzed later. The last element in the credit policy decision, the use of cash discounts for early payment is analyzed by balancing the costs and benefits of different cash discounts.(d.larson,15<sup>th</sup> edition,1999)

### **2.6.7. Legal Considerations**

It is illegal under the Robinson Patman act for a bank to charge prices that discriminate between customers unless these differential prices are cost justified. The same holds true for credit it is illegal to offer more favorable credit terms to one customer or class of customers than to another unless the differences are cost justified.(khan, pajain,5<sup>th</sup> edition ,2004)

### **2.6.8. Customers Response**

A bank's prior relationship with customer reveals information about past credit and deposit experience that is useful in assessing willingness and ability to replay.(Koch and Macdonald, 2000)

## **2.7. Analyzing Proposed Changes in Credit Policy**

### **2.7.1. The Income Statement Approach**

In the National Bank credit policy is eased by such actions as lengthening the credit period, relaxing credit standards, following a less tough collection policy: Easing the credit policy stimulates loan. Of course, if credit policy is eased and loan rise, then costs will also rise because more labor, materials and so on. Additionally, receivables outstanding will also increase, which will increase carrying costs, and bad debt may also rise. Thus, the key question when deciding on a proposed credit policy change is this will loan interest rise more than costs, including credit related costs, causing cash flow to increase, or will the increase in loan interest be more than offset by the higher costs.

One can take two approaches of analyzing proposed changes in credit policy the income statement approach and the incremental analysis approach. The income statement approach, which we discuss in this section. Focuses on the effects of a credit policy change on the bank's income statement, incremental analysis, which we discuss in the next section, leads to the same results, but thorough the use of formulas.(Stanly B.Block and Geoffery A.Hirt,Ibid,1992)

### **2.7.2. Granting Credit**

Credit may be granted to those receiving the departmental loan service including the general public, students and staff. Although cash should be collected whenever possible, credit may be granted when there are not facilities for the collection of cash, or when non-collection of cash is deemed to be in the best interest of the bank. In these cases, prudence with respect to the credit risk incurred must be observed at the time of transaction.

Credit is automatically extended to governmental units and foundations during the time claims for reimbursement are outstanding. Diligence must be exercised to insure timely billing and collection efforts and to minimize uncollectible receivables.

Implicit in the granting of credit is the intention that payment will be made in full upon customer's receipt of a bill. (Stanly B. Block and Geoffery A. Hirt, Ibid, 1992)

### **2.7.3. Write-Off Procedures**

Uncollected accounts are to be considered as bad debts and written off, subject to appropriate approval authority, when they are determined to be uncollectible or when they are placed with a collection agency. Such write-offs should occur no less frequently than annually.

Requests to write off uncollectible accounts must be categorized by type of bill and submitted for approval. Supporting documentation must be provided to justify write-off of each item, and the source of funds for financing the write-off must be so indicated. All necessary budget documents and references to local financing action must likewise accompany the request.

Routine disallowed claims under contracts and grants to be written off against funds received from the federal government in reimbursement of indirect costs, subject to the limitations contained in Delegation of authority policy. (Stanly B. Block and Geoffery A. Hirt, Ibid, 1992)

## **CHAPTER THREE**

### **DATA ANALYSIS AND STUDY FINDINGS**

#### **3.1. Data Analysis**

In this selection attempts have been made to assess the internal control over receivables activities by using the primary data collected from questionnaires totally the number of employment on the branch are 38. However the researcher team distributed the questionnaire only 10 respondents by random selection. Accordingly, the analysis and findings of this paper are based on the number of the respondents of the questionnaires conducted with finance and credit operation departments. The secondary data collected from different related books and from company documents.

#### **3.2. Credit Activity**

The most important activity of CBE is to mobilize deposits from the public people who have surplus income and savings find it convenient to deposit the amounts with bank.

Depending upon the nature of deposits, funds deposited with bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, public are motivated to deposit more funds with the bank. So it facilitate CBE to great loan and advances. Such loan and advance are given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. The rate of interest charged on loans and advance various depending upon the purpose, period and the mode of repayment. So this rate charged on the loans is the main sources of a bank income.

CBE has given different types of loan and advance to customers looking into distribution of loans and advances by major end use shows the domestic trade service, foreign trade, agriculture, manufacturing sector, Building and construction and personal loans.

### 3.2.1. Analysis of Questionnaire

This section of data analysis and presentation part issued to analyze and present the data obtained through questionnaires distributed to the 10 CBE finance and related department employees. As mentioned earlier the questionnaire was distributed only at the Habte Georgis branch of the bank from the respondent point of view the given question's that are topics were responded as follows.

**Table – 1: How Do You Evaluate the Internal Control System Over Receivables in Your Bank?**

No	Description	V. poor	Poor	Fair	Good	Total
1	How do you evaluate the internal control system over receivables in your bank?			5	5	<b>10</b>
	Percentage			50%	50%	<b>100%</b>

Source: Questioner.

For the above question 5(50%) of the respondents said that the internal control system over receivable in the company is good end the rest of the respondents reply that fair internal control system over receivables because:

The number of staffs who control the account receivables are more than one, so it may not be create a gap for fraudulent activity and there is direct participation by the two middle management of the bank in the activities of the service so the management and employee should be honest and trust worthy. And also there is strong internal control structure.

Even though there is a sense of owner shipping of the management the bank should run its services based on its policy and procedure and should control its receivables.

**Table – 2: Does the Bank have a Collection Department Independently to Follow up Receivables?**

<b>Nō</b>	<b>Description</b>	<b>Yes</b>	<b>No</b>	<b>Total</b>
4	Does the bank have a collection department independently to follow up receivables?	8	2	<b>10</b>
	Percentage	80%	20%	<b>100%</b>

Source: Questioner.

In the given response for 8(80%) respondents said that the bank have independently collection departments, and the rest of the respondents replied that the bank does not have. This happen because of Lack of management attention and there is no independent body to control with collection of receivables without accountability.

Most of the respondents respond that the bank has a collection department independently. Since the bank has huge and most of its asset are based on credit that will be good to take attention on collection department.

**Table – 3: Does the Bank Communicate or Contact with the Credit Customers by Phone, Mail or Other Method?**

<b>Nō</b>	<b>Description</b>	<b>Yes</b>	<b>No</b>	<b>Total</b>
6	Does the bank communicate or contact with the credit customers by phone or other methods?	10		<b>10</b>
	Percentage	100%		<b>100%</b>

Source: Questioner.

The result shows that 10(100%) of the respondents responded that it communicate with credit customers by phone or remind them the due date of two or three days.



**Table – 4: How do you Evaluate the Bank giving of Credit Limit to the Customers?**

No	Description	V. poor	Poor	Fair	Good	Total
8	How do you evaluate the bank giving of credit limit to the customers?			3	7	<b>10</b>
	Percentage			30%	70%	<b>100%</b>

Source: Questioner.

From the given response 7(70%) respondents said that its giving of credit limit to the customer are good and the rest of the responders reveals that the bank’s giving of credit limit is fair .This is because the existing and handling of costumer credit faculty and procedure is non thoroughly studied and revised timely the bank has a credit limit for some customers and do not have some parties end sometimes the credit faculty do not studied well. Since the bank has a structured policy and procedure that related with credit limit or granting procedure it is well that for all customers to be applied.

**Table – 5: Does the Bank have Specific Credit Term or Agreement?**

No	Description	Yes	No	Total
10	Does the bank have specific credit term or agreement	10		<b>10</b>
	Percentage	100%		<b>100%</b>

Source: Questioner.

From the given responses 10(100%) respondents said that it has credit term or agreement.

**Table – 6: Is Statement of Account Receivable Strictly Prepare and sent to the Debtors?**

No	Description	Yes	No	Total
12	Is statement or account receivable strictly prepare and sent to the debtors?	9	1	<b>10</b>
	Percentage	90%	10%	<b>100%</b>

Source: Questioner.

The answer reveals that 9(90%) respondents make known that statements of account receivable is prepared and sent to the customers strictly and the rest respondent said that not strictly send to customers there is a delaines in sending to the customers and it is no sent regularly to debtor.

The statement of account sent to the debtor for the purpose of reconciliation and confirmation of their debts but sometimes there is delaines, the dalliance of sending statement affects not collect on due date.

**Table – 7: Does the Bank Prepare an Account Receivable Aging Report?**

No	Description	Yes	No	Total
14	Does the bank prepare an account receivable aging report?	8	2	<b>10</b>
	Percentage	80%	20%	<b>100%</b>

Source: Questioner.

For the above question 8(80%) of the respondents response that the bank prepare an aging report.

**Table – 8: How do you Assess the Credit Customers Pay According to their Agreement?**

No	Description	V. high	high	low	V.low	Total
15	How do you assess that the credit customers pay according to their agreement?	1	8	1		<b>10</b>
	Percentage	10%	80%	10%		<b>100%</b>

Source: Questioner.

From the respondents give answer 8 respondents said that the credit customer pay according to their agreement is high and the rest 2 respondents said that the credit customer pay according to their agreements low and very high.

There is a sense of owner shipping of the branch the bank should run it services based on its policy and procedure and should control its receivables and the owner has to give attention.

**Table – 9: Does the Bank take a sort of Action for those who Do Not Pay on Due Date?**

Nō	Description	Yes	No	Total
17	Does the bank take a sort of action for those who do not pay on due date?	10		<b>10</b>
	Percentage	100%		<b>100%</b>

Source: Questioner.

From the given respondents answer 10 of the respondents said that it takes action for those customers who do not pay on due date by forbidding giving of credit and by taking legal action.

It is good that the company take a legal action for those customer's who do not pay on their due date and also the company should give attention for the follow up of for those who do not pay on the due date and it is advisable that if the legal action is applicable for all credit customers.

**Table – 10: Does the Bank Change an Account Receivable to Promissory Notes Receivable?**

No	Description	Yes	No	Total
19	Does the bank change an account receivable to promissory notes receivable?	10		<b>10</b>
	Percentage	100%		<b>100%</b>

Source: Questioner.

For the above question all the respondents says that the bank does change an account receivable to promissory note receivable the bank can exchange an account receivable to promissory notes receivable because it has clearly stated policy and procedures and modern management. It is very good mechanism if the company uses a promissory note properly because it can force the customer to pay since it is legally advisable and it is more secure than account receivable.

**Table - 11: Is there a Procedure that Follow-up to Write-off Uncollectible?**

No	Description	Yes	No	Total
25	Is there a procedure that follow-up to write-off uncollectible?	10		<b>10</b>
	Percentage	100%		<b>100%</b>

Source: Questioner

All of the respondents said that there is procedure to write-off uncollectible, the finance division transfers to the responsible department to take a legal action for the customer.

### **3.2.2. Reason's for Uncollectability**

As per responses obtained from the General Account Section Accountant, there are many reasons for the uncollectability of account receivable.

Among the many critical reasons are the following

- ❖ Customers unwillingness to pay
- ❖ Business shut down
- ❖ Premature death
- ❖ Parent and subsidiary relation with the affiliation business company.

### **3.2.3. Techniques used by CBE**

The techniques and efforts made by CBE to collect its account receivable are found to appropriate but the most common are:

- ❖ To notify the customer by calling before the payment day.
- ❖ To make a time table that comforts the customer
- ❖ Post dated check

### **3.2.4. Account Receivables Turn Over**

Account receivables turnover measures how many times in average credit activity is made in a year. A high value of accounts receivable turnover is favorable and it indicate the efficiency of business in collecting outstanding credit, the following tables are summary of the required data from the annual report. this ratio indicated how many times and how rapidly receivables are converted in the cash during a year.

Account Receivable Turnove

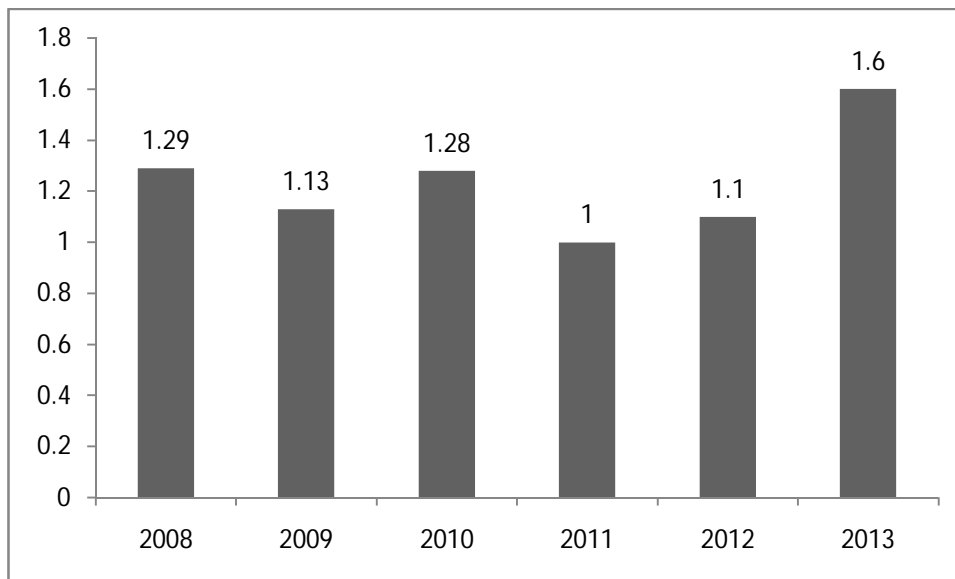
$$r \text{ (ARTO)} = \frac{\text{Net Loan}}{\text{Account Receivable}}$$

**Table - 12: Account Receivable Ratio (ARTO)**

Description	2008	2009	2010	2011	2012	2013
Loan Disbursement (in million birr)	1,614.1	2,579.4	3,972.2	4,115.9	6,087.4	8,870
Loan Collection (in million birr)	1,246.7	2,277.6	3,106.6	4,075.8	5,563.5	5,675
Ratio	1.29	1.13	1.28	1.00	1.1	1.6

Source: Annual report

### Account Receivable Ratio



Source: Annual report

As it is shown in the above presentation the ARTO (account receivable turnover ratio) is not constant rate; the ARTO is fluctuating year to year. Thus, the bank experiences increasing in the receivable balance without corresponding increasing loans.

### 3.2.5. Average Collection Period

It is useful in evaluation credit and collection polices. It represents the average length of time a bank must wait to receive cash after making loan. The shorter the average

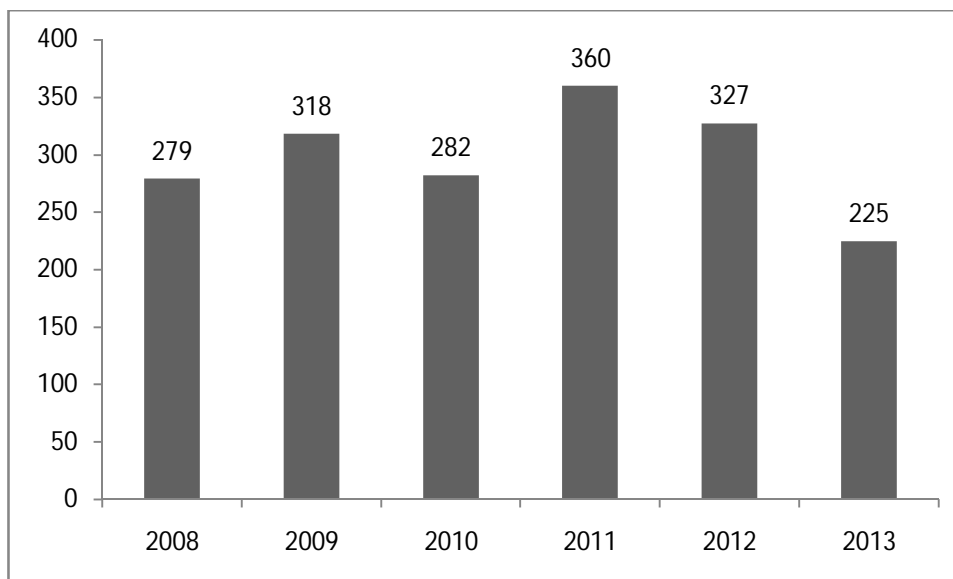
collection period the better it will be. In addition it's preferable for average collection period to decrease from time to time. But, this thing is not true in the case of CBE.

**Table - 13: Average Collection Period**

Description	2008	2009	2010	2011	2012	2013
ARTO	1.29	1.13	1.28	1.00	1.1	1.6
$ACP = \frac{360}{ARTO}$	279	318	282	360	327	225

Source: Annual report

### Average Collection Period



As it can be seen from the presentation the average collection period is increasing from about 279 days in 2008 to about 225 days 2013. Based on the responses from the General Account Head, there are some accounts which are long outstanding and the bank is trying all effort to make those credits to be collected.

### 3.2.6. Uncollectible Receivables

When loans are given to consumer a part of the claims against customers usually proves to be uncollectible this situation is common, regarding of the care used in granting credit and the effectiveness of the collection procedures used the operating expense incurred because of the failure to collect receivable is called an expense or loss from uncollectible

accounts, doubtful accounts or bad debts and it affect negatively the bank by reducing it's operating revenue.

**Table – 14: Uncollectible Receivables**

<b>Description</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Provision for doubtful debts (in million birr)	1,002.5	1,241	2,015	3,065.99	5,068	6,475
Percentage of the total annual Account Receivable	80.4%	54.4%	64.9%	75.2%	91.0%	72.9%

Source: Annual report

As we can understand the presentation the amount of uncollectable account become significant from year to year.

### **3.3. Major Findings**

Based on the gathered analysis made researcher team tried to find out some major points that are basically related with the strength and weakness of internal control over receivables in CBE.

#### **Strength**

- ❖ The bank as a structured policy and procedure for internal control of receivables.
- ❖ Write off of receivables in done based on legally when the debtor gives evidence.
- ❖ The bank have a collection department independently.
- ❖ Take a legal or other action like by forbidding the debtors give credit base on other time for those customers who do not pay on their due date and according to their agreement.



## **Weakness**

- ❖ Sometimes credit is given by the willingness of the management without detailed study of the customer's credit faculty.
- ❖ There is delay in sending statement of account receivable
- ❖ There is a delay in collection on cash.

## **CHAPTER FOUR**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

#### **4.1. Summary**

The overall objective of this study is to address the internal control over receivable system of Commercial Bank of Ethiopia Habte Georgis Branch and to find out the problems related with internal control systems of receivables.

The method used to prepare this research is simple random sampling technique to pick subjects from the population and used primary and secondary data obtained through questionnaire and document from the company's annual report and magazines the method in analyzing and presenting data the researchers used qualitative and quantitative data analysis methods. From quantitative data analysis method, simple percentage is used the researcher analysis can be summarized as follows:

- From the thirty eight (38) population size, the researchers selected ten (10) samples from different department.
- 10(100%) of respondents replied that the bank has a good internal control system over receivables.
- 8(80%) of the respondents replied that the bank have independently collection department and the rest of 2(20%) of respondents said that does not have
- All respondents 10(100%) replied that the bank communicate with credit customers.
- 7(70%) of respondents replied that its giving of credit limit to the customer are good and the rest said it is fair.
- All the respondents said that the bank has credit term or agreement on the bank.
- 9(90%) respondents replied that statements of receivables is prepared and sent to customers strictly on the bank and the rest said not
- From the respondents 8(80%) respondents said that the bank prepare an aging report and the rest said no aging report on the bank.

- 8(80%) respondents said credit customer pay their agreement highly and the rest respondents said that the credit customers pay their agreement lowly and very highly.
- All the respondents said that the bank takes action for these customers who do not pay on due date by forbidding giving of credit and by taking legal action.
- As all the respondents said the bank does change an account receivable to promissory note and also there is a procedure to write-off uncollectible.

## **4.2. Conclusion**

It is obvious that banks are very complex due to different types services they handle even Is banks handle different types of services, it should be controlled properly. Accordingly the internal control system over receivables of CBE Habte Georgis branch is concluded below.

- The bank have a credit service is under taken in all branches of the bank. In this service the payment is made according to the agreement by the two parties based on the operating sectors credit service polices. Since the bank is Huge it gives different types of loans to customers. For example domestic trade service foreign trade agriculture, manufacturing building construction and personal loan.
- As mentioned before most of the activity of the bank is to give that the bank treats as receivable from the credit customers
- In CBE receivables are control based on the structured credit policy and procedures the control mechanisms for the credit debtors are making follow up by independent collection departments.
- Regarding the credit policy the bank gives credit based on the granting policy credit is automatically expended to customers during the time claims for reimbursement are outstanding
- Concerning contract with the credit customers a bank prior relationship with customer reveals information about past credit and deposit experience that is use full in assessing willingness and ability to replay.

- Regarding the credit limit, the bank giving of credit limit to customers is existing and handing of customer credit faculty and the procedure is non thoroughly studied and reused.
- Concerning the use of a giving account receivable report, the bank process of aging account receivable the management should evaluate current financial statement of major customers to make a better assessment of the probability of collection.
- The bank takes a legal action for those customers who do not pay according to the agreement and due dates.
- Regarding write off requests of write off uncollectible accounts must be categorized by types of bill and submitted for approach. Supporting document must be provided to justify write- off of each item and the sources of funds for financing the write-off must be so indicated.
- Even through the bank has well structured policies and procedures of the purpose of internal control over receivables sometimes those policies and procedures are not strictly followed by the different sectors of banks and these affects the receivables not to be collected easily.

### **4.3. Recommendation**

According to the gathered data from both primary and secondary data of the company and the analysis shown the researcher would like to recommend on the following points over the internal control of receivables.

- Due to absence of strict follow up this receivables policy and procedures and lack of management attention. Since one of the most activity is give credit for different types of business sector and individual. so it is preferable that the bank has a strong collection department which help the bank to collect its receivable attentively, effectively.
- Even though the bank has limit for the giving of credit to the customer's these is not applied for all customers and this is done by the willingness of the management, it is better if the bank uses its credit limit policy equally though the related branches are under management of the same person.

- For some division there is no stated credit policy and procedure these should be taken under consideration because it make the collection difficult.
- Sending of statement to the debtors should be made strictly, in this case the bank send the statement but sometimes there is a delay.
- The bank takes action for those customers who do not pay on their due date but sometimes there is no proper follow up or attention in these case immediate action has to be taken.
- If the bank select those customers which are credit worthy it receivable will be fully paid. Therefore, it's better for CBE to undertake an appropriate credit analysis and give credit only to those customers which are credit worthy.
- It is better for this bank to require additional guarantees from its customers especially for big amount of credit services.
- It is advisable if CBE introduces an intrusive schema for its credit customers i.e. those customers who pay earlier than the used pervious would get some discount or bonus and CBE will have more cash and secures collection.

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<http://www.CBE.Gov.et>

<http://www.West.com/receivables>



7. If your answer is “No” what should you recommend?  
\_\_\_\_\_  
\_\_\_\_\_
8. In your opinion how do you evaluate the bank giving of credit limit to the credit customer?  
 Very poor       Poor       Fair       Good       Very Good
9. If your answer is “very poor or poor” what should you recommend?  
\_\_\_\_\_  
\_\_\_\_\_
10. Does the Bank has specific credit term or agreement?  
 Yes       No
11. If you answer is “No” what should you recommended?  
\_\_\_\_\_  
\_\_\_\_\_
12. Is statement of account receivable strictly prepared and sent to debtors?  
 Yes       No
13. If your answer is “No” what should you recommend?  
\_\_\_\_\_  
\_\_\_\_\_
14. Does the bank uses prepare an account receivable aging report?  
 Yes       No
15. How do you assess that credit customers pay according to their agreement?  
 Very High       High       Low       Very Low
16. If your answer is “very low or low” what should you recommend?  
\_\_\_\_\_  
\_\_\_\_\_
17. Does the bank take sort actions for those customers who do not pay on due date?  
 Yes       No



18. If your answer is "No" what should you recommend?

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19. Does the bank change an account receivable to promissory notes receivables?

Yes  No

20. If your answer is "No" what should you recommend?

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21. Does the bank give credit with interest?

Yes  No

22. Does the bank forces the credit customer to pay according to their credit agreement or policy?

Yes  No

23. If your answer is "No" what should you recommend?

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24. Does the bank have a well established write-off method?

Yes  No

25. Is there procedures that follow-up to write off uncollectible?

Yes  No

26. If your answer is "No" what should you recommend?

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## DECLARATION

We, the undersigned student researchers, declare this research paper entitled “The Effect of Internal Control over Account Receivable” the case of Commercial Bank of Ethiopia Habte Georgis Branch” Is our on original work prepared under the guidance of Ato Ahmed.

Name	Signature
Hayat Fentaw	_____
Meskerem Abera	_____
Muhareba Nesro	_____

Place of Submission: \_\_\_\_\_

Date of Submission: \_\_\_\_\_

### Advisor Declaration

Name: \_\_\_\_\_

Signature: \_\_\_\_\_

Date: \_\_\_\_\_