

The Impact of Internal Control Activities on Financial Performance of Tertiary Institutions in Nigeria

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Abstract

The purpose of this study is to establish the relationship between internal control activities and financial performance in Tertiary Institutions in Nigeria. The study area is Cross River State College of Education, Akamkpa. Data was collected using questionnaires and interview guide as well as review of documents and articles. The method of analysis employed was survey design while the stratified sampling procedure was adopted in administering the questionnaires. The data were analyzed using simple percentages, tables, correlation coefficient and z-scores. The study revealed that all activities of the College are initiated by the top management. Regarding control activities, the study found that there is clear separation of role in the institutions' finance and account department and that superior officer in the College supervised regularly work done by their subordinate. Also, the study found that the institution financial statements are audited annually by external auditors. However, there is a possibility for a single staff to have access to all valuable financial information without the consent of other staff. On the budgetary control, the study revealed that the institution adhere strictly to the provisions of annual departmental budget and that control are in place to exclude incurring expenditure in excess of allocated fund. Also, there is poor security network in the College. The study result further shows that there is no significant relationship between internal control activities and financial performance of Cross River State College of Education. The investigation recommends proper checks and balances in all financial transactions. There should be effective and efficient security network to reduce frequent theft, threat to life and property. The study also recommends that management of the institution should organize regular training for staff on control mechanism.
Keywords: Internal control, control activities, financial performance, financial and non financial procedure.

1 Introduction

Internal controls refer to the measures instituted by an organization so as to ensure attainment of the entity's objectives, goals and missions. They are a set of policies and procedures adopted by an entity in ensuring that an organization's transactions are processed in the appropriate manner to avoid waste, theft and misuse of organization resources. Internal Controls are processes designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Mwindi, 2008). It is worth noting that internal controls only provide reasonable but not absolute assurance to an entity's management and board of directors that the organization's objectives will be achieved. "The likelihood of achievement is affected by limitations inherent in all systems of internal control" (Hayes et al., 2005).

In Cross River State College of Education, Akamkpa, financial performance is one aspect that has not been given the attention it deserves. College staff has in a number of cases been given College resources and have failed to account for the resources entrusted to them or have not made the necessary accountabilities on time. During the 1980s, several high-profile audit failures led to creation of the Committee of Sponsoring Organizations of the Treadway Commission (COSO), organized for the purpose of redefining internal control and the criteria for determining the effectiveness of an internal control system They studied the causal factors that can lead to fraudulent financial reporting and developed recommendations for public companies, independent auditors, educational institutions, the Securities Exchange Commission (SEC), and other regulators (COSO 1985). The product of their work is known as the COSO Internal Control—Integrated Framework (Simmons 1997).The framework also points out that controls are most effective when they are "built into" the entity's infrastructure (COSO 1992,) and further states that "built in controls support quality and empowerment initiatives, avoid unnecessary costs and enable quick response to changing conditions" (COSO 1992).

At the turn of the century, another group of corporate scandals resulted in enactment of the Sarbanes-Oxley Act of 2002 (SOX) which, among other things, requires a formal report on the effectiveness of internal controls. The COSO framework plays a key role in compliance because Section 404 of the Act requires companies to include in their annual report, a separate management report on the company's internal control over financial reporting and an attestation report issued by a registered public accounting firm.

John J. Morris. (2011) separates internal controls into those that are general (entity-wide) controls from those that are specific (account-level) controls. He believes that if management was overriding control features in order to manage earnings, then one would expect to find more Internal Control Weaknesses related to general controls, even if the specific (account-level) controls are effective. This type of behaviour should be uncovered during the audit process since this is an area of concern specifically identified in Auditing Standard No. 5, Paragraph 24, which states that "entity-level controls include controls over management override." On the other hand, a stronger argument could be made that if general controls are in place and working, then one would expect to find less Internal Control Weaknesses related to general controls.

In their publication Whittington and Pany (2001), attempt to explain the meaning, significance of Internal Controls, and the Components of a Company's internal controls. They also attempt to explain the relevancy of internal controls in large scale business organizations. In their book while borrowing the definition of the Committee of Sponsoring Organizations (COSO); Internal Control- Integrated Framework, Whittington & Pany.2001 define internal control as "a process effected by the entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories; reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations." They emphasize that internal controls is a process and not an end in or of itself. They note that internal controls provide reasonable but not absolute assurance about the attainment of an entity's objectives.

1.1 Research Hypothesis

Ho: There is no significant relationship between internal control activities and financial performance of Tertiary institutions in Nigeria.

1.2 Organization of the study

The rest of the paper is organized in four sections. The theoretical framework as well as review of relevant literature regarding internal audit function is contained in section 2. Section 3 identifies the research methodology and model specification. Section 4 represents data presentation, analysis and discussion of finding while conclusion and recommendations are stated in section 5.

2. Theoretical Framework and Literature Review

2.1 Theoretical Framework

Organizational Control Activities

Whittington and Pany (2001) also mention Control activities as another component of Internal controls. They note that control activities are policies and procedures that help ensure that management directives are carried out. Controls activities in an organization basically comprise; performance reviews (comparing actual performance with budgets, forecasts and prior period performance), information processing (necessary to check accuracy, completeness and authorization of transactions), physical controls (necessary to provide security over both records and other assets), and segregation of duties (where no one person should handle all aspects of a transaction from the beginning to the end). The last component of internal control according to Ray and Pany is monitoring. This is aimed at ensuring that the internal controls continue to operate as intended. This can be achieved through ongoing monitoring or separate evaluations. Separate evaluations are non routine monitoring activities such as period audits by the internal auditors.

2.1.1 Financial performance

Mawanda (2008), performance refers to the ability to operate efficiently, profitability, survive grow and react to the environmental opportunities and threats. They assert that, performance is measured by how efficient the enterprise is in use of resources in achieving its objectives. It is the measure of attainment achieved by an individual, team, organization or process. Hitt, et al (1996) believes that many firms' low performance is the result of poorly performing assets (businesses). Low performance from poorly performing assets is often related to strategic errors made in the acquisition process in earlier years. For example, some firms acquire businesses with unrealistic expectations of achieving synergy between the acquired assets and their current sets of assets. A common reason for such errors is managerial hubris or overvaluation of managerial capability in the acquisition process.

2.1.2 Measures of financial performance

Appropriate performance measures are those which enable organizations to direct their actions towards achieving their strategic objectives. Performance is measured by either subjective or objective criteria; arguments for subjective measures include difficulties with collecting qualitative performance data from small firms and with reliability of such data arising from differences in accounting methods used by firms. Kent (1994) found out that, objective performance measures include indicators such as profit growth, revenue growth, return on capital employed.

Financial consultants Stern Stewart & Co. created Market Value Added (MVA), a measure of the excess value a company has provided to its shareholders over the total amount of their investments. This ranking is based on eight more traditional aspects of financial performance including: total return for one and three years, sales growth for one and three years, profit growth for one and three years, net margin, and return on equity. Verschoor (1999) however, mentions other financial measures to include value of long-term investment, financial soundness, and use of corporate assets. He also talks of non financial performances measures to include; innovation, ability to attract, develop, and keep talented people, quality of management, quality of products or services, and community and environmental responsibility.
Hitt, et al., (1996) mention accounting- based performance using three indicators: return on assets (ROA), return on equity (ROE), and return on sales (ROS). Each measure was calculated by dividing net income by total assets, total common equity, and total net sales, respectively.

2.1.3 Liquidity

Hitt, et al (1996) mention current ratio (current assets/current liabilities) as a standard measure of liquidity in organizations. Baysinger, (1989) also emphasized the importance of current ratio as a measure of an organization's liquidity. Other measures of Liquidity according to ACCA are; Acid test ratio (i.e. Current Assets less Inventory/Current Liabilities).

2.1.4 Accountability

According to Hayes, et al., 2005, Managers need regular financial reports so as to make informed decisions. Reporting (particularly financial reports) is one way through which managers make accountability for the resources entrusted to them. Emasu (2010) asserts that Accountability can be political, social or financial accountability.

2.1.5 Reporting

Whittington & Pany (2001), talk about the comprehensiveness of internal controls in addressing the achievement of objectives in the areas of financial reporting, operations and compliance with laws and regulations. They further note that "Internal control also includes the program for preparing, verifying and distributing to the various levels of management those current reports and analyses that enable executives to maintain control over the variety of activities and functions that are performed in a large organization"

They mention internal control devices to include; use of budgetary techniques, production standards, inspection laboratories, employee training and time & motion studies among others. According Bakibinga 2001, corporate law requires a divorce between ownership and management of an entity. Owners normally entrust their resources in the hands of managers.

Managers are required to use the resources entrusted to them in the furtherance of the entity's objectives. Managers normally report to the owners on the results of their stewardship for the resources entrusted to them through a medium called financial statements. It is these financial statements that reveal the financial performance of an entity. John J. Morris (2011) believes that Enterprise Resource Planning systems provide a mechanism to deliver fast, accurate financial reporting with built-in controls that are designed to ensure the accuracy and reliability of the financial information being reported to shareholders.

2.2 Control Techniques/ Foundation in Cross River State College of Education

Internal controls are method and measures adopted by the College to promote thoughtful and efficient use of state resources and public funds. It provides that complete and accurate records are kept of transactions involving students and that College assets are secured. Put differently, a well-designed system of controls safeguards College assets and ensures accuracy and reliability in the use of such assets and in the performance of employees' respective job.

In addition to the College system of internal control, the Government Accountability, Audit and Internal Control Act of 1987 formalizes Cross River State commitment to efficient and effective business practices, quality services, and ethics in the operation of state government.

The government Financial Regulation (FR), Fiscal Responsibility Act (FRA), Public Procurement Act (PPA) and financial circulars issued from time to time forms the basis for the College internal control technique, and in line with the civil service rules. It requires that all states Ministries, Departments and Agencies (MDAS) institute a formal internal control programme. There are six (6) requirements of the Internal Control Act. These include;

- Maintain written internal control guidelines
- Maintain an internal system for continuous review of operations.
- Maintain a concise statement of policy and standards available to all employees
- Designate and internal control officer
- Educate and train all employees on internal control
- Evaluate the need for an internal audit function

According to Cross River State College of Education, Akamkpa (2010) handbook, the foundations of internal control system in the college are the policies and procedures applicable to its daily operations. Below is a sample of basic foundations that affects all employees;

- Personnel handbook

- College rules & regulation
- Public service guide
- Due process & Price intelligence procedures
- Policy hand book
- Hiring practice
- Transaction process

Other example of internal control system that regulates activities and performance in the college include but are not limited to;

- External laws (National commission for colleges of education) Regulations, policies and procedures
- Policies of the College Governing Council
- College handbook and catalog
- Academic curricula and course outline
- Student registration and admission procedure
- Financial & personnel procedure
- College strategic plan/Medium term framework
- Bargaining contract
- Financial & Operational Audit
- Employees performance, Appraisal & Evaluation programme
- Accreditation
- Time and attendance reporting/crossing of line
- Network security, software control
- Public safety, environmental safety, code compliance practice
- Academic board and management committee governance process.
- Service contract revocable permit
- Building door lock systems and key control
- Student and staff identification card, etc.

2.3 Literature Review

According to Mawanda (2008), Board of Directors (Governing Council) ought to supervise the management of an entity (institution), but it has always turned out that Governing Council merely implement recommendations of the management committee of an institution.

Recent case studies on internal auditing in Belgium illustrate the importance of the control environment when studying internal auditing practices.

According to Saren & De Belde in Mawanda (2008), when an organization pursues integrity and clear ethical values reflected in a formal code of conduct/ethics, the internal audit function will take a greater importance. Internal control systems not only contribute to managerial effectiveness but are also important duties of corporate board of directors. Accounting literature likewise emphasizes the importance of an organization's integrity and ethical values in maintaining an effective control.

A focus on integrity and ethical values was the principal contribution of internal control – integrated framework published by COSO on fraudulent financial reporting. To trigger independence and integrity of Auditors and Accountants, the Accountancy profession globally has a document called the code of Ethics issued by the International Federation of Accountants (IFAC). In the case of Nigeria, there is a code of conducts issued by the Institute of Chartered Accountants of Nigeria (ICAN). This code contains some ethical standards which members are expected to comply (Kalu 2011).

3. Research Methodology

The cross sectional survey design approach was justified on the account of its economy, rapid data collection and ability to understand a population from a part. The researcher designed, developed and administered close ended questionnaires to top management staff, academic and non – academic staff of Cross River State College of Education, Akamkpa. This was used for the purpose of obtaining data to test the hypothesis. Emphasis was laid on capturing members of management committee, heads of department, finance and finance related offices. The stratified sampling procedure was adopted in administering the questionnaires to guide the study. The sampling technique used for the study is the judgment (purposive) sampling. Purposive sampling is where the researcher consciously decides who to include in the sample. Data was collected using both primary and secondary data collection technique. Primary data was gathered basically through structured questionnaires and interviews with "key informant members". Secondary data was gathered through College publications, text books, journal, etc.

The data collected were synthesized and analyzed to give meaning to the specific objective of the study. The data were tabulated and presented using such statistical tools like percentages, tables and correlation coefficient. The entire hypotheses formulated were tested using the z-score. Correlation was used as a way of assessing the relationship between internal audit function and financial performance. Narrative analysis was used to explain the qualitative results of the survey.

4 Data Presentation, Analysis And Discussion Of Findings

4.1 Data Presentation

The data collected for the study are presented using tables:

Table 4.1: Questionnaire Distributed and Received

S/No	Group of Staff	QD	QR	PQR(%)	QNR	PQNR(%)
1	Deans of School	5	4	80	1	20
2	Heads of Dept.	23	22	96	1	4
3	Bursary Staff	16	16	100	-	-
4	Internal Audit Staff	6	6	100	-	-
5	Other Academic Staff	10	10	100	-	-
6	Other Non-academic	17	17	100	-	-
	TOTAL	**77**	**75**		**2**	

Source: Field work

Where:

QD	=	Questionnaire distributed
QR	=	Questionnaire received
PQR	=	Percentage of questionnaire received
QNR	=	Questionnaire not received
PQNR	=	Percentage of questionnaire not received

Table 4.1 shows that the total number of questionnaire distributed to the selected staff is 77 with 75 of them representing 97 percent completed and returned. Only 2 or 3 percent of the questionnaire were not returned. Therefore, completed and returned questionnaire have been used for the analysis and evaluation of the reasons for the effect of internal controls system on Financial Performance of Tertiary Institution, with Cross River State College of Education, Akamkpa as case study.

4.2 Analysis of Data Collation of Responses on whether review of organizational control activities has any significant effect on financial performance.

Q.NO	QUESTIONS/STATEMENT	RESPONDENTS	%
1.	There is adequate segregation of duties in the institution's finance and accounts departments.		
	a) Strongly agree	32	43
	b) Agree	31	41
	c) Strongly disagree	4	5
	d) Disagree	8	11
2.	Superior officers in the accounts and audit department of the College supervise regularly the work done by their subordinate.		
	a) Strongly agree	31	41
	b) Agree	34	45
	c) Strongly disagree	4	5
	d) Disagree	6	9
3.	Management review financial transactions regularly.		
	a) Strongly agree	36	48
	b) Agree	24	32
	c) Strongly disagree	12	16
	d) Disagree	3	4
4.	Staff are train to implement the accounting and financial management systems.		
	a) Strongly agree	20	27
	b) Agree	15	20
	c) Strongly disagree	18	24
	d) Disagree	22	29
5.	The institution's financial statements are audited regularly by		

	external.		
6.	a) Strongly agree	55	73
	b) Agree	18	24
	c) Strongly disagree	-	-
	d) Disagree	2	3
7.	There is a possibility for a single staff to have access to all valuable financial information without the consent of other staff.		
	a) Strongly agree	8	11
	b) Agree	7	9
	c) Strongly disagree	32	43
	d) Disagree	28	37
8.	Departments/units of the college adhere strictly to provisions of budget.		
	a)Strongly agree	29	39
	b)Agree	21	28
	c)Strongly disagree	10	13
	d)Disagree	15	20
9.	Controls are in place to exclude incurring expenditure in excess of allocated fund.		
	a)Strongly agree	16	21
	b)Agree	38	51
	c)Strongly disagree	7	9
	d)Disagree	14	19
	Security system do identifies and safeguard institutional assets.		
	(a.)Strongly agree	9	12
10.	(b.)Agree	22	29
	(c.)Strongly disagree	24	32
	(d.)Disagree	20	27
	Follow-up actions are taken to remedy previously identified weakness in internal controls system.		
	(a) Strongly agree	16	21
	(b) Agree	23	-
	(c) Strongly disagree	21	28
	(d) Disagree	15	20

Source: Field Survey Data, 2013.

Table 4.2 has been presented and analyzed to show whether organizational internal control activities has any significant effect on financial performance of the college. The analysis has been done with the title control activities.

Control Activities:

Out of 75 respondents, 63 representing 84% were of the opinion that there is adequate segregation of duties in the finance and accounts department while 12 respondents representing 16% expressed contrary view. On whether superior officers supervises work done by their subordinate, 65 representing 86% answered in the affirmative, while 10 or 14% disagreed.

Also, 60 or 80% of the respondent agreed that the college management conduct a review of financial transactions regularly, whereas, 15 or 20% disagreed.
On whether staffs are train to implement accounting and financial management systems, 35 representing 47% of the respondents affirmed that the college did, while 40 or 53% of them disagreed. 97% or 73 respondents confirmed that the college financial statements are regularly audited by external auditors, while 3% or 2 respondents disagreed.

Also, 29 or 39% strongly agreed that departments/unit adhere strictly to provision of the budget, 21 or 28% also agreed, 10 or 13% strongly disagreed while 15 or 20% also disagreed.
Also there are positive responses as per whether controls are in place to excluded incurring expenditure in excess of allocated funds. This is shown by their responses, 54 or 72% agreed while 21 or 28% disagreed.

4.3 Test of Hypothesis

Ho: There is no significant relationship between internal control activities and financial performance of Cross River State College of Education.
Decision Rule:
Reject Ho: if z > za or if z < -za
Accept HO: if z < za or if z > -za
Where; z = test statistic (value)
Za = critical (table) value.
Level of significance used is 5%
The critical value is z = 0.05 = 1.96

The statistical test $z = \dfrac{Ø - Ø_o}{S\,Ø}$

Table 4.3 Computation of the test value for z for Hypothesis
Let X represents strongly agree and agree and
Let Y represents strongly disagree and disagree

X	Y	X^2	Y^2	XY
63	12	3969	144	756
65	10	4225	100	650
60	15	3600	225	900
35	40	1225	1600	1400
73	2	5329	4	146
15	60	225	3600	900
50	25	2500	625	1250
54	21	2,916	441	1134
31	44	961	1936	1364
39	36	1521	1296	1404
$\sum X = 485$	$\sum Y = 265$	$\sum X^2 = 26{,}471$	$\sum Y^2 = 9{,}971$	$\sum XY = 9{,}904$

Substituting these values in the formula

$$r = \frac{N(\sum XY) - (\sum X)(\sum Y)}{\sqrt{N\sum X^2 - (\sum X)^2 \,.\, N\sum Y^2 - (\sum Y)^2}}$$

$$r = \frac{10\,(9904) - (485)\,(265)}{\sqrt{(10 \times 26{,}471 - (485)^2 \,.\, (10 \times 9971 - (265)^2)}}$$

$$r = \frac{99040 - 128{,}525}{\sqrt{(264{,}710 - 235{,}225)\ .\ (99{,}710 - 70{,}225)}}$$

$$r = \frac{-29{,}485}{\sqrt{29{,}485 \times 29{,}485}}$$

$$r = \cancel{\frac{-29{,}485}{28{,}485}}$$

$$r = -1.0000$$

Comparing the critical value with the test statistics = -1.0000 > - 1.96
Decision: since the negative value of the z statistic is higher than the critical or table value and falls outside the acceptable region.
Therefore, the alternative hypothesis HA is rejected. The null hypothesis Ho is then accepted that there is no significant relationship between internal control activities and financial performance of Tertiary institutions in Nigeria.

4.3 Discussion of Findings

Internal Control Activities and Financial Performance: -
Management of every organization has the line responsibility for designing, implementing and monitoring their internal controls system. The study revealed that there is regular review of financial transaction by management, strict adherence to budget provisions, and adequate segregation of duties, but that staff are not adequately train to implement the accounting and financial system. This renders the current internal control structure at Cross River State College of Education ineffective.
It was also observed that both practice and detective security control system is lacking in the College as revealed in the responses from respondents contained in table 4.2 and also attested by the hypothesis which accepted the null hypothesis that, there is no significant relationship between internal control activities and financial performance of tertiary institutions in Nigeria.

5 Conclusion and Recommendations

Based on the findings of the study, it is concluded that the College financial statements are audited annually by external auditors. The study also concludes that all activities of the College are initiated by the top management and that there is clear separation of role in the institutions' finance and account department and that superior officer in the College supervised regularly work done by their subordinate. On the budgetary control, the study concluded that the institution adhere strictly to the provisions of annual departmental budget and that control are in place to exclude incurring expenditure in excess of allocated fund.
Since it was evident in the study, that the there is poor security network in the College, the study recommends that management of the institution should put effective and efficient security network in place to reduce frequent theft, threat to life and property. The study also recommends proper checks and balances in all financial transactions. Also the study recommends that management of the institution should organize regular training for staff on control mechanism.

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