

# Internal Audit and Fund Misappropriation in the Public Sector of Nigeria

Edoumiekumo, Adesewa R <sup>1\*</sup> Nkak, Promise E <sup>1</sup> Faleti, Joseph O. (ACA) <sup>2</sup>  
Abah-Marcus, Oladiza P <sup>1</sup> Tiemo, Harmony <sup>1</sup>

1. Department of Accountancy, Niger Delta University, Amasoma, Bayelsa State, Nigeria

2. Wellspring Professional Solutions and Apex Executive Professional Studies, Calabar

## Abstract

The preceding unusual in the financial activities of the government revealed by the auditor-general on the financial health of the country has drawn the attention of the public of the wrongdoing and audit queries observed the audit. The study investigated the roles of internal audit in the misappropriation of public funds. Primary data was our main source of data and structured questionnaire was designed to collate data from the audit and account department of the selected ministries. The descriptive statistics and least square regression analysis was used to test the hypotheses premise. From the analytical output, our study found that Effectiveness of Internal Audit (EIA) is negatively statistical not significant with the misappropriation of funds (MF) in the public sector. On the other hand, Internal Control System (ICS) was positive and statistically significant which implies that an efficient internal control system help to fight against misappropriation of funds in public place. Our study recommended that management and top executives saddle running an entity/managerial function should upgrade the competency of the audit/account department personnel for proper effective internal control Audit system in other to avoid the misappropriation of resources; There should be a good feedback mechanism and whistle blowing system.

**Keywords:** Misappropriation, Internal Audit, Internal Control System, Public Sector

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## 1. Introduction

Auditing is the systematic process of cross-examining the financial records and whether the financial statement complies with the relevant accounting standard. The financial report prepared must reflect the true picture of the event that occurred within that accounting year. Auditing is a specialized function having economic and ethical implications. The auditor examines reports on the economic information linking to the firms in which millions of people have their stake individually or through the state. Auditing is a basis of good public sector governance by ensuring that the public funds are utilized effectively without biased, and it is the responsibility of the auditor to ensure that government parastatal achieves the accountability, integrity, and public confidence among citizens (Stephen, Kenneth & Jacques, 2012). Jocelyn (2003), cited in Badara (2012), viewed internal auditing from the definition of the Institute of Internal Auditors as an independent appraisal function set up within an organization or firm to examine the events that occurred. Auditing has continued to grow with the increasing complexity in the way government funds have been used, and it is expected of the internal auditor to examine the activities and provide reports. Oyadongha and Ogoun (2017) questioned the roles of an internal auditor and their responsibilities in the detection and prevention of misappropriation of public funds. The preceding unusual in the financial activities of the government revealed by the auditor-general on the financial health of the country has drawn the attention of the public of the wrongdoing and audit queries observed the audit.

In Nigeria, the report gathered from the Guardian Editorial Column August 25, 2019, shows that most Ministries, Departments, and Agencies (MDAs) are guilty of financial wrongdoings and non-compliances with the financial regulations despite having a government that has a zero-tolerance for corruption. The non-retirements of overdue personal Advances of #4.87billion, none remittance of collected reductions in the sum of #3.79billion; the existence of doubtful cash balance of more than #315billion as at December 31, 2016. The sum of #60.39 million was claim to have been used for the purchase of estacode and air tickets for some government officials without an evidence which is against the ethics of financial regulations. It is against this back drop that the unaudited and non-submission of audit reports to the respective authorities on the government financial affairs have violated the breach in the financial regulatory and unethical professional practice in the federal public service.

The provisions of Financial Regulations 3210(v), which stated that the government agencies to submit their audited accounts and management reports to the office of the Auditor-General not later than May, 31 of the following year, the infamous development in the financial affairs of the government as at April 2018 only 109 MDAs had not submitted their audited reports beyond 2013, 76 MDAs last submitted their report for 2010 financial year. While 65 MDAs are yet to submit any of their accounts since establishment. All these problems

are attributed to the lack of adequate oversight, weak internal control system, and accountability from the internal auditor who is saddled to checkmate whether the disbursed funds are appropriately used for the intended need. If the reverse is the case, it is expected of the internal auditor to report back to the Auditor-General (AG), who reports the financial wrongdoings and breach of financial regulations to the legislative arm of government. In light of the above, there is a need for the presidency to intervene in this situation by ordering all government institutions and agencies to update their financial records within a given time or face sanctions. It is on this backdrop the objectives of the study is examine the effectiveness of internal audit in the misappropriation of funds and Determining the efficient internal control system in the fight against misappropriation of funds in the public sector. The study intends to review the roles internal auditor plays in fund misappropriation in the public sector, and the research will recommend measures to curb the misappropriation of funds and ensure the efficient use of the fund.

### Research Hypotheses

**Ho<sub>1</sub>:** Effective internal control Audit does not lead to the misappropriation of funds

**Ho<sub>2</sub>:** Efficient internal control system does not fight against misappropriation of funds in public sector

## 2. Literature Review

### 2.1 Concept of Internal Audit

Auditing is an independent examination an expression of opinion on the financial statement of an organization by an appointed auditor in pursuance of that appointment and compliance with statutory relevance body. Auditing is a valuable exercise that is statutorily required to ascertain the level of fairness in the management of organizational resources, compliances with regulatory requirement or standards as well as ascertaining the substantiveness of reported data and information in other to conclude. The Auditor seeks to establish an opinion concerning the truth, accuracy, validity, and reliability is fairness or otherwise of the statements or underlying records on which the statement has been built and whether or not they comply with any statutory or other requirements (ICAN, 2014). The result of auditing required the Auditor to make a report to the users of financial statements, giving his opinion concerning the accuracy and integrity of the accounting records and information. Historically, internal auditing is confined to merely ensuring that the accounting and allied records have been adequately maintained, the assets management system is in place to safeguard the assets and also to see whether policies and procedures are in place and are duly being complied with. With changing times, this concept has undergone a sea change concerning its definition and scope of coverage. The modern approach suggests that it should not be restricted to financial issues alone but also on issues such as cost-benefit analysis, resource utilization and their deployment, matters of propriety, the effectiveness of the management, etc. The contribution of the activity of internal audit is potential of significant importance as an effective internal audit system leads to improved accountability, ethical and professional practices, effective risk management, improves the quality of output and supports decision making and performance tracking (Adeniji, 2011). Institute of Internal Auditors (1999) defines Internal Audit as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”.

The Institute of Internal Auditors New York defines Internal Audit as “an independent, appraisal activity within an organization for the review of accounting, financial and other operations on the basis as a basis of service to the organization. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls” (ICAN, 2014).

### 2.2 Public Sector Attributes

The public sector is a sector of the economy that is managed and controlled by the government on behalf of the public. It is the sector of the economy that is publicly owned other than the sector owned, financed, and managed by individuals. Adams (2004) Public sector is all organizations that are not privately owned and operated, but which are established, run, and financed by the Government on behalf of the public. This definition conveys the idea that the public sector consists of organizations where control lies in the hand of the public as opposed to private owners, and whose objectives involved the provision of services, where profits making is not the primary objective.

Jimoh (2014), posited the following significant characteristics of public sector establishments:

- **Not for Profit Motive:** Public sector organizations are established to provide certain essential services to the citizens at no or low costs. They are not formed to make a profit but to cater for the wellbeing and welfare of the general public.
- **Taxation:** Taxes are the significant sources of Public sector revenue. However, unlike private establishments that generate their revenue through sales of goods or services. Taxes are compulsory levies imposed on both natural and artificial persons, and the payments are not based on services

rendered, i.e., whether welfare amenities are provided or not, taxes must be paid. Payment of tax is not a function of services provided.

- **Government operates in a non-competitive environment:** Most of the public organizations are non-competitive and exclusively reserved for Government. Though recently private participations are being allowed on specific operations, yet Government still has a lot of non- competitive areas.
- **Debt Capacity:** The government can take as many loans as its ability to survive the debt burden can take. Whereas private sector organizations have limited access to loan facilities and also, loans cannot be obtained without any economic justification.
- **High Level of Accountability:** Unlike the private sector that is only accountable to a certain number of shareholders. The public sector is responsible is expected, especially if the Government is democratically elected.
- **Nature of Government Fixed Assets:** Private organizations fixed assets are used to generate revenue for the organizations. However, most of the public sector fixed assets are used for the provision of welfare services to the citizens and not necessarily for revenue generation.
- **Provision of Essential Services:** The goal of any responsible Government is to provide welfare services to the citizens, not minding how much such services would costs. E.g., provision of electricity, Health Care Centre, water, construction of bridges, roads, schools, etc.

### **2.3 Benefits of Internal Audit**

Internal audit helps to ensure that there is a sound internal control structure within an organization. Every organization is set to achieve specific goals; for those goals to be achieved, there must be a form of checks and balances to ensuring that procedures are not breached, and possible loopholes are detected, prevented, and blocked.

The following are the benefits of internal audit, according to Kiabel (2002):

- **Quality Control:** Internal audit empowers the internal auditors in playing the role of combining assurance and consulting. Assurance informs the management of how well systems and processes are designed to keep the organization's goals on track. While consulting advises the management on how to improve those systems and processes whenever it is necessary.
- **Increase in Productivity:** Internal audit is designed to appraise the internal activity of organizations, taking cognizance of the objective assurance and consulting activity to add value and improve operations. Internal audit helps organizations to accomplish their strategic objectives by bringing a systematic and disciplined approach to evaluating and improving the effectiveness of risk management control and governance processes.
- **Detection of Frauds:** Internal audit helps put mechanisms in place to prevent and detect frauds, waste, and malpractices within an organization. The establishment of an internal audit unit in an organization will reduce exposure of the organization to fraudulent activities.
- **Good Corporate Governance:** Internal audit evaluates an organization's internal controls, including its corporate governance and accounting processes. It ensures compliance with law and regulations, accurate and timely financial reporting, and data collection. It also helps in maintaining operational efficiency by identifying problems and correcting lapses before they are discovered during the external audit.
- **Independent Appraisal:** It serves as an early warning system, enabling deficiencies to be identified and remediated on a timely basis. Internal audit helps in identify redundancies in operational and control procedures and provides recommendations to improve the efficiency and effectiveness of procedures.

### **2.4 Public Sector Organizations Internal Audit**

The public sector sets the economic plan for the nation. It implies that a robust system of internal checks needs to be put in place to provide assurances that government funds are used for purposes they were meant. One significant way of achieving this is the institution of internal audit. In the absence of an effective internal audit, individuals with questionable character may exploit inherent loopholes to their advantage. It is argued that the historically centralized and hierarchical structure of the public sector, with its complex bureaucratic procedures, tends to provide some level of comfort to those entrusted with the disbursement of public funds. Consequent to some layers of control embedded in the public sector, those responsible do not often see the need for another institutional layer (internal audit) to strengthen public assurance of accountability (Udeh & Eugene, 2016).

Badara (2012) explained Internal audit as an additional safeguard for proper financial control in the public sector. He further stressed that there is a need for internal audit division in the various ministries, agencies, and departments. The objectives of internal audit are unarguably broad, but governments differ in their commitment

to them; this is why it is generally asserted that the effectiveness of the internal audit can only be as good as the commitment of the government to pursue these objectives. Unegbu and Obi (2012), internal audit is part of the internal control system put in place by public sector organizations to ensure adherence to stipulated work procedures and as an aid to management. They believe that internal audit measures, analyses, and evaluates the efficiency and effectiveness of other controls established by management to ensure smooth administration, control cost minimization, capacity utilization, and maximum benefit derivation. This implies that internal audit is an integral part of a complex system designed by the public sector organizations to ensure the orderly conduct of its activities and prevent abuse of assets.

There is a considerable concern when ministries, departments, and agencies of government refusing to provide the auditor the fundamental access to the books, records, documents, and persons or even establish sound internal control system operated by the competent and qualified auditor to ensure the smooth financial and operational status of the establishments. It is indeed more worrisome when individuals who were supposed to be accountable for the resources entrusted in their custodies decided to convert public funds into their purse at the expense of the general public. Public sector key players aimed at frustrating the establishment of an internal audit unit and do anything possible to frustrate audit exercise to cover their malpractices and fraudulent activities. Notwithstanding, an internal audit is a very vital financial control system that is capable of detecting, preventing, and possibly eradicating misappropriation of public funds and other financial malpractices. Auditor General for the Federation job becomes less cumbersome when there is a robust internal audit department in all the public sector organizations. This is because internal audit will ensure the reliability of financial information as well as their accuracy before it will get to the external auditor who will vet the financial statements to give an opinion on the accurate and fair view.

### **2.5 Federal Government of Nigeria Financial Regulations**

Financial Regulation (2009) describes the internal audit as a managerial control that functions by measuring and evaluating the effectiveness of the internal control system in an organization. Section 1701 (ii) of the same Act requires the Accounting Officer of a ministry or extra-ministerial office and other arms of government to ensure that Internal Audit Unit is established to provide a complete and continuous audit of the accounts and records of revenue and expenditure, assets, allocated and unallocated stores, where applicable. Section 1702 states that the Accountant General shall ensure that a suitably competent Accountant is placed directly in charge of the Internal Audit Units of ministries/extra-ministerial offices and other arms of government.

To section 1703 of Financial Regulations, 2009 internal auditor will be directly responsible to the Accounting officer for a detailed audit of the accounts and records and the examination of the systems and procedures in force. Initially, he will submit to the Accounting officer a detailed program of audit, and after that, he will report monthly to the Accounting Officer on the progress of the audit. He will also issue special reports, if necessary, when, in his opinion, the attention of the Accounting Officer and the Accounting-in-charge must be called to an irregularity in the accounting records, or any apparent inattention to the reports of the Auditor-General, or earlier internal audit report(s) issued by him.

Section 1704 (ii) enumerated the following as the contents of the programme of audit for ministries, department, and agencies of government to be ensured:

- The safeguards introduced for the prevention or the prompt detection of fraud and loss of cash are adequate. In this regard, safeguards mean compliance with existing rules and regulations and the existence of internal checks.
- The system for the control of the collection of revenue is adequate, and that all amounts of money received are promptly and accurately brought to account under the correct heads and sub-heads
- The system for the control of expenditure is adequate and that all payments made and authorized adequately for the correct amounts and that they are paid to the right persons, classified to the correct heads and sub-heads, and made for the purpose for which they were authorized.
- A system for the control of the issue and consumption of stores is adequate that all issues are appropriately authorized, that issues are made to the right persons for the purpose for which they must have been authorized, and that adequate store records are maintained.
- There are adequate means for the verification of all cash, stores, and assets held,
- The accounting records are adequate.

### **2.6 Internal Audit and Misappropriation of Funds In Nigeria**

One major encumbrance that mitigates against the growth of Nigeria's economy is the misappropriation of available funds by the government at all levels. Nigeria as a developing nation with the dwindling economy which in many times survive with borrowing from both from internal (through issuing of bonds, treasury bills, etc.) and external (from London Club of Creditors, Paris Club of Creditors, International Monetary Funds, World Bank, Africa Development Bank, and through bilateral means) sources is guilty of mismanagement,

misapplication, and misappropriation of funds which is a pivotal contributor to the high poverty rate of its citizens while few public officers live in luxury at the expense of the entire citizens.

According to Wikipedia, misappropriation is the intentional, illegal use of property or funds of another person for one's use or another unauthorized purpose, particularly by a public official, a trustee of a trust an executor or administrator of a deceased person's estate or by any person with a responsibility to care for and protect another's assets (a fiduciary duty). Depending upon the jurisdiction and value of the property, misappropriation may be felony crime punishable by a prison sentence. Misappropriation is the highest type of fraud in the public sector. People deliberately convert public fund to personal use without a blink of fear or conscience disturbance (Ibanichuka & Onuoha, 2012). Udoayang and James (2004) as in Oyadongha and Ogoun, (2017) outlined the following as the primary ways misappropriation, and financial malpractices are perpetrated in the public sector organizations:

- Outright taking away of corporate or government assets for personal use.
- Payment of salary for non-workers.
- Payment for fictitious purchase and contract.
- Payment for no return inwards.
- Teeming and landing.
- Manipulation of any form for personal gains.
- Over-stating of the contract price.
- Conversion of government money into personal use.
- Conversion of office imprest to the personal allowance.
- Unauthorized use of public funds or asset
- Payment against uncleared cheques.
- The claim of disease staff gratuity and pension benefits.
- Misuse of medical allowances and reimbursements.
- Embezzlement
- Larceny
- Cheque fraud and some fraudulent behavior may include cutting costs and manipulating financial records for personal needs.

### 3. Methodology

In this study, the researcher adopted the survey research design to examine the effectiveness of internal audit in the misappropriates of public fund in Akwa-Ibom State. The study adopted a primary data and was obtained through the questionnaire. The questionnaire was administered to (60) respondents made up of the audit and accountants' departments. Sixty (60) questionnaires were distributed to the employees of the audit and account departments in Akwa-Ibom State. (55) Questionnaires were retrieved and (5) questionnaires were excluded for lack of information. This led to the final form of the sample at (50) male and female employees. The questionnaire consist of two sections, section one explains the Job title, age, academic qualification, years of experience while section two views the internal audit roles in the misappropriation.

#### 3.1 Model Specification

The Ordinary Least Square regression model was steered by the linear model:

$$Y = f(x_1, x_2) \dots \dots \dots (1)$$

Where;

$x_1$  = effectiveness of internal audit (EIA)

$x_2$  = internal control system (ICS)

$e$  = error term

$$MF = a + \beta EIA + \beta ICS + e \dots \dots \dots (2)$$



#### 4. Results and Discussion of Findings

Table 4.1 Descriptive Statistics

	MF	EIA	ICS
Mean	36.66667	40.83333	54.16667
Median	55.00000	45.00000	55.00000
Maximum	55.00000	55.00000	55.00000
Minimum	0.00000	20.00000	50.00000
Std. Dev.	28.40188	12.00694	2.041241
Skewness	-0.707107	-0.782260	-1.788854
Kurtosis	1.500000	2.664205	4.200000
Jarque-Bera	1.062500	0.640119	3.560000
Probability	0.587870	0.726106	0.168638
Sum	220.0000	245.0000	325.0000
Sum Sq. Dev.	4033.333	720.8333	20.83333
Observations	6	6	6

Source: Researchers' Computation from Respondent, 2020

Table 4.1 shows the summary of the descriptive statistics our respondent, it shows that MF, EIA, and ICS has mean respondent of 36.66667, 40.83333 and 54.16667 respectively with ICS been the highest and MF the lowest. The maximum values of MF, EIA, and ICS are 55.00000, 55.00000, and 55.00000 respectively and further shows the standard deviations of MF, EIA, and ICS which are 28.40188, 12.00694 and 2.041241 respectively, it shows that EIA is the most dispersed among the variables while ICS is the least dispersed. The Jarque-Bera statistics and the associated probability values showed that MF, EIA, and ICS are distributed normally with a probability of 0.587870, 0.726106 and 0.168638 respectively. The skewness is less than 0 and the kurtosis is One indicating that the variables are not perfectly distributed in the model.

Table 4.2 Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
$\hat{EIA}$	-1.295676	0.842898	-1.537168	0.1991
ICS	1.656904	0.657521	2.519927	0.0654
R-squared	0.408806	Mean dependent var		36.66667
Adjusted R-squared	0.261007	S.D. dependent var		28.40188
S.E. of regression	24.41559	Akaike info criterion		9.489522
Sum squared resid	2384.484	Schwarz criterion		9.420109
Log likelihood	-26.46857	Hannan-Quinn criter.		9.211654
Durbin-Watson stat	1.247999			

Source: Researchers' primary data computation using E-views 10\*

Table 2 shows the results, the coefficient of determination (R-squared) value of 0.408806 indicates that about 41% of changes in the dependent variable are accounted for by the combined effect of variations in the independent variables. The Durbin- Watson statistics (1.247999) indicates the non-existence of serial auto correlation among the independent variables.

The results showed that Effectiveness of Internal Audit (EIA) is negatively statistical not significant with a coefficient of -1.295676 and p-value of 0.1991 with misappropriation (MF), this implies that Effective internal control Audit does not lead to the misappropriation of public funds which therefore accept are hypothesis. On the other hand, Internal Control System (ICS) positively statistical significant with coefficient of 1.656904 and p-value of 0.0654 which implies that Efficient internal control system help to fight against misappropriation of funds in public place, which reject our second hypothesis.

#### 5. Conclusion

We examine the effective and efficient ways in curbing the financial misappropriation of public funds and in other judiciously expend what the money was approved for. Most projects are been awarded and funds are made available for the completion but the funds are misappropriated by agents in charge and which ensure the

effective internal control system in the fight against misappropriation of funds in the public sector. Thus, the study investigated the effectiveness of internal audit in the Nigerian public sector.

The study recommended that;

- Management and top executives saddle running an entity/managerial function should upgrade the competency of the audit/account department personnel for proper effective internal control Audit system in other to avoid the misappropriation of resources; the staff needs to be trained on-or-off the job to broaden their scope on the financial control and the implications of embezzlement.
- Review of the financial control system should be carried out continuously other mitigate against embezzlement and to ensure that the control system are updated in line with the international accounting regulation.
- There should be a good feedback mechanism and whistle blowing system; There is need for the government to protect the whistleblower from attack from the culprit.

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