International Journal of Science and Technology (STECH)
Bahir Dar- Ethiopia

Vol. 4(1), S/No 9, February, 2015: 142-151
ISSN: 2225-8590 (Print) ISSN 2227-5452 (Online)
DOI: http://dx.doi.org/10.4314/stech.v4i1.12

Determinants of Effective Internal Control System in Nigerian Banks

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Abstract

This study was aimed at investigating the determinants of effective internal control system in Nigerian banks and the impact of such determinants. In order to generate the necessary data for the study, a questionnaire designed in modified Likert-scale was administered on twenty-one (21) chief internal auditors of selected recapitalized banks currently operating in Port Harcourt. The data were analysed using the mean scores and the multiple regression. Our findings in this study revealed that presentation of early report, respect for authority, willingness to effect changes, lack of workers collusion, workers competence, independence of internal control staff, management observance of control, good remuneration of internal control staff, cost of instituting internal control measures, willingness to enforce controls, control *measures for unusual transactions, and well-designed organizational structure have a significant impact on the effectiveness of internal control system in Nigerian banks. Based on the finding of this study, the following recommendations were made: internal control staff should be made to be answerable to authorities outside management to promote independence, internal control staff should be given the autonomy to operate so that proper investigation of the activities of executive members can be carried out, high level ethical standards should be enshrined in Nigerian banks to make internal control more effective.*

Key words: Determinants, internal control, Nigerian banks

Introduction

Banking is a financial intermediary service which is the link between two units of the economy, that is the surplus unit and deficit unit. The surplus unit supplies financial resources in the form of deposits to the bank which in turn channel these resources to the deficit unit in the form of loans, advances, investment, and leases.

There are different stages in banking operations. These stages involve – documentation, records of prime entry, double-entry records, summarization of entries, balancing of accounts and the preparation of financial statements (Kiabel and Akenbor, 2008). In order to minimize and prevent the occurrence of errors and irregularities in banks, previous studies have shown that internal control mechanism is a veritable measure (See Ogundikpe, 2000; Nwaiwu and Peters, 2014). Kudinz (2009) defined internal control as all forms of control techniques instituted by management to ensure an efficient and effective performance of the organization. Therefore, any control measure adopted by the bank for the realization of its pre-determined objective, is described as an internal control system.

As a result of the branch networking of banks and the high volume of bank transactions, executive directors increasingly find it difficult to exercise personal first-hand supervision of operations; hence they have come to depend on accounting and statistical reports that summarize current happenings and conditions throughout the bank. The information carried by this stream of reports enables the executive directors to control and direct the operations of the bank group. It keeps them informed as to whether the bank policies are being followed, legal and governmental regulations are being observed, accounting principles are being adhered to, and whether interpersonal and inter-departmental relationship exists (Smith and Jacknes, 2003).

It was observed from investigation that some banks are engaged in the falsification of their status reports in order to enhance their share market value (Osisioma and Enahoro, 2006). With this scenario, one begins to image what is happening to the internal control system of those banks. Could it be that the internal control officers of the banks are yielding to the demand of management for the perpetration of such acts or the internal control system is generally ineffective? Previous studies such as Smith and Jacknes (2003), and Kudinz (2009), have indicated some determinants of effective internal control system as presentation of early report, respect for authority, willingness to effect changes, lack of workers collusion, workers competence, independence of internal control staff, management observance of control, good remuneration of internal control staff, cost of instituting internal control measures, willingness to enforce controls, control measures for unusual transactions, and well-designed organizational structure.

It is upon this premise that this study is consummated to determine the impact of presentation of early report, respect for authority, willingness to effect changes, lack of workers collusion, workers competence, independence of internal control staff, management observance of control, good remuneration of internal control staff, cost of instituting internal control measures, willingness to enforce controls, control measures for unusual transactions, and well-designed organizational structure on effective internal control system in Nigerian banks.

Literature Review

In banking operations – mobilization of savings, extension of credit facilities, credit creation, management of customer'\s investments, loan syndication, provision of foreign exchange facilities to travelers, provision of business, status report and references, provision of business advisory services, safe-keeping of valuables, purchase, repairs and maintenance of fixed assets, payment of wages and salaries etc, there must be documentations, records of prime entry, double entry records, summarization of entries, balancing of accounts and finally preparation of financial statements (Harrison, 2000). In each of the stages in banking operations, the effectiveness of the internal control system demands considerable attention.

According to Aguolu (2002), internal control is the whole system of controls, financial or otherwise established by management, in order to secure, as far as possible, the accuracy and reliability of records, run the business in an orderly manner and safeguard the company's assets, its objective being the prevention or early detection of fraud and errors. Henshaw and Barban (2000) classified internal control into two broad forms. These are accounting controls and administrative controls. Accounting controls are those measures having to do with the reliance on the accounting records and financial statements. They include internal audit and internal checks. Internal audit is an independent appraisal activity within the bank for the review of accounts, financial and other operations as a basis for service to management. Osisioma and Enahoro (2006) posit that the job of the internal auditor is to investigate and appraise the system of internal control and the efficiency with which the various units and branches of the bank are carrying out their assigned functions.

According to Aguolu (2002), internal checks refer to those checks on the day-to-day transactions, which operate continuously, as part of the routine system whereby the work of one staff is proved independently or is complementary to the work of another. Its major objective is to obtain confirmation of facts and entries, physical and financial by the creation and preservation of necessary records.

Smith and Jacknes (2003) described administrative controls as those internal control measures that have no bearing on financial records and statements. Kiabel (2002) posits that administrative controls are established to provide operational efficiency and adherence to prescribed policies in all departments and branches of the organization. They include: quality control, operation scheduling, budgeting control, and annual plan control. Kudinz (1998) noted that the reasons for internal control in any organisation are (i) to safeguard resources against waste, fraud and inefficiency (ii) to promote accuracy and reliability in accounting and operating data, and (iii) to encourage and measure compliance organization's policy.

A critical review of related literature revealed that the internal control measures adopted in the banking industry are not effective enough in minimizing or eradicating accounting irregularities. The effectiveness of the system is hindered by several factors among, which are: many of the bank workers have no proper accounting and finance background; hence they are incompetence and are prone to making wrong accounting entries; today, most bank workers are hired on the basis of god-fatherism while integrity has been relegated to the background. The aftermath of this is negligence on the part of the worker in the performance of assigned duties; long duration of the working hours in the banking industry makes bank workers weary thereby committing errors in accounting entries and records; some bank workers may collide with each other to be engaged in fraudulent acts and renders the segregation of duties irrelevant (Okoh and Unugbro, 2003). To maintain and ensure their job security, Welkazi (2004) asserted that auditors dance to management music, and management are reluctant to enforce controls relating to their personal activities, hence they indulge themselves in various forms of irregularities, abuse of authority, reluctance to effect changes when necessary in the internal control system, and frequent alterations in the internal control system, which can lead to a total break-down of the system (Labaran, 2011; Kiabel and Akenbor, 2008).

Methodology

In this study, the survey method of research design was adopted. The choice of this method of research design stems from the fact that it enables the researcher to generate data from a cross-section of people thereby enhancing the validity of generalizing the research findings. The population of the study consists of twenty-one (21) recapitalized banks currently operating in Port Harcourt.

In order to generate the necessary data for the study, a questionnaire designed in modified Likert-scale was administered on twenty-one (21) chief internal auditors of the selected banks. The data were analysed using the mean scores multiple regression analysis with the aid of the Statistical Package for Social Sciences (SPSS) version 17.

The model specification designed for this study is as estimated thus-

EICOS = f {ao + b1POER + b2REFA + b3WOEC + b4LAWOC + b5WOC + b6IND + b7MOC + b8GOR + b9COC + b10WIECM + b11COM + b12WEDOS}

Where:

POER = Presentation of early report

REFA = Respect for authority

WIEC = Willingness to effect changes

LAWOC = Lack of workers collusion

WOC = Workers competence

IND = Independence of internal control staff

MOC = Management observance of controls

GOR = Good remuneration of internal control staff

COC = Cost of instituting internal control measures

WIECM = Willingness to enforce control measures

COM = Control measures for unusual transactions

WEDOS = Well designed organizational structure

Data Analysis and Discussion

The data generated in this study were presented in the table and analysed using the mean score while the stated hypotheses were statistically tested with regression analysis.

Table 1: Determinants of Effective Internal Control System in Nigerian Banks

Determinants	**SA (5)**	**A(4)**	**D(3)**	**SD(2)**	**I(1)**	**Total**	$\bar{x}$
Presentation of early report	7 35	5 20	4 12	4 8	1 1	21 76	3.61
Respect for authority	4 20	6 24	8 24	1 2	2 2	21 72	3.43
Willingness to effect changes	3 15	7 28	5 15	5 10	1 1	21 69	3.29
Lack of workers collusion	3 15	5 20	9 27	2 4	2 2	21 68	3.24
Workers competence	6 30	6 24	5 15	4 8	0 0	21 77	3.66
Independence of internal control staff	9 45	5 20	4 12	2 4	1 1	21 82	21 3.90
Management observance of controls	7 35	7 28	5 15	0 0	2 2	21 80	3.81
Good remuneration of internal control staff	4 20	8 32	7 21	2 4	0 0	21 77	3.66
Cost of instituting internal control system	3 15	4 16	8 24	3 6	3 3	21 64	3.05
Enforcement of controls	5 25	3 12	6 18	7 14	0 0	21 69	3.29
Control measures for unusual transactions	3 15	4 16	7 21	3 6	3 3	21 71	3.38
Well-designed organizational structure	7 35	5 20	4 12	2 4	3 3	21 74	3.52

Source: Field Work (2014)

Table 1 shows that the determinants have a mean score above the expected mean of 3.0, and therefore affects the effectiveness of internal control system in Nigerian banks.

The data presented in table 2 below indicate an average mean score of 3.21, which is above the expected mean of 3.0. This implies that there is a positive reflection of the internal control system of Nigerian banks.

Table 2: Internal Control System of Banks

Item	**SA (5)**	**A(4)**	**D(3)**	**SD(2)**	**I(1)**	**Total**	$\bar{x}$
All transactions are recognized and recorded	2 10	6 24	8 24	5 10	0 0	21 68	3.24
The recorded transactions are real, properly valued and correctly posted	3 15	4 16	6 18	7 14	1 1	21 64	3.05
Verification of the accuracy and integrity of financial and accounting records	6 30	6 24	5 15	4 8	0 0	21 77	3.66
Financial records and statements are prepared in conformity with standard practice	8 40	4 16	5 15	3 6	1 1	21 78	3.71
No single transaction is exerted from the beginning to the end by one staff	3 15	3 12	7 21	4 8	4 4	21 60	2.86
Adherence to management policies	4 20	5 15	6 18	5 10	1 1	21 64	3.05
There is proper safeguard of cash and other assets of the bank	3 15	3 12	6 18	7 14	2 2	21 61	2.90
Average Mean							**3.21**

Source: Field Work (2014)

In testing the stated hypothesis in this study, data on the determinants were related with data on the reflection of internal control system, and the result obtained is presented in the table below.

Table 3: Relationship between effective internal control system and its determinants in Nigerian banks

Statistical Variables	Co-efficient	Std Error	t-Statistics	p- value
Intercept	5.7993	1.86205	2.641	0.009
POER	0.0728	0.0599	2.000	0.046
REA	0.4828	0.4471	2.449	0.032
WIEC	0.7558	1.3570	2.347	0.005
LAWOC	0.3061	0.5780	2.712	0.029
WOC	0.6729	1.1425	3.000	0.008
IND	0.7202	1.6113	3.107	0.006
MOC	0.1896	0.3296	2.011	0.049
GOR	0.7170	0.1792	3.006	0.008
COC	0.2375	0.3310	2.054	0.040
WIECM	0.8821	1.7642	5.213	0.000
COM	0.4519	0.8243	2.945	0.025
WEDOS	0.1384	0.5638	2.018	0.05
Co-efficient of Correlation	0.827			
Co-efficient of Determination	0.684			

Source: SPSS Version 17 Windows Output

The table above shows a multiple correlation coefficient of 0.827, which is close to 1.0 from the positive side. This suggests a strong association between the variables. The t-statistic and p-values (0.000) indicate a significant impact. This implies that presentation of early report, respect for authority, willingness to effect changes, lack of workers collusion, workers competence, independence of internal control staff, management observance of control, good remuneration of internal control staff, cost of instituting internal control measures, willingness to enforce controls, control measures for unusual transactions, and well-designed organizational structure have a significant impact on the effectiveness of internal control system in Nigerian banks.

Conclusion and Recommendations

Internal control provides assurance to management of the dependability of the accounting data used in making decisions. It consists of all measure employed to-safeguard the resources of the bank against waste and inefficiency promote accuracy and reliability in accounting and operating data, judging the efficiency of operations in all divisions of the bank. However, the effectiveness of internal control system in Nigerian banks is being questioned because of the high rate of errors and irregularities that occur in this industry. In most cases management is frequently in a position to over-ride controls which it has established.

In this study, it was revealed that presentation of early report, respect for authority, willingness to effect changes, lack of workers collusion, workers competence, independence of internal control staff, management observance of control, good remuneration of internal control staff, cost of instituting internal control measures, willingness to enforce controls, control measures for unusual transactions, and well-designed organizational structure have a significant impact on the effectiveness of internal control system in Nigerian banks.

Based on the finding of this study, the following recommendations are made:

(i) Internal control staff should be made to be answerable to authorities outside management to promote independence.

(ii) Internal control staff should be given the autonomy to operate so that proper investigation of the activities of executive members can be carried out.

(iii) High level ethical standards should be enshrined in Nigerian banks to make internal control more effective.

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