Internal Control Procedures And Firm's Performance

Eniola Anthony Abiodun

Abstract: The overall objective of this research was to analyze internal control procedures and the performance of the company in Nigeria's south-west region. The study framework was developed on the basis of an in-depth review of the literature and in accordance with stakeholder theory. The analysis followed a qualitative approach to descriptive research design. Multiple regression models were used to check whether there is any impact on financial performance from internal audit control, control practices, risk management control, control environment and monitoring activities. The survey results indicated the positive relationship between internal audit control, risk management and monitoring practices and organizational success. Control practices and control environment, however, have a significant negative impact on firm performance. The survey recommended regular monitoring and management of internal auditors. In addition, internal auditors must examine and evaluate the framework of internal control and the efficiency with which the various departments conduct their assigned duties. Management should also carefully assess the level of risk to be expected and seek to manage the risk at certain points.

Keywords: internal audit, risk management control, control activities, monitoring activities

1 INTRODUCTION

Internal controls are set up to ensure that all assets are safeguarded, to avoid misuse or misappropriation of the company's assets and to uncover and secure against likely frauds. Munene (2013) suggested that some of the problems encountered in relation to internal controls include: liquidity challenges, no adequate financial statements, lack of accountability of financial resources, corruption and abuse of administrative capital and the outcomes anticipated have not been obtained through a series of decisions made. World Bank statistics (2014) shows a drop in demand in all economic sectors, including tourism. Poor financial performance of quoted companies adversely impacts the Nigerian economy's economic growth. The majority of companies listed have operational Internal Audit divisions with accountability for ensuring leadership of the adequacy of internal control processes and the quality of services (Omolaye & Jacob 2017). Nevertheless, poor financial quality persists where plans are not accepted, fiscal rules and regulations are not enforced and large funds struggle to be accounted for (Omolaye & Jacob 2017). This has led to financial inadequacy, employee insatisfaction and poor financial performance in companies (Mikes & Kaplan, 2014). Following corporate scandals and the global financial crisis, an internal auditing department should always help to ensure that internal policies and procedures are complied with. Most companies have made the above efforts to achieve positive results. Despite all these efforts, companies are still struggling with liquidity problems, untimely financial reporting, inefficient financial accountability, fraud and mismanagement of the company's resources and several decisions made that do not yield the anticipated results.

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Thornton (2004) states that stakeholder perceptions for internal audit activities have dramatically changed in recent years. The emphasis has now moved from a role of regulation and financial control to promoting the constructive detection, evaluation and monitoring of threats. Prior studies centered on the importance of internal control mechanisms to small and medium-sized enterprises financial performance (Nyakundi, Nyamita & Tinega, 2014). Mawanda (2008) studied the impact of internal control mechanisms in an institution of higher education on financial performance. Khamis (2013) studied the role of the financial institution's internal control mechanisms. Many internal control research concentrate on the features of organizations that reveal fundamental vulnerabilities in internal control. Al-Matari, Al-Swidi, Faudziah and Al-Matari (2012) noted there was a noticeable lack of research into the direct integration of internal control systems and firm performance in both developed and developing countries. In the Nigerian economy, studies related to internal control and financial performance in Ejoh and Ejom (14) and Small Business Monday, Ineh and Ojo (2014) tertiary institutions have been carried out which do not explicitly show the impact of the quoted firms on the bond on the financial performance of businesses. The concern is how internal controls influence Nigeria's efficiency. This paper thus sheds light on the broader range of companies listed on the Nigerian stock exchange and aims to resolve existing research limitations in assessing the financial performance impact of the internal control structures of companies quoted on the NSE. The research would add to the existing knowledge regarding internal control mechanisms and organizational efficiency. This thesis would help scholars and aspiring scientists who will carry out other research on this subject. This is because it enhances your internal control awareness which offers the details that you need to integrate into your job. The research will also allow them to come up with better ideas regarding internal control systems and their effect on Nigerian corporate results. In fact, the research would help instille rational and inductive thought and enable all workers within the organisation to establish reasonable processes and thoughts. The research findings should concern the leadership of organizations as they suggest issues neglected in the processes of internal control or ways to improve the performance of the internal control process. While government and policymakers will also gain insight into the critical role of internal controls in Nigeria's corporate performance. In particular, policy makers will be told about the sort of internal audits to be implemented in government undertakings. Many organizations would profit from an appreciation of corporate management procedures and the important role of internal control structures in improving corporate governance, particularly in encouraging corporate accountability and transparency in the effects of corporate success.

2 STAKEHOLDER THEORY

A redefinition of the corporation is a general idea of the Stakeholder principle. The theory was basically about what the organisation should be and how it should be conceptualised. Friedman (2006) argues that the association itself should be regarded as a shareholders community, and its goal should be to address its priorities, needs and viewpoints. This management of stakeholders is thought to be carried out by the managers of a company. Managers should manage the company for its stakeholders, on the one hand, to ensure their rights and participation in decision-making. The active management of the environment, relationships and the promotion of shared interests to develop business strategies is of great concern to stakeholders (Friedman & Miles, 2001). A wide range of issues, such as labor conditions, environmental issues or social responsibility, might be included in stakeholder interests, and may be in conflict with the interests of a company (Friedman & Miles, 2006). This is expressed in Frooman's 11 (1999) assertion that stakeholder management could be viewed as conflict management resulting from divergent interests. Waddock (2001) argues in a related discussion on corporate responsibility and citizenship that becoming a good corporate citizen means defining, and achieving, accountable operational practices fully integrated into corporate strategies, planning, management and decision-making. It is a philosophy in corporate and business ethics which encompasses principles and ideals of institutional leadership. According to the traditional view of the business, the investors become owners of the company and the corporation has a contractual fiduciary duty to put their interests first and to increase value to them. Stakeholder theory claims that other entities, including workers, consumers, vendors, societies, governmental bodies, political groups, trade associations or trade unions, are concerned. Only rivals are sometimes listed as interested parties-their position is dependent on their ability to influence the business and its shareholders. The research was based on the theory of investors. Stakeholders involved lenders, executives, workers, consumers, vendors, neighborhoods, governmental institutions, political groups, trade unions and syndicates (Eniola & Akinselure, 2016). Jensen (2001) suggests that the stakeholder hypothesis solves the problems created by several targets as this concept is essential to our research and offers an understanding of how the company works. It states that it must create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others with the money if any company is successful. The Stakeholder Theory states that each and every stakeholder in a company or organization is equal and treated in the same way, its priorities need to be coordinated and the role of a director or businessman is to decide whether consumers, vendors, societies, staff and financiers are involved in that path. Each of these groups is important for the success of a company, and it is important for managers and entrepreneurs to figure out where their interests go in the same direction. One of the latest implementations of Stakeholders Theory is the risk management of organizations which attempts to understand the mutual effects of different threats systematically in the interest of the parties concerned (Beasley, Chen, Nunez & Wright, 2006). A stakeholder approach can help managers, analyzing how the company fits into their larger environment, how its standard operating procedures affect stakeholders in the company (employees, management, shareholders) and immediately beyond the company (customers, suppliers, financiers) from an analytical standpoint. Freeman, for example, suggests that each company should complete a' generic stakeholder map' with specific stakeholders. More specific stakeholders would be included in general categories such as owners, financial, community, activist groups, suppliers, government, political groups, customers, unions, employees, trade associations and competitors. In addition, the logical director would not make major decisions for the company before taking into consideration the effects on each of the shareholders. As the company evolves over time and decision-making concerns evolve, the individual stakeholder map will be changed. If the executive just wants to optimize stockholder capital, it is easy to ignore other company interests (stakeholders). The Stakeholder Theory in a normative sense strongly suggests that overlooking those other stakeholders is (a) unwise or untrue and/or (b) ethically unjustified. The Stakeholder Theory thus engages in a wider corporate and ethical debate: is an ethical organization longer to gain than a corporation that only looks at the' bottom line' in any given quarter or year? Those who argue that corporate managers were unwise and imprudent by dismissing numerous non-stockholder groups will reply "yes." Others would say that avoiding these other constituents is not ethically justified, regardless of the corporation's short-term and long-term performance. Premised on the empirical frameworks to the influence of the internal control process on firm performance this analysis suggested the following graphical interpretation, which is supposed to clarify a significant amount of the variation in firm performance. Internal control mechanisms, like internal auditing, are mainly intended to improve the quality of organizational results, whether directly or indirectly, by making information sources in an organization increasingly accountable (Jensen, 2003). Internal monitoring therefore has the much broader aim of providing an independent assessment of the quality of the management performance when carrying out assigned revenue responsibilities in order to achieve an organizational level of control problems associated with lower revenue, which explores the link between disclosure of material weakness and fraud, revenue management or restatement internal controls (Beeler, Hunton & Wier, 1999). Fadzil, Haron, and Jantan (2005) reported that an active internal control process correlates unambiguously with corporate progress in achieving the target level of sales. Good internal control of company quality includes a frequent examination of the accuracy and credibility of financial and administrative records, a review of the measures used to protect property, an evaluation of employee adherence with management practices, protocols and related laws and regulations, and an assessment of the efficiency and efficacy of leadership. Many companies no longer develop an internal control structure as a regulatory requirement, but also as it helps to ensure that all administrative operations are carried out properly (Kenyon & Tilton, 2006). Therefore, companies find it a responsibility to prepare, inform and sensitize their workers on how to use such internal control mechanisms as their success relies on the expertise and efficiency of the individuals who use them. All of these control actions ensure that any risks that may affect the ability of the company to achieve its objectives are adequately avoided and should occur at all levels and in all organizational functions (Doyle et al, 2005). There are three major internal management classifications: prevention, investigator, and punitive. Preventive systems foresee potential problems, make adjustments, or avoid a mistake, absence, or malicious act from happening until they happen. Detective controls are used to detect and report an omission, error, or malicious act that occurs. Ultimately, the correction controls aim to minimize the impact of a hazard, identify the cause of an incident and recognize the appropriate errors resulting from the issue. Corrective checks correct detective control problems and modify the processing system to minimize the problem's future occurrence (Singleton, Bologna, Lindquist, & Singleton, 2006).

3 INTERNAL AUDIT

Internal auditing is a distinct, objective, value-adding and advisory practice designed to improve the operations of an organization It assists an organization in achieving its goals by offering a structured, competency-based approach to assess and improve the efficiency of managing risk, control and management processes (Internal Auditor Institute). Gupta (2001) argues that internal audit is an independent evaluation function set up within an organization to review and evaluate its activities as a service to the organization. Internal audit serves to support company leaders in the successful execution of their obligations. It is also an independent assessment feature developed within an organization to assess and evaluate the efficacy, productivity and economy of the control system for management (Subramaniam, 2006). The goal is to convince management that its internal control mechanisms are adequate to the organization's needs and function satisfactorily (Reid & Ashelby, 2002). It is a part of an enterprise management's internal control process set-up to audit, analyze and monitor accounting and other control operations. For practice, the performance and efficiency of internal audit procedures is important because internal auditors perform a wide range of tasks, not all of which apply to accounting areas of interest to the external auditor. Emasu (2007) states that the efficacy of the internal audit role depends in part on: the legal and regulatory structure, the location of the function and its autonomy, the presence of audit committees, resources allocated to the internal audit staff's task and professionalism. Nevertheless, it is a bitter reality that divisions of internal audit are seldom properly facilitated. Gerrit and Mohammad (2010) found evidence in support of the monitoring position of the internal audit system with respect to the size and facilitation of the internal audit function. We find specific evidence that management ownership is positively linked to the relative size of the Internal Audit Unit, which is inconsistent with conventional company theory claims suggesting a negative relationship, but more in line with recent earnings management studies. This finding suggests that increased ownership of management may influence the board of directors to support larger internal audit functions to enable them to monitor the performance of managers closely. Internal audit procedures ' efficacy is an indicator of the program's ability to produce a desired effect or result that can be calculated qualitatively (Harvey, Leinicke, Rexroad & Ostrosky, 2004). Rezaee and Zabihollah (2002) contend that efficient internal audit procedures should be in place to ensure the reliability of financial statements, operational reports, corporate asset protection and effective organizational controls. A study by Eniola and Akinselure (2016) examines the impact of internal control on Nigerian firms ' financial performance. The research result shows that internal control has a significant relationship with organizational fraud. Based on this outcome, the study suggests that management implement more effective strategies to ensure effective and efficient internal control to significantly reduce the perpetration of fraud in the company. Mwakimasinde, Odhiambo and John (2014) are also studying the impact of internal control systems on the financial performance of outgrower sugarcane companies in Kenya. A descriptive survey correlation model was adopted by the study. Using questionnaires, primary data was collected from main informants from all the nine out of Kenya's growers. The approach of the main informant was used; thus all Finance Managers and Internal Audit Heads were selected to participate in the study for each out grower company. The study found a significant positive effect on financial performance of the internal control process. Ibrahim, Diibuzie and Abubakari (2017) are also investigating the effect of the internal control process on financial performance among five health institutions in Ghana's Upper West Region. In choosing a sample of fifty (50) respondents, a purposeful sampling strategy was used. Using the ordered logistic regression method, the data are analyzed. The outcome of the study found a positive correlation between controls of internal audit and financial performance. Internal audit is thus embraced as a factor affecting the company's performance.

$H0_1$: Internal audit has no significant influence on firm's performance in Nigeria

4 CONTROL ACTIVITIES

Whittington and Pany (2001) say that tracking practices are just another aspect of internal controls. These researchers recognize that control operations are codes of conduct that assist with the execution of management directives. Organizational management tasks include: performance reviews (compare actual performance with plans, prediction and output for the previous period), storage data (needed to check reliability, completeness and payment authorization), physical control (relevant protection to both the documents and the other assets), and separation of duties (where no one is involved). Manasseh (2004) has found that management practices lower the risk of theft and mistake and market exploitation, thus improving the efficiency and performance of the company's operations. Although Barra (2010) claimed that the existence of monitoring operations, the separation of tasks, increases the cost of fraud. The benefits of fraud must therefore outweigh the costs of an employee committing fraud in an environment of segregated duties. However, it was observed that the separation of tasks is the least cost deterrence for non-managers, but for managers, the maximum penalties are the "lowest cost" disincentives for cheating. He states that the efficacy of proactive checks and monitoring such as role division relies on investigator measures. The correlation between internal control operations and financial performance in Tertiary Institutions in Nigeria is being analyzed by Ejoh and Ejom (2014). The results of the study indicate that there is no important link between internal control practices and financial performance. The study also recommends that management of the institution organize regular control mechanism training for staff. A management operation is therefore implemented as a variable not to impact the output of the company.

$H0_2$: Control activities have no significant effect on firm's performance in Nigeria

5 RISK MANAGEMENT CONTROL

In 2004, COSO introduced Enterprise Risk Management (ERM) to tackle the risks associated with an organization The frame incorporates all elements of internal control frame work, but nonetheless provides elements of objectives structure, incident detection and threat response (Rittenberg & Schwieger, 2005). COSO (2011) highlights the significance of the entity's target environment and compares it as a precondition for risk evaluation. It should be noted, though, that the internal control system for the organization should be defined in order to have reasonable assurance as the critical components for achieving identified aim, threat recognition and evaluation. It is important to assess the efficacy of internal control operations against the objectives and associated threats of the organization. Internal control should provide for an evaluation of both internal and external indicators of the threats posed by the company. They should be analyzed for their possible effect once risks have been identified. Management must then formulate a risk management approach and decide on the internal control activities necessary to mitigate those risks and achieve the internal control goals of efficient and effective operations, reliable financial reporting, and compliance with laws and regulations. The goal of financial reporting and entity performance, producing accurate, complete, relevant, timely and reliable financial information to demonstrate and maintain accountability, complying with statutory reporting requirements, accounting for the financial performance of an organization's stakeholders. In their research, Cebenoyan and Strahan (2004) observed that businesses that have progressed in risk management have lower availability of credit. The improved availability of credit contributes to the opportunity to increase the benefit of the productive assets and the business. Schroeck (2002) and Nocco and Stulz (2006) emphasize the importance of good practices in risk management to maximize the value of businesses. In particular, Nocco and Stulz (2006) suggest that effective corporate risk management (ERM) provides the company (or banks) with a long-term competitive advantage over those that individually manage and monitor risks. Schroeck (2002) proposes to increase earnings by ensuring good practices through prudent risk management. A financial organization's sustainability and performance depends significantly on how well such threats are handled (Khan & Ahmed, 2001). Therefore, financial institutions ' conservative risk management is the foundation of preventing financial distress that could contribute to a full-blown financial crisis. A Kamau (2014) study investigates the effect of internal controls on manufacturing firms ' financial performance in Kenya. The empirical findings of the regression analysis indicate that there is a positive relationship between manufacturing firms ' internal control and financial performance in Kenya. Most specifically, good risk control is highly relevant to keeping the investors better off (Akkizidis & Khandelwal, 2008; Al-Tamimi & Al-Mazrooei, 2007).

$H0_3$: Risk management control has no significant influence on firm's performance in Nigeria

6 CONTROL ENVIRONMENT

Management system as a set of policies and practices to be implemented while carrying out internal controls within an organization (Kgabo, 2013). COSO (2013) claimed that the effective control enviroment provides a mental attitude within which the institution's internal control process will function at all levels. Numerous reports also tried to highlight the impact on financial performance of the management system. Among the lists are among others the studies carried out by Kinyua, Gakure, Gekara and Orwa (2015), Muraleetharan (2013), Mawanda (2008), and Ali (2013). Kinyua, Gakure, Gekara and Orwa (2015) investigate the impact on financial performance in Kenya of the internal control system. Internal control mechanisms are shown to have a significant financial quality partnership. Based on the research findings, it can be concluded that a positive predictor of financial performance is the internal control system. Muraleetharan (2013) investigates whether an internal control process results in an improvement in an organization's firm output and identifies a statistically insignificant correlation between the management structure and firm performance. Although, Mawanda (2008) has identified a positive relationship between the management system and the financial performance of higher learning institutions in Uganda, as shown by his case study at the University of Uganda Martyrs. Ali (2013) found a significant positive relationship between the management process and financial institutions ' success in his research on the importance of the internal control framework to financial institutions ' financial performance. Malekmahmoudi, Saeidi and Shokoohi (2015) examine the partnership between the Iranian telecommunications company's internal control system and financial performance. The study findings revealed that the internal control process and financial performance of the Golestan Province Telecommunications Company in Iran had a strong and positive relationship. Although Muraleetharan's research (2013) attempts to decide whether the internal control process can lead to an increase in an organization's financial performance. The study finds that in assessing efficiency, internal control and financial performance are statistically significant. In the financial performance of non-governmental organizations in Uganda, Etengu and Amony (2016) examine the role of the internal control process in the governance climate. The study findings revealed a significant relationship between financial performance and control environment. The report proposed improving the management system to further improve the efficiency of the company. A control environment is thus adopted as a factor influencing the company's performance.

$H0_4$: Control environment has no significant effect on firm performance in Nigeria

7 MONITORING ACTIVITIES

Monitoring describes the process of measuring the consistency of the system for internal control over time. To order to ensure reasonable assurance about the accomplishment of the company goals, Coffin (2003) indicated that a review mechanism should be conducted to assess and analyze internal control systems to ensure that processes are enforced continuously over an extended period of time. He also claims the internal audit is part of the internal control system oversight. Managers will analyze audit results and other reports immediately, including those identifying shortcomings or suggestions identified by auditors and others reviewing the activities of departments, in order to identify necessary actions in response to audit and evaluation findings and recommendations. Jones (2008) describes monitoring as the process of evaluating the output value of a system over time. Staff should evaluate the various internal control systems on an ongoing basis and update / modify / enhance where necessary. Some vulnerabilities found will be addressed immediately and applied to the internal control mechanisms as a whole. Internal monitoring should include policies and procedures to ensure prompt resolution of audit findings and other reviews. Coffin (2003) also claimed that monitoring involves the activities and procedures designed to evaluate the effectiveness of the internal control system in achieving the financial reporting goals of the entity. Monitoring efforts can be ongoing or independent assessments, and it is important given the complex and dynamic situations that most companies are experiencing (Henle 2005). This helps to ensure the quality of programs as expected. Nonetheless, this is done by continuous surveillance operations, annual reviews or a mixture of the two (COSO, 2004). Monitoring has therefore helped to evaluate the quality of the organization's performance over time. Through reporting, the company is ensured of timely confirmation of examination results and other assessments (Amudo and Inanga, 2009). Amudo and Inanga (2009) reported that organizational supervision guarantees the efficient running of the network of internal controls. It is through supervision that a company decides whether or not workers are successfully following the policies and procedures designed and implemented by management.

$H0_5$: Monitoring activities have no significant influence on firm performance in Nigeria

8 CONCLUSION

An internal control system is an important mechanism for proper and responsible management in all types of companies. It can lend itself to manual executive supervision for small firms alone, but the more sophisticated the companies and the more personnel and procedures it has, the more features the system needs to provide that can allow the management to insure the internal controls are in place and operate as expected. The effect of such flexibility would increase the likelihood that processes and procedures will perform as expected and the hazard will be retained at tolerable levels. Accountability and regulatory compliance accompany this state of affairs, as do the company's improved productivity opportunities and a safer work environment. After examining relevant related literature and various analyzes, it concludes that internal control as a model has an influence on firm performance through internal audit, control activities and control of risk management. On the other hand, on quoted firms in Nigeria, control environment and monitoring activities have a significant negative impact on firm performance.

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