

Internal Control Systems and Effectiveness of Public Enterprises in Rivers State

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Abstract: *This study investigated the relationship between internal control systems and the effectiveness of public enterprises in Rivers State. A cross-sectional research design was adopted in studying five (5) public parastatals. Our respondents were managerial employees, constituting the population of the study. From the field survey, we retrieved and analysed one hundred and eighty-two (82) copies of the questionnaire from the participants; Spearman's rank correlation coefficient statistical tool was used to determine the relationship existing between the variables, while the p-value obtained was used to test hypotheses formulated. Findings revealed the existence of a significant relationship between the components of internal control systems, such as the control environment, control activities, and effectiveness of public enterprises. Hence, it was concluded that an effective internal control system will benefit an organisation by preventing the incidence of bad financing and assisting organisations or government enterprises in working effectively and in harmony while detecting errors and irregularities in their operation. As a result, a dependable internal control system aids in the prevention and early identification of fraud in the public sector. It was thus recommended that the government should create an Internal Audit Department in those enterprises where there is none, and existing departments should be strengthened by accordig them the necessary professional independence and employing an adequate number of experienced and qualified staff to enable them to perform their duties effectively; public-sector organisations should carry out periodic training of personnel in order to identify weaknesses in executing responsibilities and make recommendations for improvements; as well as a focus on developing workers' skills in computer operations and electronic data processing to help automate tasks such as salary preparation, pension accounts, vote book recording, etc., in order to minimise the frequency of fraud and sharp practises.*

Keywords: Internal control systems, Control environment, Control Activities, Effectiveness

Introduction

All around the world, there is a common understanding that public sector management has to be improved. As a result of its size and expenditure patterns through different parastatals, agencies, and commissions, government is the largest single corporate organisation in the country. As a result of this government's massive engagement in economic operations, accounting and auditing departments in government are being improved all over the world (Ndungu, 2013). There are two distinct roles played by public sector accounting and auditing: one is to support management in providing efficient service to the public; the other is to examine whether management is truly providing effective services (Kantzios & Chondraki, 2006). It is the responsibility of the public sector auditor to ensure that the presented financial statements have been produced in conformity with all applicable statutory and constitutional rules and regulations, as well as good accounting practises.

As public sector size and complexity have expanded, the relevance of internal audit has also increased, making it a key factor in the quality of public sector internal control and a significant role in the improvement of public sector management. An organization's financial structure wouldn't be complete without an internal audit. The internal audit department is frequently criticised for being understaffed and under-resourced in general. Internal audit departments have a lot of backlog owing to understaffing. An efficient audit of computerised systems cannot be performed due to a lack of expertise in electronic data processing (EDP) and computers (Abdel-Khalik, 1993). It's because of this difficulty that most public sector management working papers fail to offer proper documentation. Internal audit staff are underpaid, which makes them less enthusiastic about their profession.

Many argue that because internal auditors work for the government, they do not have the freedom to exercise the unbiased and objective attitude required of an auditor. In the midst of the issues surrounding inadequate public sector performance, Nigeria, as a developing economy, and Rivers State in particular, must focus its resources on effective developmental use, making the need for internal auditors in the public sector even more critical. As a result, the goal of this study is to rely on internal control audit to evaluate the effectiveness of the public sector in Rivers State, Nigeria.

Literature Review

Theoretical Framework

The Agency Theory

Agency theory is based on the concept of a separation of ownership (principal) and management (agent) who are in charge of using and regulating resources (Jensen & Meckling, 1976).

According to Jensen and Meckling (1976), the agency theory recognises that insufficient information about the agent's connection, interests, or work performance might be unfavourable and represent a moral hazard. Moral hazard and adversarial selection exert control on the agent's output in two ways: insufficient knowledge about what should be done and failure to do precisely what the agent is assigned to accomplish.

This theory pertains to this study since internal control is one of many strategies employed in organisations to manage the agency problem by minimising agency costs that influence the overall functioning of the relationship as well as the principal's advantages (Abdel-Khalik, 1993).

Reliability Theory

According to Gavrilov and Gavrilova (2001), dependability theory specifies the likelihood of a system performing its intended function within a certain time span. The dependability of a comprehensive system of internal control is characterised by the two conceivable states of "success" and "failure," according to reliability theory. The primary goal of internal control is to analyse and control risks. This is done to avoid material mistakes or to notice them in time to avoid losses. Weak internal control systems lead to more substantial work and, as a result, higher costs.

According to Gavrilov and Gavrilova (2001), determining the "weakness" of any internal control system is essentially a judgment call. Comparison with data from the organization's past financial events or other firms, based on the process formulation and system reliability estimates, may provide a more solid basis for judging the impact of an internal control system on the firm's income risk and thus provide for a more rational allocation of the auditor's time and effort.

According to Messier and Austen (2000), one of the key benefits of the dependability theory is its strong link to the auditor's demands in terms of comprehending the internal control system and assessing control risk. The aspect of the reliability theory that connects the internal control system to component reliabilities was studied in this work (Ndungu, 2013).

Conceptual Framework

Internal Control

Organizations put in place procedures to ensure that their objectives, goals, and purpose are accomplished through internal controls (Rezaee, 2001). They refer to a system of rules and processes established by an organisation to guarantee that all transactions are carried out in an efficient manner and that no resources are wasted, stolen, or misused. Incorporating internal control systems into an organization's operations helps it achieve its goals, prevents waste, and ensures compliance with laws and regulations, among other things. As a result, institutions implement internal controls to maintain a work environment conducive to efficiency. This guarantees that management policies are adhered to, assets are protected, and records are accurate and thorough. An institution's internal control systems are regularly and substantially improved in order to grow revenue, survive in a fast changing economic and competitive environment, and adapt to the altering client priorities (Kantzios & Chondraki, 2006).

An internal control system is comprised of five connected components: control environment; risk assessment; control actions; information and communication; as well as monitoring and evaluation (Carmichael, 1996). Six major categories of internal control are identified by Rittenberg (2005), which are: detecting errors and fraudulence, decreasing illegal conduct, improving the competence of the business entity and enhancing data quality. The auditors' fee is also reduced as a result of these six categories of internal control.

For the sake of achieving operational and financial goals and disseminating corporate policy, management institutes internal control measures to assure data integrity. Accounting and administrative controls can be used to ensure that financial and accounting information is accurate. In order to protect assets and ensure the accuracy of financial records, the organization's plans are subject to accounting control. Organizational plans and all coordinated processes and procedures that affect operational efficiency and conformity to management policy and directives are included in administrative control (operational control).

Internal Control Systems

An internal control system, according to Ngugi (2011), is a comprehensive system of controls set up by management with the goal of ensuring the smooth operation of the company. When it comes to an internal control system, it's all of the methods and procedures that the management uses in order to ensure a high degree of successful cooperation with their CEOs, as well as to ensure that the company's capital is insured, that fraud is prevented, and that all useful financial information is prepared early. In the same way that the human nervous system carries commands and reactions to and from the management, so too does the internal control system. It is a direct result of the organization's structure and the laws of the game.

The Control Environment and Effectiveness of Public Enterprises

An organization's control environment is considered as the foundation of its internal control systems, which in turn impact the control awareness of its employees (Ramos, 2004). A person's attitude, philosophy, and way of thinking are all part of the control environment, according to Jokipii (2006). Additionally, the organization's ethics, competency, morale, and integrity must be considered. As Whittington and Pany (2006) put it, "the structure and discipline of internal control systems ensures the realisation of their primary objectives." Internal control systems are also affected by environmental factors such as humidity and temperature.

Organizations need to regulate the environment in order to encourage employees to be aware of control and increase control consciousness, according to Messier, Glover, and Prawitt (2006). Honesty, moral values, promise of proficiency, board audit committee, and directors with management's operating supervision and organisational culture are all variables that influence the control environment. To this end, we hypothesize that:

H₀₁: There is no significant relationship between control environment and effectiveness of public enterprises.

The Control Activities and Effectiveness of Public Enterprises

Control Activities are policies, procedures, and processes put in place to guarantee that management instructions and financial reporting controls are appropriately implemented (Aikins, 2011; Kaplan, 2008). Control activities are also implemented to guarantee that all required steps are made to handle risks in order to accomplish organisational goals (Committee of European Insurance and Occupational Pensions Supervisors, 2003). Control operations take place all around a company. Control operations, according to Shelton and Whittington (2008), include reconciliations, approvals, verifications, assessments of operative performance, and division of roles. Similarly, Horngren, Harrison, and Oliver (2012) note that critical tasks within the control environment include asset security, job segregation, activity authorization, approval, verification, and reconciliation, full documentation, and integrity in effectiveness evaluation. As a result, control activities are required to be carried out by various levels of management and units within the organisation in order to meet the overall company's goals. Consequently, we hypothesize that:

H₀₂: There is no significant relationship between control activities and effectiveness of public enterprises.

The Relationship between Internal Control Systems and Effectiveness of Public Enterprises

Most internal audit experts believe that a well-functioning internal audit function corresponds with greater financial performance. A successful internal audit service, according to Bejide (2006), may assist decrease costs, discover methods to enhance efficiency, and maximise exposure to potential losses from insufficiently secured business assets, all of which can have a substantial impact on the bottom line. Internal audit, according to Venables and Impey (1991), is a "invaluable instrument of management for enhancing performance." Internal auditors, according to Fadzil et al. (2005), assist a firm function more efficiently and effectively, increasing the value of stakeholders and shareholders. Furthermore, Hermanson and Rittenberg (2003) contended that the presence of an effective internal audit function is linked to higher organisational performance.

At the empirical level, a survey conducted by KPMG (1999) discovered that the internal audit function in organisations where it exists significantly contributes to performance improvement and assists in identifying profit evidence in corporate disasters, particularly financial fraud, consistently documents an association between weak governance (e.g., less independent boards or the absence of an internal audit function) and the incidence of problems (e.g. Beasley et al., 2000; Abbott et al., 2000). Thus, internal audit might safeguard the organisation from malpractices and irregularities by serving as a watchdog, allowing the organisation to fulfil its goals of maintaining a high level of production and profit.

Although studies have revealed a link between accounting control systems and performance theories, Greenlay and Foxall (1997) expect that these associations will be altered by external environmental effects. While public businesses are designed to be politically insulated, they are nonetheless related to politics through the powers granted in the relevant Ministers, Commissioners, or Deputy Governors. According to Akinsanya (1992), these powers include the authority to choose chairmen, chief executive officers, and members of boards, as well as the authority to provide advise, ideas, or make requests. According to Akinsanya (1992), board members of public firms in Nigeria are selected mostly for political reliability rather than for any required experience. As a result, board members not only interfere with company management but also use their positions to promote the interests of their favourites, which has a negative impact on the enterprise's performance.

Methodology

This study adopted a cross sectional survey research design in studying five (5) public parastatals in Rivers State which forms our accessible population, however our study units include the managerial employees of the firms having that our unit of analysis is organizational and such employees are to stand in proxy for the organization. The human resource department provided the data on functional departments within the organization. Out of one hundred and forty nine (149) managerial employees we retrieved and analyzed eighty two (82) copies from managers who were our study objects. The instrument with which we elicited data from the respondents is the questionnaire and was analyzed using Spearman's Rank order coefficient of correlation statistical tool.

Results and Discussion

Table 1.1: Spearman's rho correlation coefficient: A test of association between the variables

			Control.Envi	Control.Activi	Pub.Enter.Effective
Spearman's rho	Control.Envi	Correlation Coefficient	1.000	.790**	.883**
		Sig. (2-tailed)	.	.000	.000
	Control.Activi	N	82	82	82
		Correlation Coefficient	.613**	1.000	.769**

Pub.Enter.Effective	Sig. (2-tailed)	.000	.	.000
	N	82	82	82
	Correlation Coefficient	.883**	.769**	1.000
	Sig. (2-tailed)	.000	.000	.
	N	82	82	82

** . Correlation is significant at the 0.05 level (2-tailed).

SPSS output, Version 20 – Field Survey, 2021

Table 1.1 presents Spearman's rank order correlation run to ascertain the relationship between control environment as a dimension of internal control systems and effectiveness of public enterprises as reported by eighty-two (82) respondents. A strong positive correlation coefficient value was reported between variables which were statistically significant ($\rho = .883^{**}$, $p = .000 < 0.05$ (alpha value) this suggests that there is significant relationship between control environment and the criterion variable; also control activities and effectiveness of public enterprises reported significant values of correlation ($\rho = .769^{**}$, $p = .000 < 0.05$); accordingly.

Decision: The null hypotheses stated are rejected and we state that there is significant relationship between the components of internal control systems and effectiveness of selected public parastatals in Rivers State.

Discussion of Findings

It is widely believed that internal control systems enabled by a supportive control environment, where it exists, contribute to the improved effectiveness of public institutions. According to Bejide (2006), "an effective internal audit service can, in particular, help reduce overhead, identify ways to improve efficiency and maximise exposure to possible losses from inadequately safeguarded company assets, all of which can have a significant effect on the bottom-line." Venables and Impey (1991) opined that internal audit as a control system is an "invaluable tool of management for improving performance."

Bianchi (2010) reflected that in public-sector organisations, the role of internal control through control activities is to support the establishment of the system while fostering the decision maker's accountability. However, failing to establish a reliable and dependable system could harm the organisation in many ways while exposing at risk the efforts of those nurturing accountability in the public sector. To Hermanson and Rittenberg (2003), the existence of effective control activities through an internal audit function is associated with superior organisational performance. Prasad and Rao (1989) expressed similar sentiments when they observed that the internal auditor by acting as a watchdog saves organisations from malpractices and irregularities, thus enabling the organisation to achieve its objectives of ensuring a high level of productivity and outcomes.

Conclusions

Based on the literature reviews, analyses, and discussions, it is concluded that an effective internal control system will benefit an organisation by preventing the incidence of bad financing and assisting organisations or government enterprises in working effectively and in harmony while detecting errors and irregularities in their operation. Internal control systems are especially important in internal auditing practises since internal auditors are often regarded as management control specialists.

As a result, internal control is an essential component of an organization's overall governance structure, with the goal of directing and controlling its actions while encouraging openness, accountability, responsibility, and fairness to all stakeholders. As a result, a dependable internal control system aids in the prevention and early identification of fraud in the public sector. As a result, increased dependence on the control system is inexorably tied to growing expectations for improved accountability and, ultimately, the efficacy of government businesses.

Recommendations

On the basis of the conclusions drawn, it is recommended that:

- i) Government should create an Internal Audit Department in those enterprises where there is none. Furthermore, existing departments should be strengthened by according them the necessary professional independence and employing adequate number of experienced and qualified staff to enable them perform their duties effectively.
- ii) Public sector organizations should carry out periodic training of personnel in order to identify weaknesses in executing responsibilities and make recommendations for improvements. A pivotal area of focus in this regard is skills in computer operations and electronic data processing to help automate tasks such as salary preparation, pension accounts, vote book recording, etc., in order to minimize the frequency of fraud and sharp practices.

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