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Internal Control Practices and Financial Performance of Listed Commercial Banks in Nigeria

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ABSTRACT

This paper studied internal control practices and financial performance of listed commercial banks in Nigeria. The scope of this study is limited to listed commercial banks. In the organized sector of the economy which is the private sector. A hypothesis was made to guide this study. The study employed cross-sectional survey design approaches, comprising descriptive and exploratory research designs. The targeted population of this study comprises all the 13 listed commercial banks in Nigeria. Both primary and secondary data was used in this study, five hundred (500) questionnaire was administered to management staff of the banks. Findings from pooled correlation test of hypothesis one shows that internal control practices is positively and significantly correlated with commercial banks financial performance. The empirical tests conducted revealed that internal control practices have significant relationship with financial performance of listed commercial bank in Nigeria. This therefore suggests that an optimal internal control practices affects the institutions positively, while a wrong mixture inadequate internal control and fraud prevention measures affects institution's profitability adversely.

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Introduction

The implementation of effective internal control policies should be done after a thorough analysis of the existing policies and future outlook of a company. In addition, it is important to ensure the following four processes when implementing internal control in a business: Detecting overlaps and anomalies: financial reports, profit & loss statements, balance sheets, etc. present the overall performance and/or operational picture of a business. Hence, while formulating internal control policies, it is very important to detect any overlaps and/or anomalies arising out of the data available. It helps in detecting any existing loopholes in the current management framework and eliminating them (Rubasin, & Nuradhi, 2021).

Before implementing an effective internal control strategy in an organization, it is important to thoroughly evaluate all possible operational scenarios. Viewing the policies from the perspectives of different operational scenarios – such as profitability, expenditures, safety, and scale of production or volume – can provide the necessary information. Also, it helps establish an effective financial control policy that covers all operational aspects of the organization (Dauda, 2015).

This study is centered on the relationship between internal control practices and financial performance, with emphasis on internal control measures. The geographical scope of this study is listed commercial banks in Nigeria. The unit of analysis of this study is focused on listed commercial banks in Nigeria as extracted from their financial statements. The scope of this study is limited to listed commercial banks. In the organised sector of the economy which is the private sector, the banks are inclusive and constitute the financial institutions under review. However, to guard against data omission and ensure uniformity in presentation, thirteen (13) listed commercial banks with complete data sets covering a period of 19 years (2002-2020) were selected.

Aim and Objectives of the Study

The main aim of this study is to ascertain the relationship between internal control practices and financial performance of listed commercial banks in Nigeria. To achieve this broad objective, the following specific objectives have been highlighted to;

1. Ascertain the relationship between internal control and return on assets of listed commercial banks in Nigeria.

Research Questions

Based on the purpose of the study, the following research questions were considered;

1. What is the relationship between internal control and return on assets of listed commercial banks in Nigeria?

Hypotheses

In line with the objectives of this study and the research questions posed, the following hypotheses were formulated and tested later;

1. **H_{01}:** There is no significant relationship between internal control and return on assets of listed commercial banks in Nigeria.

Review of Literature

Dimensions of Financial Control Practices

Internal Control

Businesses, including banks, face numerous risk factors, including employee risk or insider threats (Amoateng et al. 2017). Employee risk of insider threat, are events that permeated the current business environment and business finances in particular. Employee risk of insider threats as Safari and Thilenius (2013) described, involves the ability to manipulate security situations for financial and material benefits by corrupt employees (Agbi et al. 2017). The fact that company employees could steal, embezzle and pilfer from the employer is a risk hard to assess and manage. The likelihood of insider threat undermines business practice, erodes, and destroys trust and business goodwill. Mitigation of insider threats requires an understanding and application of an effective internal controls system. Control mechanisms such as (a) electronics surveillance, (b) active monitoring systems, and (c) clearer job descriptions can appear effective. Rules emphasizing less dependence on human intelligence can be a great control tool also (Mowaiye et al., 2022). The business implication for retail companies is to take the risk of insider threat seriously the author stressed.

Under the auspices of the Sarbanes-Oxley Act of 2002, the extent of reporting a material weakness in internal control remains small. This lack of reporting is indicative of poor risk assessment and management inadequacy. The implication is that future reporting of material weaknesses becomes difficult (Dauda, 2015). Material resource constraints weaken the operational ability of small retail companies and make the companies report their material weakness more. In some instances, what causes the reports of the material weakness under the Sarbanes-Oxley Act of 2002 are information technology (IT) and non-information (Non-IT) related. Poudel, (2012) examined information technology (IT) and non-information technology, (Non-IT) specifics, about entity levels and account-level deficiencies. The examination of information technology (IT) indicated the existence of a high degree of defects. The examination also showed that defects occur at a higher rate in Sarbanes-Oxley 404 reports, both in IT and non-IT material weaknesses. Lyndon, and Paulina, (2019) cautioned that unless a strong and efficient internal control is in operation, a high frequency of deficiencies of material weaknesses would persist. The increase and high deficiencies of a material weakness may result in low profitability, and prolonged negative firm activity (Agbi, et al 2017).

An analysis of two important operational factors revealed the effectiveness of at-risk assessment and management tools, system theory (ST) and corporate financial controls (CFC) (Lyndon, & Paulina, 2019). The purpose is to determine how the two factors influence business operation and the achievement of business objectives. System theory (ST), according to Palfi, & Muresan, (2009), is an independent component factor that forms an integral part of a whole system. Corporate financial controls (CFCs) on the other hand, are a part of the whole system. When the two factors combine, they are effective in organizing, planning, and monitoring internal control activities. Such activities remove internal control restraints and operational efficiency. While voicing support for the business use of system theory (ST) and corporate financial controls (CFC) strategies, questions remain about how most retail companies benefit (Palfi, & Muresan, 2009).

The U.S General Account Office (GAO, 2012) in a report to the Bureau of Consumer Financial Protection (BCFP) described internal control problems it identified during its fiscal year audit. General Accounting Office (GAO) officials reviewed the bureau of consumer financial protection (BCFP). A report from the review supports the assertion that internal control systems are a good risk assessment and management tool. The report of the findings also revealed that the government use of various internal control strategies showed that the control strategies are effective. The report of the finding also indicated that internal control strategies are the protective device that can work and benefit retail companies (RCOs) (GAO, 2012). The audit report also identifies compliance requirements that are lacking in seven internal control issues it reviewed. An active and efficient internal control can be a risk assessment and management mechanism. Such activity can be the early identification of an operational defect (Eddy et al 2020). Management can use the strategy to prevent crime and help with compliance requirements. Retail companies (RCs) could benefit from this approach. An examination of business ownership structure as a risk assessment and management tool sheds some light on the working of retail company strategies (Agbi, & 2017).

The Committee of Sponsoring Organization of the Treadway Commission (COSO) officials designed a strategic framework that promotes business function and efficiency (Thompson, 2013). As an internal control strategy, management, auditors, and companies use the framework to measure performance (COSO, 1992). The function of the structure included (a) risk assessment, (b) compliance with rules and regulations and, operational effectiveness and efficiency practice (Feng, 2014). The intention is to use the work to teach students the importance of strong business strategy, like adequate internal control systems while re-enforcing businesses objectives recognition. Information from the research underscores the importance of an adequate risk assessment and management plan that leads companies to the desired goal. COSO integrated framework concept stands as a risk evaluation and management tool that retail companies could use to their advantage.

The importance and place of effective internal audit activities consistent with the standards set by the United States Government should not be over-emphasized (Charles 2015). Accepted Auditing Standard (GAAS) and International Standard on Auditing (ISA) are professional personnel that set audit risk assessment and performance measurement standards. The rules established by the agency personnel measure, (a) compliance, and (b) accounts and financial statements that determine whether the risk of material misstatement in a business operation is high or low. The auditing standard is a measure of the degree of internal control system monitoring (Charles 2015). The measurements imply that a business creates a satisfactory risk assessment and management mechanism. For retail company decision-makers, the ability to identify risk first leads to the early identification of internal control deficiencies. Tax risk deficiencies could hurt the business operation and reduce the chances of accomplishing business objectives (Charles 2015). Final exploration led to the conclusion that internal audit activities constitute a reliable risk assessment and management tool.

In examining the role of internal control, risk evaluation and management strategy called meta-model emerged as a measurement tool. Businesses, including retail companies (RC), can use this tool to further their operational objectives (Seini, & James, 2020). Managers can facilitate the development, and design, the application of a concept called meta-model, to enhance the internal auditor's risk assessment strategies the authors stressed. The meta-model concept plan is an innovation manager could use to assess the likelihood of fraud and other business crimes. The meta-model strategy includes an alternative risk assessment methodology outside the traditional use of internal controls. The American Association of Certified Public Accountants (AICPA) and the Public Company Accounting Oversight Board (PCAOB) support and recommend the meta-medal concept. Among business operators, survival, profitability, and sustainability are the primary concerns regarding large and small retail companies within the enterprise environment. Instability in the retail company environment and concern for commercial activities' success led to the discovery of innovative mediums for fraud prevention, and mitigation (Seini & James 2020).

The constraints small and medium-sized retail companies face while trying to obtain loans and funding from banks and other venture capitals in Uganda have seen some improvement (Amoateng et al. 2017).

An examination of the risk of cash flow failure, by looking at factors responsible for such problems helped in forging a solution. The result of the study found that difficulty in assessing inherent risks was part of the problem. Failure to catalogue and present the information to lenders, to make an informed decision remains an obstacle (Amoateng et al. 2017).

Method

The study employed cross-sectional survey design approaches, comprising descriptive and exploratory research designs. Specifically, exploratory research design focuses on generation of data for the formulation of hypotheses (Angella, & Eno, 2009). Hence, the researcher focused on the formulation of hypothetical statements, model formulation, and the analysis of results, so as to draw inferences concerning the relationships among the variables under investigation.

The population of this study comprises all the 13 listed commercial banks in Nigeria. It is relatively difficult to cover the entire population of this study. Consequently, a sample is usually chosen for effective investigation. This is to ensure reliability, coverage and completion of the study on record time. Deliberate effort was made to represent the sub-sectors in the sector chosen for this study. To this end, the researcher used census sampling in selecting all 13 listed commercial banks in Nigeria which is the population of the study.

There are two (2) main sources of data in every research study, namely primary and secondary sources of data. Data from primary and secondary sources were used in this study. The data for the study are time series figures extracted from the financial statements of the listed commercial banks under study, also 500 questionnaires was employed. The validity of the data used for this research was ensured by the consistency of the source from which the facts were gotten from online sources of data from their financial statement variables that are serving as proxies for financial control practices and financial performance of listed commercial banks' indices. To establish the validity of the research instrument the study sought for opinions of experts in the field of study. This facilitated the necessary revision and modification of the research instrument thereby enhancing validity.

Cronbach's Alpha was applied to measure the co-efficient of internal consistency and therefore reliability of the instrument. In order to check reliability of the results, study used Cronbach's alpha methodology, which is based on internal consistency. Cronbach's alpha measures the average of measurable items and its correlation. SPSS software was used to verify the reliability of collected data. Overall scales' reliability of the present situation and the desirable situation were tested by Cronbach's alpha, which should be above the acceptable level of 0.70 (Hairetal 1998). The Cronbach's alpha obtained from the instruments used to collect data was 0.886 which indicates that the research instruments were reliable.

In this study, regression analysis via SPSS 23 version is employed as a statistical tool for estimating the significant relationship of the financial variables that we seek to explain (the dependent variable) and the independent variables.

Findings

Table 1: Coefficients of the parameter estimates of the regression analysis showing ROA

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B		Correlations			Collinearity Statistics	
	B	Std. Error	Beta			Lower Bound	Upper Bound	Zero-order		Part	Tolerance	VIF
(Constant)	55.562	236.360		.235	.814	-409.896	521.019					
FCP	-.114	.519	-.014	-.219	.827	-1.137	.909	-.014	-.014	-.014	1.000	1.000

a. Dependent Variable: ROA

Table 1 above shows the coefficients of the parameter estimates, which is used to determine the contribution of each variable included in the model. However, since we are interested in constructing a regression equation, we would use unstandardized coefficients value listed as Beta to explain the table. The result shows that ROA is very strong positively related to profitability while IC, are positively related to profitability, measured in terms of ROA. This implies that as ROA increases, IC increases by 0.814units.

It could however be observed that IC significance value is 0.155. This means that the variables make significant unique contribution to the prediction of the dependent variable -ROA.

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.022[a]	.000	-.004	16.39725	.000	.119	1	245	.731	1.535

a. Predictors: (Constant), FCP

b. Dependent Variable: ROE

In addition, table 2 provides Durbin-Watson (DW) Statistics which explains the connection between the explanatory and dependent variables. It also shows how changes in the explanatory variables affect the dependent variables.

Data Analyses Discussion of Findings and Results

Hypotheses One

H_{O1}: There is no significant relationship between internal control and return on assets of listed commercial banks in Nigeria.

Model Summary in table 2 above shows that there is relationship between internal control and return on assets of listed commercial banks in Nigeria, with a significant value of 0.827>0.05. Therefore the researcher concludes that there is very strong positive significant relationship between internal control and return on assets of listed commercial banks in Nigeria.

Findings from pooled correlation test of hypothesis one shows that internal control practices is positively and significantly correlated with commercial banks financial performance, internal control in most cases has a very strong significant relationship with return on assets of commercial banks in Nigeria. In this direction, Ejoh and Ejom (2014) observed that internal control practices constantly execute there turn on assets of tertiary institutions in Nigeria.

Conclusions

The concept of internal control practices centers on the manner in which an organization monitor its activities through mixture of internal control measures. The empirical tests conducted revealed that internal control practices have significant relationship with financial performance of listed commercial bank in Nigeria. This therefore suggests that an optimal internal control practices affects the institutions positively, while a wrong mixture inadequate internal control and fraud prevention measures affects institution's profitability adversely. Hence, financial institutions should strive to ensure that they efficiently affect a consistent internal control measures in other to plan and monitor their funds and ensures it used as pre budgeted, so as to maintain an optimal financial control level.

From the findings of this study, it can be concluded that return on assets (ROA) has a strong relationship with internal control practices while adequate monitoring of organization funds affects profitability positively. The results of this study support prior empirical studies like: Hendri et al (2020), Ahmed et al. (2021); and Hadlock & James (2002) who found a positive relationship between profitability and resource management and firm performance.

Recommendations

The following recommendations have been proffered, based on the findings of this study;

1. Since, the outcome of the research findings one (1) shows a positive and significant relationship and in Ejoh and Ejom (2014) observed that internal control practices constantly executes the return on assets of tertiary institutions in Nigeria. Organizations should constantly execute their financial control practices. The researcher therefore recommends that such financial control practices should be sustained because it enhances internal control for a quality performance for the banks. Considering that financial institutions vary in size, efforts should be made to adopt internal control measures to monitor capital structuring by incorporating factors like: riskiness of debt, management dexterity, cost of debt and equity, and so forth, in order to maximize the institutions' value.

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