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Effects of Internal Control System on the Activities of Thrift and Credit Cooperatives

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ABSTRACT

This research work explored the effects of internal control system on the activities of thrift and credit cooperatives. Chi-Squared Test Statistics was used employed for the testing of hypotheses. Findings revealed that control environments have significant impact on the performance of thrift and credit cooperatives, risk assessments have significant influence on the performance of thrift and credit cooperatives and that control activities have significant impact on the performance of thrift and credit cooperatives.

Keywords: *Internal Control System; Thrift and Credit Cooperatives; COSO*

1. Introduction

The rapidly changing economic and competitive environments, shifting customer demands and priorities, and restructuring for future growth and social trend indicates how extensive an organization internal controls should be structured to ensure continuous growth in revenue generation (Magu & Kibati, 2016). Internal control is a dynamic integral process that is adapting continuously to the changes facing modern organizations of which thrift and credit cooperatives cannot be left out. At all levels of the organization, the management and personnel have to be involved to address risks and to provide reasonable assurance of the achievement of the organization's mission and general objectives.

Internal Controls are processes designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of the financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Mwindi, 2008). Tunji (2013) and Dhillon (2001) argue that internal controls encompass a set of rules, policies, and procedures an organization implements to provide reasonable assurance that: (a) its financial reports are reliable, (b) its operations are effective and efficient, and (c) its activities comply with applicable laws and regulations. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework look at internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide "reasonable assurance" regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting, compliance with applicable laws and regulations. The COSO framework (2013) identifies five main elements of internal control systems against which the review should take place. These include Control environment, Risk assessment, control activities, information and communication and monitoring. There is a general expectation that institution and enforcement of proper internal control systems will always lead to improved financial performance.

The COSO framework also found out that properly instituted systems of internal control improve the reporting process and also give rise to reliable reports which enhances the accountability function of management of an entity. Internal controls are put in place to ensure safe custody of all companies' assets; to avoid misuse or misappropriation of assets and to detect and safeguard company's resources against probable frauds.

Internal controls are measuring that organizations institute with the aim of ensuring that the objectives, goals, and mission of the organization are met (Rezaee, 2002). They refer to set of organizational policies and procedures that ensure any transaction is processed in the appropriate way to avoid waste, theft and misuse of organization resources. Through internal control systems, organizations achieve performance and organizational goals, prevent loss of resources, enable production of reliable reports and ensure compliance with laws and regulations. Thus, internal control is established by the organizational management to ensure that the business of enterprise is carried out in an orderly and efficient manner. This further ensures adherence to management policies safeguard the assets and secure the completeness and accuracy of the records.

Firms are always keen on their financial performance and they usually engage in activities to appraise their financial performance and thus, make changes in their operations (Visser, Matten & Pohl, 2010). However, it is evident that there are some firms that are considered more successful than others. Similarly, there are firms that have traditionally adopted different methods to improve their financial performance, and these have made them more successful than other firms, this process is internal control measures.

A research on internal controls in Belgium illustrated the importance of the control environment when studying internal control systems. Research has found that certain control environment characteristics like tone-at-the-top, level of risk and control awareness, clearly defined and communicated are significantly related to the role of the internal control system and fraud detection within an organization (Sarens & De Beelde, 2006).

If an organization pursues integrity and clear ethical values reflected in a formal code of conduct, the internal control will take a greater importance (Saren & Beelde, 2008). A study was done to establish the impact of internal control design on banks' ability to detect staff fraud and staff life style in Nigeria. Data were collected from 13 Nigerian banks using a four point like Scale questionnaire and analyzed using percentages and ratios. The study found that Internal control design influences staff attitude towards fraud such that a strong internal control mechanism is deterrence to staff fraud while a weak one exposes the system to fraud and creates opportunity for staff to commit fraud (Ewa & Udoayang, 2012).

More so, a research also was conducted by Mawanda (2008) on influence of internal control systems on financial performance of an institution of higher learning in Uganda. Internal controls were looked at from the perspective of control environment, risk assessment, Control Activities, information and communication and monitoring process whereas financial performance focused on liquidity, accountability and reporting as the measures of financial performance. The researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls. The study established a significant relationship between internal control system and financial performance. The study recommended competence profiling in the Internal Audit department which should be based on what the firm expects the internal control system to do. The study therefore acknowledged the role of internal audit department to establish internal controls which have an effect on the financial performance of organizations.

Olumbe (2012) conducted a study to establish the relationship between internal controls and corporate governance in commercial banks in Kenya. The researcher conducted a survey of all the 45 commercial banks in Kenya. It was concluded that most of the banks had incorporated the various parameters which were used for gauging internal controls and corporate governance. This was indicated by the means which were obtained enquiring on the same and this showed that the respondents agreed that their banks with high financial performance had instituted good corporate governance with a strong system of internal controls and that there was great improvement of their financial performance.

All these studies point to the fact that internal control has significant impact on performance of organizations, hence the appetite to embark on this study to see if the researcher can obtain same results with the rest of the world given different economic environment.

Statement of Problem

It is worthy of note to state that internal control systems and its effect on corporate performance is a less researched area in Nigeria, whereas it is taught by the existing institutions of learning, there has been little or no knowledge contribution to the world's literature.

With the aforementioned besides, organizations (particularly thrifts and credit cooperatives) in Nigeria continue to experience low levels of revenue generation most of which are manmade and therefore could be avoided. Despite the numerous rules and regulations, the varying levels in revenue generation occur across all entities in the government and private sectors. No matter how well internal control system is designed and operated, it can only provide a reasonable, not absolute assurance that the objectives of the company's internal control system are met in terms of revenue generation.

This research work is borne out of the little or no research input carried out to examine the effect of the internal control system on performance in Nigeria. The researcher therefore wants to see if internal control system has any significant impact on thrift and credit cooperative.

Objectives of the Study

1. To assess the effects of control environments on the performance of thrift and credit cooperatives.
2. To investigate the effects Risk Assessments on the performance of thrift and credit cooperatives.
3. To examine the effects of control activities on the performance of thrift and credit cooperatives.

Theoretical Framework

The Agency Theory

Agency theory has been widely used in literature to investigate the information asymmetry between principals (shareholders) and agent (management). This study used the agency theory to determine the effect of internal control systems on the financial Performance of quoted companies in Nairobi securities exchange. Sarens and Abdolmohammadi (2011) state that according to the agency theory, a company consists of a set of linked contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling these resources. A significant body of work has been undertaken in this area within the context of the principal-agent framework. The work of Jensen and Mecklin (1976) in particular as well as that of Fama (1980) is important. Agency theory identifies the agency relationship where one party, the principal, delegates work to another party, the agent.

The agency relationship can have a number of disadvantages relating to the opportunism or self-interest of the agent: For example, the agent may not act in the best interests of the principal, or the agent may act only partially in the best interests of the principal. There can be a number of dimensions to this including for example, the agent misusing their power for pecuniary or other advantage, or the agent not taking appropriate risks in pursuance of the principal's interests because the agent views those risks as not being appropriate while on the other hand the principal may have different attitudes to risks.

There is also the problem of information asymmetry whereby the principal and the agent have access to different levels of information; in practice this means that the principal is at a disadvantage because the agent has more information. The theory was therefore very relevant in this study as shareholders who are the owners of the quoted companies have delegated the responsibilities of daily running of the companies to the management who acts as their agents and hence great need for strong internal control systems to ensure shareholders and other stakeholder's interests are adequately safeguarded. The theory therefore supports existence of control environment, internal audit and risk management.

Stakeholder Theory

This theory was originally detailed by Freeman (1984) in the book, 'Strategic Management: A Stakeholder Approach'. The theory identifies and models the groups which are stakeholders of a corporation. It is a theory of organizational management and business ethics that addresses morals and values in managing an organization.

In the traditional view of the firm, the shareholder view, the shareholders or stockholders are the owners of the company, and the firm has a binding fiduciary duty to put their needs first, to increase value for them. Stakeholder theory argues that there are other parties involved, including employees, customers, suppliers, communities, governmental bodies, political groups, trade associations, and trade unions. Even competitors are sometimes counted as stakeholders - their status being derived from their capacity to affect the firm and its stakeholders. The nature of what is a stakeholder is highly contested (Miles, 2012), with hundreds of definitions existing in the academic literature.

More recent scholarly works on the topic of stakeholder theory that exemplify research and theorizing in this area include Donaldson and Preston (1995), Mitchell, Agle, and Wood (1997), Friedman and Miles (2006), and Phillips (2003). Donaldson and Preston (1995) argued that the theory has multiple distinct aspects that are mutually supportive: descriptive, instrumental, and normative. The descriptive approach is used to describe and explain the characteristics and behaviors of firms, including how companies are managed, how the board of directors considers corporate constituencies, the way that managers think about managing, and the nature of the firm itself. The instrumental approach uses empirical data to identify the connections that exist between the management of stakeholder groups and the achievement of corporate goals (most commonly profitability and efficiency goals). The normative approach, identified as the core of the theory by Donaldson and Preston (1995), examines the function of the corporation and identifies the "moral or philosophical guidelines for the operation and management of the corporation.

Mitchell, et al., (1997) derived a typology of stakeholders based on the attributes of power (the extent a party has means to impose its will in a relationship), legitimacy (socially accepted and expected structures or behaviors), and urgency (time sensitivity or criticality of the stakeholder's claims). By examining the combination of these attributes in a binary manner, 8 types of stakeholders are derived along with their implications for the organization. Friedman and Miles (2007) explore the implications of contentious relationships between stakeholders and organizations by introducing compatible/incompatible interests and necessary/contingent connections as additional attributes with which to examine the configuration of these relationships. Phillips, Freeman and Vicks (2003) distinguishes between normatively legitimate stakeholders (those to whom an organization holds a moral obligation) and derivatively legitimate stakeholders (those whose stakeholder status is derived from their ability to affect the organization or its normativity.

Blattberg (2004), political philosopher criticized stakeholder theory for assuming that the interests of the various stakeholders can be, at best, compromised or balanced against each other. He argues that this is a product of its emphasis on negotiation as the chief mode of dialogue for dealing with conflicts between stakeholder interests. He recommends conversation instead and this leads him to defend what he calls a 'patriotic' conception of the corporation as an alternative to that associated with stakeholder theory.

Stakeholder Theory is relevant to our study as it gives an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and other people with the money. It clearly states that you can't look at any one of their stakes or stakeholders if you like, in isolation. Their interest has to go together, and the job of a manager or entrepreneur is to work out how the interest of customers, suppliers, communities, employees and financiers go in the same direction. Each one of these groups is important to the success of a business, and figuring out where their interests go in the same direction is what the managerial task and the entrepreneurial task is all about. One of the most recent application of the Stakeholders Theory is Enterprise Risk Management which seeks to strategically consider the interactive effects of various risks within the stakeholders‟ appetite (Beasley, Chen, Nunez, & Wright, 2006).

Empirical Framework

Mawanda (2008) conducted a research on the effects of internal control systems on financial performance in an institution of higher learning in Uganda. A questionnaire was used to collect data to achieve the objectives. A census was done from a population of 270 staff at Uganda Martyrs University. This research established a strong relationship between internal control system and financial performance of the Uganda Martyrs University. The study concluded that internal control systems do function although with hiccups and that there is a significant relationship between internal control systems and financial performance in an Institution of higher learning.

Gathoni (2013) conducted a study focused on the factors affecting sustainability of micro-credit groups in Kalama Ward- Machakos County in Kenya. Data was collected mainly by use of questionnaires had both closed and open-ended questions. Out of the 2287 clients in Machakos region which is comprised of 183 active groups and 40 inactive groups, 330clients from Kalama Ward and 12 Staff were considered and applied Stratified Random sampling applied leading to a sample of 52 Respondents. The study concluded and recommended that Policy and internal control are the foundations of strong groups and forms the basis of partnership with service providers. Well-articulated constitution and credit policy facilitate client appraisal and set the basis of vetting criteria when evaluating prospecting loan applicants.

Muraleetharan (2012) in his study, 'Internal Control and Impact on Financial Performance of the Organizations in Jaffna District in India', examined whether the internal control systems lead to increased and better financial performance of the Organizations. In his study, internal control was measured by control environment, risk assessment and control activities and financial performance was measured by profitability, efficiency and liquidity. To test his hypothesis, data was collected by use of questionnaires, observation and personal interviews and 181 samples were selected from employees in the offices. He used Chi square and regression analysis to measure the variables, and a value of 161.1 (p=0) at 0.05 significant level indicated that there was a relationship between internal control and financial performance.

Methods and Hypotheses Testing

This study employed a descriptive survey design. Data were sourced primarily and secondarily. The primary data was collected through a structured questionnaire and oral interview. The Lickert-Summated Rating scale was used in the questionnaire to elicit information from the respondents. The Licker- Summated Rating scale is given below:

Strongly Agree (S A)

Agree (A)

Undecided (U)

Disagree (D)

Strongly Disagree (SD) (Samie, 2006).

Secondary data used for the purpose of this research were obtained from books, internet, academic articles and journals.

Stratified purposive sampling method was employed in determining the sample size for this study. Leedy (1989) states that a purposive sampling procedure is one which individuals or samples thought to be most important and relevant to the issue are targeted for the research. Population was stratified into three strata's: Upper management; Middle level management Lower level employees. The researcher chose to make use of more middle management and upper management employee because they have better knowledge of cost control and reduction as it relates to their company. The questionnaire also was designed to suit the test of the respondents as they said they would prefer a short questionnaire.

Table 1

Respondent	Population	Sample size
Upper Management	12	8
Middle level Management	32	20
Lower Level Employees	94	12
Total	138	40

In this research work, the responses of the respondents are analyzed with SPSS (Statistical Package for Social Sciences) Version 23. Also, the hypotheses are tested using the Chi-Square test of independence and association. The Chi-Square test, X^2, is a test of independence where the concept identified in one variable is not necessarily affected or related to another variable within measure (Ewurum, 2005). The Chi-Square test of independence is used to estimate the likelihood that some factors other than chance (sampling error) account for the apparent relationship and the chi-square could also be used to test for independence and association between two or more variables.

The Chi-Square test of independence is denoted as follows:

$$X^2 = \frac{\sum (F_o-F_e)^2}{F_e}$$

Where

X^2 = Chi-Square

$\sum$ = Summation

F_o = Observed frequency

F_e = Expected frequency

Hypothesis Testing

Decision Rule: ***Reject H_0, if p-value (Sig.) ≤ 0.5, otherwise do not reject H_0***

Hypothesis I: Control environments have no significant impact on the performance of thrift and credit cooperatives.

Table 2 Chi-Square Test for Hypothesis One

To what extent do you agree that control environments has significant impact on the performance of thrift and credit cooperatives in Awka south			
	Observed N	Expected N	Residual
Strongly Agree	16	8.0	8.0
Agree	10	8.0	2.0
Undecided	10	8.0	2.0
Disagree	2	8.0	-6.0
Strongly Disagree	2	8.0	-6.0
Total	40		

Table 3 Test Statistics for Hypothesis One

	To what extent do you agree that control environments has significant impact on the performance of thrift and credit cooperatives
Chi-Square	18.000[a]
Df	4
Asymp. Sig.	.001

Decision

The P-value on which basis we can reject the null hypothesis that control environments have no significant impact on the performance of thrift and credit cooperatives is [p-value (.001) <.05]. Hence, the researcher rejects the null hypothesis and state alternatively that control environments have significant impact on the performance of thrift and credit cooperatives.

Hypothesis II: Risk assessments have no significant influence on the performance of thrift and credit cooperatives

Table 4 Chi-Square Test for Hypothesis Two

	Observed N	Expected N	Residual
Strongly Agree	11	10.0	1.0
Agree	19	10.0	9.0
Undecided	8	10.0	-2.0
Disagree	2	10.0	-8.0
Total	40		

Table 5 Test Statistics for Hypothesis Two

	To what extent do you agree that Risk Assessments have significant influence on the performance of thrift and credit cooperatives
Chi-Square	15.000[a]
Df	3
Asymp. Sig.	.002

Decision

The P-value on which basis we can reject the null hypothesis that risk assessments have no significant influence on the performance of thrift and credit cooperatives is [p-value (.002) <.05]. Hence, the researcher rejects the null hypothesis and state alternatively that risk assessments have significant influence on the performance of thrift and credit cooperatives

Hypothesis III: Control activities has no significant impact on the performance of thrift and credit cooperatives.

Table 6 Chi-Square Test for Hypothesis Three

	Observed N	Expected N	Residual
Strongly Agree	14	10.0	4.0
Agree	19	10.0	9.0
Undecided	6	10.0	-4.0
Strongly Disagree	1	10.0	-9.0
Total	40		

Table 7 Test Statistics for Hypothesis Three

	To what extent do you agree that control activities on the performance of thrift and credit cooperatives.
Chi-Square	19.400[a]
Df	3
Asymp. Sig.	.000

Decision

The P-value on which basis we can reject the null hypothesis that control activities has no significant impact on the performance of thrift and credit cooperatives is p-value < .001. Since the p-value < .001 < .05, the researcher rejects the null hypothesis and state alternatively that control activities have significant impact on the performance of thrift and credit cooperatives

Findings

Having subjected the hypotheses under tests, findings revealed that

1. Control environments have significant impact on the performance of thrift and credit cooperatives.
2. That risk assessments have significant influence on the performance of thrift and credit cooperatives.
3. Control activities have significant impact on the performance of thrift and credit cooperatives.

Conclusion

The researcher having come to the end of this study, opines that for increased performance of thrift and credit societies, there should be a sound basis of internal control system, this means that the system should be adequate and effective by being able to remove opportunities that will lead to fraud and embezzlement.

Recommendation

In view of findings, the following is recommended

1. Internal control measures should be taken serious among credit and thrift societies as this ensures the reliability of financial report.
2. Good internal control measures should be employed by thrift and credit societies to avoid misleading decision making by management.
3. On cash disbursement, persons who sign cheques should be prohibited from having assess to petty cash, recording cash receipts and approving cash disbursement.

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