

## EFFECT OF INTERNAL CONTROL SYSTEM ON FINANCIAL PERFORMANCE OF SOME SELECTED CONSUMER GOODS FIRMS IN NIGERIA

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### ABSTRACT

This study focuses on the effect of internal control system on financial performance of some selected goods firms in Nigeria. The methodology of the study is based on survey research approach. The statistical data used for the study were obtained by distribution of fifty (50) questionnaires among selected employees, of the consumer goods firms considered in this research work. These respondent were selected using simple random sampling method, the data obtained from the questionnaire were analyzed using multiple regression statistical tools in SPSS (Statistical packages for social sciences.). The result of the analysis shows that internal control system and risk management has significant positive effect on financial performance of organization, and this was because the P- value obtained (0.000) and (0.010) respectively. The study concludes that effective internal control system and risk management will significantly improve financial performance of firms by helping the organization towards effective and efficient utilization of resource (both financial and non-financial) at their disposal. Based on this result, the study recommends that management of Nigerian companies should develop policies aimed at improving internal control systems.

### 1. INTRODUCTION

The survival of any organization depends on the effective and efficient utilization of resources (financial and non-financial) at the disposal of the organization. Hence, to optimize the utilization of resources entrusted to all employees in an organization, various form of control are put in place by management of the organization, among these major controls are internal control and internal audit to mention a few. Internal control, also known as an internal control system, is the integration of an organization's people's actions, goals, and efforts in order to provide reasonable assurance that the company will fulfill its objectives and mission.

Every organization has a goal in mind. Similarly, International Standard on Auditing (ISA 400) defines internal control as all policies and procedure adopted by the management of an entity to assist in achieving the primary objectives of the management by make sure the business is conducted in the most possible efficient way and also ensuring strict adherence to management policies, safeguarding of asset, prevention and detection of fraud and timely preparation of reliable account. Morris (2011) separates internal controls into those that are general (entity-wide) controls from those that are specific (account-level) controls. He further believes that if management was overriding control features in order to manage earnings, then one would expect to find more Internal Control Weaknesses related to general controls, even if the specific (account-level) controls are effective. This type of behavior should be uncovered during the audit process since this is an area of concern specifically identified in Auditing Standard No. 5, Paragraph 24, which states that "entity-level controls include controls over management override." On the other hand, a stronger argument could be made that if general controls are in place and working, then one would expect to find less Internal Control Weaknesses related to general controls. Benefits of an internal control system include effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations (Nyakundi, Nyamita & Tinega, 2014).

The performance of any organisation is subject to measures integrated to support its operations and facilitate the achievement of its objectives by protecting its resources against waste, fraud, and inefficiency, assuring the quality and dependability of financial and operating data, ensuring compliance with corporate policies, and assessing the degree of performance in all organisational units (Oyedokun & Felejaye, 2022). Financial performance is a complete evaluation of a company's overall standing in categories such as assets, liabilities, equity, expenses, revenue, and overall profitability (Akinyemi, Peter & Cole, 2021). It is measured through various business-related formulas that allow users to calculate exact details regarding a company's potential effectiveness. For internal users, financial performance is examined to determine their respective companies' well-being and standing, among other benchmarks. For external users, financial performance is analyzed to dictate potential investment opportunities and to determine if a company is worth their while. Financial Performance in broader sense refers to the degree to which financial objectives being or has been accomplished and is an important aspect of finance risk management (Hussaini &

Mohammed, 2018). It is the process of measuring the results of a firm's policies and operations in monetary terms. It is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Nyakundi, et.al, 2014).

Financial performance is an indication of how efficient an organization can generate income using the capital accessible in the market. A firm's financial performance reflects its capability to make profit from all its business lines which is evidenced by consistent growth in earnings. In an aggressive marketplace, a firm needs to determine how to attain an optimal level of financial position, which comprises defining the result of firms' policies and operations in monetary terms (Babalola, 2015). Financial performance is a measure of the profitability position of an organization which is the difference between revenue generated from the sale of output and the full opportunity cost of factor used in the production of that output (Siddikin, 2017).

Financial performance of a company, on the other hand, can be measured in a variety of ways, including return on assets, return on sales, return on equity, return on investment, return on capital utilized, and sales growth (Gerrit&Abdolmohammadi, 2010). It's also a measure of a company's surplus value to its shareholders above the total amount of their investments. Appropriate performance measurements, according to Donald & Delno (2009), are those that enable companies to guide their efforts toward accomplishing their strategic objectives.

### 1.2 Statement of problem

Most organizations have had internal control systems in place for many years with little result at curbing the problem of financial crimes which had continued to grow and had eaten deep into the fabric of the society. Financial irregularities within departments, cooperation among senior or highly trusted personnel, and control breaches are only a few examples of financial crimes. Internal controls established by management in most organizations have not been able to completely prevent these fraudulent occurrences, according to various researchers, because these controls have not significantly reduced reoccurring fraud and corruption perpetrated by employees in most organizations.

Eniola, Tonade and Adeniji, (2021) suggested that a few of the internal control issues encountered involves: liquidity difficulties, no acceptable financial statements and reports, 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. This paper examined An internal auditing department should always help guarantee compliance with rules and regulations amid corporate scandals and the global financial meltdown (Eniola et.al, 2021). Having the foregoing in mind, this study examines the effect of internal control on financial performance of organizations in Nigeria.

### 1.3 Objective of the Study

The main objective of the study is to examine the effect of internal control on financial performance of organizations in Nigeria. The specific objectives are to:

- Examine the effect of internal control system on financial performance of selected consumer goods in Nigeria.
- Determine the effect of internal audit on the financial performance of selected consumer goods in Nigeria.

### 1.4 Research Hypotheses

The following hypothesis will be formulated in their null form and will be tested in the study.

**H0<sub>1</sub>:** Internal control system has no effect on financial performance of selected consumer goods in Nigeria.

**H0<sub>2</sub>:** Internal audit has no significant effect on financial performance of selected consumer goods in Nigeria.

### 1.5 Scope of the Study

This paper will examine the impact of internal control system on financial performance in some consumable firms which represents certain major proportions of economic sector.

#### SELECTED NIGERIAN FOOD AND BEVERAGE FIRMS

##### SECTOR A: Breweries and Soft Drinks

7-UP BOTTLING COMPANY PLC

##### SECTOR B: Flour Mills

FLOUR MILLS OF NIGERIA PLC

##### SECTOR C: Sweet and Beverages

CADBURY NIGERIA PLC

##### SECTOR D: Integrated Food and Salt

NATIONAL SALT CO. (NIG). PLC

## 2. LITERATURE REVIEW

### 2.1 Conceptual Review

#### 2.1.1 Concept of Internal Control System

Internal Control System: Internal control system can be defined as a set of mechanism designed to motivate an individual or a group towards achievement of a desired objectives.

Cahill (2016) defined internal control as a system of internal administrative efficiency which often leads to design of a system that will enhance financial check and balance which will support corrective actions intended by the management of the organization and will ensure that the primary goal of the organization is achieved. Doyrangol (2017) argued that internal control system encompass all measures and procedures employed by a firm which assist in the exploration of appropriate activities in compliance with specific policies institutionalized by the Board members and the management of such firms. A contemporary definition of internal control is that given by the Committee of Sponsoring Organization Commission (COSO). COSO (2014) defined internal control as a process effected by those charged with governance, management and other employees to provide reasonable assurance regarding the achievement of an entity's objectives in the areas of efficiency and reliability of financial information or reports, and compliance with legal and regulatory requirements. The creation of an effective internal control system remain one of the basic instruments of enterprise control, whose implementation in modern economic conditions provide conditions for achieving a competitive advantage over other enterprises. In the industry sector, the market is constantly changing, and this requires changing the attitude to internal control from treating it only in the financial aspect to the management of the control process. Internal control as such becomes an instrument and means of risk control, which helps the enterprise to achieve its goals and to perform its tasks. Consequently, it may help decrease the number of mistakes and frauds in enterprises and to offer the precautionary means that might help to avoid mistakes and build an effective internal control system.

It also ensures that financial reporting information is accurate and that a firm follows all applicable rules and regulations (COSO 2013). Internal control may be deduced from these principles as a sequence of procedures and rules that continue to be processed. It is connected to both financial and non-financial operations and is based on judgment and cost/benefit calculations. Internal control in companies is divided into five components according to the COSO framework. As a result, (i.) the control environment, (ii) the entity's risk assessment process, (iii) the information and communication system, (iv) control activities, and (v) monitoring are all important. Internal controls, according to Whittington (2017), go beyond bookkeeping and the preparation of financial reports. Internal controls, he continued, may be defined as "structured procedures that lead to evaluation of the degree of pre-determined objectives in connection to the company's actual outcomes."

### FINANCIAL PERFORMANCE

A firm's financial performance reflects its capability to make profit from all its business lines. This is an indication of how efficient the administration can generate incomes using the capital accessible in the market. Growth in earnings is said to be the key aim of every firm. In an aggressive marketplace, a firm needs to determine how to attain an acceptable level of productivity, which comprises of defining which parts of monetary policies are functioning and which ones require upgrading (Babalola, 2015). Financial performance measures the extent of achievements by organizations, which could reflect a good result for certain periods and otherwise for other periods (Batchimeg, 2017). One of the main aim for measuring the achievements of organizations is to obtain useful information related to flow of fund, the use of fund, effectiveness and efficiency in the utilization of the funds. This information also motivates managers to make good informed decisions (Amal, Sameer, & Yahya, 2012).

### 2.2 Theoretical Review

#### 2.2.2 Agency Theory

The underlying assumption of this type of agency problem is the conflict of interest between the major and minor owners. Major owners are termed as a person or group of persons holding the majority of the shares of a firm, while minor owners are those persons holding a lesser portion of the firm's share. The major shareholders have higher voting power and can take any decision in favour of their benefit, which hampers the interests of the minor shareholders. This kind of agency problem prevails in a country or company, where the ownership is concentrated in the hands of few persons or with the family owners, then the minority shareholders find it difficult to protect their interests or wealth (Pan, 2013).

In support of the agency theory, Pan (2013) noted that agency theory deals with the ownership structure of a firm. That is, the mechanism that helps firm managers align their interests with the interests of the owners and controlling

the mechanism so that they work in aligning the principal's interests to the agent's. This is seen in the form of the firm's Board structure, rules on strategy-setting and strategic decision-making processes, reporting and controlling mechanisms, and the management of risk, which are indispensable in managing businesses. Others are the selection and remuneration of Board members and executives which serve to control the behavior of the agent, bringing it in line with the principal's interests.

### 2.2.3 Institutional Theory

According to Williamson (1985), institutional theory emphasizes that without institutions and markets, a fixed existence was impossible and trading never started. Traditionally, institutions are defined as what people consider to be acceptable or unacceptable, and often provide a framework within which all behavior finds its justification. Institutional principles are usually achievable if companies adhere strictly to high-level regulations. This theory also emphasized that organizations are not only places where goods and services are produced, but also managers of social and cultural systems. An important scholar of institutional theory is DiMaggio and Powell (1983), who define institutional theory as the organization that, as a whole, constitutes the recognized domain of institutional life. These organizations include major suppliers.

### 2.3 Empirical Review

Eniola and Akinselure (2016) shows that internal control has significant relationship with fraud perpetrated in the organization, and recommends that management should develop more effective strategies that will ensure that internal control is effective and efficient, so that fraud perpetration in the organisation will be significantly reduced. Hussaini and Mohammed (2018) revealed that there is a positive and significant relationship between the four components of internal control (control environment, control activities, monitoring and risk assessment) and bank performance. While information and communication were found to have an insignificant positive relationship with bank performance.

Afolabi, Ogunleye and Olukoya (2020) found that control environment, risk assessment, control activities, information and communication and monitoring exert a significant positive influence on deposit money banks liquidity and positive effect on their solvency. The study concluded that, control environment and information and communication are the two control measures with which deposit money banks improve their solvency level significantly. It is recommended that adequate measures be put in place in various deposit money banks to ensure that the systems of internal control put in place are adequate and working and that the efforts of employees are tailored towards the goal congruence. Danjuma (2020) realized that the control environment, risk assessment, control activities and information and communication as indicators of internal control systems have a significant influence on the financial performance of the federal parastatals and recommends that internal control systems among the federal parastatals need to be improved and accountability of organizational resources be upheld. Eniola, Tonade and Adeniji (2021) indicated a favourable association between internal audit control, risk management, monitoring practices and operational performance, pointing to the objectives. Monitoring practices and control environments have a significant negative impact on asset returns. It demonstrates the elements that are overlooked in internal control systems and strategies to improve the performance of the internal control system. Odunko (2022) showed that cash control, risk assessment and internal control has positive and significant effects firm performance in Nigeria. It was recommended that management of quoted firms in Nigeria should formulate policy that will be geared toward enhancing cash control. Increasing firm risk assessment will significantly affect firm performance in Nigeria. Also that management of quoted firms in their drive to enhance firm performance; management should increase and improve risk assessment and that the management of quoted firm should improve in internal control. Most of the researchers focus on financial institutions and other manufacturing sectors, therefore, this paper will examine the impact of internal control on financial performance in some selected consumable firms which represents certain major proportions of the economic sector.

## 3. METHODOLOGY

The methodology of this study is based on a survey research approach with distribution of fixed number (50) questionnaire to a selected number of employees of the companies considered in this study. This company was selected based on the sampling method used in the study (target sampling method). Results from the questionnaire were analyzed using SPSS (Statistical Package for Social Sciences) regression analysis.

### 3.1 Model Specification

The model specification used for this study hinged on the examining of the relationship among variables (the dependent and the independent variable) of this research work. Therefore, the linear regression equation for this study was specified as;

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon_t$$

$Y=f(x)$

Where;

$Y$ = Dependent Variables which is represented by financial performance measured through Return on Asset and Return on Equity.

$X_1$ = Independent Variables which is represented by internal control System measured through Internal Control System Procedure, and Internal Audit.

$B_0$ = Represents the intercept or constant

$B_1$ = Represents the regression coefficient

$\varepsilon_t$  = Represents error term

For this study

$ROA = f(ICSP, IA, FS)$

Where;

$ROA$ = Return on Asset

$ICSP$ = Internal Control System Procedure

$IA$ = Internal Audit

$FS$ =Firm Size

In mathematical form, the model taken is specified as;

$$ROA = \beta_0 + \beta_1 ICSP + \beta_2 IA + \beta_3 FS + \varepsilon_t$$

Also;

$ROE = f(ICSP, IA, FS)$

Where;

$ROE$ = Return on Equity

$ICSP$ = Internal Control System Procedure

$IA$ = Internal Audit

$FS$ =Firm Size

In mathematical form, the model taken is specified as;

$$ROE = \beta_0 + \beta_1 ICSP + \beta_2 IA + \beta_3 FS + \varepsilon_t$$

#### 4. ANALYSIS AND TEST OF HYPOTHESES

This section describes the analysis and interpretation of data collected from respondents in selected organizations. Respondent's responses basically fell into three categories, and these three categories represent the variables used in generating the results of this survey. Data from the questionnaires were analyses using SPSS (Social Science Statistics Package) multiple regression analysis.

##### 4.1 Test of Hypotheses

###### Hypothesis One

$H_{01}$ : Internal control procedures have no significant effect on financial performance of organizations in Nigeria.

**Table 4.1:** Result of the Regression Analysis of Internal control procedures and financial performance of organizations

Variables	F- Ratio	Sig of P	R	R <sup>2</sup>	Adj R <sup>2</sup>	B	t	P
Cost Efficiency	58.809	.000	.757	.573	.567	.293	3.274	.000
Profit Growth						.204	3.389	.006
Financial Efficiency						.291	5.195	.000

The result of the multiple regression analysis as shown in table 4.1 reveals that the model has a good fit based on the value of the F-statistics (58.809). The value of  $R^2$  (0.573) show that all explanatory variables (Cost Efficiency, Profit Growth and Financial Efficiency) explains 57.3% of variation in the dependent variable (financial performance). The regression coefficient gives a relative result as follow; Cost Efficiency ( $B=.293$ ,  $P < 0.01$ ), Profit Growth ( $B=.204$ ,  $P < 0.05$ ) and Financial Efficiency ( $B=.291$ ,  $P < 0.01$ ). The result shows that the P-value obtained (i.e. 0.000) for the



regression coefficient was also lower than the alpha level of significance of 5% specified for this analysis. Therefore, the Alternate Hypothesis will be accepted while the Null Hypothesis will be rejected, which means that internal control procedures have significant effect on financial performance of organizations in Nigeria.

### Hypothesis Two

H0<sub>2</sub>: Risk management has no significant effect on financial performance of organizations in Nigeria.

**Table 4.2:** Result of the Regression Analysis of Risk management and financial performance of organizations

Variables	F- Ratio	Sig of P	R	R <sup>2</sup>	Adj R <sup>2</sup>	B	t	P
Liquidity	28.231	.010	.546	.298	.287	.298	3.274	.031

The result of the regression analysis as shown in table 4.2 reveals that the model has a good fit based on the value of the F-statistics (28.231). The value of R<sup>2</sup> (0.298) show that all explanatory variable (risk management proxied by liquidity) explains 29.8% of variation in the dependent variable (financial performance). The regression coefficient gives liquidity (B=.298, P < 0.05). The result shows that the P-value obtained (i.e. 0.010) for the regression coefficient was also lower than the alpha level of significance of 5% specified for this analysis. Therefore, the Alternate Hypothesis will be accepted while the Null Hypothesis will be rejected, which means that risk management (liquidity) has significant effect on financial performance of organizations in Nigeria.

## 5. DISCUSSION OF RESULTS

The findings of this study show that internal control system has significant effect on financial performance of organization. This was confirmed by the result of the statistical analysis which shows that that the P-value obtained (0.000) was lower than significance value of 5% specified for this analysis, Furthermore, the study also established that risk management has significant effect on organization financial performance, this was also confirm by the result of the P-value obtained (0.010) which shows that that the value obtained was lower than the significance value of 5% specified for this analysis.

## 6. CONCLUSIONS AND RECOMMENDATION

The study concludes that effective internal control system and risk management will significantly improve financial performance by helping the organization to effective and efficient utilization of resource (both financial and non-financial) at their disposal. This is a wakeup call that organization must find new ways to strengthen our internal control departments as organizational management strategy for rapid improvement of organizational goals. The study recommends that management of Nigerian companies should develop policies aimed at improving internal control systems. The results showed that risk management has a significant positive impact on the financial performance of Nigerian companies. Therefore, enhanced risk management by companies will have a significant impact on the financial performance of Nigerian companies. The study recommends that corporate management should: Management should increase and improve the risk assessment.

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