CHAPTERONE

INTRODUCTION

1.1 Backgroundto the Study

An organization can besaid to be successful when the measures it has put in place to support itsoperations and facilitate the achievement of its objectives are very effective.Such measures may include, but not limited to, having policies and proceduresfor execution of operations, establishing standards for recruitment andcompetency development of employees, development of policies which govern thebehaviour of organizational members, having security measures to guaranteeassets protection, establishing proper procedures for record keeping, definingreporting relationships among organizational members, establishing proceduresfor authorization of transactions and the limits thereon as well as topmanagement supervision. These measures, together with many others, such asinternal auditing, budgeting, performance evaluation and the likes, that an organizationmay implement in order to achieve its objectives, constitute the internalcontrol system of the organization.

Manybusiness failures around the world, in the recent past, have been partlyattributed to failure in internal control system. It is common knowledge thatthe collapse of some notable organizations across the world, like Enron EnergyCorporation, WorldCom, Tyco (in the US); Maxwell Communications Corporation,the Mirror Group Newspaper (in the UK); as well as NITEL and NAFCON (inNigeria) was due to failure in internal control system and by extensioncorporate governance failure. Few years ago a number of manufacturing orpharmaceutical organizations in Nigeria which were known to be performingexcellently in financial terms collapsed irrespective of the existence ofinternal controls (ICs).

Byinternal control system it means that all the policies and procedures adoptedby the directors and management of an organization to help in achieving theircorporate objective of ensuring a practicable, orderly and efficient conduct ofbusiness activities which include strict adherence to internal policies, thesafeguarding of assets, the prevention and detection of frauds and errors, theaccuracy and completeness of accounting records, and the timely preparation ofreliable financial information (Ofori, 2011). Internal control can be said tobe measures introduced by an organisation to ensure a prompt achievement of theorganisation's corporate objectives, goals, visions and missions. They can beviewed as a set of policies and procedures employed by an organisation towardsensuring appropriate transactions so as to avoid waste, theft, fraud and misuseof organisation's resources.

Management of many organisations now use internal controlsystem as a tool to checkmate staff activities as a result of managers'inability to monitor the activities of the organisations. They therefore employthe internal control system in such a way that the system checks itself and anyirregularity within the system is being detected and corrected. To ensure thatthe system checks itself, management could use devices such as segregations, supervisionof work and acknowledgement of performance. The effective arrangement andimplementation of this control system would ensure proper management.

Internal controls areexpected to assist organisations, whether profit making or not, achieve theirobjectives. However, the collapse of organisations like Enron, WorldCom, NITELand NAFCON have raised concerns about the relevance and influence of internalcontrol especially as it affects the financial performance of an organisation.Furthermore, many empirical studies like those carried out by Kinyua (2016),Kiabel (2007), Nyakundi, Nyamita & Tinega (2014), Njeri (2014), Ejoh &Ejom (2014), Etengu & Amony (2016), and the likes, focus on industrialsectors such as manufacturing, banking, tertiary education, agriculture as wellas oil and gas. There seems to be no empirical research, especially in Nigeria thatfocus on the effect of internal control system on financial performance of pharmaceuticalorganisation. Hence, there is need to investigate the effect, if any, ofinternal control on the financial performance of pharmaceutical organisation inNigeria and the nature of the relationship between internal control andfinancial performance of pharmaceutical organisation. Therefore, this studywill seek to examine the effectiveness of internal control system on financialperformance of Norvatis Nigeria Limited.

1.2 Statementof the Problem

The continous failure and extinction of manybusiness organisation and corporate scandals being experinced by many notableorganisations in Nigeria have been attributed to be as a result of weakinternal control system by KPMG (1999). The failure of fiirm like Enron in 2001was as a result of precipitous decline in investor confidence in the capitalmarkets of the firm. The federal government through the regulatory authoritieshas responded to this, by passing guidelines using SAS2 under information whichis to be disclosed in financial statements. The guidelines outlined the rolesof corporate executives, corporate directors, lawyers, accountants and createda board oversight regime for auditors of public companies. In a bid to enhanceaccountability and restore investor's confidence, the guidelines emphasize thecritical role of internal control over financial reporting. This brought aboutthe issue of corporate governance particularly in public institutions.

InternationalAuditing Guidelines (IAG) deals with the auditor's responsibility for detectionof material misstatement resulting from error when carrying out an audit offinancial statements. The guidelines in conjunction with the related SEC rulesand auditing standard No 2, established by the public company AccountingOversight Board (PCAOB), requires management of a public accounting and theorganisation's independent auditor to issue two new reports at the end of everyfiscal year. These reports must be included in the organization's annual reportfiled with the Securities and Exchange Commission (SEC). In the past, an organization'sinternal controls were considered in the context of planning the audit, butwere not required to be reported publicly except in response to the SEC's formrequirements when related to a change in auditor. The new audit and reportingrequirements have drastically changed the situation and have brought theconcept of internal control over financial reporting to the forefront for auditcommittees, management, auditors, and users of financial statements. The new prerequisiteslisted material weakness in internal control system over financial reporting,and made it a compulsion that both management and the independent auditor mustpublicly report any material weakness in internal controls system overfinancial reporting which occurs as a result of physical year, at the end ofassessment dates. Under both PCAOB auditing standard

NO 2 and the SEC rulesimplementing the guidelines, the existence of a single material weaknessrequires management and the independent auditors to conclude that internal controlsystem over financial reporting is not effective. It is on this foundation thatthis study seeks to examine the use of internal control system in an organizationby using Novartis Nigeria Limited as a case study.

1.3 ResearchQuestion

The following are some of the questions which this study intends toanswer:

1) To what extent does weakness in theinternal control system of an organization have impact on the perpetration offraud and losses of revenue?

2) What is the relationship betweeninternal control system and organizational performance?

3) Is there a relationship that existsbetween internal control system and proper keeping of accounting records?

1.4 ResearchObjectives

The general objective of this study is to assess the impactof internal control system on the financial performance of Novartis NigeriaLimited. The specific objectives are:

1) To investigate impact of weakness inthe internal control system of an organization on the perpetration of fraud andlosses of revenue

2) To determine the relationship betweeninternal control system and organizational performance

3) To find out the relationship thatexists between internal control system and proper keeping of accounting records

1.5 Statement ofHypothesis

This research is undertaken on the basis of the followinghypothesis.

1) There is a significant relationshipbetween weakness in the internal control system of an organization and theperpetration of fraud and losses of revenue

2) There is a significant relationshipbetween internal control system and organizational performance

3) There is no significant correlationbetween internal control system and proper keeping of accounting records

1.6 Significanceof the Study

There is no doubt that this research work has been conductedon internal control system, however much emphasis has been placed on the impactof a good internal control system on financial performance of Novartis NigeriaLimited. This study will go a long way in helping the management of NovartisNigeria Limited to discover the effect of weakness in internal control systemand suggest measures in correcting them. However, other manufacturing andpharmaceutical organizations in Nigeria can as well tap from this idea from NovartisNigeria Limited to ensure a better internal control system that will curbexcessive fraud in the organization and enhance improved financial performanceof the organization. It will also reveal the problems caused by bad internalcontrol system and be useful to students, scholars, lecturers and other thirdparties as it shall open new area of further research work and at same timeadvance challenges to up-coming researchers.

Moreover,the study will be more relevant to management and social science studentsbecause they will be exposed to the effect of internal control onorganizational performance and not only that it would also serve as an eyeopener to the fact that as managers, there are lots of issue relating tointernal control within the organization which if left unattended to willjeopardized organizational goal of the company.

Thestudy will also attempt to contribute to the available literature or researchesthat will serve as a guide for organizational staff in order to prevent fraudand risks within the organization.

Policymakers would also benefit from this study in formulating policies relating tothe effect of internal control on organizational performance.

Thestudy of the effect of internal control on organizational performance isanother area of study that is wide for researchers to tap into. So, this studywould benefit researchers in looking beyond the scope of the present study andimpacting to the knowledge already acquired.

Theeffect of internal control on organizational performance will also helppractitioners such as Auditor, tax practitioners, etc in increasing theircredibility.

1.7 Scope of Study

There is no doubt that a good internal control system aidsmanagement effectiveness in its organization. This study will specifically paymore attention on the activities of manufacturing and pharmaceuticalorganisations in Nigeria and due to the logical point that not everyorganisation can be studied. This research is therefore limited to the NorvatisNigeria Limited. The main of this study is to reveal the effect of a good internalcontrol system in the financial performance of Norvatis Nigeria Limited.

1.8 Limitation ofthe Study

The main challenge of this study is the conservating natureof Norvatis Nigeria Limited and their apathy towards providing information,especially with respect to their internal operation policies. Also, humanerrors and biasness are other limiting factors of this study. This is becausesome data were obtained through discussions and interviews therefore there isthe possibility of human error of omitting some vital information. Respondentmay also exaggerate important information in order to give their organization apositive credit for fear of what seems an invasion into the organization'sprivacy. Time and finance are other limiting factors encountered on this study.

1.9 Definition ofTerms

Thefollowing terms have been used in the course of this study and as such need tobe explained. They are as stated below:

Internal Control: it has been defined by the Auditing Planning committee (APC)IN UK as "the whole system of control financial and otherwise established bymanagement in order to carry out the business of the enterprise in an orderlyand efficient manner to safeguard the assets and secure as far as possible, thecompetence and accuracy of records, the prevention and detection of errors andfraud in accordance with the final preparation of financial statement."

Control: is an exercise performed in the present to achieve a plandrawn up for the future.

Management: it is defined as the process of planning, organizing coordinatingand controlling the activities of an organization. It is seen as a group ofpeople who monitor and control the organization activities towards theachievement of the organization objectives.

Audit: this comes from a Latin word "AUDIRE"meaning to hear in otherwords it means official examination of account and records.

ENHANCING THE INTERNAL CONTROL SYSTEM AT NORVATIS NIGERIA LIMITED