

ABSTRACT

The impact of having internal control department in all organizations and banking institution in this era of stiff competition and financial regulation cannot be over emphasized. The process of financial account and data production should be based on a recognized, well-defined and well-organized system of procedures. If the business transaction are to be properly and correctly observed, documented, recorded and collated, then there must be a system which is designed to cope with these activities.

The objective of this study was to evaluate the internal control system in operation at Skye Bank Plc. With a view to examine the effectiveness of internal control system in Nigerian banks.

The population of the study consists of all banking institutions in Nigeria, the sample is Skye Bank Plc, Lagos from the accounting and internal control departments because of significant relationship with the research topic and simple random sampling was employed to give members of staff equal opportunity of being selected.

Data were collected through questionnaire as its instrument and interview to assist in the data from the questionnaire and also the examination of existing records. The collected data were analyzed using simple percentage, chi-square analysis, and they were presented using tables.

The research study tested variables which were vital for an internal control.

CHAPTER ONE INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The banking industry is the live-wire or the equivalent to the central nervous system of the human in all capitalist economics. The institution provide the vital link between the surplus unit and the deficit unit of the economy. Banks promote investment by providing facilities for mobilizing savings and appropriate instruments without which either economic growth or development can take place smoothly and efficiently. In the process of performing these functions, banks come to hold the single largest proportion of the economy's financial resources and correspondingly account for a similar lion share of the credit that propels the engine of growth and development. In the light of this, the subject of internal control in the industry is of interest to all western type economies of the world.

The process of financial account and data production should be based on a recognized, well-defined and well-organized system of procedures. If the business transactions are to be properly and correctly observed, documented, Recorded and collated, then there must be a system which is designed to cope with these activities. For this reason, management of the organization has in general, over a period of many years, placed a great deal of emphasis on having strong system of internal control, where possible. This system is intended to maintain adequate process of accounting data production and safeguarding the organization

against possible financial loss due to fraud or error.

Internal control, in its broadest sense, includes all controls, checks and procedures, formally instituted by the management, to maintain the maximum administrative and operational efficiency possible within the accounting and non-accounting function of the business organization. However, in terms of financial accounting, the system is mainly concerned with those controls which exist to aid the processing of reliable accounting data and to safeguard companies' asset.

The International Auditing Standard and Guidelines [2002] defined Internal Control as 'the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly and efficient manner; ensure reliance to management policies, safeguard its assets and secure as far as possible the accuracy and reliability of its records. The special Report on Internal Control of the Association of Certified Chartered Accountants, London, defines internal control as follows: "Internal Control includes not only internal check or internal audit but all systems of controls, financial or otherwise established by management to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records.

An important feature of the impact of Internal control is the director review of company financial operations and position at regular and frequent intervals by means of interior account and report, operating summaries and other appropriate financial and statistical. In addition to regular view, management may from time to time call for special reviews of particular items e.g. wages, stock, salary access etc. Managerial review and supervision are essential element in an efficient and effective internal control system.

Banks like other business organization achieve their objective through the use of human and economic resources. In most cases, the economic resources are provided by various interest group that do not participate in the day today normal running of the operation of the business. The onus is therefore, on the management to make sure these resources are effectively and efficiently managed to achieve the set goal and to build up public confidence, the desired control achieved through the setting up of a good and valid internal control system.

Internal audit which is an integral aspect of internal control. As a part of management team of the control function, it is clearly described in the statement of responsibilities of the internal auditor as an independent appraisal of activity within an organization for the review of accounting, financial and other operation are basis for service to management. For instance, Cadbury Nigeria sacked its Managing Director, Mr. Bunmi Oni and Mr. Ayo Akadiri, the company's Finance Director recently, which is a fallout of the financial book padding scandal and corruption that recently rocked the company, and that is the way it should be commended. The Board recently commissioned the firm of price water Coopers to review and investigate the company's financials. The outcome of the investigation "has confirmed a deliberate overstatement of the company's financial position over a number of years to the tune of between N13 and N15 billion"! This is Nigeria's version of the Enron Corporation

scandal in the United State.

In case of ENRON which brings to mind the collapse of the seventh largest company in the United States of America and the largest bankruptcy seen by the country till date. There are many issues that were raised with the collapse of Enron as described in the CRS Report for the Congress in 2002:

- Auditing** - There may have been a possibility that the auditors were misled into preparing the wrong financials for the company. Often companies pay more to auditors for non-audit fees than for audit fees, which may bring the auditors to compromise their standards.

- Accounting** - There are several questionable accounting techniques like subsidiary accounting, derivatives and third party investors used by Enron. The loopholes in the accounting system need to be rectified.

- Pension** - More than 60% of the assets held in the 401(k) plan consisted of Enron stock, which when plummeted put stockholders and employees in huge losses and setbacks. Such grave scenarios need to be avoided in the future.

- Corporate Governance** - The board of directors is meant to protect the interest of the shareholders. In Enron's case the CFO was allowed to create private partnerships to deal with the company which is against the best interest of the company.

- Securities Analyst** - The credibility of analysts came under question following the collapse of Enron stock in November 2001 as even the Wall Street analysts failed to predict the Enron disaster.

This study is therefore established to evaluate internal control as a management tool in banking industry using Skye Bank Plc as a case study.

1.2 STATEMENT OF THE PROBLEM

A notable feature of the industry is low ethical standard and transparency. These are manifesting in the rising cases of unwholesome practices being recorded. A number of banks engage in some sharp and unorthodox practices to achieve compliance with some regulatory requirements "on paper". Many banks' returns provide inaccurate/misleading financial report thereby preventing timely detection of emerging problems by the supervisor.

The managerial incompetence of the top management of some banks as evident in weak internal control system of the banks. Substantial losses incurred by many banks on their credit portfolio, frauds and forgeries and outright negligence have brought to the fore, the importance of sound internal control system. Appraisals of fraud-related losses by Bank Examiners revealed that such losses could have been prevented had the affected banks maintained effective internal control systems.

The trend in deficiencies in banks' earning assets especially loans and advances, arising from either poor loan administration or unethical lending (such as insiders' abuse). This is an indication of managerial problems in this regard.

The importance of internal control system cannot be overemphasized where a variety of requirements, processes that are both manual and information communication technology-based (ICT) are used. Organizations have recognized internal audit function as a tool for

ensuring effective workings of the internal control system. Okolo (2001) describes the internal control function as an aspect of control mechanism, within a business, manned by specially assigned staff. However, in Nigeria, the internal control function in the banking sub-sector has not been fully tapped; consequently, cases of errors and intent to defraud and other fraud cases exist in the banking industry. The distress in the banking sub-sector in the nineties reflected lack of effective control mechanism of the audit function in the banking industry. The experiences of failed bank in Nigeria have therefore called for the reinforcement and the strengthening of the controls system in the Nigerian banks.

1.3 OBJECTIVES OF THE STUDY

The main objective of the study is to evaluate the effectiveness of internal control as management tool in banking industry in Nigeria. The specific objectives of the study are:

- i. To verify the existences of internal control and auditing system in banks.
- ii. To ascertain whether the existing level controls and internal audit procedure in banking industry are adequate to ensure staff efficiency, services delivery, prevention of fraud and embezzlement forestalling occasion of mismanagement.
- iii. To identify the various type of fraud that can be penetrated in banks and strategies of fraudsters.
- iv. To determine the suitability or otherwise of the bank official in charge of internal control system.
- v. To examine the possible effect of fraud on the earnings and profitability of banks

EFFECTIVENESS OF INTERNAL CONTROL SYSTEM IN NIGERIAN BANKS [A CASE STUDY OF SKYE BANK PLC]

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