

PDF - EVALUATION OF THE EFFECTIVENESS OF INTERNAL CONTROL SYSTEM IN NIGERIAN BANKS (A STUDY OF DIAMOND BANK) - researchcub.info

CHAPTER ONE

INTRODUCTION

1.1 Background to the study

Banking industry is the live-wire or the equivalent to the central nervous system of the human in all capitalist economics. The institution provides 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.

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 groups 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.

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 is 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 Institute of Charter Accountants defines the concept internal control system as "The whole system of

control financial and otherwise established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as fast as possible the completeness and accuracy check and internal audit" It cannot be over emphasized here that an effective internal control system does not only ensure financial accuracy of transactions, but it reduces trade to the barest minimum. A good internal control system can only operate in a fairly large organization that employs a good number of staff.

It is also important to note that there is high rate of fraudulent practices in Nigerian ministries and parastatals today and the commercial banks are not an exception. That is why the internal control system must not only be put in place, but is also having to be effective in removing such irregularities.

Fraud is a threat common to most organizations. It is a threat to the effective utilization of resources and as such, it will always remain an important concern to management. Fraud needs to be deleted and potential fraud needs to be prevented. Effective internal control system is vital for the survival of any organization it serves as a check on fraudulent activities of the management and employees of organization and it brings about solutions to likely fraudulent acts in an organization. Management is totally responsible for establishing the internal control system in an organization. Auditing today is based on internal control.

Internal control system is a necessity in large organizations especially where management is removed from day to day routine operations of the organization. An effective internal control system and its fraud preventive measures in an organization will help to prevent fraud and errors in an organization thereby reducing fraud to its minimum than when internal control is not in existence or when there is weakness in the system. Internal audit which is an integral aspect of internal control. As apart 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 PricewaterCoopers 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 Corporations 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.

1.2 Statement of Problem

One of major challenges facing Nigerian Banks 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 supervisors.

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. 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.

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:

To ascertain control activities in banks.

To ascertain the monitoring process in banks in Nigeria.

To determine risk assessment in banks in Nigeria.

1.4 Research Questions

In pursuance of the objectives of the study, the researcher was guided by the following questions:

How effective are control activities in banks in Nigeria?

How effective is the monitoring process in banks in Nigeria?

To what extent is risk assessment process in banks in Nigeria effective?

1.5 Research Hypotheses

To achieve the above objectives, the following hypotheses are postulated and will be tested for their validity.

Ho1: Control activities in banks in Nigeria are not effective.

Hi: Control activities in banks are effective.

Ho2: Internal control monitoring process are not effective in banks in Nigeria.

Hi: Internal control monitoring process are effective in banks in Nigeria.

Ho3: Risk assessment process in banks in Nigeria are not effective.

Hi: Risk assessment process in banks in Nigeria are effective.

1.6 SIGNIFICANCE OF THE STUDY

The study will assist the government/policy makers, banks, scholars and the public in the following ways.

1. It enables managers of services, organizations and government owned public utility establishments to bring the accounting and the internal control procedures inherent in them in conformity with internal accounting standards and practices.
2. It helps government owned establishments to assess their internal control measures and make amendments where necessary.
3. The study could arouse further research into some other functional areas in the company by students and accountants, which will help scholars to broaden the scholar's knowledge.
4. The research work helps in widening the scholar's knowledge of practical application of internal control system in banking organization.
5. The study also enhances the appreciation of internal control as a necessary tool used by the policy makers in the smooth and efficient running of an organization.
6. The study also enables the public to appreciate the operation of internal control system in a business organization vis-a-vis its theoretical frame work.

1.7 Scope of the Study

The study focused attention in the evaluation of the effectiveness of internal control system adapted in Diamond Bank, avenue, Enugu State.

1.8 Limitation of the study

In carrying a research work, certain problems were encountered which limits the precision of the research and the extent of generalization of the research work.

The problems include a time constraint which renders one from delving into areas other than accounting and administrative control in the organization, geographical location of the case study in relation to researcher's institution, and limitations to the amount of information obtainable from the respondents to the oaths of secrecy of the organization.

However, through persuasion and hard work we were able to obtain data such that the quality of the research was not affected.

1.9 Definition of Terms

Internal Audit: This can be define as the independent appraisal of activities within the organization for the review of accounting, financial and other operations as basis for service to management.

Internal Check: These are day to day administrative control within the internal control system which aims at detecting and minimizing the risk of fraud and error.

Accounting Control: This comprises of the plan of the organization and all methods and procedures that are concerned mainly with and directly to reliability of the financial records.

Test Checking: This is a method of verifying the operations of a computer program by tracking likely transactions through a print-out of the program

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