

EFFECTIVE INTERNAL CONTROL SYSTEM AS A MANAGEMENT TOOL FOR FRAUD PREVENTION IN BORNO STATE BOARD OF INTERNAL REVENUE

By

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ABSTRACT

The internal control system is not even established in some organization and even when established it is not given proper functioning because effective control system is very critical for the existence and sustainability of any organization. The objective of this paper is to examine the board of internal control system. Descriptive statistics such as simple percentage and chi-square were used. Data was generated through question. Both primary and secondary sources of data were employed. That findings revealed that control has played vital roles on accountability and fraudulence on generations of revenue, most of the staff accepts that control has direct being on their roles which effective control had their attitudes positively. The paper recommends that the board should adopt additional measures to generate revenue so also proper channels of communication should adopt to inform the staff with new means and information.

Keywords: *Internal Control System, Management, Accountability and Transparency.*

Introduction

Management in every kind of organisation is solely responsible for establishing and maintaining internal control system. Internal control system covers the control of the whole management system in order to carry out all functions in an orderly and efficient manner by having an automatic check and balance for the overall transaction. This control may be financial and or non-financial. This has become so crucial because the high rate of fraudulent practices in Nigerian Government Ministries and Parastatals today especially Board for Internal Revenue cannot be

overemphasized. That is why internal control system must be properly put in place because of these irregularities. Fraudulent practices need to be completely discarded and potential fraudulent practices needs to be prevented.

Internal control system is an integral part of any organization's financial and business policies and procedures. It consists of all measures taken by the organization for the purpose of protecting its resources against waste, fraud and inefficiency thereby ensuring accuracy and reliability of accounting and operating data, compliance with policies and procedure and evaluating the level of performance in all the units of the organization (Likis and Giriunas 2012; Kamau, 2014; Aramide and Bashir, 2015). It involves assessing the level of performance of the whole organisation. Control itself is the measurement and correction of the performance of activities of subordinates, in order to make sure those organization objectives and the plans to attain them, are being accomplished.

Kumuthinidevi (2016), submitted that the distinction between internal audit, internal check and internal control in the following manner: *Internal Audit* is an independent appraisal activity within an organization to review the operations and records as to service for management and is done by specially assigned staff. *Internal Check* means a system under which the work relating to carrying out and recording of transactions is arranged in such a manner that the work of one staff member is automatically checked by another. Thus under these system possibilities of fraud and error or irregularities are minimized, if not completely eliminated, and *Internal Control* means not only internal check and internal audit but the whole system of controls-financial and otherwise, established by the management in the conduct of a business in an orderly manner, safeguard its assets and maintain the accuracy and reliability of its operations and records. Thus it is apparent that internal control expression is used in a wide sense and includes internal check and requirements, and the organization's policies and procedures. This objective must be met in order to protect the bank's franchise and reputation (Basle Committee for Banking Supervision, September 1998). The objective of this paper is to examine the board of internal revenue standard control system and evaluate the effectiveness of the internal control system.

The high rate of fraud in public officer which board for internal revenue is found to be one can be attributed to lack of sound internal control system and the existence of poor control environment. The internal control system is not even established in some organization and even when established it is not given proper functioning. This is because effective internal control system is very crucial for the existence and sustainability of any organization. Basically, it serves as a check on fraudulent activities of the management and employees in an organization and it brings about way out on likely fraudulent acts in an organization... the researcher observed that board for internal revenue Borno State is engulfed with some irregularities that is why this study aimed at investigating the *Effectiveness of Internal Control System as a Measure for Fraud Prevention in Borno State Board of Internal Revenue*.

Review of Literature

Conceptual Clarification

Internal control is a process designed to provide reasonable assurance regarding the achievement of management's objectives. In addition, internal control is the group of norms, routines and procedures adopted by each Administrative Unit such as routine manual, segregation of duties, determination of attributions and responsibilities, employee training, limitation of access to assets and the limitation of access to computer systems seeking to prevent mistakes, fraud and inefficiency. According to Ravinder, Kumar, Virender and Sharma, (2005), internal control system refers to the whole system of control employed by the management in order to carry on with the business of the enterprise in an orderly and efficient way by having an automatic check and balance overall the transactions. It includes internal check, internal audit and other devices of control. Internal control system assures the management that the information it receives is both reliable and accurate. The system also helps to ensure that assets are secure and management policy is being followed properly. Its efficient working not only guarantees management as to the reliability of accounting information, independent auditors also rely on system of internal control in determining the timing, nature, and extent of the audit work.

Objectives of Internal Control

Internal control is a process affected by the board of directors, senior management and all levels of personnel. It is not solely a procedure or policy that is performed at a certain point in time, but rather it is continually operating at all levels within the bank. The board of directors and senior management are responsible for establishing the appropriate culture to facilitate an effective internal control process and for monitoring its effectiveness on an ongoing basis; however, each individual within an organization must participate in the process. The main objectives of the internal control process can be categorized as follows:

1. ***Performance objectives (Efficiency and effectiveness of activities):*** Performance objectives for internal controls pertain to the effectiveness and efficiency of the bank in using its assets and other resources and protecting the bank from loss. The internal control process seeks to ensure that personnel throughout the organization are working to achieve its goals with efficiency and integrity, without unintended or excessive cost or placing other interests (such as an employee's, vendor's or customer's interest) before those of the bank.
2. ***Information objectives (reliability, completeness and timeliness of financial and management information):*** Information objectives address the preparation of timely, reliable, relevant reports needed for decision-making within the banking organization. They also address the need for reliable annual accounts, other financial statements and other financial-related disclosures and reports to shareholders, supervisors, and other external parties. The information received by management, the board of directors, shareholders and supervisors should be of sufficient quality and integrity that recipients can rely on the information in making decisions. The term reliable, as it relates to financial statements, refers to the preparation of statements that are presented fairly and based on comprehensive and well-defined accounting principles and rules.
3. ***Compliance Objectives (Compliance with applicable laws and regulations):*** Compliance objectives ensure that all banking business complies with applicable laws and regulations, supervisory requirements, and the organization's policies and procedures. This

objective must be met in order to protect the bank's franchise and reputation. (Basle Committee for Banking Supervision, September 1998).

Forms of Internal Control

The definition of internal control given by the American Institute of Certified Public Accountants (AICPA), indicates that internal control goes beyond the accounting functions of the organization and incorporates both accounting and administrative controls.

- i. **Accounting Controls** - According to the first part of the said definition, accounting control concerns the controls related to the accounting system that is checking transactions as per the prescribed procedures and safeguarding the assets. Accounting control comprises of budgeting control, standard control and deviation analysis, internal check, internal audit, bank reconciliation and self-balancing ledgers etc.
- ii. **Administrative Control** - The last phrase of the definition "Operational efficiency and encourage adherence to prescribe managerial policies", indicates towards administrative control. administrative control comprises of time studies, motion studies, quality control, performance appraisal and statistical analysis etc.

Principles of Good Internal Control

- i. A well-designed accounting system should be in operation. Financial and accounting operations must be separated, that is, handling of cash and the recording of the movement thereof should be done by different persons.
- ii. Responsibility for the performance of the job must be clearly stated so that there remains no room for doubt or confusion subsequently. To achieve this clear-cut and well-conceived organization structure should be established.
- iii. Too much confidence should not be pinned in one individual. Nearly all frauds are committed by 'trusted' officials are employees. It is interesting to note that frauds have acquired owing to their being trusted.
- iv. Rotation principle relating to transfer of an employee from one job to another should be the inflexible guiding rule. This is

effective safeguard against collusion and is recognized as an important canon of sound organization.

- v. Mechanization of the work wherever feasible and practicable, should be resorted to. Mechanical devices such as cash register, recording time clocks, calculation machines, etc should be introduced.
- vi. The work should be so arranged that work done by one employee could be promptly checked by another independent employee such continuous and constant checking stimulates moral control and also the error and the frauds cannot go undetected.
- vii. The arrangement of the work should be in such a manner that written record of the role played by each employee should be maintained and the work should pass through several hands in a well-defined manner.
- viii. Clear and well-defined rules should be laid down and practically followed relating to dealing of the cash, ordering, receiving and issuing goods etc. Instructions should be in writing in the form of accounting manuals.
- ix. Employees must be in bond so that the tempted employee will be deterred from committing fraud and employer being protected.
- x. Although not a substitute for protective financial internal control, yet existence of an efficient internal auditing staff is an important element of an effective internal control system (Ravinder Kumar, Virender Sharma, 2005).

Importance of Internal Control System

The existence of an efficient system of internal control can be of great help to the management as well as to the auditor because it offers the following: 1. Assures a high degree of accuracy and reliability of all the financial and operating information management receives; 2. Minimizes occurrence frauds and errors or any other irregularity, if not eliminates completely; 3. Safeguard assets against any misuse; 4. Promotes operational efficiency and prevent wastages; 5. Judges operating efficiency and highlights weaknesses and 6. Above all encourages adherence to the established managerial policies.

Basic Components of Internal Control System

The internal control system consists of five closely related components. Although these components apply to all companies, the way they are implemented will vary depending on the size and the business sector of companies. They are; control environment, risk assessment, control activities, information and communication, monitoring of controls (Internal Control Reference, AMF 2004)

1. **Control environment:** This element is the underlying foundation for all of the other elements of an internal control system. The control environment is indicative of the overall awareness of both a bank's board and management - and their attitude as well - in assigning an adequate level of importance to the control activities. The control environment reflects the overall contributions by a bank's board and management towards the necessary discipline and the appropriate structure for ensuring proper internal controls over a bank's operations. The essential components of an effective control environment include: personnel integrity and ethical values; dedication to staff competence and skill enhancement; participation of board members and board committees; positive influence of management's commitment; organizational structure that enables the management of the bank; authority and responsibility that is clearly defined and effective policies and practices for human resources.
2. **Risk Assessment:** Is the umbrella term for the process and methodology by which a bank's board and management identify and analyze the various kinds of risk that might prevent a bank from realizing its budgetary objectives. Risk assessment is intended to assist in determining exactly what kinds of risks are present, how to manage those risks identified and what kinds of controls are needed to be established.
3. **Control Activities:** Control activities are all of the policies and procedures that have been instituted by the bank to direct bank staff in carrying out the directives of both board and management. All of these activities help the board and management control risks that could adversely affect the bank's operations and results. The policies that direct these control activities should also provide that

the bank personnel who are responsible for these control activities do not evaluate their own work in these areas.

4. **Information and Communication:** Capture and impart pertinent and timely information in a form that enables the board, management, and employees to carry out their responsibilities. Accounting systems are the methods and records that identify, assemble, analyze, classify, record, and report a bank's transactions. Information and communication systems enable all personnel to understand their roles in the control system, how their roles relate to others, and their accountability. Information systems produce reports on operations, finance, and compliance that enable management and the board to run the bank.
5. **Monitoring:** Self-assessment or monitoring is intended to provide an oversight function in assessing the performance of the bank's control systems. Bank directors and management constantly review internal controls for their proper functioning and for modifications to the internal control systems when deemed necessary. Self-assessment is only one approach to a basic review of these internal control activities; however, self-assessment cannot be the only approach to assessment of the effectiveness of a bank's internal control systems. Internal and external audits provide a more independent approach to the assessment of the bank's internal control function. Supervisory examinations additionally provide another layer of assessment of these controls. (A Guide for Directors and Managers of Liberian Banks, March 2005)

Internal Control Activity

Internal control activity refers to the policies and procedures established by an organization to aid the directives issued by management in ensuring that activities are carried out in compliance with the established standards. It includes both manual and automated tools that help in prevention or reduction of risks that can affect accomplishments of organisation objectives (Yee, 2015).

According to Kamau, 2014; Aramide and Bashir, (2015), control activity is categorized into three, namely; preventive, detective and corrective. The preventive control is essentially to prevent errors and fraud from occurring and it includes the following control elements; authorization

and approval procedures, segregation of duties, control over access to resources and records. The detective control is to detect errors and fraud that have occurred. It includes such control elements as verifications/reconciliation, review of operating performance and supervision. The corrective controls help to identify and reduce or eliminate the causes of a problem that resulted into errors, omission, misstatement and any malicious act from happening. It is an adequate balance between detective and preventive controls necessary to complement control activities in order to achieve the organizational objectives. Errors that failed to be prevented and detected are corrected through corrective controls.

Internal control activity it is being done to ensure that employees work provides checks on others and effective checks and balances to exist so that corrective action is taken to address weaknesses identified. It restrict access to resources and records of the organization to only authorized individuals who can account for the custody and/or use of the resources, transaction be verified before and after processing and also it ensures that actual accomplishment should meet the established standard or objectives (Hannah, 2013; Wakiriba, Ngahu, and Wagoki, 2014; Yee, 2015).

Accountability and Transparency

Accountability draws its origin from financial accounting which is focused on checking the way the books are kept and how the money is spent (Rabrenovic 2007). Accountability refers to the manner how resources are used in relation to objectives (Mohammed, 2015). It involves the verification of legality and regularity of financial accounts to ensure that the rules and regulations are followed. Apaza (2011) asserted that financial accountability is concern with tracking and reporting on allocation, disbursement and utilization of financial resources, using the tools of auditing, budgeting and accounting.

On the other hand, transparency encompasses rules such as rule of law, accountability, public participation and deliberative democracy. Therefore, for information or process to be transparent, is for it to be open and available for examination and scrutiny manner. The degree of transparency depends upon which records, proceedings, or data are available and which are not available (Bauhr and Grimmes, 2012; Mohammed, 2015). Furthermore, the transparency laws provides that information on financial dealings of government should be managed and

published in time and to be accurate, complete, up to date, reliable and made available in sufficient time to permit analysis, evaluation by relevant stakeholders (Transparency and Accountability Initiative, 2016).

In a study conducted by Ahmad, Nifa, Peter, & Pwagusadi, (2017), on Effect of Internal Control Activity on Financial Accountability and Transparency in Local Government Areas of Borno State. The study revealed that internal control system is not very effective in the Local Government Areas of Borno State, hence, it has no significant impact on the financial accountability and transparency. The study therefore recommends that Borno State Government through the Ministry of Local Government Affairs in conjunction with the Local Governments' Management should revisit the policies and procedures of internal control activity through reforms in order to strengthen the effectiveness in financial accountability and transparency of the Local Government Areas in the State.

Methodology

The study used descriptive statistics such simple percentage and chi-square, both primary and secondary source of data was used for the study. Data was generated through a questionnaire. A sample of sixty respondents were used. Random sampling techniques was employed.

Chi-square distribution

The chi-square test is given by the formula

$$X^2 = \frac{\sum (O - E)^2}{E}$$

Where

\sum = the summation

E = expected frequency

O = observed frequency

X = chi-square

Degree of freedom = $(r - 1)(k - 1)$

Where r = No of row

K = No of column

Level of significance = 0.05

RESULTS AND DISCUSSION

Table I: Basic control process and standard

Option	Frequency	Percentage
Adequately	35	87.5
Not adequately	3	7.5
Undecided	2	5
Total	40	100%

The table above focus on the stated control process which will lead to improvement of standard in the organization. Out of the forty respondents in gathered that thirty five (35) adequate agree which constitute 87.8%). On the other hand not adequately falls (7.5%), which has three (3) respondents. But undecided staff of the organization respect of their question is only five percent (5%).

Table II: requirement for effective control to meet the organizational objective and standard.

Option	Frequency	Percentage
Very effective	28	70
Effective	12	30
Ineffective	0	0
Total	40	100%

This table demonstrate the view of the staff toward the effectiveness of control in meeting the organization objective and standard, it has shown that most respondent were of view that it will meet the respondent effective by twenty eight (28) respondents which give seventy (70%) and on the other side viewed it effective by twelve (12) respondents which has thirty percent (30%).

Chi-square distribution

The chi-square test is given by the formular

$$X^2 = \frac{\sum (O - E)^2}{E}$$

Where

X= chi-square value

Σ = the summation

E= expected frequency

O= observed frequency

Degree of freedom = $(r - 1)(k - 1)$

Where r = No of row

K = No of column

Level of significance = 0.05

Chi-square table

0	E	O – E	$(O - E)^2$	$(O - E)^2/E$
35	30.88	4.12	16.997	0.5495
3	0.31	2.69	7.24	32.3548
2	0.1	2.68	2.68	8.8125
28	24.7	3.3	10.89	0.4409
12	1.24	10.76	115.78	93.3690
0	0	0	0	0

Level of significance = 0.05

Degree DF = $(K - 1)(r - 1)$

If the calculated value is greater than the table value, then the null hypothesis should be rejected. If no on the other hand, the calculated value is less the table value than null hypothesis should be accepted.

Findings

Control has played vital roles of accountability and fraudulence on generation of revenue, most of the staff accepts that control has a direct bearing on their roles which effective control had change their attitudes positively. However, there is a significance relationship between control and management because all efforts of controlling are geared towards staff so as to act upon by taking a decision on revenue generation and other related roles. The boards/management has been able to progress more through its ability to monitor closely on performance of its staff and other necessitates on planning, controlling accordingly.

Conclusion

It is necessary to add the control that is part of measurement activities under taken to ensure that outcome is consistent with planned organizational objective. The board has its goals and standards as contained

in the rules and regulation. The management monitors the performance and results of the staff and eventually takes corrective measures.

Recommendations

Based on the findings on the control as an effective tool of management, the following are hereby recommended:

1. The board chairman should adopt additional measures to generate revenue so as the staff be developed through proper usage of the revenue.
2. Proper channels of communication should be adopted to inform the staff with new means and information.
3. The Board should check the influence from non-staff within and outside the board premises with the activities of the organisation.

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