

# **An Investigation into the Internal Control System in the Banking Industry**

## **(A Study of Some Selected Banks in Asaba, Delta State)**

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### **Abstract**

This research examines and investigates the internal control system in the banking industry. The study examined the major types of control which include management oversight and the control culture, risk recognition and assessment. Samples were drawn using simple random sampling techniques and they included First bank Plc and Fidelity Bank Plc and 80 personnel's from the banks. The researcher used chi-square as a statistical tool to analyze the data obtained from the samples. The finding revealed that managerial supervision and inspector of activities in banking industry has not been carried out adequately to expose the irregularities and misappropriations. The researcher recommended that management supervision and inspection should as a matter of necessity be carried out regularly to ensure effective and affective performance by staff. There should be segregation of duty and authority to avoid over centralization, clerical errors and international manipulations.

### **INTRODUCTION**

A system of effective internal control is a critical component of bank management and a foundation for the safe and sound operation of banking industry. An investigation into the internal controls in banks aim at identifying the weaknesses in the internal control system and to offer guidance on how to present inefficiency, wasteful assets and eradication of fraud and prevention of unreliable information in banking industry. The prime aim of most business endeavours is not only to render service but also to make reasonable returns to the share holders. The business of banking is not different from other business, but in many ways, it calls for special dedication as the stock in trade of this type of business is money. Because of this special situation the management of bank is placed in fiduciary position that calls for integrity, honesty and trust of all people that are engaged in the business. A system of internal control consists of all measures employed by an organization for the purpose of:

- i. Safe guarding its resources against waste, fraud and inefficiency.
- ii. Promoting accuracy and reliability in accounting and operating data.
- iii. Encouraging and measuring compliance with organizational policy.
- iv. Judging the efficiency of operation in all decision of the business.

It is imperative to establish a well designed and reliable accounting system to aid decision making process, dictate fraud and errors. However, the system of internal control is much more than a device for the prevention of fraud and dictation of accidental errors in the accounting process, but also as a whole management, internal control embraced internal check and balance established by management.

Internal control system defers from organization to organization. It is the responsibility of management to decide the extent to which the control system is appropriate to the organization.

- i. The nature of the business.
- ii. The size of the organization.
- iii. The volume of transaction carried out by the organization.

Therefore, internal control system should not be sought as an end itself, but as basis ensuring that the organization goal are achieved. (European monetary institute internal control system of credit institution, 2007).

### **OBJECTIVE OF THE STUDY**

The broad objective of the study was to examine those internal control problems and ascertain the major reason for the weakness in internal control system of banks (Mill Champ, 2008). Other objectives include the following:

1. To ascertain the extent of compliance to the laid down policies and procedures by management.
2. To verify whether the right caliber of qualified staff are being recruited in banking industry.
3. To find out if payments and loans given out are duly approved and backed up with adequate security and collateral.
4. To verify if proper managerial supervision and inspection are being carried out in banking industry.

## REVIEW OF RELATED LITERATURE

Internal control is such a complex system that is so interwoven with control activities as internal audit and information system. These three activities must be undertaken by management in ensuring effectiveness and efficiency in the management of a financial institution. Internal auditor play very essential role in internal control system through the defection and prevention of fraud, especially when they are functioning independently.

Meig et al (2009), confirms this fact by acknowledging that internal auditors provide a higher level of internal control; they design and carry out audit procedures that test the efficiency of virtually all aspect of company's operations. In other words every organization should have plans of activities and all of the co-ordinate methods; measure adopted within a business to safeguard its assets, check on accuracy and reliability of its accounting data, promote operational efficiency and encourage adherence to prescribed management policies, (American Institute of Certified Public Accountants (2006).

## THEORETICAL REVIEW

For many years, the study and practice of internal control centered on the pure mechanics of conducting an audit, concentrating on how to perform audit. Thus, questions were explicitly raised about why certain procedures were carried out. The sixth attempt (and some say the best) come from American academics, Meutz, R, K. and H. A. Sharaf, (2006) published the philosophy of internal control system. This was an important development as it helped gain some measure of management acceptance for internal control. Meutz, R.K. and H. A. Sharaf drew from established fields of study as philosophy the sciences and law in producing a theory which helped to explain much of the accepted practice in internal control. Their theory also helped to highlight areas of practice that did not stand up to critical review, notwithstanding that such were generally accepted.

In the UK more, than two years later, Vende-Van (2008) built on and adapted the work of Meutz, R, K. and H. A. Sharaf to produces his own theory in company internal control. In a related development, Otley (2010) developed a written philosophy and principle of internal control on both Meutz, R, K. and H. A. Sharaf Vandervan the accounting establishment has shown little interest in, or enthusiasm for pursuing theoretical line of enquiry. This is in contrast to the financial reporting field where over the years millions of dollars have been invested in seeking what some have called the holy grail of accounting. These endeavours have produced a framework for the preparation and presentation of financial statement published by the International Accounting Standards Board. (IASB), and similar statements by national standards-settlers, such as the statement of principles by the Accounting Standards Board (A.S.B.) of the UK without a theoretical basis, internal control the application of a series of procedures, more akin to the practice of a trade, rather than a policy. According to Otley (2010) theory of philosophy and principles of internal control, five (5) assumptions were considered:

- i. The subject matter of internal control can be verified by collection of evidence
- ii. The purpose of internal control sufficiently clear that its results can be communicated clearly.
- iii. The subject matter is too remote, too complex or too important to accept without an internal control.
- iv. Standards of accountability, performance, etc can be set and actual performance can be measured against these standards.
- v. The internal control must be complied with independence and without constraints.

## EMPIRICAL REVIEW

This is in relation to or based on experience and observation rather than theory or principle. This section of the study therefore will be based on experience and observations of various study carried out by different individual. Some Banks have well developed internal control system department, while others do not. According to Ejiofor (2007) in a study carried out on compliance of management to policies and procedures in Banks. He based his study on Bank with proper internal control system According to him in the study, two hundred (200) questionnaires were sent out to some banks in Ibadan, Ilorin, Lagos and Benin. The basis for the selection of these cities was by obtaining various banks existing in the Urban Centers in order to make sure that they study covers all banks adequately. The objectives of the study according to Ejiofor (2007) were that:

- i. To verify whether internal control system exist in the banks.
- ii. Obtaining information to identify whether adequate compliance to management policies and procedure exist in Bank.

Two sets of Hypothesis were postulated in his study which was subjected to test by the aid of correlation analysis. The result of the findings according to Ejiofor (2007). Shows that most policies and procedures were not strictly complied with by management his result showed that 152 respondents representing 73% of the total responses attest to it.

In yet another study done by Otusumi (2007) in a study carried out to investigate the impact of regular balancing of Account in Nigerian Banks. The methodology adopted in his investigation was the evaluative and expository system. Secondary data contained in books financial statements of Banks, accounting standards, laws and

regulations and various other documents were source of information. Investigations were carried out on Oceanic Bank Plc, it is the belief of the researcher that what is obtain in First Bank of Nigeria plc also applies to many other bank.

Two hypotheses were tested:

- H<sub>1</sub> Regular balancing of the account affects the internal control system.
- H<sub>2</sub> Recruiting unqualified staff affects proper balancing of account.

The analysis of findings in the study. Completed questionnaires for the study were collected from sixty-five management staff the response rates represent 1.25% of the total sample. The sample size for testing therefore, were N = 65, N = 65 for the hypothesis

N = Number of sample. The study two hypotheses were subjected to test while the chi-square test statistics was employed. The result of the chi-square calculated for hypothesis is 6.538 with as its degree of freedom (DF=5) and Asymp. Significance of 257. The level of significance = 0.5. The tabulated chi-square ( $X^2_c$ ) is 11.07. Since  $X^2_c < X^2_t$ , the alternate hypothesis is hereby accepted that the regular balancing of accounts affects the internal control system and the null rejected. The study hypothesis II the respondents agree that recruiting unqualified staff affect proper balancing of account with a mean score of 4.64 and standard deviation of 1.356. The  $X^2$  calculated was 35.892 at degree of freedom (df=5) and Osymp. Significance, since the  $X^2_c > X^2_t$  therefore, the alternative hypothesis is accepted that recruiting unqualified staff affects proper balancing of account.

### POPULATION AND SAMPLE SIZE:

The first step is selecting the study subject is to define the target population. Target population is the entire collection to which the findings of the study are applicable. Target population is the entire group of items which the researcher wishes to study and also plans to generalize. For this study, the population id the entire senior and Management staff of First Bank Plc and Fidelity Bank Plc.

On the other hand, the sample size comprise of hundred (100) respondents which are comprised of internal department of the two banks.

### TECHNIQUES OF DATA ANALYSIS

In the course of this study, data collected are descriptively interpreted. The research proposes to take his decision based on the use of simple percentage and chi-square to test the hypothesis. The degree of frequency at which each option occurs in response to the questionnaire represents the percentage of that option. The option with the highest percentage is finally accepted to the option adopted by the generality of the staff in banking industry.

### ANALYSIS OF DATA AND INTERPRETATION

Data analysis and interpretation is very vital and useful to any research work, it is one of the most important section in project research. According to Oshevire .S. Ofotokun, (2008). It aids comprehension and give shape to the raw data collected from the organization under study. This session is designed to present and analyses responses gotten from the respondents through the use of questionnaires with a view to testing the hypothesis formulated from the stated problem. A total of 100 questionnaires were administered out of which 80 were retrieved and the remaining 20 were not returned by respondents.

In accordance to the research on internal control system of banks carried out. Set out below are the summary and percentages of response to the questionnaires.

### TEST OF HYPOTHESIS ONE

Alternative hypothesis (H1) proper managerial supervision and inspection still carried out in banking industry.

Foi	Fei	Foi-fei	(foi-fei) <sup>2</sup>	(foi-fei) <sup>2</sup> Fei
4	1.95	2.05	4.20	2.15
3	3.9	0.9	0.81	0.21
2	4.35	2.35	5.52	1.27
3	1.8	1.2	1.44	0.8
2	2.93	0.93	0.86	0.29
5	5.85	0.85	0.72	0.12
9	6.63	2.47	6.10	0.93
2	2.7	0.7	0.49	0.18
5	6.83	1.83	3.35	0.49
18	15.23	2.77	7.67	0.50
4	6.3	2.3	5.29	0.84
2	1.3	0.7	0.49	0.38
3	2.6	0.4	0.16	0.06
0	2.9	2.9	8.41	2.9
3	1.2	1.8	3.24	2.7

$X^2c = 13.95$   
 Degree of freedom (df) = (Row-1)  
 (column 1)  
 $(4 \times 1) - (4 - 1)$   
 $4 \times 3 = 12$   
 from the chi-square table the value of  
 $(x^2t) = 16.92$   
 $(X^2c) = 13.95$

**DECISION**

The chi-square calculated value

$(X^2c) = 13.95$  is less than table value.

The alternative hypothesis is therefore rejected and nil accepted this means that proper managerial supervision and inspection is not effectively and adequately carried out in banking industry.

**TEST OF HYPOTHESIS TWO**

Alternative hypothesis (Hi) payments and loads given out are duly approved authorized and backed up with adequate collateral.

Foi	Fei	Foi-fei	(foi-fei) <sup>2</sup>	(foi-fei) <sup>2</sup> / Fei
6	2.93	3.07	9.42	3.07
4	5.85	1.85	3.42	0.58
6	6.53	0.53	0.28	0.04
2	2.7	0.7	0.49	0.18
2	1.95	0.05	0.00	0
6	3.9	2.1	4.41	1.13
2	4.35	2.35	5.52	1.27
2	1.8	0.2	0.04	0.02
0	0.81	0.81	0.66	0.81
3	1.63	1.37	1.88	1.15
2	1.81	0.19	0.04	0.02
4	4.06	0.06	0.00	0.75
8	8.13	0.13	0.02	0.00
9	9.06	0.06	0.00	0
4	3.75	0.25	0.06	0.02
1	3.25	2.25	5.06	1.56
5	6.5	1.5	2.25	0.35
10	7.25	2.75	7.56	1.04
4	3	1	1	0.33

$X^2c = 12.32$   
 Degree of freedom (df) = Row x (column - 1)  
 $(4 - 1) \times (5 - 1)$   
 $3 \times 4 = 12$   
 From the chi-square table the significance 21.03  
 $X^2t = 21.03$   
 $X^2c = 12.32$

**DECISION**

Since the calculated chi-square value  $(X^2c) = 12.32$  is less than the table chi-square value  $(X^2t) = 21.03$ . The decision is therefore to accept the Null hypothesis (Ho) which says that payment and loans granted are not duly approved authorized and backed-up with adequate collateral.

### TEST OF HYPOTHESIS THREE

Alternative hypothesis (H<sub>i</sub>) management complied with laid-down policies and procedures in the banking industry.

Foi	Fei	Foi-fei	(foi-fei) <sup>2</sup>	(foi-fei) <sup>2</sup> Fei
0	1.3	1.3	1.69	1.3
5	2.6	2.4	5.76	2.22
3	2.9	0.1	0.01	0.00
0	1.2	1.2	1.44	1.15
3	1.63	1.37	1.88	1.15
2	3.25	1.25	1.56	0.48
3	3.63	0.25	0.06	0.02
2	1.5	0.5	0.25	0.17
2	1.63	0.37	0.14	0.09
3	3.25	0.25	0.06	0.02
2	3.63	1.63	2.66	0.75
3	1.5	1.5	2.25	1.5
8	6.5	1.5	2.25	0.35
12	13	1	1	0.8
15	14.5	0.5	0.25	0.02
5	6	1	1	0.17
0	1.95	1.95	3.80	1.95
4	3.9	0.1	0.01	0.00
2	1.8	0.2	0.04	0.02

$$X^2_c = 12.1$$

Degree of freedom (df) = Row X (Column - 1)

$$(4 - 1) (5 - 1) \\ 3 \times 4 = 12$$

From the chi-square table the value of ( $X^2 + C$ ) at 5% level of significance is 21.03

$$X^2_t = 21.03$$

$$X^2_c = 12.10$$

### DECISION RULE

From the above test the calculated chi-square value ( $X^2_c$ ) 12.1 is less than the tabulated chi-square value  $X^2_t = 21.03$ . We therefore accept the Null Hypothesis which says that the policies, rules and regulations of the banks as laid-down by management are being passed and not complied with strictly.

### TEST OF HYPOTHESIS FOUR

Alternative hypothesis (H<sub>i</sub>) the right caliber of persons are being recruited in banking industry.

Fo <sub>1</sub>	Fe <sub>1</sub>	Fo <sub>1</sub> - Fe <sub>1</sub>	(Fo <sub>1</sub> - Fe <sub>1</sub> )	(Fo <sub>1</sub> - Fe <sub>1</sub> ) <sup>2</sup> Fe
0	3.25	3.25	10.56	3.25
8	6.5	1.5	2.25	0.35
8	7.25	0.75	0.56	0.08
4	3	1	1	0.33
9	5.69	3.31	10.96	1.93
12	11.38	0.62	0.38	0.03
14	12.69	1.31	1.72	0.14
0	5.25	5.25	27.56	5.25
2	0.81	1.19	1.42	1.75
0	1.63	1.63	2.66	1.63
0	1.81	1.81	3.28	1.81
3	0.75	2.25	5.06	6.75
0	2.44	2.44	6.00	2.46
3	4.88	1.88	3.53	0.72
7	5.44	1.56	3.43	0.45
5	2.25	2.75	7.56	3.36
2	0.81	1.19	1.42	1.75
3	1.63	1.37	1.88	1.15
0	1.81	1.81	3.28	1.81
0	0.75	0.75	0.56	0.75
			$X^2_c =$	35.75

$$\text{Degree of freedom (df)} = (\text{Row}-1) (\text{Column} - 1)$$
$$(4 - 1) (5 - 1)$$
$$3 \times 4 = 12$$

From the chi-square table the value of  $X^2_{t+C}$  at 5% level of significance is 21.03  
 $X^2_t = 21.03$   
 $X^2_c = 35.75$

### DECISION

As shown in the chi-square calculation, the calculated chi-square value ( $X^2_c$ ) = 35.75 is greater than table chi-square value ( $X^2_t$ ) = 21.03.

The alternative hypothesis ( $H_1$ ) is accepted which say that the right caliber of person are being recruited in banking industry.

### DISCUSSION OF FINDINGS

Based on the data analysis in chapter (IV) which examined the major objective of the research. To ascertain the reason for the weakness in the internal control system of banks which has contributed to the banks distress in Nigeria. The findings can be summarized as follows:

Firstly, the police and procedures laid down by management were not strictly being complied with. It suffice to say there were bye-pass of polices and procedures by staffs who sometimes use their own discretion rather than adhere strictly to rules.

This can be affirmed from 52 respondents representing 65% of the total responses who attested to it.

Secondly the research revealed that payment loans granted were not duly approve and backed up with adequate collateral which can be affirmed from 45 % respondents representing 56% of the total responses attesting to it.

Thirdly it was revealed that the right of caliber of persons were being recruited into banking industry as disclosed by 60 respondents representing 75% of the total responses in agreement to the view.

Fourthly managerial supervision and inspector of activities in banking industry has not been carried out adequately to expose the irregularities and misappropriations. As revealed by 50 respondents representing 62.5%of the total respondents to the questionnaire administered.

### CONCLUSION

The persistent increases in the number of distressed banks in Nigeria which has partly been attributed to internal control weaknesses demands that urgent review and implementation of effective and efficient internal control system be carried out. The management and especially the inspection department should evolve preventive inspection to minimize the possibility of fraud been perpetrated. However, experience has shown that even in the most secured homes accidents still happen, internal control systems should therefore not be sought as an end to itself, but should be backed up with adequate staff motivation and moral strengthening to reduce and contain the high acquisition instruct which leads to fraud.

### RECOMMENDATION

Based on the findings and in consideration of the objectives of internal control, the following suggestion on how to actualize the objectives minimizes fraud and other irregularities in banking industry are as follows:

Firstly, Management supervision and inspection should as a matter of necessity is carried out regularly to ensure effective and affective performance by staff.

Secondly, the policy makers of banks (management) should ensure and enforce strict compliance to laid-down rules and regulations and were a staff user of his or her own discretion, appropriate penalty should be meted out to the culprit.

Thirdly, with regard to recruitment of staffs management should evolve a sound employment policy to ensure that the right caliber of person are employment into banking industry because the success of any organization is determined by the integrity and capability of it's staffs in operation.

Fourthly, loans should only be granted were adequate collateral is given and such collateral should be verified were applicable to ascertain it existence and adequately.

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