Effect of Internal Control on Performance of Cooperatives in Nigeria: A Case Study of CSM Cooperative Society Abuja, Nigeria

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Abstract: This paper examined the impact of internal control on operational performance in CSM Cooperative Society. Cooperatives have become a good source of affordable finance for both low and medium income group all over the world. As critically important as cooperatives are to the growth and development of Nigeria vide the provision of funds for business and investment hence employment, they may not survive in the long term if they are not properly managed. The presence of an effective and efficient internal control system will go a long way in aiding the cooperatives to manage their operations well. The study investigated internal control impact on performance of cooperatives in Abuja. The target population was the Executive Management Committee, Senior Management, Senior and Junior staff of CSM Cooperative, Abuja, Nigeria. Survey method was employed, and questionnaires were distributed to all the categories of employees identified. Multiple-Linear Regression was used to analyze the data collected vide a 5 point Likert-scale questionnaire. The study revealed that the relationship between internal control (monitoring, control environment, control activities) and performance of cooperatives is not significant. It was recommended that cooperatives should ensure that they seek for and implement measures that increase profitability in addition to instituting a good and functioning system of internal control. The study also recommended that future research should add the two variables of internal control not covered in this research and also use a sample number of cooperatives in Abuja.

Keywords: Internal Control, Cooperatives, Control Environment, Performance, Control Activities, Monitoring

1. Introduction

It is now a common knowledge that cooperative societies have become a major source of financing aside from the regular financial institutions. The practice of forming cooperative societies by various groups to mediate in making finances available to members, especially to those who are financially excluded is a fact that is well-known in our society [20]. The importance of cooperatives in economic empowerment and poverty reduction cannot be overemphasized hence the need for effective management of such organizations [16]. Businesses need to deliberately institute internal control measures aimed at achieving their objective otherwise they stand the risk of being inefficient and may even go out of business. Corporate failures, especially in

the developed world have called for firms to be more proactive in implementing a robust internal control system as a check to the excesses of business managers. The collapse of big companies like Leeman Brothers and Enron have confirmed that too big to fail is a delusion [19].

Implementation of a functional system of internal control would normally enhance reliable financial reporting, operational efficiency and compliance with regulations and laws [13]. Performance is viewed as profit generation, survival, effective and efficient operation and ability to effectively react to both internal and external environment [14].

Cooperative societies will usually not expend resources in

setting up a good internal control system due to size, lack of funds, knowledge, etc. The absence of an efficient and effective internal control system, amongst many other reasons, could affect the performance of businesses. It is against this backdrop that the research set out to investigate the effect of internal control on the operational performance of cooperatives in Abuja, Nigeria.

1.1. Statement of Problem

Cooperative societies are critically important to the growth and development of Nigeria because they provide financing for members to start or support an existing Small and Medium Enterprise (SME), acquire assets like houses, etc. It is because of the important role that cooperatives play in providing finances for its mostly poor members who may not meet the stringent requirements to access loans from the regular financial institutions that various stakeholders like the federal government, through its many agencies including the Bank of Industry (BOI), Nigeria Export-Import Bank (NEXIM) and Central Bank of Nigeria (CBN) have provided financial and non-financial support in form of loans, capacity development, etc. to cooperatives. The numerous assistance and support provided for these cooperatives will not achieve the purpose for which they were provided if the cooperatives do not have effective and efficient internal control system, amongst others, to aid their performance. It is common knowledge that many cooperatives are poorly managed hence leading to poor performance and inability to effectively achieve the objective for which they were set up.

However, as far as the researcher is aware, no empirical study has investigated the effect of internal control on the performance of cooperative societies. The few studies that have focused on cooperatives in Nigeria examined the commitment of members in cooperative organizations [18], the impact of cooperative membership on rural income generation [1] and relevance of entrepreneurial orientation strategy [17]. This study intends to bridge the gap by investigating the impact of internal control on performance of cooperatives in Abuja, Nigeria.

1.2. Research Objectives

Generally, this research's objective is to investigate how internal control impacts the performance of cooperatives in Abuja, Nigeria. Specifically, the objectives of the study are.
1. To assess how control environment impacts the performance of cooperatives.
2. To examine the influence of control activities on Cooperative Societies' performance.
3. To investigate the effect of monitoring element of internal control system on the performance of Cooperative Societies.

1.3. Research Questions

This study seeks to offer responses to the questions that follow.
1. What is the connection between control environment

component of internal control and operational performance of cooperatives?
2. Does control activities component of internal control system have any effect on the operational performance of cooperatives?
3. What effect does monitoring has on the operational performance of cooperative?

1.4. Statement of Hypotheses

To answer the research questions, the study used the following hypotheses.
1. Ho1: no significant relationship exists between control environment and operational performance of cooperatives.
2. Ho2: the relationship between control activities component of internal control system and operational performance is not significant in cooperatives.
3. Ho3: monitoring component of internal control and operational performance of cooperatives are not significantly related.

2. Literature Review

2.1. Conceptual Framework

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defined Internal control as a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance [4]. The implementation of an effective system of internal control is a broad concept that covers the entire range of procedures, methods and controls established by an organization to increase the probability to achieve its business goals [9].

Internal control system is built with the objectives of enhancing operational efficiency and effectiveness. The system serves to ensure that activities conform with operating laws and regulations and the enhancement of a reliable financial reporting function [7]. For an internal control system to be adjudged as being effective, an assessment will need to be done as to whether the elements of internal control - Risk Assessment, Control Environment, Information and Communication, Control Activities and Monitoring - are existing and effective. This study, like that of [13], considered only three components of internal control system: control environment, control activities and monitoring of controls.

Components of Internal Control

Control environment

Control environment provide the foundation for successful implementation of internal control and it includes tone of top management, integrity, the value system of the organization, communication relating to ethical behaviour, etc. [12]. It deals with the understanding of senior management on how to control the business, its attitude to problems, approach to problem solving and viewpoint regarding how vital moral

values are [7].

Control activities

Control activities refer to those tools which aid in mitigating or reducing the numerous risks that can hinder an organization from effectively achieving its set objectives and targets. It is Management's responsibility to ensure that control activities are established with a view to effectively and efficiently achieve the company's objectives and mission [19]. These could be either preventive or detective and may cover a whole range of activities (manual or automated) including authorizations/approvals, restriction of physical access, reconciliations, verifications, and review of performance [5].

Monitoring of controls

In order to determine whether the elements of internal control are not just present but are properly functioning, the management would need to carry out an evaluation of the controls [6]. When ongoing assessments are built into the different levels of the business processes, information would be timely provided. The findings are benchmarked against the standard set by management, regulators, board of directors and standard-setting bodies, and any deficiency observed is brought to the attention of management and the board as appropriate [6]. For an organization to achieve the objectives mentioned above, it will need to ensure it continuously observe or monitor the internal control system in order to ensure deviations are handled appropriately [7]. The best designed internal control system is bound to end up being ineffective if it is not monitored periodically by competent hands who make adequate recommendations for improvement.

Performance

The ability of an organization to effectively and efficiently use resources at its disposal to achieve its goals and objectives is referred to as performance [2]. It is impossible for a firm to achieve its goals and objectives unless it effectively and efficiently performs its operations [20]. In this study, operational efficiency is used as the proxy for measuring performance. By operational efficiency, we are referring to a firm's ability to as much as possible, reduce waste in materials, time and effort and still deliver products or services that are of very high quality.

2.2. Empirical Review

Umar and Dikko conducted a research to determine the relationship between internal control and performance in commercial banks in Nigeria [20]. The research revealed that risk assessment, control environment, monitoring and control activities have a positive and significant relationship with bank performance while the last component (information & communication) have an insignificant positive relationship with bank performance.

A study by [10] to examine the effect of internal control on performance of pharmaceutical firms in Vietnam found that information & communication and monitoring are the elements with the strongest impact on performance.

The research by [13] that investigated the relationship between control activities, monitoring and control environment and financial performance in SMEs in Kisumu city, Kenya found that a significant positive relationship exists between these elements of internal control system and financial performance.

Channar et al examined how each of the five elements and the effectiveness of the system of internal control impacted on the performance of banks from the public sector, private sector and Islamic banks in Hyderabad, India. The study revealed that the relationship was positive and that private banks had the most effective internal control with public banks being the next and Islamic banks had the weakest. The level of performance was high, moderate and low in private, public, and Islamic banks respectively [3].

2.3. Theoretical Framework

This study used Agency theory, a theory expounded by Jensen and Meckling in 1976 to deal with the agency problems that arise from businesses because of an appointed agent not fully representing the interest of the principal. Agency theory is used to explain the existence of mechanism for the resolution of the problems that exist in principal-agent relationships [8]. Implementing a good and proper Internal control system and governance structure would go a long way to protect the shareholders' interests and enhance business performance [11, 15].

3. Methodology

3.1. Research Design

Cross-sectional survey research design was used in this study. The population of study is the entire staff and because of the small number of the staff strength of CSM Cooperative, the entire population of twenty four (24) was used in the study.

3.2. Data Collection

Data for this research was obtained from staff of the cooperative. Questionnaires were distributed to Senior staff, Middle, Senior and Executive Management of the CSM Cooperative. The questionnaire was divided into two sections a) demographic and b) the three components of internal control used in the study. A total of 24 questionnaires were distributed and 17, representing 71% were returned and found to be fit for analysis. The items of internal control and performance were measured on a five-level Likert scale ranging from Strongly Agree, Agree, Neutral, Disagree, and Strongly disagree with 5 being the highest and 1 the lowest. These were used to measure the knowledge and perception of respondents on internal control and performance. Thereafter, the questionnaire responses were analyzed using regression model.

4. Discussion of Findings

This section of the study discusses the results of the regression analysis conducted on the responses obtained from the respondents. For the hypothesis testing, the P-Value

measure was used and benchmarked against a level of significance of 0.05. With 0.05 level of significance, the null hypothesis is rejected, thus concluding that the element of internal control (independent variable) has a statistically significant effect on performance (dependent variable). Otherwise, we accept the null hypothesis and thus conclude that the independent variable does not have a statistically significant effect on the dependent variable.

The study's first objective is to assess how control environment impacts the performance of cooperatives. The results of the regression to test hypothesis Ho1 which states that "no significant relationship exists between control environment and operational performance of cooperatives" is presented below.

SUMMARY OUTPUT								
Regression Statistics								
Multiple R	0.870587498							
R Square	0.757922591							
Adjusted R Square	0.636883887							
Standard Error	1.210693483							
Observations	4							
ANOVA								
	df	*SS*	*MS*	*F*	*Significance F*			
Regression	1	9.17844258	9.17844258	6.261820094	**0.129412502**			
Residual	2	2.93155742	1.46577871					
Total	3	12.11						
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.780912428	0.930723793	0.839037783	0.489754213	-3.223668839	4.785493695	-3.223668839	4.785493695
0	0.693759832	0.277241895	2.502362902	**0.129412502**	-0.499115763	1.886635427	-0.499115763	1.886635427

Figure 1. Control Environment Vs Performance.

From the above table, the P-value of 0.129 is greater than 0.05 and we therefore accept the null hypothesis that no significant relationship exists between control environment and operational performance of cooperatives. This agreed with the findings of [8] and means that control environment component of internal control system does not have significant effect on performance.

The second objective examined the influence of control activities on Cooperative Societies' performance using Ho2 which states that "the relationship between control activities component of internal control system and operational performance is not significant in cooperatives." The results of the regression are as shown in figure 2 below.

SUMMARY OUTPUT								
Regression Statistics								
Multiple R	0.844398437							
R Square	0.713008721							
Adjusted R Square	0.569513082							
Standard Error	1.318230706							
Observations	4							
ANOVA								
	df	*SS*	*MS*	*F*	*Significance F*			
Regression	1	8.634535613	8.634535613	4.968852878	**0.155601563**			
Residual	2	3.475464387	1.737732194					
Total	3	12.11						
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.761367521	1.038405077	0.733208589	0.539726043	-3.70652892	5.229263962	-3.70652892	5.229263962
0	0.701424501	0.314668205	2.229092389	**0.155601563**	-0.652483511	2.055332514	-0.652483511	2.055332514

Figure 2. Control Activities Vs Performance.

Based on the table above, the p-value for control activities is 0.156, and because it is greater than 0.05, we accept the null hypothesis that the relationship between control activities component of internal control system and operational performance is not significant in cooperatives.

Finally, the third objective is to examine the relationship between internal control (with monitoring as proxy) and operational efficiency. Ho3 proposed that "monitoring component of internal control and operational performance of cooperatives are not significantly related." The results gave a p-value of 0.262 which is greater than 0.05 and hence we accept the null hypothesis that monitoring component of internal control and operational performance of cooperatives are not significantly related. The details of the regression are

as shown in figure 3.

SUMMARY OUTPUT								
Regression Statistics								
Multiple R	0.738056685							
R Square	0.54472767							
Adjusted R Square	0.317091504							
Standard Error	1.660323451							
Observations	4							
ANOVA								
	df	*SS*	*MS*	*F*	*Significance F*			
Regression	1	6.596652079	6.596652079	2.392975075	**0.261943315**			
Residual	2	5.513347921	2.756673961					
Total	3	12.11						
	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.781181619	1.413020943	0.55284504	0.635910721	-5.298556799	6.860920038	-5.298556799	6.860920038
0	0.693654267	0.448408643	1.546924392	**0.261943315**	-1.235692403	2.623000937	-1.235692403	2.623000937

Figure 3. *Monitoring Vs Performance.*

5. Conclusion / Recommendations

This study set out to investigate whether there is any significant effect of three of the five components of internal control as classified by COSO (control environment, control activities, and monitoring) on performance using CSM Cooperative, Abuja, Nigeria. Multiple-Linear Regression analysis Model was used to analyze the responses supplied by the respondents. It was revealed from the study that a significant relationship does not exist between the three elements of internal control (monitoring, control environment and control activities) used in this study and operational efficiency of cooperative societies.

From the findings of the study, it is therefore recommended that cooperatives should ensure that they seek for and implement measures that increase profitability in addition to instituting a good and functioning system of internal control.

Areas for further research

This study investigated whether three (control environment, control activities, and monitoring) out of the five components of internal control as defined by COSO had significant relationship with performance. The study used only primary data obtained through questionnaire. Other researchers may consider the following in future research:

Investigate the relationship between performance and the other two components of internal control not covered in this study.

Examine the influence of internal control on the performance of cooperatives in Abuja using a more representative sample of cooperatives and not a case study.

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