Internal Control Practices and Financial Management of Local Governments: A Quantitative Framework Approach

Oyetunji, O.T*[1], Lawal, B.A*[2], Yinus, S.O*[3], Akodu, A.A*[4], and Lawal, B.O*[5]

*[1, 2] Department of Accounting, McPherson University, Seriki-Sotayo, Ogun State
*[3] College of Economics, School of ELearning, KIU, Kampala, Uganda.
*[4]Department of Accounting, Babcock University, Ilishan, Ogun State,Nigeria.
*[5]Extension Publications, Oke Ado, Ibadan, Oyo State

ABTRACT

A properly developed internal control system is expected to expose how comprehensive the government handles its finances and how well they make use of its resources. This study examined how effective internal control is in the local government in relation to how well finances are managed. Internal control faces some challenges such as poor accountability where the day to day transactions are not accounted for and also ineffective measures put in place to apprehend offenders who tamper with the finances amongst others are some of the problems associated with internal control practice. The methodology of the study is based on survey research approach. The statistical data used for the study were obtained by distribution of Two-Hundred (200) questionnaire among employees, in the five (5) local governments considered in this study. These respondents were selected using purposive sampling technique and the data obtained from the questionnaire were analyzed using regression analysis. The result of the analysis shows that internal control has significant relationship with budget control with p-value = (0.000<0.05). Based on this result, the study recommends that local government management should develop more effective strategies that will ensure that internal control is effective and efficient, so that budgets can be managed properly.

Keywords: Accountability, budget, budget control, financial management, internal control, and Local government

1. Introduction

A well-established internal control system reveals how the government efficiently manages its finances and its use of public resources. Unegbu and Kida (2011) laid emphasis on the need to special attention to the improvement of public sector management, to ensure that public resources entrusted with public office holders are properly managed and utilized for growth and development of the society. According to Surono and Hariyanto, (2012), all government ministries and organizations ought to enhance the adequacy of internal control systems, internal audit function and organization committee because they improve good governance. Moreover such successful internal control framework can give information to management about the firm's advancement, or absence of advancement towards the accomplishment their destinations (Vijayakumar & Nagaraja, 2012).

Puttick (2001) stated that internal controls as an arrangement of hierarchical strategies and internal processes (internal control) created by organizations to apparently accomplish management essential target of guaranteeing that the business works faultlessly. He further asserted that a business is said to be running easily in the event that they find themselves able to stick to the management policies, to secure the organization's assets, setup a framework that would stop and eradiate manipulation of the accounting information. IFAC (2006); Lee, Johnson and Joyce (2004); and Omolehinwa (2003), share a core principle that good governance by its nature, demands effective system of internal control. This view was supported by Dandago's (2008) study on the fight against corruption in the Nigeria's government stating that Nigerians at all levels, must make it a duty to dig out the root cause of corruption in the country and provide lasting solutions to it, no matter how bitter, painful or difficult the actualization of the solutions would be.

The Nigerian public sector is made up of the largest portion of the economic forces of developing countries, as most of the major institutions are either state owned or state operated. This makes the roles of public institutions of such economies very critical one, which must be efficient in order to improve economic activities of such countries. However, evidence has shown that operational and financial mismanagement does exist in countries where the public sector takes center stage in economic forces of a nation due to high level corruption and over-bloated contracts and projects, which in turn act as a ban on the economic performance of such developing nation (Ziniyel, Otoo & Andzie, 2018).

There is a general notion that public enterprises have failed to perform and deliver on the purpose for which they were established, management ineffectiveness and inefficiency have been advanced by practitioners and researchers of public enterprises as the bane of the Nigerian public sector (Esu & Inyang, 2008). Public financial management is a key element in public development process. Public financial management examines how government deals with its financial practices and its influence on its capacity to give fundamental enhancements required assuming itself as a part of the general public. Financial management is very important because it ensures proper allocation of resources. It also helps to reorganize financially disturbed organizations. According to Ozuomba, Nwadialor and Ifureze (2017), Nigeria was associated with poor financial management since the introduction of democratic governance in 1991. The civilian government inherited lots of problems ranging from large external debt, to lack of auditing of government accounts due to the wasteful spending, with leakage in both current and capital projects and careless leadership style of the military government. This explains that corruption and misappropriation has been in existence for a long time in Nigeria.

Ozuomba, Nwadialor and Ifureze (2017), discussed that the administration of the former president Olusegun Obasanjo and his successor Goodluck Ebele Jonathan, they introduced a number of measures to curb corruption and mismanagement of public finances which includes establishment of anti-corruption enforcement agencies (Economic and Financial Crime Commission (EFCC), Independent Corruption and other Practices Commission (ICPC), and also the introduction of new civil service standards. Some reforms have also been put in place in order to improve quality spending and further minimize fraud and misappropriation of public finances. The reforms include the introduction of Treasury Single Account (TSA), Integrated Payroll and Personnel Information System (IPPIS), Adoption of International public-sector Accounting Standards (IPSAS) and Government Integrated Financial Management Information System (GIFMIS). The reforms have so far addressed issues concerning weak internal control system, huge wage bill and lack of data base of civil servant and inability to track revenues and expenditure. Despite all these reform corruption and financial mismanagement still persist. The extent to which internal control practice can enhance financial management of government at local level worthy of an exploration. Therefore, this study examined the effect of internal control practices and financial management of Local Governments in Lagos State.

2. Literature Review

Concept of Internal Control

The Turnbull Report, first published in 1999, defined internal control and its scope as follows: “The policies, processes, tasks, behaviors and other aspects of an organization that taken together:Facilitates effective operation by enabling it to respond in an appropriate manner to significant business, operational, financial, compliance and other risks to achieve its objectives. This includes safeguarding of assets and ensuring that liabilities are identified and managed.Ensure compliance with applicable laws and regulations and also with internal policies.”

Turnbull’s explanation focused on the positive role that internal control has to play in an organization. Facilitating efficient operations implies improvement, and, properly applied, internal control processes add value to an organization by considering outcomes against original plans and then proposing ways in which they might be addressed. At the same time, Turnbull also conceded that there is no such thing as a perfect internal control system, as all organizations operate in a dynamic environment: just as some risks recede into insignificance, new risks will emerge, some of which be difficult or impossible to anticipate. The purpose of any control system should be there therefore be to provide reasonable assurance that the organization can meet its objectives.

Gariba (2015) opined that internal control is a method that an entity adopts in achieving its goal, results also plan authority performance, arrangement, Monitoring in the whole enterprise or separate subdivision. Gariba (2015) suggested that 'internal control is a summation of company's components (including its resources, systems, process, culture, structure and tasks) that helps the employees to achieve the company's goal.

The following are some of the internal control objectives:

Efficient conduct of business: Controls should be in place to ensure that processes flow smoothly and operations are free from disruptions.

Safeguarding assets: Controls should be in place to ensure that assets are deployed for their proper purposes, and not vulnerable to misuse or theft.

Prevention and detecting fraud and other unlawful acts: Also, small businesses with simple organization structures may fall victim to these violations, but as organizations increase in size and complexity, the nature of fraudulent practices become more diverse, and controls must be capable of addressing these.

Completeness and accuracy of financial records: An organization cannot produce accurate financial statements if its financial records are unreliable.

Timely preparation of financial statements: Organizations should be able to fulfil their legal obligations to submit their account accurately and on time. They also have a duty to their shareholders to produce meaningful statements.

Financial Management

In the view of Esu and Inyang (2008), the Nigerian public service "is a product of colonialism, established as an instrument of British colonialist, from the 19th century" the system begun in 1989 when the British colonial administration undertook the railway transport project from Dido in the capital city of Lagos. This was followed by coal mining, electricity and marine ports. All these enterprises were established primarily as administrative organs for facilitating trade and commercial activities of colonial government.

Esu and Inyang (2008) stated that in 1949, the Fitzgerald commission into the colliery trouble articulated the idea of public corporation. This concept was borrowed from the British labor party rationalization of British coal in1947 and electricity in 1949. Subsequently in the 1950's some public corporations were established in Nigeria such as the Nigerian Coal Corporation;

Electricity Corporation; Nigerian Cement Company, Nkalagu; Nigerian Railway Corporation and Nigerian Ports Authority.

Public Sector financial management in Nigeria is governed by the relevant provisions of enactments, rules and regulations such as the constitution of the Constitution of the Federal Republic of Nigeria Decree 63 of 1999, LFN, the Finance (Control and Management) Act, Economic and Financial Crimes Commission (EFCC) Act 2002 Independent Corrupt Practices Commission Act 2000- (Anti- corruption Law 2000), the Nigerian Accounting Standards (NAS), International Public Sector Accounting Standards (IPSAS) and the Nigerian Standards on Auditing (NSA).

However, IFAC(2006) argued that there are alternatives to hard and fast legal requirements, which can be more efficient in bringing about changes in behaviour, particularly in jurisdiction where ownership have effective power.

Budget Control

According to Institute of Chartered Management Accountant (2008), budgetary control is viewed as the groundwork of spending plans identifying with the obligations of officials to the requirements of a strategy and the nonstop correlation of genuine with the planned results, either to secure by individual activities the goals of that arrangement or to give a premise to its modification.

Budgetary control is also a way to prevent irrelevant losses that may come from fraudulent cases by unsatisfied employees. Such as thefts are always committed intentionally and use malfunction of technologies adopted by an entity. Thus, the level of spending on these activities must be monitored and controlled, so that it stays in the planned limits that are managed efficiently and effectively. Therefore, accounting and management functions within many that compose any entity need to work together to minimize all malfunctions and retain more revenues thereby minimizing spending (Suberu, 2010).

Adeniji (2002) noted a budget is seen as a quantitative estimate that shows a set of relevant actions, prepared and approved before its related period of time. In public sector, it contains goals and aspirations of the government. Budgeting enables plan and programs relating to macroeconomics objectives within a definite time period to be accomplished. It also includes an estimate of resources required and available and allows comparison between actual and pre-determined activities, as well as between more past accounting periods that form the basis form the basis for future requirements (Smith & Thomas, 2004).

Control Environment

The control environment is the foundation of an organization, influencing the control consciousness of its people. It lays the basis for all other internal control components. The Control environment of any organization will include the integrity, ethical values, and competence of the organization's employees; management's philosophy, management method of assigning authority and responsibilities and Human resources.

Empirical Review

Internal Control Environment and Budget Control

Kamau, Rotich and Anyango, (2017) argued that budget characteristics such as budget participation, sophistication, feedback and budgetary control, affect budget performance and budget participation has the greatest effect. The results were consistent with the findings by Lambe (2014) who focused on appraising the impact of budgeting and planning on organizational performance and found that budgeting and planning significantly affect performance. However, despite reporting a significant effect of budgeting process on performance, Lambe (2014) found the level of budget participation was low, meaning that other factors of budget characteristics had a greater effect.

Warue and Wanjira (2013) their own research from Kenya addressed the issue of budgetary control in local administration, they revealed that budgetary process is inclusive with all the stakeholders from the beginning up to the end and once this is done it becomes an important tool for performance of public entities in terms of efficiency and effectiveness of financial resources allocation with implementation of organizational activities.

In another study carried by Kwakye and Nkechi (2014) they discovered that budget preparation in Ghana is to a large extent in conformity with global guidelines. They established that deficits in public budget allotments opposite solicitations by line services are a formula for resulting spending invades. A more severe issue is the area of large spending plan usage and verifying slips in the public sector and the parliamentary oversight of expenditure is very weak.

Mohammed and Ali (2013) argued that strategic budgeting, participatory budgeting, budgetary control have a positive relation to firm performance and suggested participatory budgeting had a greater effect. According to Warue and Wanjira (2013), lack of budgeting and financial discipline lead to poor performance. They further argued that if workers are involved in the budgeting process, then the overall performance increases. While budget participation features prominently as having an impact on performance, other factors such as culture may weaken budget participation and still result in good performance. Hosen, Hui and Sulimani (2011) focused on the relationship between the level of budget participation and firm performance found no significant association between the variables because of the influence of culture in the budgeting process. However, Shields and Shields (1998) argued that the budgetary participation enhance an employee's trust, sense of control, and involvement with the organization, which then leads to more acceptance and commitment to the budget decision and in turn causes improved performance.

The theoretical framework for this study is based on agency and contingency theory. The agency was employed based on emphasis that states that the existing agency problems are “the separation of ownership and control, which leads to conflict in interests”, and “risk sharing”. The adoption of contingency theory is based on the fact is a new approach to examine internal control and its effectiveness.

3. Methodology

The research design adopted for this study is survey design. The population of the study is the twenty (20) Local Government councils in Lagos State. Among these Local Governments five (5) Local Governments were purposive selected based on their record as major administrative divisions in Lagos State LCDA. The choice of Lagos State is based on the fact that the state is a major economic center in Nigeria with well-organized local government system. The sample size was achieved through purposive sampling technique.Two hundred and fifty (250) Questionnaire was administered and distributed to the staff of selected local government across the entire relevant department like accounting department , internal control and budget department, and procurement department, Out of the Two hundred and fifty (250) questionnaire administered (200) were returned and found useful for the purpose of the study.

Model Specification

Regression Equation

$Y = \beta_0 + \beta_1 X_1 + \varepsilon t$…………………………………… Equation 1

Where;

Y = Budget control (BC)

β_1 = Parameter to be estimated

β_0 = constant

X_1 = Internal Control Environment (ICE)

4. Results and Discussion

Response Rate

The response rate for the study is important because it reflects the suitability of the study procedure. The study achieved a response rate of 87.5% and non-response rate of 12.5% from a sample of 200 questionnaires administered to the employees of the local government in Lagos State. Table 4.1 shows the distribution and response rate of questionnaire from the respondents.

Table 4. 1: Response Rate

Response	**Total**	**Percent**
Returned	175	87.5%
Unreturned	25	12.5%
Total	**200**	**100%**

Source: Author's compilation 2021.

Regression Analysis

Objective: ***Effect of internal control environment on budget control of Local Government in Lagos State***

Table 4.2 shows the regression relationship analysis result between internal control environment and budget control. The regression analysis shows a relationship R=0.602 and R^2=0.552. This means that 55.2% of variation in budget control be explained by a unit change in internal control environment. The remaining percentage of 44.8% is explained by variables outside the model.

Table 4.2 Model Summary for Internal Control Environment and Budget Control

R	**R Square**
.602[a]	.552

Source: Author's compilation 2021

a. **Predictors: (Constant), Internal Control Environment**

F-test was carried out to test the null hypothesis that there is no relationship between internal control environment and budget control. The ANOVA test in Table 4.3 shows that the significance of the F-statistic 0.000 is less than 0.05 meaning that null hypothesis is rejected and conclude that there is a relationship between internal control environment and budget control.

Table 4.3 ANOVA Results for Internal Control Environment and Budget Control

	Sum of Squares	**Df**	**Mean Square**	**F**	**Sig.**
Regression	3167.679	1	3167.679	293.450	.000[b]
Residual	4378.223	184	10.755		
Total	7545.902	185			

a. Dependent Variable: Budget Control

b. Predictors: (Constant), Internal Control Environment

To test the significance of regression relationship between internal control environment and budget control, the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to the t-test to test the null hypothesis that the coefficient is zero. The null hypothesis state that, β (beta) = 0, meaning there is no significant relationship between internal control environment and budget control as the slope β (beta) = 0 (no relationship between the two variables). The results on the beta coefficient of the resulting model in table 4.4 shows that the constant α = 12.304 is significantly different from 0, since the p- value = 0.000 is less than 0.05. The coefficient β = 0.631 is also significantly different from 0 with a p-value=0.000 which is less than 0.05.

This implies that the null hypothesis $\beta_1=0$ is rejected and the alternative hypothesis $\beta_1 \neq 0$ is taken to hold implying that the model Y=12.304+0.631FI (internal control environment) is significantly fit. The model budget control = α + β (internal control environment) holds as suggested by the test above. This confirms that there is a positive linear relationship between internal control environment and budget control.

Table 4.4 Coefficient for Relationship between Internal Control Environment and Budget Control

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	**Std. Error**	**Beta**		
(Constant)	12.304	1.148		10.506	.000
Internal Control Environment	.631	.048	.602	12.511	.000

Source: Author's compilation 2021

Test of Hypothesis

There is no significant effect of internal control environment on budget control of Local Government in Lagos State

To test the significance of regression relationship between internal control environment and budget control, the regression equations were first obtained using the standard beta coefficients on the line of best fit. The study also carried out the t-test to each beta coefficients in the fitted regression models. The findings in Table 4.4 indicated that internal control environment positively and significantly influence budget control of local government in Lagos State with β =

0.631 with p-value = 0.000 < 0.05. It implies that for every unit increase in internal control environment there is an increase in budget control by 0.631 units.

Discussion of Findings

The regression analysis shows a relationship between internal control and budget control showing by the values of the R^2=0.552. This means that, 55.2% of variation in budget control be could bring a unit change in internal control environment. The remaining percentage of 44.8% is explained by other variables outside the model. To test for significant regression relationship between internal control environment and budget control the regression coefficients (β), the intercept (α), and the significance of all coefficients in the model were subjected to the t-test to test the null hypothesis that the coefficient is zero. The null hypothesis state that, β (beta) = 0, meaning there is no significant relationship between internal control environment and budget control as the slope β (beta) = 0 (no relationship between the two variables).

The results on the beta coefficient of the resulting model in table 4.3 shows that the constant α = 12.304 is significantly different from 0, since the p- value = 0.000 is less than 0.05. The coefficient β = 0.631 is also significantly different from 0 with a p-value=0.000 which is less than 0.05. This means that the null hypothesis is rejected (no significant relationship between internal control environment and budget control) and the alternative hypothesis is accepted and implies that internal control environment is significantly fit. In other words, there is a positive linear relationship between internal control environment and budget control.

Nevertheless, this aligns with theoretical framework which relates to Contingency Theory. It agrees with the findings of Shields and Shields (1998) who argued that the budgetary participation enhance an employee’s trust, sense of control, and involvement with the organization, which then leads to more acceptance and commitment to the budget decision and in turn causes improved performance. According to Warue and Wanjira (2013), lack of budgeting and financial discipline lead to poor performance. They further argued that if workers are involved in the budgeting process, then the overall performance increases.

This supports with the theory’s which focus on the need for organizations to have a suitable control system with this in place it can foster budget participation which can lead to improved performance. Contingency theory provides an explanation for the diversity of internal control in reality (Jokpii, 2010). This theory provides an approach on internal control and its effectiveness in relation to budget control.

4. Conclusion

The study examined the effect of internal control practices on local government financial management in Nigeria. The regression estimates show the effect of internal control practices on budget control which indicates that the internal control practices have a positive significant effect on budget control of the surveyed and studied Local Governments. The study however recommended that discrepancies in the budget should be properly investigated to ensure that proper budget implementation has been done. Also, in situations where management is found to have tampered with budgeted figures, adequate procedures should be followed to raise alarm and prevent such operations in order to further reduce the level of financial mismanagement in the Local Government.

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