Internal Control System in Small Scale Manufacturing Enterprises in Ondo State, Nigeria

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Abstract: *This study assessed internal control system in small scale manufacturing enterprises in Ondo State, Nigeria and the challenges encountered in the implementation of internal control system. The population of the study consisted of 4,500 enterprises registered with the Nigerian Association of Small Scale Industrialists (NASSI) Ondo State chapter, out of which 195 enterprises were randomly selected as sample. Primary data were collected using a set of questionnaire and descriptive statistics was employed in analysing the data. The findings revealed that most small scale manufacturing enterprises had control activities in place, with employment of competent staff in the first position (29.8%) while segregation of duties coming eighth (1%)in the rank order. It was also established that some internal control activities such as job description, organizational chart and procedures for transactions were absent. The study also revealed that the main challenges encountered in the implementation of internal control system in the small scale manufacturing enterprises were employees' lateness to work (28.5%) in the first position, and fatigue and stress(4.1%)coming last. In conclusion, the major challenges associated with the implementation of internal control system in small scale manufacturing enterprises are employee related. It is recommended that small scale manufacturing enterprises should pay particular attention to human resource management practices.*

Keywords: *Internal control system, Small scale enterprises, Manufacturing*

I. Introduction

In her quest to achieve sustainable economic devlopment, Nigeria tends to be focusing part of its economic reforms on small and medium scale enterprises. This is a shift of priority from the capital intensive, large-scale industrial projects because small scale enterprises possess immense potentials for developing domestic capacity for rapid substantial industrial development (Dasanayaka, 2009). Thus, Small and Medium Scale Enterprises (SMEs) in Nigeria are seen as the backbone of the economy and a key source of economic growth, dynamism and flexibility (Agwu and Emeti, 2014). SMEs exist in the form of sole proprietorship and partnership, though some could be registered as limited liability companies and characterized by: simple management structure, informal employer/employee relationship, labour intensive operation, simple technology, fusion of ownership and management and limited access to capital. The seven major sources of funding available to SMEs in Nigeria include: personal resources, family and friends, partners or business associates, informal financial markets, banks, specialized funding facilities such as NERFUND, NBCI, BOI, NIDB among others (Owualah, 1999). Their role in economic development includes: technological/industrial development, employment generation, technology acquisition, capacity building, promotion of economic growth, increased standard of living, industrial dispersal or spread, servicing of large-scale industries, export promotion, structural transformation of rural areas, flexibility and low take-off requirements (Odubanjo, 2000).

According to Agbotoba(2016), empirical studies have shown that SMEs have greater economic benefits compared to large firms in terms of job creation, poverty reduction and the general growth of the economy. Ihua (2009) argued that SMEs in Nigeria are not only catalysts of economic growth and development, but are also the bedrock of the nation in the area of employment generation, labour intensity, job creation and poverty reduction. However, it has been discovered that lots of small enterprises shut down before they can achieve their goals as a result of poor management arising from inadequate, weak and not dependable internal control system (Safiriyu, 2012). It can then be argued that the success of small scale enterprises depend in part on the internal control system put in place in the organization. Accordingly, Mosher (2009) viewed internal control system as, keeping an eye on organization's assets and resources; finding ways to make sure people do not do bad things; protecting the organization from being accused of doing bad things; having good, sound business practice and common sense.

In contrast to the aforementioned, Campbell and Hartcher (2003) opined that small businesses are known for having weak internal controls. Modisane (2013) observed that most small businesses have no internal control in place because they are costly to implement. According to Oseifuah and Gyekye (2013), the absence of internal control mechanisms has been cited as one of the contributing factors to most business failures. A small business particularly is a natural target for fraudulent schemes, scams, employee embezzlement, pilferage, workers' crime, and theft (Braun 2016). Most studies on internal control system are not conducted in the manufacturing SMEs in Ondo State, Nigeria (Oseifuah and Gyekye, 2013; Olatunji 2000). With increased promotion of entrepreneurship and empowerment programmes in Ondo State in order to stem the growing tide of unemployment, the need then arises to examine the internal control system in small scale manufacturing enterprises in the state. This research assessed internal control system in small scale manufacturing enterprises in Ondo State, Nigeria.

The specific objectives are to:

(1). Examine the internal control activities in small scale manufacturing enterprises in Ondo State, Nigeria; and

(2). Assess the challenges associated with internal control system in the selected small scale manufacturing enterprises.

II. Review Of Related Literature

Internal Control and Small Businesses

Internal control refers to the measures instituted by an organization so as to ensure attainment of the entity's objectives, goals and missions. They are a set of policies and procedures adopted by an entity in ensuring that an organization's transactions are processed in the appropriate manner to avoid waste, theft and misuse of organization resources. (Ndifon and Patrick, 2014). The controls instituted depend on the particular circumstances of the business and a business need not possess all of the control activities or features which might even be expensive. The range of internal controls an organisation ends up with is called the business's internal control system (Adeniji, 2012).

Control activities in an organization basically comprise; performance reviews (comparing actual performance with budgets, forecasts and prior period performance), information processing (necessary to check accuracy, completeness and authorization of transactions), physical controls (necessary to provide security over both records and other assets), segregation of duties (where no one person should handle all aspects of a transaction from the beginning to the end) (Ndifon and Patrick 2014). In addition, Adeniji (2012) mentioned other activities as management (overall supervisory controls exercised by management), supervision of day-to-day transactions and the recordings by responsible officers, personnel (procedures to ensure that personnel have capabilities commensurate with their responsibilities) and organisation (having organisational plans). This shows that internal control system of an organization is broad and all-encompassing hence very important. It appears to cover all areas of the organization.

The legal definition of small business varies by country and by industry. Small business is an enterprise that is independently owned and operated for profit and that is not dominant in its field (Bryd, 2009). According to Agupusi (2007) small businesses has fewer than 50 employees. In Nigeria, Section 351 (1) of Companies and Allied Matters Act (CAMA) 1990 describes the small company as a private company having a share capital; the amount of its turnover for the year in question should be a maximum of #2 million, or such amount as may be fixed by the commission; the net assets value is not more than ₦1 million; none of its members is alien, government or a government corporation; the directors should hold at least 5% of its equity shares capital. Therefore, this study is focussing on manufacturing businesses with less than fifty employees.

Manufacturing enterprises or companies seem to have performance measures which include quality, delivery speed, delivery reliability, price(cost) and flexibility. These dimensions seem to be deeply connected to internal control system. The system or activities must be involved in the business success parameters of business planning, financial management, marketing, building a team, customer service strategy, sales and estimating and continuous improvement. Thus, companies with internal control system may be significantly larger, more highly regulated, more competitive, more profitable, more liquid, more conservative in their accounting policies, more competent in their management and accounting, and subject to better management controls. Therefore, internal control system is a necessity for small scale manufacturing enterprises hence this study.

Internal Control Activities in Small Scale Enterprises

Internal control system is a critical component of an organization's management and a foundation for its safe and sound operations. Control activities include performance reviews, information processing, physical controls, segregation of duties, management, routine supervision, sound manpower sourcing and maintenance(Adeniji, 2012; Ndifon and Patrick 2014).

Oseifuah and Gyekye (2013) investigated the effectiveness of internal controls in SMEs in South Africa. The study focuses on SMEs in the Vhembe District of the Limpopo Province. Questionnaire was used to

collect data and Chi-square statistical procedure was employed to establish the relationship between levels of internal controls among businesses by size of business and type of business in the study area. The result showed that internal control practices among small business sector enterprises was low, with only 45 percent of firms surveyed having adequate internal controls systems in place.

Similarly, Boyle and Desai (1991) found that the majority of businesses.// fail because of internal factors affected by management's actions and discipline. They also found a negative correlation between the duration a firm is in business and its likelihood of failure; that is, if firms survive long enough, it is reasonable to expect that they have resolved their internal control issues.

Doyle, Ge and McVay (2005) attributed the accounting scandals in 2001 in United States of America, to material weaknesses in internal control and the need for regulation. They also found that material weaknesses were more likely to occur in firms that are smaller, weaker, and younger. The risk and control awareness have an influence on the scope of the internal control system (Sarens & De Beelde, 2006). These results suggest that when management is aware of risks and control activities, they are more likely to understand the role of the internal control system in monitoring risk and control activities, thus it is more likely that they will support a relatively larger internal control system. Lack of or weak internal control systems are therefore an indicator of poor financial performance.

Aladejebi(2016) studied the effects of procurement management on agribusiness performance in Ondo State, Nigeria using 35 selected agribusiness establishments. The study revealed that monitoring and control play signifcant positive roles in determining company performance. Also, the result showed a weak functional Enterprise Resource Planning(ERP) system used in procurement process. From the foregoing, most of the studies were conducted in non-maufacturing SMEs which made this study relevant and necessary in view of the high premium placed on SMEs in Ondo State.

Challenges Associated with Internal Control System in Manufacturing SMEs

Most SMEs in Nigeria fail to thrive as a result of different factors within and outside the organizations' environments. They die within their first five years of existence, a smaller percentage goes into extinction between the sixth and tenth year while only about five to ten percent survive, thrive and grow to maturity (Aremu and Adeyemi, 2011). While SMEs in countries such as China, India, United Kingdom, South Korea and Taiwan are showing good signs of performance, perhaps the ones in Nigeria seem to be overwhelmed by a myriad of problems (National MSME Collaborative Survey, 2010).

Adagye (2015) found out in his research on effective internal control system in the Nasarawa State tertiary educational institutions for efficiency at Nasarawa State Polytechnic, Lafia that the right people are not assigned to the right job in the bursary department and that checking of subordinate by their superior officers is not regular. The research concluded that the foregoing made internal control system in the institution ineffective and weak. Thus ineffective staff job placement contributed to the institution's ineffective and weak internal control.

Similarly, Ndifon and Patrick (2014) in their research on the impact of internal control activities on financial performance of tertiary institutions in Nigeria at Cross River State College of Education revealed that there is adequate internal control in place but the staff are not adequately trained to implement the internal control system and this renders the existing internal control system ineffective. Staffing is the main challenge identified by the researchers.

Nyakundi, Nyamita and Tinega (2014), carried out a research on the effect of internal control systems on financial performance of small and medium scale business enterprises in Kisumu City, Kenya. The research specifically assessed the relationship between internal control systems and return on investment. The study used both primary and secondary data. Data was analyzed using descriptive statistics as well as inferential statistics. The study revealed that a significant change in financial performance is linked to internal controls systems. Based on the findings of the study, it is concluded that internal control systems significantly influence the financial performance of Small and Medium Scale Enterprises. The investigation recommended training on the significance of internal controls among proprietors of Small and Medium scale Enterprises. The researchers reported that there are challenges in the implementation of internal controls due to lack of technical manpower and inappropriate business knowledge of entrepreneurs in internal control system.

Ndiwa and Kwasira (2014) also carried out a research on the effects of internal control on financial performance in tertiary institutions in Kenya. The study used a case study research design. The target population of the study comprised all the employees of the institution who totalled 68. Data was collected using a set of structured questionnaire. The data was subjected to analysis using simple descriptive methods. Further, to assess the nature and strength of relationship between the independent variables and dependent variable, the Pearson's Product Moment Correlation Coefficient (PPMC) was used. The findings showed that the institutions Internal Audit Department was not sufficiently staffed. The researchers concluded that the problem encountered by

internal control system in training institutions in Kenya is that of insufficient staff and management interference on the staff**.**

It can be deduced from the related literature that there are challenges in the implementaton of internal control in the organizations. However, the prominent challenges include ineffective staff job placement, insufficient staff and management interference on the staff, lack of technical manpower and inappropriate business knowledge and staff are not adequately trained to implement the internal control system. Perhaps these and /or other challenges abound in the manufacturing SMEs in Ondo State.

III. Methodology

The study made use of descriptive survey research design. Internal control system being the independent variable and small scale manufacturing enterprises is the dependent variable. The population of this study comprised all the registered members of Nigeria Association of Small Scale Industrialists (NASSI), Ondo State Chapter which was obtained from the state secretariat. The total number of registered members is 4,500 (NASSI, 2016). Using Yamane's Statistical Distribution Formula (1967), a sample size of 195 was used and this was selected randomly from the three senatorial districts of the state. A self-structured set of questionnaire was used in the collection of primary data. The descriptive statistical analysis involved using simple percentages for data analysis. Items such as age of enterprises, number of employees, internal control activities and problems encountered in the implementation of internal control system were so analysed and their percentage distribution were shown.

IV. Results And Discussion

Age of the Enterprise

The 195 respondents were requested to indicate the age of the manufacturing enterprises in order to establish the internal control system in the sampled small scale manufacturing enterprises. Table 1 below presents the age of the enterprises. It shows that 1% of the enterprises have existed for less than one year, 3.1% for 1 to 2 years, 56.4% for 3 to 4 years and 39.5 for over five years. This indicates that most of the enterprises(60.5%) have only existed for less than five years. The implication of this is that 39.5% have existed for more than five years and are still in active business which could be a sign of effective internal control system. Safiriyu (2012) found that weak and inadequate internal control kill small scale enterprises before maturity. Likewise, Campbell and Hartcher (2003) revealed that small businesses are known for having weak internal control system.

Table 1: Age of the Sampled Manufacturing Enterprises

How old is the manufacturing enterprise?	Frequency	Percent (%)
Less than 1 year	2	1.0
1 - 2 years	6	3.1
3 - 4 years	110	56.4
5 years and above	77	39.5
Total	**195**	**100.0**

Source: Field Survey, 2017

Number of employees

According to the findings of this study, majority of the enterprises(94%) have 1-19 employees. The result shows that most small scale enterprises have lower than 20 employees. This shows that the manufacturing enterprises are truly smale scale according to the Nigerian classification. Specifically, Table 2 shows that 30.8% of the enterprises had less than 10 employees, 63.1% had less than 20 employees, 3.0% had less than 30 employees and 3.0% had above 30 employees.

Table 2: Number of Employees in the Manufacturing Enterprises.

Number of Employees	Frequency	Percent (%)
1 – 10	60	30.8
11 – 20	123	63.1
21 – 30	6	3.1
31 and above	6	3.1
Total	**195**	**100.0**

Source: Field Survey, 2017

Internal Control Activities

The findings of this study revealed that a major internal control activity in the small scale manufacturing enterprises was employment of competent staff which ranked highest on the list of identified inetrnal control activities among small scale manufacturing enterprises in the study area. Authorisation procedures for transactions ranked second, approval authority for transactions ranked third, documentation and record retention ranked fourth, time and leave reporting ranked fifth, monitoring operations ranked sixth, new technologies ranked seventh, physical restrictions ranked eighth, and segregation of duties ranked nineth. This revealed that segregation of duties was practiced at a very low level and this could be due to the fact that the number of employees employed in the small scale enterprises in the study area were not sufficient. This findings agree with the findings of Ndiwa and Kwasira (2014) that insufficient staff caused weak internal control in their study area. It supports the findings of Adagye(2015) that internal control system may be effective but wrong and ineffective staff job placement ineffective staff job placement caused ineffective and weak control system in the studied institutions.   Table 3 presents the internal control system activities in the selected small sc   ale manufacturing enterprises in the study area

Table 3 Internal Control Activities

Activities	Frequency	Percentage	Ranking
Competent staff are employed	57	29.2	1st
Authorisation and approval procedures for transactions	43	22.1	2nd
Documentation and record retention	30	15.4	3rd
Time and leave reporting	28	14.4	4th
Monitoring operations	21	10.8	5th
New Technologies	10	5.1	6th
Physical restrictions	4	2	7th
Segregation of duties	2	1	8th
Job descriptions and procedures for transactions	0	0	-
Periodic updates of job descriptions	0	0	-
Organisation charts	0	0	-

Source: Field Survey, 2017

Challengess Encountered in the Implementation of Internal Control System

Based on the findings of the study, the major challenges encountered in the implementation of internal control system in the small scale manufacturing enterprises are: employees' lateness to work (28.5%), employees' lack of skills (21.5%), no defined job descriptions (19.5%), lack of cooperation (10.3%), human error (9.2%), misunderstanding (7.2%), fatigue and stress(4.1%). The finding is in consonance with the work of Nyakundi, Nyamita and Tinega (2014) that lack of technical manpower and inappropriate business knowledge were challenges to effective internal control system in the Kenyan organization. Similarly, Ndifon and Patrick (2014) in their research identified staffing as the main challenge to implementation of internal control system.
In other words, employees' lateness to work has been identified as the major problem while the least significant problem is that of fatigue and stress. The result of the analysis is shown in Table 4.

Table 4: Challenges Encountered in the Implementation of Internal Control System

Challenges	Frequency	Percent (%)	Ranking
Employees lateness to work	55	28.2	1st
Employees lack of skills	42	21.5	2nd
No defined job descriptions	38	19.5	3rd
Employees lack of cooperation	20	10.3	4th
Human error	18	9.2	5th
Misunderstanding	14	7.2	6th
Fatigue and stress	8	4.1	7th
Total	**195**	**100.0**	

Source: Field Survey, 2017

V. Conclusion

The findings of the study led to the following conclusions. Most of the sampled enterprises are aged between three and four years and have between 11 and 20 employees. It is concluded that internal control activities in the small scale manufacturing enterprises are competent staff, authorisation and approval procedures for transactions, documentation and record retention, time and leave reporting, monitoring operations, new technologies, physical restrictions and segregation of duties. In the order of ranking,

employment of competent staff being the first and segregation of duty the last. Consequently, the challenges encountered by the small scale manufacturing enterprises in the implementation of internal control system are employees' lateness to work, employees' lack of skills, no defined job descriptions, lack of cooperation, human error, fatigue and stress. It is then concluded that challenges associated with the implementation of internal control system in small scale manufacturing enterprises are employee related with employee lateness having the highest percentage. From the findings of this study, it is recommende that small scale manufacturing enterprises should pay particular attention to human resource management practices and invest in new technologies that will aid their employees in the performance of their duties while segregation of duties will make employees to be accountable..

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