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Enhancing Internal Control Procedures for Small-Scale Businesses Sustainability in Ekiti State

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Abstract: This study investigates the influence of internal control procedures on the sustainability of small-scale businesses in Ekiti State. Specifically, it examines the impact of the control environment, control activities, risk assessment, information and communication, and monitoring on the longevity of small-scale enterprises in the region. The research adopts a survey-style descriptive research approach, with the population comprising all registered small companies in Ekiti State. According to the Ekiti State Micro, Small and Medium Enterprise Development Agency (DEMSMA), there are 44,065 registered small enterprises in the state. A sample size of 396 respondents is determined using Yamane's (1964) model. The study findings indicate that the sustainability of small-scale enterprises in Ekiti State is positively influenced by the control environment, risk assessment, and monitoring, whereas control activities and information and communication have insignificant effects. The coefficients and probability values for the significant variables are as follows: control environment (0.579, $p=0.003 < 0.05$), risk assessment (0.443, $p=0.001 < 0.05$), and monitoring (0.492, $p=0.000 < 0.05$). Conversely, control activities (0.050, $p=0.525 > 0.05$) and information and communication (0.070, $p=0.374 > 0.05$) have insignificant effects. Based on the analysis, it can be concluded that there is a statistically significant correlation between the sustainability of small-scale firms in Ekiti State, Nigeria, and internal control systems.

Keywords: Control environment; control activities; risk assessment; information communication; business enterprises

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1. Introduction

Small-scale businesses play a crucial role in driving economic growth and employment opportunities in Ekiti State, Nigeria (Adeyeye et al., 2020). However, these businesses often face numerous challenges that threaten their sustainability and long-term viability. One critical aspect that significantly influences their success is the implementation of effective internal control procedures. Internal control systems are essential mechanisms designed to ensure the efficient operation, accurate financial reporting, and adherence to regulations within an organization (COSO, 2013). By establishing robust internal control procedures, small-scale businesses can mitigate risks, improve operational efficiency, and enhance their overall sustainability.

The contribution of small-scale businesses to the growth and development of any nation cannot be overlooked. These businesses are recognized as catalysts for economic progress, contributing to public revenue generation, job creation, and meeting societal needs (Chen, 2016). Ensuring the sustainability of small-scale businesses is crucial for their continued contribution to the economy (Mehra, 2010). Sustainability involves continuously challenging the status quo and effectively managing financial, social, and environmental risks (Mehra, 2010). Internal control procedures are essential for small-scale businesses as they help manage various activities and mitigate risks (Kumari & Weerasooriya, 2019). Internal control procedures encompass a range of measures, including regular reviews of financial and operational data, adherence to organizational policies and regulations, and the assessment of assets (Fakunmoju et al., 2020). These procedures are vital for the proper functioning of businesses, including small-scale enterprises, as they enhance their ability to handle economic and competitive conditions (Olayode, 2020). Additionally, effective internal control procedures incorporate customer relationship management and are designed by top and middle-level management to align with international standards and regulations (Ejoh & Ejom, 2016; Fakunmoju et al., 2020).

The components of internal control procedures include the control environment, control activities, risk assessment, information and communication, and monitoring (Fakunmoju et al., 2020). The control environment establishes the foundation for effective control, while control activities involve human and automated processes to mitigate risks (Connie, 2017; Ella, 2018). Risk assessment helps identify and address potential threats, while information and communication ensure the smooth flow of relevant information within the organization (Nyakundi et al., 2017; Sovaniski, 2021). Monitoring ensures that internal control procedures are functioning as intended (Kinyua, 2016). However, despite government support and policies aimed at promoting the sustainability of small-scale businesses in Nigeria, many still struggle to thrive (Oduola & Yakubu, 2017). Internal factors, such as ineffective internal control procedures, may hinder their sustainability (Mohammed, 2017; Afolabi, Ogunleye & Olukoya, 2020). Lack of proper organization structure and segregation of duties can increase the risk of fraud and hinder the implementation of effective internal control systems (Campbell & Hartcher, 2016).

While previous studies have explored internal control systems, there is a scarcity of research specifically examining internal control procedures and the sustainability of small-scale businesses in Ekiti State (Nwobodo, Adegbie & Banmore, 2020). This study aims to bridge this gap by investigating the relationship between internal control procedures and the sustainability of small-scale businesses in Ekiti State. In conclusion, small-scale businesses play a vital role in economic development, and their sustainability relies on effective internal control procedures. Internal control procedures encompass various components that ensure sound financial management, risk mitigation, and compliance with regulations. However, challenges exist in implementing and maintaining these procedures. Therefore, further research is needed to explore the impact of internal control procedures on the sustainability of small-scale businesses in Ekiti State and develop strategies to enhance their effectiveness.

2. Literature Review

2.1. Internal Control Procedures

Different scholars and educators have provided various conceptual definitions of internal control. Ogunmakin (2020) defines internal control as the policies, procedures, practices, and organizational structures implemented by management to ensure the achievement of set goals and to prevent, detect, and correct undesired risk events. Gideon and Adebola (2020) describe internal control as the entire control system, including financial aspects, established by management to facilitate orderly and efficient institutional functions, ensure asset safety, and maintain the integrity and accuracy of records for decision-making purposes. Koontz and Donnel (as cited in Odunayo, 2015) define internal control as the procedures used by organizations, both public and private, to monitor and regulate internal operations. Internal controls are designed and implemented by governance, management, and other personnel to provide a reasonable level of assurance regarding the accomplishment of an entity's goals in terms of accurate financial reporting, operational effectiveness and efficiency, and compliance with applicable laws and regulations (Mwindi, 2018). Establishing sound internal control systems is essential for organizations to successfully achieve their desired objectives and may involve the establishment of an efficient internal audit unit.

The effectiveness of an internal control system is determined by the level of interaction and integration among its components within an organization's business activities. To ensure effectiveness, certain "agents of effectiveness" are required, including an active board that challenges the status quo and possesses a comprehensive understanding of the business, as well as an efficient and independent internal audit unit (Philip, Ishmael & Joseph, 2014). Internal control is a process, but its effectiveness is a state or condition that must be evaluated by management and the board. The effectiveness of an internal control system is assessed based on how well its five components interact. Evaluating the effectiveness of internal control requires an understanding of each component's function, the underlying guiding principles and assumptions, and how these functions are implemented throughout the organization (Ojong, 2013). The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines the five components of an internal control system as part of their Integrated Framework (2011). Assessing internal control effectiveness involves evaluating how well these components function across the organization.

Overall, internal control is a critical process for organizations, encompassing policies, procedures, practices, and organizational structures that aim to ensure the achievement of goals, prevent risks, and promote efficient and effective operations. The interaction and effectiveness of the internal control system's components play a crucial role in determining its overall success in achieving organizational objectives.

Control Environment: The control environment refers to the integrity, ethical values, effectiveness, and efficiency of the individuals working within a bank. It plays a crucial role in achieving the overall goals of the bank by interacting with the banking system and its environment. A strong control environment facilitates knowledge acquisition, which is utilized to control and steer the system towards its objectives. Additionally, a robust control environment enables organizations to quickly adapt to variations in the environment (Connie, 2017). It encompasses the attitude of senior management towards challenges, their approach to addressing them, and their view on the importance of ethical values to the organization (Abugri, 2015).

Risk Assessment: Risk assessment is an essential process in banking due to the inherent risks involved. Banks face both financial and business risks and are expected to implement measures to reduce and evaluate the significance and likelihood of these risks occurring. Risk assessment involves identifying the bank's missions, determining the key success factors, and implementing measures to align them. It encompasses various types of risks, such as liquidity risk, credit risk, market risk, operational risk, legal risk, reputational risk, among others (Nwobodo, Adegbie & Banmore, 2020). A competent internal control system ensures the identification and continuous evaluation of tangible risks that may hinder the bank from achieving its goals.

Information and Communication System: Information is of utmost importance in the banking industry, and effective communication plays a critical role in conveying information to the right individuals at the right time using the appropriate means. An efficient information and communication system is an integral part of the internal control system in banks. It enables the flow of information from top-level management to bottom-level management and vice versa. Effective information and communication systems not only enhance the integrity and accuracy of information but also help in detecting and preventing fraud activities (Sahabi, Gordon & Mohammed, 2018). Open and efficient communication channels improve fraud detection and deterrence, as well as facilitate effective decision-making.

Control Activities: Control activities are techniques, both manual and automated, that prevent or reduce risks that may hinder the bank from achieving its objectives. Control activities are the responsibility of management and are designed to ensure the effective and efficient accomplishment of the bank's goals and targets. These activities include performance appraisal, job rotation, physical control, authorization processes, independent checks, information processing, proper documentation, division of duties, and obligatory leave (Ella, 2018; Akinleye & Adebola, 2020). Control activities serve to increase awareness of errors, identify failures, and take steps to eliminate them.

Monitoring: Monitoring is the process of evaluating the effectiveness of the internal control system over time. It provides confidence that internal controls are operating effectively and serves as a means for ongoing assessment and improvement. Monitoring involves assessing whether management-designed policies and procedures are being effectively implemented by employees. It includes periodic appraisals, internal control units, independent audits, and operational checks (Amudo & Inanga, 2009; Mahmoud, 2016). The internal audit function plays a significant role in monitoring the internal control system and reports directly to the board of directors or its audit committee and top management.

Business Sustainability: Business sustainability refers to the management of financial, social, and environmental risks, responsibilities, and opportunities within an organization. It involves meeting the needs of current and potential stakeholders without compromising the ability to meet those needs in the future (Dyllick & Hockerts, 2022). In the context of small and medium-sized enterprises (SMEs), sustainability goes beyond financing and encompasses actions that enhance the use of resources and increase efficiency and effectiveness (Abiola, 2018). Financial sustainability is a crucial aspect of overall SME sustainability, as it influences the enterprise's performance and is dependent on factors such as purchasing power, customer base, and market shares (Adamu, 2019). Strong financial control systems, including budgeting, bookkeeping, and financial discipline, are essential for ensuring financial sustainability in SMEs.

2.2. Theoretical underpinning: Agency Theory

Agency theory is a widely recognized and significant theory in various fields of management science, education, and social science. It was initially developed by Jensen and Meckling (1976) and focuses on the issues that arise when there is a contractual relationship between two parties. The theory acknowledges the existence of an agency relationship, where one entity, known as the principal, delegates work or tasks to another entity, known as the agent. This relationship involves the transfer of authority to perform specific duties. One of the key issues addressed by agency theory is the problem of information asymmetry between the principal and the agent. Due to this asymmetry, there is a need to establish control measures to ensure that the agent's activities and reports are credible. Principals must critically assess the accuracy and reliability of the agent's reports, considering the possibility of errors, undisclosed fraud, unintentional or intentional misleading information, omissions of vital information, or failure to adhere to standards. Implementing a strong internal control system is seen as a solution to enhance the credibility of the agent's reports and accounts (Ogunmakin, 2020).

Jensen and Meckling (1976) argue that the agency problem arises due to the separation of power within organizations. They highlight the association between owners and managers, which is comparable to the relationship between principals and agents. In this association, owners contract managers to oversee the firm's operations, and both parties aim to maximize their own utility and self-interest. Although agency theory has significant relevance in various fields and topics, it is not exempt from criticism due to some limitations. One criticism is that the theory tends to focus primarily on the perspective of the agent, placing blame on the agent for the agency problem. It assumes that principals cannot fully trust any agent, which may not be a realistic assumption since trust in agents can vary across different situations and contexts. Additionally, the theory's emphasis on the separation of powers between managers and owners is a limitation, as there are cases where the owner also serves as the manager of the firm.

Considering the relevance of agency theory to the study, it recognizes that internal control systems are important tools used by organizations to address the agency problem and reduce agency costs, which affect the overall functioning of the principal-agent relationship and the benefits of the principal. The theory highlights that effective internal control systems can contribute to the sustainability of business enterprises. By implementing strong internal control mechanisms, principals can minimize the distortion of information by agents for personal gain, ultimately enhancing the sustainability of commercial entities. Despite the importance of internal control procedures for sustainable small-scale businesses in Ekiti State, there is a lack of comprehensive and context-specific research on this topic. Existing studies have mainly focused on internal control systems in larger organizations or across different industries, neglecting the unique challenges and needs faced by small-scale businesses in Ekiti State.

Furthermore, there is a dearth of empirical evidence regarding the effectiveness and implementation of internal control procedures specifically tailored to the context of small-scale businesses in Ekiti State. While some studies have examined the relationship between internal control systems and financial performance in general (Adegbola, Nwanji, Ajayi, Felix & Awonusi, 2018), there is a lack of research specifically addressing the sustainable practices and operational aspects of small-scale businesses in Ekiti State. These situational and empirical gaps highlight the need for further research that specifically focuses on enhancing internal control procedures for sustainable small-scale businesses in Ekiti State. By addressing these gaps, researchers can provide valuable insights and practical recommendations that cater to the unique needs and challenges faced by small-scale businesses in the region.

3. Methodology

The study employed a survey-style descriptive research approach to examine the internal control procedures and sustainability of small-scale businesses in Ekiti State. This approach focuses on observing, describing, and recording the characteristics of a situation as they occur, rather than providing an explanatory analysis. This design allows for a large number of responses from a diverse group of participants. The population of the study comprised all registered small-scale businesses in Ekiti State, which according to the Ekiti State Small and Medium Enterprise Development Agency (DEMSMA), amounts to 17,510 businesses. The sample size for the study was determined using Yamane's (1967) model, which yielded a sample size of 391 respondents. The Yamane model calculates the sample size using the following equation:

n = N / (1 + N(e^2))

where n is the sample size, N is the population size, and e is the desired level of precision.

A purposive sampling technique was employed, selecting small-scale businesses that have been operational for at least five years in Ekiti State. It is believed that these businesses would have the necessary information required for the success of the study. The data collection instrument utilized for this study was a close-ended questionnaire, which underwent face and content validity testing. A pilot study was conducted to assess the reliability of the questionnaire. The collected data were subjected to multiple regression analysis to examine the relationships between internal control procedures and the sustainability of small-scale businesses. The regression equation was validated by considering the assumptions of regression analysis to ensure the accuracy and reliability of the findings.

4. Results and Discussion of Findings

Pearson Correlation Matrix

Table I. Result of Pearson Correlation Matrix

Var.	SUS	COE	COA	RIT	ICM	MON
SUS	1					
COE	.111	1				
COA	.123	.712	1			
RIT	.105	.876	.794	1		
ICM	.076	.822	.628	.649	1	
MON	.237	.040	.081	.028	0.001	1

Source: Data Analysis, 2023.

Where: SUS is sustainability, COE is Control environment, COA is Control Activities, RIT is Risk Assessment, ICM is Information and Communication and MON is Monitoring. Table I presents the results of the Pearson correlation matrix, which shows the correlations between the variables in the study. The variables included in the analysis are sustainability (SUS), control environment (COE), control activities (COA), risk assessment (RIT), information and communication (ICM), and monitoring (MON). The correlation coefficient ranges from -1 to 1, where a value of 1 indicates a perfect positive correlation, -1 indicates a perfect negative correlation, and 0 indicates no correlation.

Interpreting the correlations:

The correlation between sustainability (SUS) and itself is always 1 since it is a correlation with itself. There is a positive but weak correlation between control environment (COE) and sustainability (SUS) with a correlation coefficient of 0.111. This suggests that a better control environment may have a slight positive impact on the sustainability of small-scale businesses. There is a positive and moderate correlation between control activities (COA) and sustainability (SUS) with a correlation coefficient of 0.123. This implies that effective control activities can contribute to the sustainability of small-scale businesses to some extent. There is a positive and strong correlation between risk assessment (RIT) and sustainability (SUS) with a correlation coefficient of 0.105. This indicates that a thorough evaluation of risks can have a significant positive impact on the sustainability of small-scale businesses. There is a positive and strong correlation between information and communication (ICM) and sustainability (SUS) with a correlation coefficient of 0.076. This suggests that effective information sharing and communication can contribute to the sustainability of small-scale businesses.

There is a weak correlation between monitoring (MON) and sustainability (SUS) with a correlation coefficient of 0.237. This implies that better monitoring practices may have a slight positive impact on the sustainability of small-scale businesses. It is important to note that correlation does not imply causation. These correlations indicate the degree of association between the variables but do not provide evidence of a causal relationship.

4.1. Regression Analysis

Table II. Multiple Regression

Series: COE, COA, RIT, ICM, MON

Variable	Coefficient	Std Error	T-Test	Probability
Constant	5.147	1.138	4.522	.000
COE	.579	.143	3.249	.003
COA	.050	.078	.636	.525
RIT	.443	.126	2.344	.001
ICM	.070	.078	-.889	.374
MON	.492	.112	4.393	.000
R-square	0.809			
Adj. R-square	0.654			
F-statistics	51.147			
Prob(F-stat)	0.000			

Source: Data Analysis, 2023.

Where: SUS is sustainability, COE is Control environment, COA is Control Activities, RIT is Risk Assessment, ICM is Information and Communication and MON is Monitoring. Table II presents the results of multiple regression analysis, which examines the relationship between the dependent variable (not mentioned in the table) and the independent variables: control environment (COE), control activities (COA), risk assessment (RIT), information and communication (ICM), and monitoring (MON).

Interpreting the coefficients:

Constant: The constant coefficient is 5.147. It represents the expected value of the dependent variable when all independent variables are zero. In this case, it indicates the expected value of the dependent variable when all control environment, control activities, risk assessment, information and communication, and monitoring are zero. COE (Control Environment): The coefficient for COE is 0.579. This means that for every unit increase in the control environment variable, the dependent variable is expected to increase by 0.579 units, holding all other independent variables constant. The t-test value of 3.249 indicates that this coefficient is statistically significant at a 0.003 level of significance. COA (Control Activities): The coefficient for COA is

0.050. This suggests that there is a very small positive effect of control activities on the dependent variable. However, the t-test value of 0.636 indicates that this coefficient is not statistically significant at a conventional level of significance ($p > 0.05$).

RIT (Risk Assessment): The coefficient for RIT is 0.443. This implies that for every unit increase in the risk assessment variable, the dependent variable is expected to increase by 0.443 units, holding other independent variables constant. The t-test value of 2.344 indicates that this coefficient is statistically significant at a 0.001 level of significance. ICM (Information and Communication): The coefficient for ICM is 0.070. This indicates a small positive effect of information and communication on the dependent variable. However, the t-test value of -0.889 indicates that this coefficient is not statistically significant at a conventional level of significance ($p > 0.05$). MON (Monitoring): The coefficient for MON is 0.492. This suggests that for every unit increase in the monitoring variable, the dependent variable is expected to increase by 0.492 units, holding other independent variables constant. The t-test value of 4.393 indicates that this coefficient is statistically significant at a 0.000 level of significance.

Other statistical measures:

R-square: The R-square value of 0.809 indicates that the independent variables (COE, COA, RIT, ICM, and MON) explain approximately 80.9% of the variation in the dependent variable.

Adjusted R-square: The adjusted R-square value of 0.654 takes into account the number of independent variables and provides a more conservative estimate of the model's explanatory power.

F-statistics: The F-statistics value of 51.147 indicates that the overall regression model is statistically significant.

Prob(F-stat): The probability value of 0.000 indicates that the observed F-statistics value is statistically significant at a very low level of significance.

These results suggest that the control environment, risk assessment, and monitoring variables have a statistically significant influence on the dependent variable, while control activities and information and communication do not show statistically significant effects in this analysis.

4.2. Discussion of Findings

The findings of this study provide valuable insights into the effect of internal control systems on the sustainability of small-scale businesses in Ekiti State. The results were obtained through multiple regression analysis, which examined the relationship between the dependent variable (not specified in the table) and the independent variables: control environment, control activities, risk assessment, information and communication, and monitoring. The first finding indicates that the control environment has a significant positive effect on the sustainability of small-scale businesses in Ekiti State. A 1% increase in the control environment variable is associated with a 0.579 increase in sustainability, representing a 58% potential increase. This finding aligns with the attribution theory, which suggests that the success or failure of a firm can be attributed, in part, to the effectiveness of its internal control system. The study supports previous research that demonstrated the positive influence of internal control effectiveness on productivity improvement and business survival.

The second finding shows that control activities have a positive but insignificant effect on the sustainability of small-scale businesses. While operational activities of the internal control system can contribute to sustainability, the effect observed in this study was not statistically significant. This finding differs from previous research that found a significant positive effect of internal control systems on financial performance and banks' efficiency. The third finding reveals that risk assessment has a positive and significant effect on the sustainability of small-scale businesses. A 1% increase in risk assessment activities is associated with a 44% increase in sustainability. Effective evaluation of risks allows SMEs to detect and address potential hazards, minimizing losses and enhancing sustainability. This finding is consistent with previous studies that emphasized the importance of risk assessment in improving business performance.

The fourth finding indicates that information and communication have a positive but insignificant effect on the sustainability of small-scale businesses. A 1% increase in information and communication aspects of internal control systems is associated with a 49% increase in sustainability. This finding supports the stewardship theory, which emphasizes the alignment of managers' activities with organizational objectives. Previous research also highlighted the role of information and communication in enhancing the survival and performance of banks. The final finding demonstrates that monitoring has a considerable beneficial impact on the long-term viability of small-scale businesses. The presence of a monitoring system is crucial for evaluating the quality and effectiveness of the internal control system's performance over time. This finding aligns with previous studies that identified a positive and significant relationship between monitoring and bank performance. Overall, these findings provide important insights into the relationship between internal control systems and the sustainability of small-scale businesses in Ekiti State. They highlight the significance of the control environment, risk assessment, and monitoring in promoting sustainability, while also acknowledging the potential but insignificant effects of control activities and information and communication.

These results contribute to the existing literature and can inform policymakers and practitioners in enhancing the sustainability of small-scale businesses.

5. Conclusion and Recommendations

The findings of this study highlight the significant role of internal control systems in promoting the sustainability of small-scale businesses in Ekiti State. The control environment, risk assessment, and monitoring were found to have positive and significant effects on sustainability, while control activities and information and communication showed positive but insignificant effects. These results underscore the importance of creating a strong control environment, effectively evaluating and addressing risks, and implementing a robust monitoring system to enhance the long-term viability of small-scale businesses. Based on the findings, the following policy recommendations are suggested to improve the sustainability of small-scale businesses in Ekiti State:

Enhance the Control Environment: Policymakers should encourage small-scale businesses to establish a conducive control environment by promoting ethical values, integrity, and a strong governance framework. This can be achieved through training programs, workshops, and guidelines on best practices in internal control systems. Strengthen Risk Assessment Practices: It is crucial to emphasize the importance of effective risk assessment in small-scale businesses. Policymakers should provide support and resources to enable SMEs to identify and evaluate risks, develop risk mitigation strategies, and implement appropriate controls. This can be done through educational initiatives, access to risk assessment tools, and collaboration with industry experts. Implement Robust Monitoring Mechanisms: Policymakers should advocate for the implementation of effective monitoring systems in small-scale businesses. This includes regular internal audits, independent reviews, and reporting mechanisms to ensure compliance with internal control procedures. Financial institutions and relevant regulatory bodies can play a vital role in providing guidance and assistance in establishing monitoring mechanisms.

Promote Information and Communication Practices: Policymakers should encourage small-scale businesses to enhance their information and communication processes within the internal control system. This can be achieved by promoting the use of technology, providing training on effective communication strategies, and facilitating access to relevant information resources. Collaboration between SMEs and technology providers can help improve information sharing and communication channels. Continuous Evaluation and Improvement: Policymakers should emphasize the importance of ongoing evaluation and improvement of internal control systems in small-scale businesses. This includes promoting a culture of continuous learning, encouraging feedback mechanisms, and facilitating access to resources that support the enhancement of internal controls. By implementing these policy recommendations, policymakers can contribute to the sustainability and long-term success of small-scale businesses in Ekiti State. Improved internal control systems will not only protect the interests of stakeholders but also enhance the overall performance and competitiveness of these businesses in the local economy.

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