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INTERNAL CONTROL SYSTEM AND CORPORATE SURVIVAL IN THE NIGERIAN BANKING SECTOR: THE MEDIATORY ROLE OF ETHICAL CLIMATE

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ABSTRACT

This study assessed internal control system and corporate survival in the Nigerian banking sector with particular focus on the mediatory role of ethical climate. The target population of the study included bank employees in selected bank branches across the Ibadan metropolis, Nigeria. Twelve bank branches were randomly drawn from the population of branches in Ibadan. Results showed that the internal control components (Control Environment, Risk Assessment, Control Activities, Information Communication and Monitoring) jointly predicted effectiveness of internal control system within the banking sector [$F_{(4,1615)}$ =84.68, R^2=.174; p<.01] and accounted for 17.4% of the variance in the effectiveness of internal control system within the sector. However, only Control Environment (β=.239; p<.05), Control Activities (β=.146; p<.05), Information Communication (β=.189; p<.05), and Monitoring (β=.177; p<.05) emerged as significant independent positive predictors of internal control system effectiveness within the banking sector. There was also a significant influence of ethical climate on the effectiveness of internal control system within the banking sector [t(195)=.651; p<.05]. Finally, after controlling for ethical climate as a mediator, there was a decrease in the predictive values of Control Environment (β_1=.239, β_2=.142) and Monitoring (β_1=.277, β_2=.063) on effectiveness of internal control, which implied partial mediation; however, Control Activities (β_1=.146, β_2=.006) and Info Communication (β_1=.189, β_2=.012) were no longer significant predictors of effectiveness of internal control (β_1=.146, β_2=.006); which was consistent with full mediation. It was therefore recommended that the effectiveness of internal control systems should be enhanced through continuous monitoring, related risk assessment, designing sound control methods and with an ideal ethical climate within the organization.

1.0 Introduction

The globalization process, complexity of banking transactions and the increase in fraudulent activities have recently sharpened the ever-increasing attention on internal control systems in banking sector. The growth and development of the financial institutions are dependent on the effective and efficient management of its credits. Under the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework, objective setting is considered a precondition to internal control. By setting objectives, management can then identify risks to the achievement of those objectives. To

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address these risks, management of organizations may implement specific internal controls. The effectiveness of internal control can then be measured by how well the objectives are achieved and how effectively the risks are addressed. Notwithstanding, internal controls only provide reasonable assurance, not absolute assurance. This is as a result that the people who operate the internal controls, breakdowns can occur, human error, deliberate circumvention, management override, and improper collusion among people who are supposed to act independently can cause failures of the internal control to achieve objectives.

For instance, the credit crunch that has hit the world's most developed economies is a clear indication of the failure of the system to hold in check some of the excesses in their haste to satisfy profit making agenda and to outdo one another in competition. The results of the financial crises which affected many developed countries are being felt by the developing countries of which Nigeria is no exception. Furthermore, the foundation and configuration of the Nigerian banking system has been described as one that is susceptible to abuse by corrupt minds (Ribadu, 2017). This is an indication of porous internal control systems practiced in some banks. The country needs to strengthen internal operational mechanisms as investigations reveal that almost all corruption cases in Nigeria involve banks.

There are many studies that have tried to x-ray the internal control systems of various organizations (Njanike, Mutengezanwa & Gombarume, 2011; Sartini & Wardiwiyono, 2012; Beneish, Billings & Hodder, 2008), however their major emphasis has been on trying to identify technical flaws in the control systems of these organizations, without paying much attention to the human interferences in the internal control systems. This presents a major gap in the literature which has necessitated scholarly appeals for empirical insight. Hence it is necessary to review internal control systems of some banking organizations in order to identify both technical flaws and human interferences that undermine its effectiveness. This study therefore tries to evaluate effectiveness of internal control as a means of corporate survival of banks in Nigeria by examining the predictive influence of internal control components and the mediatory role of ethical climate on the effectiveness of internal control systems in the banking sector.

2.0 Background to the Study

Finance sector has become the most important actor with the impact of globalization and technological improvements in last two decades. As a consequence, financial products have increased, operational borders have expanded, and new financial markets have emerged. These developments have increased and diversified the risks that the banking sector has to manage. Therefore, management and insufficient control of risks originated financial crises in the world. The initial domestic crises spread the world through globalization, in a short period of time. The global financial crisis highlighted the importance of well-functioning and healthy banking sector for macro stability (Hayali & Sarili & Dinc, 2012). One of the main reasons of banking failures which results in major financial loss and even bankruptcy is due to high risks taken by the bank management on an excessive scale and inability of controlling them.

Lack of an internal control system may pose a threat to the success and corporate survival of banking organizations. Internal control is a system structured within the corporation whose goal is to raise efficiency and effectiveness of activities. The system assures the conformity of activities within the laws and regulations and improves the reliability of financial reporting. Internal control system possesses vital importance for the institution to attain its ultimate objectives. Internal control system allows banks to foresee potential problems which may cause financial losses and thereby prevent or minimize any future losses. Researches on the causes of bank failures mainly concluded that an efficient and effective internal control system might prevent financial cost. The main purpose of control is to raise concern over errors, and detect the points of failure in order to prevent their re-emergence. Additionally, the system also covers all assessment and methods that are adopted in order to detect the suitability of operations in accordance with policies determined by management, implementing a chart of accounts and reporting system, specifying the duties, authority and responsibilities, and organization plan of the cooperation (Arens, 2007).

According to Committee of Sponsoring Organizations of the Tread way Commission (COSO, 1992), internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives, in doing so, supports performance-based management. Christine, Catherine and Aimee (2011) broadly define internal accounting control as a series of procedures and practices designed to promote and protect sound management practices, both general and financial. Thus an effective internal control procedures will significantly increase the likelihood that: financial information is reliable, so that managers and the board can depend on accurate information, assets and records of the organization are not stolen, misused, or accidentally destroyed, the organizations policies and government regulations are met, overall organization objective is achieved. Failure of internal control systems and the eventual circumvention of internal controls by company executives often account for corporate scandals.

The effectiveness of internal control systems also depends on the level of ethical climate within the organization. Ethical climate refers to the moral atmosphere of the work environment and the level of ethics practiced within a company. Internal control systems are set up by human effort, and are therefore likely to have loopholes with which the system can be beaten. **Ethical climate** is the culture of an organization as it pertains to questions of right and wrong. It derives from the governance, values, norms and habits that exist within an organization. Ethical climate results from both a firm's history and its leadership. Generally speaking, poor ethical practices at the top of an organization translate to a poor ethical climate. Thus, poor ethical climate may limit the effectiveness of internal control systems within the banking sector. It is has been that the frequency of occurrence of employee theft, fraud, embezzlement and unethical practices (Bologna & Lindquist, 1995) was ranked second out of the 25 most commonly committed white-collar crimes in the banking sector.

Therefore, being able to evaluate the effectiveness of the internal accounting control system is essential for the management to fulfill their duty as custodians of the entrusting parties. From banking perspectives, improving their internal control systems, internal auditing function, and reducing risk has become a priority for most banks in Nigeria. In fact, banks in the country have put in place mechanisms to ensure internal control and compliance in credit delivery. These include setting up an internal audit unit, a monitoring unit and issuing the Accounting, Treasury and Financial Reporting Rules (ATE Rules). But the unanswered question is "how effective are the internal control systems of banks in Nigeria?" While the competence and integrity of the personnel designing and operating the system may be controlled by selection and training, these qualities may alter due to pressures from within and outside the public body. Furthermore, no matter how competent the staff of organizations seem to be, the control they operate may become ineffective if they operate in unethical climates or do not correctly understand their function in the control process or choose to ignore it.

3.0 Literature Review

Mahdi, Mahmoud, Shiri and Fatemeh (2011) investigated the effectiveness of internal control in the Iranian banking sector with special reference to Bank Mellat. The study evaluated the effect of control environment, control activities, risk assessment, information and communication and continuous monitoring on failure of internal control quantified as reported errors and fraud. The empirical evaluation found out that all the elements of the internal control have significant effect on occurrence of errors and fraud, though the magnitudes are different. Accordingly, Weakness of control environment, control activities, risk assessment, information and communication and monitoring as a component of internal control system in an incident of error and fraud is effective. Therefore, the more the increase in the weakness of a control environment, control activities, risk assessment, information and communication and monitoring in Bank Mellat, the more is the incident of error and fraud. However, statistically control environment is found to have the highest effect for the failure of internal control.

Moses (2011) examined the effectiveness of Internal Control Systems in achieving Value for Money in school projects in Local Governments of Uganda. The purpose of the study was to identify the impact of internal control in achieving value for money. The study used a cross sectional survey design implementing self-administered structured questionnaire to gather data. The respondents were drawn from the elected and appointed staff, staff from the Office of the Auditor General, members of the District Public Accounts Committee and the School; were requested to respond to existence of standards of internal control. The study revealed that there a significant positive relationship between the Control Environment, Control Activities, Risk Assessment, Information and Communication and Monitoring and Value for Money in Local Governments. The findings further revealed that

Internal Control Systems have a significant positive effect in achieving Value for Money. All the constructs of Internal Control Systems (Control Environment, Control Activities, Risk Assessment, Information and Communication and Monitoring) had a significant positive relationship with Value for Money.

Sartini and Wardiwiyono (2012) conducted an exploratory study on Internal control system for Islamic micro financing The study aimed to evaluating the implementation of internal control system for Islamic micro financing. It also aims to investigate the implementation of an internal control system for financing activities practiced by Baitul Maal wat Tamwil (BMT), a special micro finance organization; in Indonesia system for Islamic financing is formulated. Primary data that related to the implementation of an internal control system for financing activities were obtained through a direct survey using questionnaires. The data were then analyzed using descriptive statistic and qualitative analysis to find the implementations of the internal control system. BMTs in Indonesia have implemented an internal control system for their financing activities. The rank of the implementation is: information and communication; monitoring; control environment; risk assessment; and control activities. This study also indicates that the implementation of authorization and consultation to the Shariah Supervisory Board was low.

Palfi and Muresan (2009) examined the importance of a well-organized system of internal control in the banking sector. The analysis of the survey revealed that continuous collaboration based on periodical meetings, between all structures of bank, characterizes an effective internal audit department. Joseph and Victoria (2012) examined the effectiveness of internal control systems of listed firms in Ghana. The study used annual reports of a sample of 33 firms listed on the Ghana Stock Exchange. In measuring the level of internal control effectiveness, 23 items relating to internal control categorized under control environment, information and communication, risk assessment, control activities and monitoring were operated and the effectiveness score was determined based on the items. Overall internal control system showed an average level of effectiveness in this study, which implied an overall low level of effectiveness. Of the five categories assessed under internal control system, control environment showed a higher level of effectiveness.

Tekalign (2011) investigated if the existing internal control in public enterprises in Ethiopia contributing to accounting fraud. The survey instruments on 11major public enterprises in Addis Ababa were conducted using self administered questionnaires to auditors and accountants. Frauds were represented as any violation of principles, manipulation of sales, expenses or inventories. The result indicated that the respondents believe the existed internal controls were sufficient to keep possibility of accounting fraud to reasonably low level. Even though the internal control would detect accounting fraud, respondents require codes of conduct and employees training as additional tool to detect fraud events.

Owusu-Boateng, Amofa and Owusu (2017) examined the internal control systems of GN Bank- Ghana. The main objective of the study was to identify the internal system of control used at GN Bank's credit department. A census sampling technique was used by the researcher in getting a sample size of eighty five (85) who consisted primarily of managers and officers of GN Bank's credit and risk departments in the south eastern zone through the administration of questionnaires. The data was analysed using the Scientific Package for Social Scientist (SPSS). The study found that there exists an internal system of control. GN Bank board of directors are ultimately responsible for ensuring that an adequate and effective system of internal controls are established and maintained. Together, both the board and senior management are responsible for promoting high ethical and integrity standards, and for establishing a culture within the organization. It was realised that GN Bank's implementation of a strong internal control system was able to detect and prevent fraudulent acts and practices. Although respondents agreed to GN Bank providing adequate training for credit personnel on internal control procedures, some substantial disagreements were recorded for this particular question.

Ehiedu and Ogbeta (2014) carried out an investigation into the internal control system in the banking industry using a study of some selected banks in Asaba, Delta State. The study examined the major types of control which include management oversight and the control culture, risk recognition and assessment. Samples were drawn using simple random sampling techniques and they included First bank Plc and Fidelity Bank Plc and 80 personnel's from the banks. The researcher used chi-square as a statistical tool to analyze the data obtained from the samples. The finding revealed that managerial supervision and inspector of activities in banking industry has not been carried out adequately to expose the irregularities and misappropriations.

4.0 Hypotheses

Based on the review of literature, the following hypotheses were formulated to guide the direction of the study.

1. Internal control components do not influence the effectiveness of internal control systems in the banking sector
2. Organizational ethical climate does not influence the effectiveness of internal control systems in the banking sector
3. There is no mediatory role of ethical climate on the association between internal control components and effectiveness of internal control systems in the banking sector

5.0 Methods

5.1 Research Design

A cross-sectional survey design was adopted to collect data through quantitative methods. The target population of the study included bank employees in selected banks across Nigeria. However, the selected banks were limited to bank branches within the Ibadan metropolis. A multi-sampling technique was adopted in selecting the participants for the study. Twelve bank branches were randomly drawn from the population of branches in Ibadan. This was achieved by using simple random sampling techniques via the ballot technique to obtain the bank branches. Purposive sampling was then employed in selecting an average of 15 respondents for the study from each of the selected bank branches. The dependent criteria for the purposive sampling included availability of respondents to participate in the study, as well as, their willingness (via verbal consent) to be involved in the study. Majority of the respondents were between ages 41-50 years (45.2%). There were more male (55.6%) respondents than their female counterparts. In terms of their marital status, majority (91.9%) of the respondents were married while more than half (54.8%) of the were first degree holders.

5.2 Research Instruments

A structured questionnaire was developed for administering to the staff of the selected banks. The items in the questionnaire were obtained based on a review of related literature on internal auditing risk management and internal control systems, which was structured in line with the objectives of the study. Section A of the questionnaire identified the socio-demographic characteristics of the respondents such as gender, educational attainment, work department etc. Section B of the questionnaire measured perceived effectiveness of internal control system and an evaluation of each component of the internal control system. Section C of the questionnaire measured respondents' perceptions of the ethical climate within their banking institutions. The instruments were validated via a pilot study.

5.3 Procedure

The administration of the research instruments for this study was accomplished by the following procedure. Upon getting the approval from the management of the selected bank branches, the researcher enlisted the services of a contact person to aid in the questionnaire distribution within each of the selected banks. The researcher introduced himself to the contact person (also a prospective participant for the study), who was then intimated about the study and expected to distribute copies of the questionnaire to their colleagues. The contact persons were encouraged to ask clarification questions and were also intimated about the mode of questionnaire distribution and retrieval. Guidelines and instructions on how to fill the questionnaire were printed on each copy for the respondents. In cases where respondents preferred to complete the instruments at a later time, arrangements were made for the collection of such completed instruments. Participants were assured that there are no right or wrong answers to questionnaire items, and that only sincere responses would be used for the research purpose. They were also reassured that responses supplied would be used strictly for the research purposes and as such will carry confidential weight. One hundred and ninety seven questionnaires were successfully retrieved for data analysis.

5.4 Methods of Data Analysis

The research made use of Statistical Package for Social Sciences (SPSS) to analyse the data. In analyzing the data, frequency tables and other descriptive techniques were used as the analytical techniques to provide suitable answers to the research questions guiding the study. Hypotheses 1 and 3 were tested using multiple regression analyses while hypothesis 2 was tested using t-test for independent measures.

6.0 Hypothesis Testing

6.1 Hypothesis One

Internal control components do not influence the effectiveness of internal control systems in the banking sector. This hypothesis was tested using multiple regression analysis. Results are presented in Table 1

Table 1: Multiple Regression Summary Table Showing Predictive Influence of Internal Control Components on Effectiveness of Internal Control System

	R	R^2	F	Sig	B	t	p
Control Environment					.239	9.423	.000
Risk Assessment					-.020	-.855	.393
Control Activities	.417	.174	84.683	.000	.146	5.804	.011
Info Communication					.189	3.613	.002
Monitoring					.277	7.256	.000

Results from Table 1 show that the internal control components (Control Environment, Risk Assessment, Control Activities, Information Communication and Monitoring) jointly predicted effectiveness of internal control system within the banking sector [$F_{(4,1615)}$ =84.68, R^2=.174; p<.01] and accounted for 17.4% of the variance in the effectiveness of internal control system within the sector. Further results on the independent prediction of the control components on effectiveness of internal control system showed that Control Environment (β=.239; p<.05), Control Activities (β=.146; p<.05), Information Communication (β=.189; p<.05), and Monitoring (β=.177; p<.05) emerged as significant independent positive predictors of internal control system effectiveness within the banking sector; while Risk Assessment did not significantly predict the effectiveness of internal control system within the sector. The null hypothesis stated is therefore rejected

6.2 Hypothesis Two

Organizational ethical climate does not influence the effectiveness of internal control systems in the banking sector. This was tested using multiple regression analysis. Results are presented in Table 2

Table 2: T-test Summary Table Showing Influence of Ethical Climate on Effectiveness of Internal Control System

	Ethical Climate	N	Mean	SD	Df	t-value	Sig
Effectiveness of Internal Control System	Positive	135	3.89	0.66	195	.651	.015
	Negative	62	2.01	0.18			

Results from Table 2 show that there is a significant influence of ethical climate on the effectiveness of internal control system within the banking sector [t(195)=.651; p<.05]. The results reveal that participants with positive perceptions of ethical climate reported higher ratings of effectiveness of internal control systems ($\bar{x}$ = 3.89), while participants with negative perceptions of ethical climate reported lower ratings of effectiveness of internal control systems ($\bar{x}$ = 2.01), within the banking sector. The null hypothesis stated is therefore rejected

6.3 Hypothesis Three

There is no mediatory role of ethical climate on the association between internal control components and effectiveness of internal control systems in the banking sector. This hypothesis was tested using multiple regression analysis. Results are presented in Table 3.

Table 3: Mediatory role of ethical climate in the relationship between internal control components and effectiveness of internal control systems

	R^2	F	Sig	B	t	p

Model 1	Control Environment				.239	9.423	.000
	Risk Assessment				-.020	-.855	.393
	Control Activities	.174	84.683	.000	.146	5.804	.011
	Info Communication				.189	3.613	.002
	Monitoring				.277	7.256	.000
Model 2	Control Environment				.142	5.695	.000
	Risk Assessment				.004	.197	.844
	Control Activities	.263	114.673	.000	.006	.238	.812
	Info Communication				.012	.362	.081
	Monitoring				.063	2.585	.010
	Ethical Climate				.393	14.039	.000

Results from Table 3 show the predictive role of internal control components on the effectiveness of internal control system in the banking sector. The table shows two predictive models. Model 2 of the table shows the mediatory role of the ethical climate when introduced into Model 1. The comparative analysis of both models show that there was a decrease in the predictive values of Control Environment (β_1=.239, β_2=.142) and Monitoring (β_1=.277, β_2=.063) on effectiveness of internal control; after controlling for the mediator. This implies that ethical climate acted a partial mediator in the predictive influence of Control Environment and Monitoring on effectiveness of internal control. However, after controlling for the mediator (ethical climate), internal control components of control activities (β_1=.146, β_2=.006) and info communication (β_1=.189, β_2=.012) were no longer significant predictors of effectiveness of internal control (β_1=.146, β_2=.006); which is consistent with full mediation. The null hypothesis stated is therefore rejected.

7.0 Discussion of Findings

Results from hypothesis one of the study showed that the internal control components which emerged as potent predictors of the effectiveness of the internal control system included the Control Environment, Control Activities, Information Communication and Monitoring. However, the influence of Risk Assessment was not statistically significant in the effectiveness of the internal control system. This does not take away the importance of risk assessment when implementing internal control systems. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with changes.

Control environment, as a component, is included also in other control frameworks with, generally, the same concepts. For example, CobiT weaves the implications of the control environment into all applicable control objectives and refers to control environment wherever appropriate (CobiT 2000: 12). As compared to other models, COSO uses a larger number of categories of environment concepts and therefore makes the control environment well-defined. The implementation of effective control environment has an impact on management and governance set up. As it appears in the professional literature, modern management techniques require a change in the control philosophy towards greater reliance on informal controls that influence the motivation and behaviour of employees. Hooks *etal.* (1994) describe the control environment as, in part, an operationalization of organisational culture.

In line with the result obtained in this study, Ezzamel *et al* (2017) found that control internalised into organisational subjects in the form of self-discipline (or responsible autonomy), thereby diminishing the relevance of obtrusive hierarchical control. Placing greater authority and responsibility in the hands of fewer employees (i.e. empowerment) can therefore be reconciled with control by placing greater emphasis on the control environment. Cohen (2002) reiterates the importance of the control environment with the findings from a survey of auditors that "tone at the top" and its implication for the behaviour of employees, is the most important ingredient for effective control. The control environment starts with the board of directors and management, who set the tone of an organization through policies, behaviours and effective governance (Rittenberg *et al.* 2005). If the tone set by management is lax, then fraudulent financial reporting is more likely to occur. Research studies have shown that over 80 percent of financial fraud cases addressed by the SEC between 1987 and 1997 involved top management (Rittenberg *et al.* 2005).

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to the achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties (COSO 1994). The concepts underlying control activities in smaller organizations are not likely to differ significantly from those in larger entities, but the formality with which they operate varies (COSO 1994). Usually certain types of control activities are not always relevant because of direct involvement of the CEO and other key managers in different activities. Appropriate segregation of duties might also present difficulties due to fewer employees in the entity.

Control activities must be evaluated in the context of management directives to address risks associated with established objectives for each significant activity. An evaluator therefore considers whether control activities relate to the risk-assessment process and whether they are appropriate to ensure that management's directives are carried out. This will be done for each significant business activity. An evaluator considers not only whether established control activities are relevant to the risk-assessment process, but also whether they are being applied properly (Hooks *et al*. 1994, Simons 1995). As a consequence of the relatively unambiguous nature, the control activities might be easier to assess than other aspects of internal control system due to their clearness and verifiability, but they should always be assessed in relation to risks that the company faces.

In relation to the component of information and communication, every enterprise must capture pertinent information – financial and non-financial, relating to external and internal events. Relevant information must be delivered to people who need it in a form and timeframe that enables them to carry out their responsibilities and make decisions. Recognising the emerging importance of information and communication, COSO has included it as a separate control component. The literature brings out following benefits from relevant, timely and effective internal and external communication; Improved communication about expectations, responsibilities and objectives of an organisation (Luscombe 1995); Enhanced decision making (Stringer *et al.* 2002); Reduced dependence on individual employees who assist in the prevention and detection of fraud (Hooks *et al.* 1994).

Information systems produce reports, containing operational, financial and compliance related information, that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to inform business decision-making and external reporting (Sawyer 2003). Financial information can also be used for operating decisions (e.g. monitoring performance and allocating resources) and some operating information can be essential for developing financial statements (e.g. routine purchases procedures, information on competitors' product releases).Communication is inherent in information systems. Communication can be divided into internal and external communication. Internal communication, in the internal control framework, involves receiving relevant data for managing entity's activities and communicating a clear message from top management to all personnel that internal control responsibilities must be taken seriously. Both the clarity of the message and the effectiveness with which it is communicated are important (COSO 1994). Open external communication channels with suppliers, customers, banks, external auditors and other stakeholders enable a company to address customer demands, highlight control weaknesses in the entity and better understand risks, but also give reverse signs, e.g. that improper acts by vendors will not be tolerated by the company.

Communication can take different forms as policy manuals, bulletin board notices, internal reports, oral communication. Information systems in smaller organizations are likely to be less formal than in large organizations, but their role is just as significant. Effective internal communication between top management and employees may well be easier to achieve in a small or mid-size company than in large enterprise, because of the smaller organization size and its fewer levels, and greater visibility and availability of the CEO (COSO 1994). Many aspects of information and communication systems in internal control framework address operations and compliance objectives, and are generally outside the scope of evaluation of internal control over financial reporting, e.g. process for capturing data about potential product improvements. In these cases, the controls are instituted to achieve operations objectives, not financial reporting objectives

Monitoring is defined as a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matter reported to top management and the board (COSO 1994). Because internal controls should and do evolve over time, COSO recognizes the need for management to monitor the entire internal control system through the ongoing activities built into the control system itself and through special evaluations directed at specific activities or areas. According to Colbert *et al.* (2005) management has the responsibility to monitor all information technology processes and need to obtain independent assurance on controls.

Ongoing monitoring activities of small and mid-sized entities are more likely to be informal and involve the CEO and other key managers and are accomplished through hands-on involvement in most if not all facets of operations. They are less likely to undergo separate evaluations of their internal control system, and the need for separate evaluations may be offset by highly effective ongoing monitoring activities. Central is the requirement that those performing the monitoring function be independent of those being monitored (Cohen *et al.* 2002). Monitoring thus includes management's methods for following-up and checking on performance to ensure that controls are complied with. With monitoring component the internal control system has made a circle and monitoring activities help to improve control activities, information systems as well as overall control environment.

The second hypothesis highlighted the influence of ethical climate on the effectiveness of internal control system in the banking sector. The importance of ethical climate sets the tone for perpetuation of fraudulent activities among employees. Thus it is essential for management to establish an appropriate ethical climate through practical organizational justice procedures and policies. This gives management the capability to control the employee behavior through enforcing the organizational values that define its culture, consequently influencing compliance to set internal controls. Pfister (2009) emphasizes the influence of the surrounding environment on ethical climate, which comprises that outside the organisation and within. The outside environment incorporates the prevailing societal values, practices, laws and regulation, whereas the internal environment comprises how employees interact with each other as well as their personal characters. Pfister (2009) points out that the environment has an effect on the organizational culture as well as how internal controls are achieved within the organisation.

According to Mihaela and Iulian (2012), internal controls represent management's effort to set rules and regulations need to manage an organization successfully. This view is similar to that given by Cameron and Quinn (2005), who note that organization ethical culture signifies the procedure and regularity of tasks, which are accounts for making an organization successful and unique. In light of these views, the idea that both organizational ethical climate and internal controls set guidelines for employee behavior and actions aimed towards achieving organizational success is developed. Schwartz and Davis (1981) are of the view that organizational ethical climate shapes the behavior of individuals and groups in the organization and molds their beliefs and belief patterns into a similar way of thinking. Previous research affirms the importance of organizational ethical climate towards establishing a system of shared beliefs, values, and philosophies and suggests that internal controls adopted are a reflection of the organization members pattern of beliefs and values and mindset. According to Jaques (2013), the ethical climate is a collective phenomenon that determines responses to certain stimuli by members of the same organisation. This suggests that employees will begin sharing common beliefs and mentalities and the internal controls adopted are a reflection of the organisation's members pattern of beliefs, values and mindset.

As highlighted in the third hypothesis, the importance of ethical climate also accounts for its mediatory role in the relationship between internal control components and effectiveness of internal control system. Individuals do not operate in a vacuum; fraudulent practices occur within an organizational context. Hence, it seems important to not only look at the 'bad apples', but also at possible 'bad barrels'. A relevant organizational-level predictor of (un)ethical behavior in organizations is the culture (Jha and Panda 2017; Kaptein 2011) or climate of an organization (Victor and Cullen 1988). One meta-analysis revealed an organizations' ethical climate as a particularly relevant organizational factor explaining a wide range of unethical decisions of employees (Kish-Gephart *et al.* 2010; Peterson 2002). Thus, ethical climate is an organizational level factor that determines the interplay between internal control components and effectiveness of the internal control systems as a whole.

An organization's ethical climate affects which issues organization members consider ethically relevant, whose interests they consider when deciding on moral issues, and which ethical criteria they use to determine what constitutes the 'right behavior' (Victor and Cullen 1988; Martin and Cullen 2006). As such, ethical climate refers to the most commonly used types of moral reasoning, rather than to the content of decisions (Victor and Cullen 1988). The assumption underlying the concept of ethical climate is that members of an organization share, at least to some extent, a form of moral reasoning. In deciding whether it is acceptable to pay or to accept bribes, organizational members can consider different ethical criteria. The dominant considerations are maximizing self-interest

(egoistic reasoning), maximizing joint interests (benevolent reasoning), or adherence to principles (principled reasoning; Victor and Cullen 1988).
In an egoistic climate, people base their decisions, first and foremost, on what will best promote their self-interest (Martin and Cullen 2006). In such a climate, organizational members perceive that self-interest commonly guides behavior, even if it is at the expense of others (Wimbush and Shepard 1994). In a benevolent climate, ethical decision-making is seen to be predominantly based on concern for the wellbeing of others, which may be others within the organization itself, or society at large (Martin and Cullen 2006). In a principled climate, ethical decision-making is primarily presumed to be based on external codes, such as the law or professional codes of conduct (Martin and Cullen 2006).

8.0 Recommendations

There is no absolute guarantee from internal control that organizations objectives will be achieved. This implies the inherent limitations of internal control; that internal control is designed, operated and monitored by human beings. However it is possible to improve internal control effectiveness through continuous monitoring, related risk assessment, designing sound control methods and with good communication in the organization. From the result of this study it is impossible to conclude the internal control systems in the banking sector are economical, efficient and effective. However, based on the responses obtained from participants of this study, there is room for significant improvement. As stated by Spencer (2003) a control environment which is an entire commitment of managements from design of internal control to its monitoring should be strong enough to keep the other components of internal control in line. Based on the finding the following are specific areas that need due emphasis to improve the internal control system within the banking sector.

- The human power of the banking organizations as a major component of control environment of the system has to understand the policies, directives and program of its respective organization.
- Internal control is a responsibility of management, employees and other stakeholders. Hence there should be a clear line of responsibility and structure of reporting to discharge any risk of collusion and fraud.
- Separation of accounting duty from authorization and custody of an asset is a key in detecting control risk. Thus due emphasis should be given to maintain segregation of duties.
- An updated asset register and adequate documentation should be maintained in the organization to achieve effective control of activities
- There should be a documented frameworks for banking organizations to identify possible risks and strategies to control the risks

- Good information flow and line of communication risk of failure in internal control caused by information gap. Thus necessary information should be communicated to all stakeholders, transactions should be recorded promptly.
- The control system effectiveness should be evaluated against clearly established criteria and should be monitored continuously. This is the responsibility of management and internal auditors.
- Finally internal control system in the banking sector is also responsibility of the government authorities to take corrective controls in a repeated failure of the system. This is the responsibility of the Central Bank, through effective policy formulation and implementation.

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