Internal Control and Effective Risk Management in Nigerian Insurance Companies

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Abstract

This research study assesses internal control and effective risk management in Insurance companies in Nigeria with the specific objective of knowing the relationship between effective risk management and internal control measures such as presentationof early report, respect for authority, cost of instituting internal control measures, control measures for unusual transactions, and well-designed organizational structure. Descriptive survey research technique was employed in the study with the aid of an adapted multiple regression model which was used to analyzed the response received from questionnaires because primary data was sourced from the audit, account and operations department of all insurance companiesrepresented in Abuja. Findings reveal that good internal control measures produces effective risk management system. This study recommends thatinternal control staffs should be autonomous, answerable to authorities and should be ethical in the discharge of their duties.

Keywords: Internal Control, Risk Management, Insurance industry, Organisational Structure

INTRODUCTION

Internal control and risk management system involve all the structure, policies, and procedures put in place to provide reasonable assurance to enable management meets its objectives and fulfils its responsibilities and mitigate possible risks. According to the University of Oregon (2016), internal controls are intended to provide reasonable assurance in the organization in order to meet its mission, to promote performance leading to effective accomplishment of objectives and goals, to safeguard assets, to provide accurate and reliable financial records, to promote operational economy and efficiency, and to promote adherence to applicable laws, regulations, and prescribed management policies and practices. It further states that internal controls make surethat the required steps are taken to address risks while attaining the institution's goals. From the above, it is apparent that internal control systems are important and applicable to organizations of all sorts and sizes for the goal of guaranteeing the organization's efficient functioning. Government-owned university libraries use a comprehensive internal control system to address concerns related to the successful achievement of library goals and objectives, adherence to rules and regulations, and the preservation of order. Internal control and risk management systems are primarily used by an organization's management to make operational efficiency decisions. Internal control is a strategy used by an organization's management to create values and improve the organization's operations by assisting them in achieving their goals in a methodical manner and evaluating the efficacy of management policies.Internal control is a critical way of validating and verifying compliance with administrative rules, legal, financial, and administrative systems inside a company. Efficient job performance to meet organizational goals with little resource waste, which includes making the best use of resources, time, materials, and people, is what the internal control system strives for.Similarly,

AuditNet (2016) states that internal control guarantees that workers are doing their utmost to create effective and efficient workplace operations while adhering to rules and regulations.

The value of an internal control and risk management system may be seen in a variety of policies that influence many areas of the company. Internal control, according to Missouri State University (2016), is a system of organizational design, written rules and procedures, operational practices, and physical barriers to protect assets.Internal control and risk management systems, it said, provide methods for preserving assets, correct transaction documentation, and efficient and effective achievement of organizational goals and objectives, including compliance with the entity's laws and regulations. Internal control systems, according to Whittington and Pany (2004), are utilized as part of an organization's monitoring activities. It entails assessing internal controls and the efficiency with which the organization's various components carry out their responsibilities.An internal control system is often used to determine if a department has a clear knowledge of its responsibilities, is appropriately staffed, keeps excellent records, correctly safeguards cash, inventory, and other assets, and works together with other departments.

Internal control system is defined by the International Auditing Standard as "all policies and procedures used by the organization to achieve management's goal of ensuring, as far as practicable, the orderly and efficient conduct of its services, including adherence to management policies, asset safeguarding, prevention and detection of irregularities, accuracy of the accounting record, and timely processing of reliable financial information."In financial operations, there are several stages. These phases include documentation, prime entry records, double-entry records, entry summary, account balance, and financial statement preparation (Kiabel &Akenbor, 2008).Previous researches have demonstrated that internal control mechanisms are a viable strategy for minimizing and preventing mistakes and irregularities in financial organizations (Ogundikpe, 2000; Nwaiwu&Peters, 2014).Internal control is described by Kudinz (2009) as "all types of control procedures implemented by management to ensure the organization's efficient and effective performance." As a result, every control measure used by a company to achieve a defined goal is referred to as an internal control system.Because of financial companies' branch networking and the high volume of transactions, executive directors increasingly find it difficult to exercise personal first-hand supervision of operations; as a result, they have come to rely on accounting and statistical reports that summarize current happenings and conditions throughout the companies. The information conveyed by this stream of reports helps the executive directors to manage and direct the firms' activities. It keeps them up to date on whether the company's policies, legal and regulatory laws and accounting principles are being followed, and whether interpersonal and inter-departmental relationships exist (Smith & Jacknes, 2003).Following an inquiry, it was discovered that several financial businesses are falsifying their status reports in order to boost their stock market worth (Osisioma&Enahoro, 2006). With this situation, one may imagine what is happening to those firms' internal control systems. Could it be that company internal control officers are yielding to management's demands for such activities, or that the internal control system is generally inadequate?

The objective of this study is to assess the impact of internal control and risk management on Insurance companies in Nigeriawhile the specific objective is to determine the impact of internal control measures such as presentation of early report, respect for authority, cost of instituting internal control measures, control measures for unusual transactions, and well-designed organizational structure on risk management in Nigerian insurance companies. Although many studies have been carried out in the past on internal control measures in the many financial institutions, but this study intends to investigate using the auditing,account and operations department of Insurance companies in Nigeriain carrying out a thorough research regarding internal control and risk management in the insurance companies.

LITERATURE REVIEW

Conceptual review

Every stakeholder in a firm is expected to be involved in risk management. It should be thorough, covering all of the company's operations, processes, and assets. Risk management is a dynamic system that is defined and applied by the organization. Risk management refers to a collection of resources, behaviors, processes, and activities that are tailored to the specific needs of each organization and allow managers to maintain risks at a manageable level. The likelihood of an incident affecting the company's employees, assets, environment, objectives, or reputation is referred to as risk. Internal control systems are critical for the efficient operation of an organization. There are financial and non-financial assets that must be handled and monitored efficiently and effectively in order for the organization to remain profitable and evergreen (Olufunmilayo& Hannah, 2018) "Internal Controls are processes designed and caused by those charged with governance, management, and other personnel to provide rational assurance about the entity goal achievement, about reliability of the financial reporting, effectiveness and efficiency of operations and compliance with appropriate laws and regulations" (Kinyua, Gakure, Gekara, &Orwa, 2015).

Corporate entities would benefit from a greater knowledge of the interconnected relationships between the components of internal control systems, which are incorporated into the management process to maximize shareholder value. While each component of an internal control system is important, combining them can result in management excellence and efficient governance (Koutoupis&Pappa, 2018). Insufficient internal control systems, according to Adenugba and Adeyemi (2011), usually result in the inability to detect fraudulent actions and a decline in insurance company performance. Previous research by Smith and Jacknes (2003) and Kudinz (2009) identified some determinants of an effective internal control system as early report presentation, respect for authority, willingness to make changes, lack of worker collusion, worker competence, internal control staff independence, management control observance, good remuneration of internal control staff, cost of internal control, Internal control staff compensation, the cost of implementing internal control measures, the desire to enforce controls, control measures for atypical transactions, and a well-designed organizational structure are all factors to consider.

Empirical review

The Sarbanes-Oxley Act of 2002 mandates insurance firms to pay greater attention to their internal controls.Internal control, according to Millichamp (2002), is a critical component of every firm. Because there are dishonest persons who appear to be honest, it is necessary to protect the company's assets. In order to reduce the risk of mistakes and irregularities in all operations, a firm must have a strong accounting system. Using five randomly selected insurance companies in Adamawa State in the North Eastern part of Nigeria, Siyanbola, Oyebamji, and Ibrahim (2016) assessed the roles that effective internal control systems play on the performance of the insurance business in Nigeria. Primary data were used to elicit responses. The Pearson Product Moment Correlation Coefficient was employed to investigate the link between internal control and insurance company performance. The study discovered a positive link between the independent and dependent variables, implying that an effective and efficient internal control system has a significant impact on insurance company performance.

Olajide (2013) investigated the influence of Information Communication Technologies (ICT) on the profitability of insurance businesses. He believes that firms must embrace ICT to enhance efficient services in order to achieve the profit maximization goal, particularly in Nigerian insurance companies. The study discovers a favorable link between ICT and insurance company profitability. Fadun (2013) investigates enterprise risk management (ERM) practices in Nigerian insurance firms. Insurers' risk management strategies in Nigeria's insurance sector were investigated using a survey and interviews. The study made use of both primary and secondary data. The sample is made up of 12 insurance firms that were chosen at random. The findings of the study reveal that the level of understanding of the nature of

ERM varies significantly between companies and between different parts of the same organisation. The implication for practice is that effective ERM requires an interdisciplinary approach; but, the ERM which is practiced by insurers in Nigeria is dominated by a single discipline. ERM design also depends on the risk appetite of an organisation, which includes both qualitative and quantitative elements. Saidu (2012), in his research on effectiveness of internal control system and the issues of independent and confidentiality in an organization, used survey method of data collection, aiming to generate and reliable data for the study. A simple percentage method was used to analyze the data. The result obtained shows that, there is a significant relationship between internal control and external control system and confidentially in business and public organization. Ozigbo and Orife (2011) also conducted a research on internal control and fraud prevention in insurance business. The study examines internal control and fraud prevention in insurance business. A survey was undertaken in some selected firms in Warri metropolis. The study population comprised of all business entities operating in Warri metropolis in Delta state. Few companies were randomly selected for sampling. Research Questionnaires were designed and administered to 80 senior staff in the accounting sections of the firms. The method of data analysis was descriptive statistics, adopting tables and simple percentages. The finding of the study was that internal control was a necessary, safeguard tool, which ensures owners of the business that their funds are being effectively efficiently.

According to Amudo and Inanga (2009), Control environment, control activities, risk assessment, information and communications, monitoring, and information technology are the six key components of an effective internal control system. Their study's findings indicated that assessing internal control efficacy is linked with the existence and operation of the six primary control components. Internal control actions have been increasingly significant as time has passed in the practices. Furthermore, it is worth noting that contemporary internal control system techniques have begun to acquire prominence over old approaches and methodologies. Internal control formation is critical in the deterrence of fraud and irregularities. It also serves as a foundation for the conclusion that management and relevant authorities should concentrate on more strategic methods of internal control establishment in order to avoid fraud in the public sector (Ademola, Adedoyin, & Alade, 2015). Olaoye (2009) uses descriptive and inferential statistical methods to determine the impact of internal control system in the banking sector in Nigeria. He concluded that the function of fraud prevention, detection and control are interwoven. He stated that the three works together to eliminate fraud and fraudulent tendencies and that internal control is highly significant in fraud detection and prevention in the Banking sector in Nigeria. Olatunji (2009) investigated the effects of internal control systems in the banking industry, concluding that poor internal control systems are the leading source of bank fraud in Nigeria. It is therefore decided that every bank's management should develop and implement a standard internal control system that is adequate to withstand fraud's tactics in order to ensure the bank's liquidity, solvency, and going concern.

Smith and Jacknes (2003) described administrative controls as those internal control measures that have no bearing on financial records and statements. Kiabel (2002) posits that administrative controls are established to provide operational efficiency and adherence to prescribed policies in all departments and branches of the organization. They include: quality control, operation scheduling, budgeting control, and annual plan control. Kudinz (1998) noted that the reasons for internal control in any organization are (i) to safeguard resources against waste, fraud and inefficiency (ii) to promote accuracy and reliability in accounting and operating data, and (iii) to encourage and measure compliance organization's policy. According to Aguolu (2002), internal control is the whole system of controls, financial or otherwise established by management, in order to secure, as far as possible, the accuracy and reliability of records, run the business in an orderly manner and safeguard the company's assets, its objective being the prevention or early detection of fraud and errors. HenshawandBarban (2000) classified internal control into two broad forms. These are accounting controls and administrative controls. Accounting controls are those measures having to do with the reliance on the accounting records and financial statements. They include internal audit and internal checks. Internal audit is an independent appraisal activity within the bank for the review of accounts, financial and other operations as a basis for service to management.

Osisioma and Enahoro (2006) posit that the job of the internal auditor is to investigate and appraise the system of internal control and the efficiency with which the various units and branches of the bank are carrying out their assigned functions.

Welkazi (2004) claimed that auditors dance to management's music, and management is reluctant to enforce controls relating to their personal activities, so they engage in various forms of irregularities, abuse of authority, reluctance to effect changes in the internal control system when necessary, and frequent alterations in the internal control system, which can lead to a total breakdown of the system (Labaran, 2011; Kiabel &Akenbor, 2008). A critical review of related literature revealed that the internal control measures adopted in the insurance industry are not effective enough in minimizing or eradicating accounting irregularities. The effectiveness of the system is hindered by several factors among, which are: many of the insurance workers have no proper accounting and finance background; hence they are incompetence and are prone to making wrong accounting entries (Okoh&Unugbro, 2003).Also, internal control officers are not adequately remunerated to function effectively in monitoring internal control system in insurance companies, management of insurance companies are not committed to ensure effective monitoring of internal control system in the industry. (Siyanbola, Oyebamji, & Ibrahim, 2016).

Theoretical Review

Signaling theory

In terms of decision-making, signaling theory is concerned with understanding why certain signals are reliable and others are not. The theory examines the quality and reliability of accounting information supplied by a firm to the users of accounting information for the purpose of making investment decisions by potential investors. A well-performing business, according to Spence (1973), separates itself from a non-performing one by giving a credible signal about its performance to capital markets and potential investors. A company's signals are the outcomes of its operations that tell investors about the company's future prospects. Signals sent by a firm are the results of its operating activities which would inform investors about the company's future prospects. Signaling theory was used in this study to underpin the various internal control measures put in place by the management in ensuring effective risk management is put in place. This will also ensure that quality and accurate report is being prepared and sent to the decision makers (board, shareholders,etc) of the firm inform of reports (signals) and this will also further increase the accuracy and reliability on the financial statement. Furthermore, effective cost management would enable a company to minimize its production operating costs, resulting in an improvement in the firm's financial performance, signaling to both current and potential investors that the company can continue to operate in accordance with the going concern concept of accounting while also satisfying the interests of its stakeholders.

Modigliani and Millers Theory ofRisk Management

In addition to the investment risks, the Modigliani and Miller approach implies that a company's market valuations are impacted by its net profit. The theory states that the selection of capital structure does not affect the valuation of the company. The Modigliani and Miller approach to capital theory was founded in 1958 and promotes the concept of capital structure irrelevance. The Modigliani and Miller strategy makes the following assumptions: no taxes, no trading costs for purchasing and selling shares, and no bankruptcy fee. There is asymmetry in information that allows an investor to have the same information as a corporation, therefore enabling investors to act wisely. For both companies, borrowing costs are same. There are no float charges, such as commissions for underwriting, payments to commercial bankers, promotional expenditures, etc. Corporate Dividends are tax-free.

Financial leverage is, according to the theory, proportionate to equity costs. As the company's debt rises, the equity owners are exposed to more risk. As a result, shareholders anticipate a larger return, raising the cost of equity and implying that debt shareholders have the upper hand when it comes to the claim on earnings.

Some finance scholars reacted to Modigliani and Miller's (1958) ''risk management irrelevance theory" by pointing out capital market flaws and presenting hypotheses that justify why risk management would improve firm worth (Syed Muhammad et al., 2012) Scholars argue in ERM studies that the presence of these imperfections causes risks to inflict specific costs on companies and that risk control may maximize firm value by reducing overall risk, which is usually calculated as some form of uncertainty.Researchers have described many value-enhancing advantages of risk management, which can be broadly classified as a reduction in potential costs associated with the following: tax payments, financial pressure, underinvestment, asymmetric intelligence, and un-diversifiable stakeholders. Such studies contribute to a better understanding of why companies want to hedge risk and provide analytical support for the correlation between risk management and other control measures.

METHODOLOGY

Descriptive survey research design was chosen to undertake this research in order to assist in assessing internal control and risk management in insurance companies.The population of the study consist of all the twenty-two (22) insurance companies in Nigeria and samples were made up of a branch of each of the twenty-two insurance companies represented in Abuja.A questionnaire was used to measure internal control and risk management of the insurance companies and it was designed with closed-ended 5-Linkert scale type.The purposive sampling is used to draw the sample from each of the branch of the insurance companies. A pilot study was undertaken to ensure that the final questionnaire was error free and amendments were made before the data was collected for the study. A total of one hundred and fifty-six (156) questionnaires were given out to be filled in the audit, account and operations department of the companies. The researcher provided a self-addressed envelope and prepaid envelop to the respondents for the return of the questionnaires. Statistical analysis, such as descriptive statistics, correlation analysis and regression were performed on the data. The study employed multiple regression as the procedure of analysis with aid of SPSSversion 20 as a tool for analysis. The model of our study was adapted from Akanni and Akaninyene (2015) and it was estimated thus:

$$ER = \alpha_0 + \beta_1 POER + \beta_2 REFA + + \beta_3 COC + + \beta_4 COM + \beta_5 WEDOS + e$$

Where:

ERM= Effective Risk Management
POER = Presentation of early report
REFA = Respect for authority
COC = Cost of instituting internal control measures
COM = Control measures for unusual transactions
WEDOS = Well designed organizational structure
α_0= constant or intercept
$\beta_1 - \beta_5$= coefficient of explanatory variables
e = error term
The study employed multiple regression as a procedure of analysis.

RESULTS AND DISCUSSION

Table 1 Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Presentation of early report	156	1.00	5.00	3.4615	1.55495
Respect for Authority	156	2.00	5.00	3.6346	1.33483
Cost of instituting internal control system	156	1.00	5.00	2.5385	1.86092

	156	3.00	5.00	4.5385	.72187
cost of control measures for unusual transactions	156	3.00	5.00	4.5385	.72187
Well designed organizational structure	156	3.00	5.00	4.3269	.77179
Risk management is responsive to internal control measures	156	2.00	5.00	4.4808	.84602

Source: Field work 2021

Table 1 above is the descriptive statistics of our study. A close look at our table shows that presentation of report has a mean of 3.4615 with a deviation of 1.55495. Respect for authority has a men value of 3.6346 with deviations from both sides being 1.33483. The cost of instituting internal control system has a mean of 2.5385 and a deviation of 1.86092 while the cost of control measures for unusual transactions has an average value and deviation being 4.5385 and 0.72187. Well-designed organization structure also has an average value of 4.3269 and deviation of 0.77179 and lastly risk management is responsive to internal control has a mean value of 4.4808 and a deviation of 0.84602.

Table 2 – Correllation Analysis

		Presentation of early report	Respect for Authority	lack of workers collusion	Workers competence	Cost of instituting internal control system	cost of control measures for unusual transactions	Well designed organizational structure	Risk management is responsive to internal control measures
Presentation of early report	Pearson Correlation	1							
	Sig. (2-tailed)								
	N	156							
Respect for Authority	Pearson Correlation	.226**	1						
	Sig. (2-tailed)	.005							
	N	156	156						
Cost of instituting internal control system	Pearson Correlation	.220**	.349**	.108	.023	1			
	Sig. (2-tailed)	.006	.000	.179	.774				
	N	156	156	156	156	156			

cost of control measures for unusual transactions	Pearson Correlation	.019	.196*	.182*	.011	.073	1		
	Sig. (2-tailed)	.818	.014	.023	.893	.364			
	N	156	156	156	156	156	156		
Well designed organizational structure	Pearson Correlation	.164*	.522**	.192*	.294**	.110	.087	1	
	Sig. (2-tailed)	.041	.000	.016	.000	.172	.279		
	N	156	156	156	156	156	156	156	
Risk management is responsive to internal control measures	Pearson Correlation	.332**	.323**	.158*	.020	.437**	.366**	.094	1
	Sig. (2-tailed)	.000	.000	.048	.807	.000	.000	.243	
	N	156	156	156	156	156	156	156	156

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the 0.05 level (2-tailed).

Source: Field work 2021

Table 2 above is the correlation analysis of our table. Presentation of early report, respect for authority, well designed organizational structure, cost of instituting internal control system, cost of control measures for unusual transactions moves in the same positive direction with risk management responsiveness to internal control measures

Table 3 - Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.692a	.479	.461	.62101

a. Predictors: (Constant), Well designed organizational structure, cost of control measures for unusual transactions, Cost of instituting internal control system, Presentation of early report, Respect for Authority

Source: Field work 2021

Table 3 above is the Model Summary showing the R square value of our model being 0.692 meaning that the coefficient of determination of the model is 69.2%, this is very good and fit the model.

Table 4 ANOVAa

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	53.095	5	10.619	27.535	.000b
	Residual	57.848	150	.386		
	Total	110.942	155			

a. Dependent Variable: Risk management is responsive to internal control measures

b. Predictors: (Constant), Well designed organizational structure, cost of control
measures for unusual transactions, Cost of instituting internal control system,
Presentation of early report, Respect for Authority
Source: Field work 2021

Above is the ANOVA table having a F- statistics value of 27.535 and a corresponding p- value of 0.000, this implies that all our predictors have a joint statistical significance on our mode because our p-value is less than 0.05. This is another good indication that our model is of good fit and can be used for forecasting and hypothetical testing.

Table 5 Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.077	.720		7.049	.000
	Presentation of early report	.181	.035	.333	5.170	.000
	Respect for Authority	.240	.054	.379	4.426	.000
	Cost of instituting internal control system	.104	.033	.229	3.143	.002
	cost of control measures for unusual transactions	.393	.072	.335	5.471	.000
	Well designed organizational structure	.265	.082	.241	3.228	.002

a. Dependent Variable: Risk management is responsive to internal control measures
Source: Field work 2021

Table 5 above shows our ANAOVA table. The results shows all p-values of our predictors and our constant having all positive coefficients and p-value of 0.000 except for well-designed organizational structure that also as a positive coefficient and a p- value of 0.002.The results therefore implies that presentation of early reports , respect for authority, cost of instituting internal control system for unusual transactions and well-designed organizational structure all have a positive significant effect on effective risk management of insurance companies in Nigeria.

Discussion of Findings

Presentation of early report, respect for authority, well designed organizational structure, cost of instituting internal control system, cost of control measures for unusual transactions as internal control measures all determines the quality of effective risk management of insurance companies. Thisfinding is supported by(Smith & Jacknes 2003;Kudinz2009;Akanni&Akaninyene2015).

CONCLUSION AND RECOMMENDATION

Internal control gives management confidence in the accuracy of accounting data utilized in decision-making. It encompasses all control methods used to protect a company's resources from waste and inefficiency in order to improve accuracy and reliability in accounting and operational data, as well as assessing the efficiency of operations across all divisions. However, this study concludes that effective risk management in Nigerian insurance companies is definitely a function of good internal control system that is put in place by the management of the companies. Based on the finding of this study, the following recommendations are made:

i. Internal control staff should be made to be answerable to authorities outside management to promote independence.

ii. Internal control staff should be given the autonomy to operate so that proper investigation of the activities of executive members can be carried out.

iii. High level ethical standards should be enshrined in Nigerian insurance companies to make internal control more effective.

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