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Internal Control - Overview

The ability of management to achieve the financial reporting objectives of fairness and faithful representation is greatly dependent on the design and effectiveness of the processes and safeguards that have been established within the control environment. The absence of such controls would pose difficulties for companies when preparing timely and reliable financial report for parties that make economic decisions with the financial statement

Management of public companies are responsible for the preparation and fair presentation of financial statements in accordance with Companies and Allied Matters Act CAP C20 LFN 2004, Financial Reporting Council Act No 6 2011 and International Financial Reporting Standards. In pursuit of this stewardship obligation, management must ensure the operating effectiveness of internal controls as the Directors of the entity determine are necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The ability of management to achieve the financial reporting objectives of fairness and faithful representation is greatly dependent on the design and effectiveness of the processes and safeguards that have been established within the control environment. The absence of such controls would pose difficulties for companies when preparing timely and reliable financial report for parties that make economic decisions with the financial statement. This implies that an effective system of internal control over financial reporting would significantly reduce the risk of such misstatement and inaccuracies in a company's financial statements.

Internal control over financial reporting in the Nigerian business environment

Over time as a result of corporate failures , the effectiveness of internal control over financial reporting has become necessary in the business community and several attempts have been made by regulators to achieve this either by enacting necessary acts or the establishment of relevant corporate governance codes. The Financial Reporting Council of Nigeria is in the process of issuing a unified corporate governance code for Nigeria. It is expected that the code will specify a uniform globally accepted internal control framework for entities reporting in Nigeria.

There have been several initiatives in the past aimed at promoting good corporate practices by regulatory agencies in Nigeria. The Nigerian Securities and Exchange Commission and Corporate Affairs Commission set up a 17-member committee led by Mr. Atedo Peterside in 2003 to report on the weaknesses of Corporate Governance and how it can be improved. The position of this committee was further enhanced by another team led by Mr. M. B. Mahmoud in 2011.

The Investment and Securities Act 2007 expressly gives guidance on issues relating to internal control. Specifically, section 60 (d-f) of this act give the following provisions as it relates to the responsibilities of the signing officers in connection with internal control of the entity

Section 60(d); the signing officers;

(I) are responsible for establishing and maintaining internal controls.

(ii) have designed such internal controls to ensure that material information relating to the company and its consolidated subsidiaries is made known to such officers by others within those entities particularly during the period in which the periodic reports are being prepared;

(iii)have evaluated the effectiveness of the company's internal controls as of date within 90 days prior to the report;

(iv)have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;

Section 60(e); the signing officers have disclosed to the Auditors of the company and audit committee:

(I) all significant deficiencies in the design or operation of internal controls which would adversely affect the company's ability to record, process, summarize and report financial data and have identified for the company's Auditors any material weakness in internal controls, and

(ii) any fraud, whether or not material, that involves management or other employees who have significant role in the company's internal controls;

Section 60(f); the signing officers have identified in the report whether or not there were significant changes in internal controls or other factors that could significantly affect internal controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Section 61 of the act further stresses the importance of internal control by giving direction as regards the responsibility of the public entities as it relates to internal control. The details of this section of the Act is stated below:

I. A public company shall establish a system of internal controls over its financial reporting and security of its assets and it shall be the responsibility of the board of directors to ensure the integrity of the company's financial controls and reporting.

ii. The board of directors of a public company shall report on the effectiveness of the company's internal control system in its annual report.

iii. In this section, "internal control" means policies, procedures and practices put in place by management to ensure safety of assets, accuracy of financial records and reports, achievement of corporate objectives and compliance with laws and regulations.

The SEC Code of Corporate Governance stresses the importance of effective and adequate internal control systems; Section 30.4 (paragraph b, c and d)of this code provides that;

In addition to its statutory functions, the audit committee, should have the following additional responsibilities:

- establish an internal audit function and ensure there are other means of obtaining sufficient assurance of regular review or appraisal of the system of internal controls in the company;
- ensure the development of a comprehensive internal control framework for the company; obtain assurance and report annually in the financial report, on the operating effectiveness of the company's internal control framework;
- at least on an annual basis, obtain and review a report by the internal auditor describing the strength and quality of internal controls including any issues or recommendations for improvement, raised by the most recent internal control review of the company;

With all these provisions clearly spelt out, it is evident that the the utmost goal of the Securities and Exchange Commission is to ensure that listed entities maintain a sound and effective internal control environment. What is missing in the SEC code is the adoption of a globally recognized internal control framework for entities that are subject to Investment and Securities Act 2007. The FRC Act 2011 was definite on the adoption of the International Financial Reporting Standards (IFRS) for financial reporting in Nigeria.

In the absence of a uniform internal control framework, entities have the option of selecting from a number of different internal control framework from different jurisdiction. This present situation could impede fairness, comparability and compliance.

The 'Internal Control Integrated framework' published by the Committee of Sponsoring Organization COSO is a framework that is widely applied in the United states of America. This framework was first published in 1992 and updated in 2013. According to the COSO framework, Internal control is defined as a process, effected by an entity's Board of Directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to Operations, Financial Reporting and Compliance.

COSO describes internal control as consisting of five essential components. These components, which are subdivided into 17 factors, include:

- the control environment;
- risk assessment;
- control activities;
- information and communication;
- monitoring

A similar framework called the "Criteria of Control" CoCo was issued by the Canadian Institute of Chartered Accountants. This was first published in 1995 and it is worth noting that this model builds on the existing US COSO framework.

CoCo describes internal control as actions that foster the best result for an organization. These actions, which contribute to the achievement of the organization's objectives, focus on:

- effectiveness and efficiency of operations;
- reliability of internal and external reporting;
- compliance with applicable laws and regulations and internal policies.

CoCo indicates that control comprises: "Those elements of an organization (including its resources, systems, processes, culture, structure, and tasks) that, taken together, support people in the achievement of the organization's objectives.

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