EFFECTS OF INTERNAL CONTROL SYSTEM ON FINANCIAL PERFORMANCE IN AN INSTITUTION OF HIGHER LEARNING

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ABSTRACT

The study investigated the relationship between internal control systems and financial performance in Surigao del Sur State University. The research was conducted using both quantitative and qualitative approaches using survey, correlation and case study as research designs. Data were collected using questionnaires and interview guide basically Deans, and Finance and Accounts staff as respondents from a population of 13 Surigao del Sur State University staff. Data was analyzed using the Statistical Package for Social Scientists where conclusions were drawn from tables. The study found that management of the institution is committed to the control systems, actively participates in monitoring and supervision of the activities of the University, all the activities of the Institution's activities are initiated by the top level management, that the internal audit department was not so efficient, in the reporting address weaknesses in the system. It was however, revealed that all revenues and expenditures are properly classified, and that assets of the University have generally increased. The Study therefore concludes that internal control systems do function although with hiccups and that there was a significant relationship between internal control systems and financial performance in an Institution of higher learning.

Keywords: Internal control system, Financial performance, Surveys, Correlation and case studies, Higher learning

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INTRODUCTION

There is a general perception that institution and enforcement of proper internal control systems will always lead to improved financial performance. It is also a general belief that properly instituted systems of internal control improve the reporting process and also give rise to reliable reports which enhances the accountability function of management of an entity (OAG, 2010).

Accountability needs to be accurate and timely so as to aid decision making. It should be noted that International Financial Reporting Standards (IFRS) emphasize timely production of financial reports. Ideally end of year financial statements should be produced within three months following the end of the period to which the financial statements relate (Mawanda, 2008).

However, Surigao del Sur State University has been in existence for over 2 years after being converted from Surigao del Sur Polytechnic State College for over 28 years. The University since its inception had management of the highest qualification, caliber and dedication. Management meets regularly (weekly) to review the affairs of the Institution and to direct the strategic path of the University and to ensure continued goal congruence. Systems have evolved over time and all the departments and units of the institution have undergone positive transformations. Internal controls have been put in place to ensure safe custody of all university assets; to avoid misuse or misappropriation of University assets and to detect and safeguard against probable frauds. The university employs professionals to fill all the key departments and units. This is ensured by the transparent and open system of selection and recruitment aided by the ably staffed Human Resource Department of the institution. All departments and units are adequately staffed with qualified and competent staff. Continuous on the job training and Continuing Professional Development courses (CPDs) have always been the greatest priority with great budget allocation for these trainings. The University records and accounting systems have been refined overtime. These records are audited by professional internal audit department to help in compliance with the internal policies and procedures.

Moreover, despite all the above efforts exerted by the University, the researchers wanted to deviate from the obvious, if there is still area needed to assist in the internal control of the university. There is a general perception that the study has been around for some time. The curiosity of the researchers was to answer the question; do the systems really work as expected?

This study will therefore attempt to investigate the persistent financial performance from the perspective of internal controls and to establish the relationship between internal control system and financial performance.

OBJECTIVES OF THE STUDY

Establish the relationship between internal control systems and financial performance in Surigao del Sur State University. Determine if there is still area of internal control needed to assess in SDSSU. Provide invaluable benefits to the Surigao del Sur State University Administration to streamline the systems of internal controls.

THEORITICAL FRAMEWORK

This study will be guided by "The Agency Theory" as initially put across by Jensen & Meckling, (1976) and later expounded on by Gerrit Sarens & Mohammad J. Abdolmohammadi, (2010). Gerrit & Mohammad theory also has connotations with the Theory of Firm articulated by Nicolai J. Foss, *et al*. According to the agency theory, a company consists of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources (Jensen & Meckling, 1976). Agency theory posits that agents have more information than principals and that this information asymmetry adversely affects the principals' ability to monitor whether or not their interests are being properly served by agents.

Furthermore, an assumption of agency theory is that principals and agents act rationally and use contracting to maximize their wealth. A consequence of this assumption may be the "moral hazard" problem (Jensen & Meckling, 1976) indicating that in an effort to maximize their own wealth, agents may face the dilemma of acting against the interests of their principals.

However, this theory was chosen for this study simply because "internal control is one of many mechanisms used in business to address the agency problem" (Jensen & Payne, 2003). Furthermore, "studies have shown that internal control reduces agency costs" (Abdel-khalik 1993; Barefield et al. 1993).

CONCEPTUAL FRAMEWORK

In making the program for the enhancement performance of the finance and accounts personnel and deans, it needs apt information that may serve as basis in proposing an

intervention with the help of the process made by the researchers through questionnaire. With the help of this information, this is the starting point where the researchers can identify the profile of the internal control systems and financial performance of the finance and accounts personnel and deans that affect their duties and responsibilities.

Control Environment, set as the tone of the organization by influencing the control consciousness of people. It is also viewed as the foundation for all the other components of internal control.

Internal Audit, performed as part of the monitoring activity of an organization. It involves investigating and appraising internal controls and the efficiency with which the various units of the organization are performing their assigned functions.

Control Activities, are the policies and procedures that help ensure that management directives are carried out.

Liquidity emphasized the importance of current ratio (current assets/current liabilities) as a standard measure of liquidity in organization.

Accountability, managers need regular financial reports so as to make informed decisions which make accountability for the resources entrusted to them. It may be political, social or financial accountability.

Reporting, Talks about the comprehensiveness of internal controls in addressing the achievement of objectives in the areas of financial reporting, operations and compliance with laws and regulations.

In getting the information needed to determine the effect of internal control system on financial performance in an institution of higher learning (Surigao del Sur State University), the researchers conducted personal interview to the respondents and formulate a survey questionnaire.

MATERIALS AND METHODS

This chapter focuses on the methods that were used to collect data and analyze it. It greatly concerns the research design, the research locale, the research respondents, the instrumentation, the data gathering procedure and the statistical treatment.

RESEARCH DESIGN

The study was conducted using both quantitative and qualitative approaches using surveys, correlation and case study. Survey (according to Oso and Onen, 2008) "present an oriented methodology used to investigate population by selecting samples to analyze and discover

occurrences". The same authors explain correlation as the determination of whether or not and to what extent an association exists between two or more variables. They also note that case study is "an intensive descriptive and holistic analysis of a single entity or a bounded case". Survey was used for its economy, rapid data collection and ability to understand a population from a part (Oso and Onan, 2008). Correlation was used as a means of trying to examine the relationship between internal control system and financial performance. Case study was used since Surigao del Sur State University was chosen as a representative of an institution of higher learning where results of the study can be replicated and applied to other institutions of higher learning. Case study was also chosen because the study focused on the Main Campus as a representative of other Surigao del Sur State University Campuses.

RESEARCH ENVIRONMENT

Surigao del Sur State University (SDSSU), formerly Surigao del Sur Polytechnic State College (SSPSC), with its main campus in Tandag City, Surigao del Sur, Philippines and five satellite campuses in Cantilan, Lianga, Cagwait, San Miguel and Tagbina. The university provides higher education in the fields of industrial technology, teacher education, agriculture, agri-business, commercial sciences, forestry, aqua-marine technology, environmental science, arts, sciences, engineering and technology (Surigao del Sur State University Profile, 2011).

RESEARCH INSTRUMENT

The researchers used an adoptive type of questionnaires (Ssuuna, 2008) to ensure its validity and reliability of the instrument used, because the questionnaire is already edited and reviewed by the experts.

Interviews where the other instrument used by the researchers. It used as a way of supplementing the questionnaires already filled to probe further into the responses given in the questionnaires.

Respondents

The study will focus on finance and finance related departments of the University targeting particularly Finance and Accounting personnel and Head of colleges (Deans). Currently the university Finance and Accounting Personnel have 10 members of staff and 4 full time staff of Head of colleges (Deans) (Surigao del Sur State University HR, 2012). All these are expected to be interviewed. The financial management process of the university involves a cross section of individual and most importantly the departmental heads of the university

(especially during the budgeting process). This was basically due to the decentralized policy adopted by the university. The units of analysis therefore included all Finance and Accounting Personnel and Head of the colleges (Deans) of the university.

Validation of Instrument:

The researchers used an adoptive type of questionnaires. Before the questionnaire was validated and finalized a copy of which, was shown to the committee and the adviser for further comments, corrections and suggestions.

Data Gathering Procedure

Data was collected using both primary and secondary data collection techniques. Primary data was gathered basically through questionnaires. According to Oso and Onen, (2008) questionnaires are data collection technique in which the respondents respond to the number of items in writing. Questionnaires were chosen simply because of the time limitation and partly because the research was dealing with an elite community (respondents).

Interviews were the secondary data collection technique used by the researchers. They were used as a way of supplementing the questionnaires already filled, but at the same time they would enable the researchers to probe further into the responses given in the questionnaires especially given the importance of the research and the specialized nature of the topic under study.

Data was basically collected from Finance and Accounting personnel and Head of the Colleges (Deans).

Statistical Techniques/Data Analysis

The respondents were selected through the use of universal sampling.

The responses were grouped according to the needs for tabulation purposes. Weighted mean was used to determine the Effects of internal control system on financial performance in Surigao del Sur State University using a 5-point scale, to wit;

Scale	Description
4.3 – 5.0	Strongly disagree
3.5 – 4.2	Disagree
2.7 – 3.4	Not sure
1.9 – 2.6	Agree

1.0 – 1.8   Strongly agree

Adjectival description was used in determining the level of effectiveness of internal control system and financial performance in Surigao del Sur State University.

Correlation analysis (PPMC) was used to establish the relationship between internal control system and financial performance in Surigao del Sur State University.

RESULTS AND DISCUSSION

This chapter presents analysis and interprets the data collected. The presentation, analysis and interpretation are illustrated with tables and are explained in the same order as they were presented in the statement of the problem.

Table 1. Control Environment

	Weighted Mean	Adjectival Description
1. Accounting & finance mgt. system	4.7	Strongly Agree
2. Management commitment	4.6	Strongly Agree
3. Management conduct assessment inside	4.5	Strongly Agree
4. Ethical values	4.5	Strongly Agree
5. Management's close monitoring	4.4	Strongly Agree
6. Management integrity	4.4	Strongly Agree
7. Management providing feedback	4.2	Agree
8. Correction of errors in the system	4.2	Agree
9. Independent audit committee	4.2	Agree
10. Council independence and its committees	4.2	Agree
Average weighted mean	4.4	Strongly Agree

Table 1 shows that control environment of Surigao del Sur State University has average weighted mean of 4.4 with adjectival description of strongly agree.

Among the 13 respondents, they answer that the control environment in the functionality of internal control system of Surigao del Sur State University, it came out that accounting and finance management system got the highest weighted mean of 4.7 among all indicators with

its adjectival description of strongly agree while the management providing feedback, correction of errors in the system, independent audit committee and council independence and its committees got the lowest weighted mean of 4.2 with an adjectival description of agree.

Having an accounting and financial management system as reflected by the above results was in line with John J. Morris' advocacy for an   Enterprise Resource Planning System that deliver fast and accurate financial reports with inbuilt controls necessary to ensure accuracy and reliability of information being reported to shareholders. It was also an indication that Whittington and Pany's requirement of preparing, verifying and distributing reports to the various management levels is achievable.

Table 2. Internal Audit

	Weighted Mean	Adjectival Description
1. Appropriate recommendations	4.1	Agree
2. Degree of autonomy from management	4	Agree
3. Existence of internal audit department	3.8	Agree
4. Conduct regular internal audit activities	3.8	Agree
5. Regular reporting of weaknesses	3.8	Agree
6. Mgt. discusses internal audit reports	3.8	Agree
7. Sufficiently staffed internal audit dep't.	3.6	Agree
8. Reporting address weaknesses	3.5	Agree
Average weighted mean	3.8	Agree

Table 2 showed that internal audit of Surigao del Sur State University has an average weighted mean of 3.8 with its adjectival description of agree.

Among the 13 respondents, they answered that the internal audit in the functionality of internal control system of Surigao del Sur State University, it came out that appropriate recommendations got the highest weighted mean of 4.1 among all indicators with its adjectival description of agree, while the reporting address weaknesses got the lowest weighted mean of 3.5 with an adjectival description of agree.

The finding was in agreement with Gupta (2001) statement that "the objective of internal audit was to assist members of the organization in the effective discharge of their responsibility".

Table 3. Control Activities

	Weighted Mean	Adjectival Description
1. Variance reports with explanations	4.5	Strongly Agree
2. Corrective action taken to address weakness	4.3	Strongly Agree
3. No expense is incurred in excess of budget	4.3	Strongly Agree
4. Clear separation of roles	4.2	Agree
5. Well develop chart of account	4.2	Agree
6. Staff trained to implement system	4.1	Agree
7. Security systems safeguards assets	4.1	Agree
8. Appropriate supervision by senior staff	4	Agree
9. Information accessed w/ consent of senior	4	Agree
10. Employees' work checked by others	3.5	Agree
Average weighted mean	4.1	Agree

Table 3 showed that control activities of Surigao del Sur State University has an average weighted mean of 4.1 with its adjectival description of agree.

Among the 13 respondents, they answered that the control activities in the functionality of internal control system of Surigao del Sur State University, it came out that variance reports with explanations got the highest weighted mean of 4.5 with its adjectival description of strongly agree while the employees work checked by others got the lowest weighted mean of 3.5 with its adjectival description of agree.

According to Whittington and Pany (2001) internal auditing was performed as part of monitoring activity of an organization. An internal auditor was normally interested in determining whether a department has a clear understanding of its assignment was adequately staffed, maintains good records, properly safeguarding cash, inventory and other assets and cooperates harmoniously with other departments. The internal auditor normally reports to the top management.

Table 4. Financial Performance

	Weighted Mean	Adjectival Description
1. Enough cash to meet obligations	4.2	Agree
2. Identifies receipts & expenditure	4.2	Agree
3. Asset base has greatly increased over time	3.9	Agree
4. Fees charges appropriate	3.5	Agree
5. Fees duly collected	3.2	Not Sure
6. Outstanding fees dully paid	3	Not Sure
Average weighted mean	3.7	Agree

Table 4 showed that financial performance of Surigao del Sur State University has an average weighted mean of 3.7 with its adjectival description of agree.

Among the 13 respondents, they answered that in examining the financial performance of Surigao del Sur State University, enough cash to meet obligations and identifies receipts and expenditure got the highest weighted mean of 4.2 with its adjectival description of agree while the outstanding fees dully paid got the lowest weighted mean of 3 with its adjectival description of not sure.

This has implications on the financial soundness of the institution and it may hinder investment as mentioned by Verschoor (1999).

Relationship between Internal Control Systems and Financial Performance

This section answers the three of the study. The researchers used the correlation analysis (Pearson Product Moment Coefficient Correlation) to establish the relationship between internal control systems and financial performance.

Table 5. Significant Relationship

Variable Tested	Computed r	Computed T	Critical T	Decision	Conclusion
Control environment vs. Financial Performance	.416	1.805	1.796	Reject	Significant
Internal Audit vs. Financial Performance	.572	2.899	1.796	Reject	Significant
Control Activities vs. Financial Performance	.436	2.526	1.796	Reject	Significant

Table 5 above shows that the control environment is positively related to financial performance with its computed r of .416, computed T of 1.805 and critical T of 1.796. The results seem to agree with Whittington and Pany's assertion of the control environment setting the tone of the organization. The control environment (as reflected by the audit committee) was what Dezoort et. al., (2002) referred to as "protecting the owners' interests by monitoring management's actions, in terms of financial reporting, risk management and internal control".

Table 5 above indicate a positive relationship between internal audit and financial performance with its computed r of .572, computed T of 2.899 and critical T of 1.796. These results seem to agree with Sebbowa (2009) where he notes that "Internal auditing was an independent, objective assurance and consulting activity designed to add value and improve

an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance processes".

Results in table 5 above also indicate a positive relationship between control activities and financial performance with its r of .436, computed T of 2.526 and critical T of 1.796. This seems to agree with Ray and Pany (2001) belief that "Control activities are policies and procedures that help ensure that management directives are carried out". Therefore internal control activities affect financial performance (Liquidity, Accounting and Reporting) of Surigao del Sur State University.

CONCLUSIONS

Based on the findings of the study, the following conclusions were derived; the institution has an effective internal control system as supported by the study findings of clear separation of roles, supervision, training and commitment of management. However, there are challenges in the implementation of controls especially considering that the audit function is not will in the reporting address weaknesses which affected their efficiency as revealed by this study.

RECOMMENDATION

The following recommendations were raised: Surigao del Sur State University administration should established and manage knowledge/information management system within the institution so as to enable all parties within the institution to freely access and utilize the official information. The study also recommends that the administration establishes a strategy for improving the generation of additional finances for the operations of the University. This could be done through writing projects, other competitive endeavors which are directly aimed at winning funds for the University. Since it was evident in the study that the internal audit department was not adequate in reporting the address weaknesses of the audit activities and operations to cover the entire University set up, the study therefore recommends competence profiling which should be based on what the University expects the internal audit to do and what appropriate number staff would be required to do this job. For the future researchers, the study recommends that there should be a deliberate attempt to conduct a study which establishes the relationship of management's commitment based on factors that are external to the University such as behavioral issues of the students, financial stress of parents, and information technology. Ex. The effect of cultural and behavioral factors on the performance of a higher institution of learning.

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