
AN EVALUATION OF INTERNAL CONTROL SYSTEM AND SEVERITY INDICES CONTROL FACTORS IN BUILDING CONSTRUCTION INDUSTRY IN ONDO STATE

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Abstract

This study evaluates the internal control and the severity indices of control factors in the building industry in Ondo State, Nigeria. A survey research design was used for this study. A well-structured questionnaire was designed to collect data for the study. A non-probability sampling technique was adopted for this research. This technique was adopted because of the peculiarity of this study. A sample of one hundred and fifty was selected for the study of which one hundred and twenty-two returned the completed questionnaire representing a response rate of 81%. The study revealed that the most severe internal control problem in the building construction industry is lack of awareness of the environment, building construction firms adopt combination of two, three or all types of internal control system in their operations and It was also revealed that the control activities are not properly put in place in the operations of internal control system in building construction industry in the study area which renders the internal control system in the building construction industry in the study area ineffective, therefore the internal control system could not perform its functions like providing check and balances to prevent fraud, to check on the appropriateness of expenditures and to assess the effectiveness and the efficiency of the industry in the study area. It is recommended that there must be an increased awareness for the importance of internal control system in building construction industry in the study area and management must ensure that the organizational charts are updated and policies reviewed to ensure staff awareness of the control environment reduces the severity of problem of lack of awareness.

Keywords: Internal control, Building, Construction Industry, Management, Control Measures

Introduction

Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of an organization. Internal control serves as the first line of defence in safeguarding assets. Internal control assists managers in achieving results through effective stewardship of public resources, promoting accuracy and reliability of an organization's accounting data, and encouraging compliance with all the policies and procedures of the State.

An internal control system is a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an organization's objectives will be achieved. In Nigeria, many construction projects development have failed. This is due to the economy down turn, management and financial pressures of cost limit, quality and value optimization. Many construction firms had gone bankrupt and workers laid off.

According to Mu'azu (2012), the responsibility for ensuring that internal control is established in the organization lies with management. The internal audit is supposed to be the custodian of internal control by providing assurance to the management that the organization has put in place adequate and effective internal control system, and must not hesitate to draw management's attention to lapses observed in the control. Internal control system is implemented by the management or those charged with governance to ensure that entity's objectives regarding reporting, compliance with applicable laws and effectiveness and efficiency of operations are achieved. However, this becomes possible because internal control system serve this purpose through its different components or subsystems working collectively like a clockwork and are known as components of internal control system According to Okoye, *et al.* (2015), the rate at which construction projects fail to achieve its objectives in Nigeria are very alarming. Thus, technical and environmental issues, and also management challenges are very dominant when managing construction projects. In Nigeria construction firms, for managers to face these challenges squarely there is need to possess the right skills and at the same time apply appropriate strategy and internal controls within the given framework. Construction industry is one of the back bones of a nation's economic development and hence the need to review the internal controls available in the construction industry. According to Cheng and Huang (2011), control of environment is the foundation of internal control. Without a sound internal control environment, the internal control will lose effective implementation. The objective of this study is to evaluate the severity indices of internal control problems in the construction industry in Akure metropolis.

Theoretical Framework

Committee of Sponsoring Organizations on Internal control framework (COSO) defined internal control 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 effectively and in compliance with applicable laws and regulations. Di Napoli (2016) defined internal control as the process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance. According to Dumfries and Galloway (2016), internal controls are the safeguards put in place to ensure that the company's business is conducted in an orderly and efficient manner, its policies adhered to, its assets protected and its records complete and accurate. Internal Control provides reasonable assurance that the objectives of the organization are being achieved in the following categories: effectiveness and efficiency of operations including the use of the entity's resources. Internal control system ensures reliability of financial statements and other reports for internal and external use, as well as compliance with applicable laws and regulations (Odunayo, 2014). According to International

Standard on Auditing (ISA) (2006) internal control is the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. From the definitions above, it is important to note that economic resources controlled by management of any organization must be accounted for in a way to show true and fair view of their operations to the stake holders, Dumitrascu and Savulescu (2012), explained that lack of internal controls and their deficient operation make companies vulnerable to number of risks, such as improper recording of accounting transactions, making unauthorized transactions, fraud, all these having a significant impact on financial performance and competitiveness.

The basic concept of internal control system as stated by Committee of Sponsoring Organizations on Internal control framework (COSO) is to identify risks, detect and prevent fraud in an entity. This concept is carried out with the use of some control activities. Control activities are the policies, procedures, techniques, and mechanisms that help ensure that management's response to reduce risks identified during the risk assessment process is carried out. In other words, control activities are actions taken to minimize risk. When the assessment identifies a significant risk to the achievement of an entity's objective, corresponding control activities are determined and implemented. What is Risk? Anything that could negatively impact the organization's ability to meet its operational objectives (Richard, 2009), it was further stated that: risk could be strategic – risk that would prevent an organization from accomplishing its objectives, risk could be financial – risk that could result in a waste or loss of assets , risk could be compliance – risk due to non-compliance with laws and regulations., risk could be reputational – risk that could expose the organization to negative publicity., risk could be operational – risk that could prevent the organization from operating in the most effective and efficient manner. Risk is that possibility of loss as the result of mixing of uncertainty, (Dumitrascu and Savulescu, 2012).Risk is the possibility that an event will occur and threaten or otherwise adversely affect the achievement of the organizations objective (Di Napoli, 2016).The management of risk requires the establishment and maintenance of effective systems of internal control. Internal control comprises all the policies, processes, tasks, behaviors and other aspects of an organization put in place to ensure, as far as practicable, the orderly and efficient conduct of business, this is in line with Audit Committee Book (2015). In recent years risk management has become an agenda in both public and private sectors. This is because organization that experience high level of risk, is possible for them to lose the achievement of their organizational objectives. Therefore, organizations should improve the effectiveness of their risk management to meet the organization's goals which can be achieved by efficient and effective internal control. Gamage, Kevin and Fernando (2014) mentioned that risks are the happenings that threaten the achievement of objectives which finally affect an organization's ability to achieve its mission. According to Richard (2009), management must be aware of, anticipate and deal with risks .management must establish methods and mechanisms to identify, analyze and manage risks that are likely to have an impact on service delivery and the achievement of desired outcomes.

Internal control consists of all measures employed by an organization to safeguard assets from waste, fraud and inefficient utilization and to promote accuracy, and reliability in the accounting records. It also measures compliance with company policy as well as evaluates the efficiency of operation (Committee of sponsoring organization, 1992). The internal control is just as relevant to non-profit and profit making organizations. Inadequate internal control can adversely affect the management responsibilities of organization officials and place them in positions where they may be tempted to engage in questionable activities and accounting practices. It could subject individuals to unwarranted accusations of such activities. Anthony and Young (2000) were of the view that the basic concepts of internal control are the same for both profit and non-profit making organizations. Agu (2002) viewed that fraud is the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of employing the organization's resources or assets. Odunayo (2014) stated that internal control has been recognized in the most organization as one of the most essential ingredients, necessary for the survival of the business enterprise and government agencies. Apart from the problem of scarce resources, organizations run a high risk of fraud, errors, miss appropriation of funds and inefficient and ineffective operations. Step are required therefore to minimize, if not eliminate completely, these risks, by establishing internal control system. Clearly, fraud is a pervasive corporate problem affecting organizations across industries and time zones without regard to company size (Adeyemi, Akindele, Aluko and Agesin2012). Because of fraud's disastrous consequences, failures to put deterrent procedures in place could put a company out of business within days, fraud prevention can be defined as a program of proactive measure to avoid or mitigate fraud, (Adeyemiet.al. 2012; Agu 2002).By a relative scaling, the greatest financial impact of fraud can occur in a small business environment. A loss of 6% revenues is significant for any company, no matter how large, even if an operation survives the fiscal loss, its business continuity can be in jeopardy and it may no longer be able to function as an independent entity (Agu 2002)

According to Audit Committee Handbook (2015), boards are responsible for both determining the nature and extent of the significant risks an organization is willing to take in achieving its strategic objectives and for ensuring that the significant risks faced by an organization are properly identified, evaluated and managed in the manner in which it has been approved. Several studies have been carried out in Nigeria to find out why many government parastatals or agency which started well later fall or remain stagnant in their operations. The major causes of this situation were traced down to low accountability which emanated from a lot of factors, part of which are poor accountability and inadequate provision of fund in an organization. According to Odunayo (2014), accountability is the key to achieving results and helping identify the opportunities in the organization. Holding employees accountable helps them to know the satisfaction of achieving a goal and performing to a standard. Accountability has always been an important feature of life. In fact, it is said to be life blood of any organization. Without accountability, it is impossible to run any activities of any organization. By interacting with other people, one is able to develop one's personality. Accountability is a relationship based on the obligation to demonstrate and take responsibility for performance in the light of agreed expectations. Anderson (2009) stated that one of the most elusive concepts in management is accountability. In leadership roles, accountability is the acknowledgment and assumption of

responsibility for actions within the scope of a role or position, encompassing the obligation to report and be answerable for resulting consequences. In brief, accountability requires a relationship of conferring responsibility and reporting back on the expected and agreed performance and on the manner in which the responsibility was fulfilled. The rendering of account, whether obligatory or on a voluntary basis, establish the relationship of accountability for results.

The Financial Accounting Standards Board's generally accepted accounting principles (GAAP) set the accounting standards that a company must follow. The Association of Certified Fraud Examiners (ACFE) (2014) stated that internal controls are designed to prevent fraud and clerical errors that may compromise the accuracy of a company's financial statements. It also explained that solid internal controls can also reduce losses from theft of company assets and identify underperforming employees. According to Babatunde and Kabiru (2014), these controls should be implemented by the company before any financial information is given to external auditors, lenders or investors: Segregation of duties, Access, Authorization, Record keeping and Verification.

Empirical Review

Leslie (2010) said that, in the construction industry, internal controls are particularly valuable because contractors tend to have operations scattered over various work sites. Fiscal controls are important because contractors, particularly in Texas, USA tend to be small to mid-size companies that often do not have enough bookkeeping personnel to properly segregate accounting responsibilities. While this lack of gatekeepers makes it easier to commit fraud, it also fosters a higher number of honest mistakes. For example, a masonry contractor may pay for a higher quality of stone than was actually delivered or an invoice may not include a discount that was promised or an invoice is correct, but inadvertently paid twice. Mistakes can be prevented when all transactions are cross-checked, but that requires more than one or two people making accounting decisions. Formal internal controls help reduce honest and dishonest accounting mistakes. On issue of lack of awareness of the environment as a challenge of internal control in the construction industry, Cheng and Huang (2011) argued that most corporate managements lack the recognition of internal control environment. Control of environment is the foundation of internal control, without a sound internal control environment, the internal control will lose effective implementation. Douglas (2011) mentioned that the precondition to risk assessment is the establishment of clear, consistent agency goals and objectives which may be lacking in some companies. There are some construction companies with few numbers of personnel where segregation of duties cannot be effectively carried out; lack of documentation and proper recordings is also experienced in such companies. Cheng and Huang (2011), also added that some part of the highway construction company pay insufficient attention to the internal control system, which involves only a small number of departments and does not penetrate into all aspects of business management in various departments which leads to lack of proper control in the construction company. Human judgments: According to Asante (2011), decisions are often made within a limited time frame, without the benefit of complete information, and under time pressures of conducting agency business. He further explained that these judgment decisions may affect achievement of objectives, with or without good internal

control. Effective internal control may be limited by the realities of human judgment. The effectiveness of controls will be limited by the fact that decisions must be made with human judgment in the time available, based on information at hand and under the pressures to conduct business. Even well designed internal controls can break down. Employees sometimes misunderstand instructions or simply make mistakes. Errors may also result from new technology and the complexity of computerized information systems (Douglas2011). Even if control activities are well designed, they can break down. Personnel may misunderstand instructions or simply make mistakes. Errors may also stem from new technology and the complexity of computerized information systems

Research Method

A survey research design was used for this study. A well-structured questionnaire was designed on the basis of literature review of various types of internal controls, factors that determine the severity of internal control system and its problems that affect the performance of building construction projects. The questionnaire was administered and supplemented with oral interview of some of the respondents. The study was carried out in Akure south local government. The population of the study comprises of stakeholders in building construction firms which include: Consultants, Architects, Engineers, Builders, and Project Managers in the study area. A non-probability sampling technique was adopted for this research. This technique was adopted because of the peculiarity of this study, not all architects or engineers understand the operations of internal control system in their various firms. A sample of one hundred and fifty was selected for the study comprising thirty each from the following strata: Consultants, Architects, Engineers, Builders, and Project Managers from various registered building construction firms in the study area

.Tables and percentages were used for proper discussion. A five point likertscale (rating) was used to assess the effectiveness of the five environments of internal control system in the building construction firms.

Results and Discussion

Out of the one hundred and fifty questionnaires administered eighty one percent of the respondents from various construction firms returned their completed questionnaire.

Out of 122 respondents 24.6% were female and 75.4% were male as indicated in table 4.1 .The sex distribution showed that both male and female were represented in the study as shown in the table. The table shows that there are more male workers than female in construction firms due to the nature of work involved. Forty percent of respondents from these construction firms are between 30 and 39years of age which is within the active age of construction workers. Majority, 54.9% of the respondents had between 6 and 10 years of working experience in the construction firm,. Questionnaires were administered to the identified professionals in the firms: Architect, Engineers, Builders, Consultant and Project Managers, the percentages of these professionals that completed the questionnaire were: 21.3%, 23.8%, 19.7%, 17.2% and 18% respectively.

Table 4.1: Social characteristics of the respondents

Characteristic	No. of Respondents	%
(a) Gender		
Male	92	75.4
Female	30	24.9
Total	122	100
(b) Age (Years)		
Below 20years	4	3.3
20- 29 Years	17	13.9
30-39 Years	49	40.2
40- 49 Years	29	23.8
50and above	23	18.9
Total	122	100.00
(c) Professional Group		
Architect	26	21.3
Engineers	29	23.8
Builders	24	19.7
Consultant	21	17.2
Projects Managers	22	18.0
Total	122	100.00
(d) Experience in cocoa farming (years)		
Below 5 Years	22	21.3

6to10 Years	67	54.9
11to15 Years	17	13.9
16 years and above	16	13.1
Total	122	100.00

Source:

Field Survery 2018

Table 4.2 reveals that 36.9% of the respondents from various building construction firms stated that only preventive internal control measure is carried out in their firms. 27.9% claimed that only directive internal control measure is in operation. The building construction firms which use detective and compensating internal control measures are 9% and 13.9% respectively. The choice of type of internal control measures in some firms includes combination of two or three of the basic types of internal control measures, 3.3% of the building construction firms use combination of preventive and directive internal control measures, also 2.5% of these firms use the combination of preventive and compensating internal control measures. However, only 2.5% of these firms combine all the four types of internal control measures in their operations. The control activities under preventive internal control measure include control activities such as authorization, approval, and segregation of duties, physical safeguard and security. Detective control includes control activities like reconciliation and review of operating performance, other types of internal control measures activities generally include: check and balances to prevent fraud or inappropriate use of funds and check on appropriateness of expenditures. It was gathered from interview of some respondents that the internal control measures are most needed in cash administration, wages and salary administration and stores management.

Table 4.2 Frequency of use of Types of Internal Control Measures

Internal Control Measures	Freq	Percentage
Preventive	45	36.9%
Directives	34	27.9%
Detective	11	9.0%
Compensating	17	13.9%
Preventive, Directive	4	3.3%

Preventive, Compensating	3	2.5%
Preventive, Directive, Detective	3	2.5%
Preventive, Directive, Compensating	2	1.6%
Preventive, Directive, Detective, Compensating	3	2.5%

Source: Field work 2018

Table 4.3 revealed the effects of control activities on the types of internal control measures adopted in each of the building construction firms. From literature reviewed, the basic types of internal controls are preventive, directive, detective and compensating measures. The F ratio at $P \leq 0.05$ of these internal control measures as shown in the table indicates the level at which the control activities affects each type of internal control measure. Adequate protection of organization’s assets has F ratio of 0.686 and a significant value of 0.562 which is greater than 0.05, this means that this control activity does not have a significant effect on preventive, directive, detective or compensating types of internal control measures. Adequacy of physical security for cash and other asset that are subject to theft has F ratio of 0.655 and a significant value of 0.582 greater than 0.05, which means that adequacy of physical security on cash and other assets subject to theft does not have a significant effect on the types of internal control measures. In the same light, notification of management during movement of equipment and resources, segregation of duties, appropriate approval of invoice payment a significant value of 0.863, 0.099, 0.245 and 0.283 respectively. The significant values of these control activities are greater than 0.05, which means that they do not have significant effect on preventive, directive, detective or compensating type of internal control measures this adopted by the building construction firm. Physical security of work areas, sites and store rooms and reporting of stolen or missing assets has F ratio of 0.746 and 1.683, also significant values of 0.527 and 0.174 respectively. This implies that these control activities have no significant effect on the types of internal measures adopted in the firm.

Table 4.3: Effects of Control Activities on Types of Internal Control Measures(Continued)

Control Activities	Types of Internal Control Measures	Mean	Std. Deviation	F	Sig.
1. Appropriate approval of invoice before payment	Preventive	.09	.288	1.405	.245
	Directive	.15	.359		
	Detective	.00	.000		

	Compensating	.05	.213		
2. Review meetings on previous projects executed	Preventive	.11	.318		
	Directive	.26	.448		
	Detective	.24	.436	1.284	.283
	Compensating	.14	.351		
3. Physical security of work areas, sites and storerooms.	Preventive	.56	.503		
	Directive	.44	.504		
	Detective	.62	.498	.746	.527
	Compensating	.45	.510		
4. Reporting of stolen or missing assets	Preventive	.16	.367		
	Directive	.26	.448		
	Detective	.24	.436	1.683	.174
	Compensating	.05	.213		

Source: Field work 2018

According to Douglas (2011), the purpose of monitoring is to determine whether internal control is adequately designed, properly executed, and effective. Table 4.4 revealed that the budget process which involves key members of the firms is considered to be good with mean rating of 4.0. Preparation of annual financial report is good and timely with a mean rating of 4.0. The routine evaluation of overall effectiveness of internal control system of the firms is considered to be on the average with a mean rating of 3.5. Conclusively, the table reveals that the monitoring of the internal control system is carried out effectively. Review meetings on previous projects executed have a mean rating of 4.0; it is considered to be good. While availability of internal audit unit in the firms is on the average, as some construction firms have no internal audit unit.

The objective of this study is to determine the severity of internal control problems in the construction industry. This was analyzed in table 4.5 using the rating indices. The most severe of these problems is lack of awareness of the environment which is 0.68; this was confirmed by 34.4% of the respondents. This was supported by oral interview of respondents who stated that they were not usually aware of environment of project site; the hostility of community, nearness to basic needs for workers until project execution begins. This further confirmed the analysis of risk assessment of internal control system in table 4.5 which revealed that strategies established for managing important risks were ineffective with mean rating of 2.4; it also revealed that performance of recent risk assessment for the building construction firms was ineffective. These two control activities contributed more to the problem of lack of awareness of the environment. Human judgments is the next severe problem of building construction firms with a severity index rating of 0.66, this problem is caused by decisions which are often made within a limited time frame and under time pressures without complete information which normally affects the achievement of stated objectives and this renders internal control ineffective. Improper

assessment of risk and breakdown problems have the same severity index ratings of 0.60; this further confirms the ineffectiveness of risk assessment of the internal control system in building construction firms selected for the study. Collusion and non-segregation of duties have severity index ratings of 0.58 each, while management override has severity index rating of 0.57. Poor system of control activities has 0.55 severity index rating, however, adequate authorization of transactions and non-proactiveness of the management in handling issues have the least severity index rating of 0.49 each

Table 4.4 Monitoring of Internal Control Systems

Activities	Options					ΣF	ΣFX	— X̄	Decision
	VE	E	A	I	VI				
	5	4	3	2	1				
1. Budget process includes key members of management in your organization.	48	48	7	10	9	122	482	4.0	Effec.
2. Preparation of timely annual financial report in the organization.	58	40	3	12	9	122	492	4.0	Effec.
3. Routine evaluation of the overall effectiveness of internal control system	36	40	13	14	19	122	426	3.5	Ave.
4. Review meetings on previous projects executed.	59	32	9	13	9	122	485	4.0	Effec.
5. Availability of Internal Audit unit in the organization.	36	35	7	24	20	122	409	3.4	Ave.

Source: Field work 2016

Key: Very Effective (VE) -5, Effective (E) -4, Average (A) - 3, Ineffective (I) -2 and Very Ineffective (VI) -1

Table 4.5 Severity of Internal Control Problems in Building Construction Firms.

<i>Internal Control Problems</i>	<i>Frequently (5) %</i>	<i>Sometimes (4) %</i>	<i>Seldomly(3) %</i>	<i>Rarely (2) %</i>	<i>Never (1) %</i>	<i>Total %</i>	<i>Severity Index</i>
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<i>i.) Lack of awareness of the environment</i>	34.4	32.8	11.5	11.5	9.8	100	0.68
<i>ii.) Improper assessment of risk</i>	10.7	41.8	29.5	11.5	6.6	100	0.60
<i>iii.) Human judgments:</i>	15.6	45.9	27.9	7.4	3.3	100	0.66
<i>iv) Breakdowns:.</i>	13.1	34.4	35.2	13.9	3.3	100	0.60
<i>v) .Collusion</i>	12.3	38.5	35.2	13.1	9.0	100	0.58
<i>vi) Non-segregation of duties</i>	17.2	33.6	24.6	13.1	11.5	100	0.58
<i>vii) Management override</i>	13.9	32.8	31.1	12.3	9.8	100	0.57
<i>viii) Poor system of control activities</i>	15.6	28.7	27.9	17.2	10.7	100	0.55
<i>ix) No adequate authorization of transactions.</i>	10.7	25.4	27.0	22.1	14.8	100	0.49
<i>x) Non pro-activeness of the management in handling issues</i>	13.9	23.0	23.0	25.3	14.8	100	0.49

Source: field work 2016

Findings

The summary of findings, conclusion drawn from the findings and the recommendations made for improvement in the internal control system of building construction industry are as follows:

- (i) The most severe internal control problem in the building construction industry is lack of awareness of the environment
- (ii) Building construction firms adopts combination of two, three or all the types of internal control system in their operations

- (iii) It was revealed that the control activities are not properly put in place in the operations of internal control system in building construction industry; it therefore renders the internal control system ineffective.
- (iv) A relationship between the internal control system and the effectiveness of the construction industry could not be established, because the five components of internal control system namely: control environment, risk assessment, monitoring, control activities, information and communication are not effectively put in place and properly integrated,
- (v) The internal control system in the building construction industry in the study area could not perform its functions like providing check and balances to prevent fraud, to check on the appropriateness of expenditures and to assess the effectiveness and the efficiency of the industry in the study area.

Conclusion

With reference to the findings of the study, the following conclusions are drawn on the study: There is reasonable amount of weakness in the internal control system of the building construction industry, especially the control environment and the risk assessment of internal control system. This accounted for the major reason for ineffectiveness of the industry's internal control system.

Recommendations

- i. There must be an increased awareness for the importance of internal control systems in building construction industry. Failure to do so results in the inability of the organizations to execute all their projects.
- ii. The finding of the study reveals that the internal control system is weak and ineffective; management must ensure that the organizational charts are updated and policies reviewed to ensure that staff awareness of the control environment reduces the severity of problem of lack of awareness.
- iii. There must be adequate security for all work areas and store rooms in the building construction firms. The study revealed that the security for all work areas is porous and poor.
- iv. There must be adequate security for cash and other assets which are subject to theft..
- v. Segregation of reconciliation duties from initiation and finalizing of transactions must also be improved upon.

Finally, a further research could be conducted on the effects of types of internal control system adopted by a construction industry and its efficiency in achieving its goals.

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