



# The Impact of Internal Control Systems on Asset Protection and Financial Reporting Accuracy in SMEs

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## **Author's contribution**

*The sole author designed, analysed, interpreted and prepared the manuscript.*

## **Article Information**

DOI: <https://doi.org/10.9734/ajebe/2024/v24i121592>

## **Open Peer Review History:**

This journal follows the Advanced Open Peer Review policy. Identity of the Reviewers, Editor(s) and additional Reviewers, peer review comments, different versions of the manuscript, comments of the editors, etc are available here: <https://www.sdiarticle5.com/review-history/127148>

**Original Research Article**

**Received: 20/09/2024**  
**Accepted: 23/11/2024**  
**Published: 29/11/2024**

## **ABSTRACT**

Any small or medium-scale enterprise without a well-established internal control system is very prone to financial losses, reduced profitability, and eventual business collapse. In view of this, this study aimed to: assess how an effective internal control system contributes to the safeguarding of assets within SMEs and offer guidance on how SMEs can establish effective internal controls to safeguard their assets; evaluate the impact of an effective internal control system on the accuracy of financial reporting among SMEs as well as to offer guidance on how SMEs can establish effective internal controls to ensure accuracy of financial reporting. In carrying out this study, a survey research design was applied on a sample size comprising 120 SMEs owners in Nigeria. Likert-based scale questionnaire was administered on the sample respondents in order to collect primary data for the study. The research questions were analysed using frequency distribution and mean. Spearman correlation was used in testing the hypotheses. The findings revealed that: internal control system significantly helps to protect assets of SMEs ( $\rho = .778$ ,  $p = .000$ ); internal control system significantly enhances the accuracy of financial reporting among SMEs ( $\rho = .644$ ,  $p =$

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.000). In conclusion, the findings illustrate the essential role that internal control systems play in fostering a culture of accountability and transparency within SMEs, which is increasingly relevant in today's dynamic business environment. It is recommended that SME owners and management implement comprehensive internal control systems that include regular audits and assessments to enhance asset protection measures. This proactive approach will help identify potential vulnerabilities and strengthen safeguards against theft or loss.

*Keywords: Internal Control System; Asset Protection; Financial Reporting Accuracy.*

## 1. INTRODUCTION

Today, in the fast stride of business development, SMEs play a fundamental role in economic development process. SMEs are considered important features of any economy because they are sometimes associated with offering a large share of employment, being good sources of innovation, and moving the development of national and regional economies further (Abdul-Azeez et al., 2024). Dynamic features of the global economy – including technological advances (Mmadubuobi et al., 2024), increased regulation, and competitive markets (Nworie and Obi 2024a; Nworie and Obi 2024b) – have created ever demanding conditions in which businesses of all sizes can survive. This is very crucial for SMEs, which mostly operate under tight resources and are more prone to financial mismanagement and fraud. For such organizations, operational efficiency and the protection of assets become all the more crucial. The success of these organizations depends on good financial management practices, one of the cornerstones of which is an internal control system. As a matter of fact, such a system helps an organization safeguard its assets, maintains accuracy in financial reporting, and ultimately provides a trajectory to sustain long-term growth.

Thus, the importance of a robust internal control system in modern business cannot be overemphasized (Nqala and Musikavanhu 2023). Ololade (2024) opined that internal control is a broad concept that involves a plan formulated and instituted by management to provide reasonable assurance of effectiveness in operations, the safeguarding of assets, and the accuracy and reliability of the records leading to the preparation of financial statements. An internal control system acts as a discouraging factor against unethical practices in this heated business environment where corporate frauds and financial statement misstatements are on the rise (Onwuchekwa et al., 2024, Ghanem and Awad 2023). Interconnectedness of the global

market is relentlessly pushing exposure to risks and compliance requirements – even for those entities that could be termed local, particularly SMEs – almost to the level experienced by larger corporations. For most SMEs, their financial capacity to recover in case of fraudulent activities or errors is often limited, and hence a good internal control system (ICS) cannot be merely a compliance matter but a strategic necessity. This control system, in line with the argument by Keaunui (2023), reduces risk, instills confidence in investors and stakeholders, and protects the integrity of financial reporting, which is crucial in obtaining external finance to enable the continuation of operations.

The internal control system encompasses several practices and policies adopted to govern and supervise the effectiveness of organizational functions and operations, both operational and financial (Oyedokun and Muhammad 2023). The system consists of five main components, which COSO identifies as the control environment, risk assessment, control activities, information and communication, and monitoring activities (Otoo et al., 2023). Each one of these components is equally important to ensure that a company or organization works in regard to effectiveness, efficiency, and ethics. First, the control environment defines the tone at the top and puts an emphasis on integrity and ethical values. Risk assessment highlights those various challenges that could be an obstacle to attaining business objectives. Control activities, inclusive of authorizations and approvals, are meant to ensure that those risks are at least minimized. The flow of information and related communication ensures proper circulation of relevant financial data in order to support informed decision-making. Finally, ongoing monitoring activities assist organizations in understanding where improvements ought to be made, thus enabling the internal control system to respond to changing challenges. Precisely fitting these components to the specific operational scale and capability of SMEs can

provide very strong protection and confidence in their financial reports (Ajala et al., 2023).

Asset protection is an issue with which businesses of every size are concerned; however, for SMEs, the stakes are higher given their often-limited financial buffers (Kehinde 2015). This could be through checking on the ability to establish an institution of checks and balances that may help in reducing such risks as misappropriation of assets, unauthorized use of assets, and inventory shrinkage. For instance, segregation of duties in SMEs can be supported whereby financial responsibilities would be divided among different employees to minimize the opportunity for errors and fraudulent activities to occur. Regular audits and reconciliations will serve to further tighten the protection of assets through independent verification of financial data and records of assets. This watchfulness ensures that discrepancies are promptly noticed and remedial action is taken to safeguard the assets of an SME from misappropriation or loss.

Improved financial reporting accuracy is another significant advantage of having a well-established system of internal controls. Accurate and reliable financial reporting forms the foundation of transparency and credibility for any business organization (Kehinde 2015). To SMEs, proper financial reports are of essence in a number of ways, such as for loan acquisition purposes, when attracting investors, and to the tax authorities. Internal controls enable effective capturing of financial operations through eliminating mistakes and omissions (Ololade, 2024). Activities of control involved consist of automated system checks and periodic financial reviews that ensure data capture practices are uniform and that they set the right accounting standards. In an effective ICS, information and communication mechanisms ensure that relevant financial information moves around the organization to accomplish an accurate and comprehensive financial reporting process. In addition, continuous monitoring activities in a system of internal control support real-time adjustments to ensure that financial statements reflect the current financial position of the SME without significant delays or inaccuracies.

However, it is still a persisting problem that this is practically not realistic for many SMEs due to various problems relating to their situation, including but not limited to lack of financial resources, poor expertise, and lack of adequate management structures (Aladejebi, 2017). Such

deficiencies heighten the propensity of SMEs towards ineffectiveness in operations, financial mismanagement, and misappropriation of assets. A shabby internal control framework makes room for unchecked errors and fraud, and inconsistency in the financial reporting system (Oyedokun and Muhammad 2023). This negatively impacts their ability to generate reports that are transparent. Apart from reducing their credibility, such conditions could also undermine their competitiveness in the market and reduce their possibilities of growth.

These drawbacks have wider repercussions since SMEs without a comprehensive internal control system are highly vulnerable to financial losses, reduced profitability, and even eventual business collapse (Oyedokun and Muhammad 2023). Poor asset protection may cause enormous financial losses; these are always worse for an SME than for a large enterprise because their own internal financial resources are too slight to absorb the impact of such loss. Besides, inaccurate financial reporting may result in stakeholder loss of trust and confidence, which would definitely discourage potential investors and lenders (Elliott et al., 2020). This will deny access to much-needed capital and limit business opportunities. Ultimately, this inability to safeguard the assets and assure the validity of financial reporting will strike a blow in the long run against the sustainability and future success of SMEs by making them far more susceptible to the demands of an increasingly competitive and regulated enterprise environment.

The significance of this study lies in its potential to highlight the critical role of a robust internal control system in safeguarding assets and ensuring the accuracy of financial reporting among small and medium-sized enterprises (SMEs). By exploring how effective internal controls can mitigate risks such as fraud, mismanagement, and errors, this research aims to provide valuable insights for SME owners, managers, and policymakers on best practices for protecting assets and enhancing financial integrity. The findings could contribute to improving the financial performance, operational efficiency, and long-term sustainability of SMEs, thereby promoting their growth and fostering confidence among investors, stakeholders, and regulatory bodies. Additionally, this study may guide SMEs in complying with financial reporting standards, enhancing transparency and accountability in their operations.

## **1.1 Objectives of the Study**

1) To assess how an effective internal control system contributes to the safeguarding of assets within SMEs and offer guidance on how SMEs can establish effective internal controls to safeguard their assets.

2) To evaluate the impact of an effective internal control system on the accuracy of financial reporting among SMEs as well as to offer guidance on how SMEs can establish effective internal controls to ensure accuracy of financial reporting.

## **2. LITERATURE REVIEW**

### **2.1 Conceptual Clarifications**

#### **2.1.1 Internal control system**

The internal control system refers to the overall structure of policies, procedures, and practices set up by an organization's management for purposes of ensuring protection of its assets, operational efficiency, and validity of its financial data (Alayli, 2022). The internal control system is thus meant to facilitate the accomplishment of an organization's objectives through the provision of an environment that favors compliance with the rules, management of risks, and timely and accurate financial reporting. It, therefore, forms the basis for the running of an organization in regard to approving, monitoring, and securing resources (Tam and Tuan 2021). It then lays down the different checks and controls that would minimize the possibility of errors, fraud, and financial misstatements.

Internal control systems are important to all organizations irrespective of their size; however, this becomes of greater importance in those entities which have a complex structure or whose operations present them to a higher level of risk (Aladejebi, 2017). It follows, then, that the effectiveness of an internal control system comes about in its incorporation into the culture and practices of an organization as a whole. An effective internal control system builds an environment of accountability where employees are cognizant of their responsibilities and the consequences that come with non-compliance (Otoo et al., 2022). It encompasses more than financial reporting and may impact other business areas, such as operational efficiency or compliance issues.

The inherent attribute of an internal control system is that it should aid management in the realization of goals and strategic initiatives as set forth by management (Artemieva et al, 2020). The internal control system plays a significant role in leading and making decisions, knowing full well that resources are applied judiciously because the system is mitigating those risks (Le and Tran 2018) and operations are aligned with the goals of the company. Even though no system can give absolute assurance because by its very nature, it may be subject to certain limitations such as human errors or collusion, however, a properly designed and applied system goes a long way in reducing risks (Ajala et al., 2023). The importance of an internal control system is echoed through various regulatory and standard-setting bodies that recognize it for increasing transparency and reliability of financial reporting. Such bodies normally advise on frameworks like the COSO Internal Control-Integrated Framework, which an organization can benefit from by implementing to give form to their internal control systems. It offers focus on how to ensure a control environment exists in such a way as to promote ethical behavior and instills within the organization the principles of integrity and compliance (Cosmin, 2011).

#### **2.1.2 Building an effective internal control system**

The development and continuous improvement of a structure are very important in building a robust internal control system that is highly effective in mitigating risks but allows operations toward attaining organizational goals at both the operational and financial levels (Aladejebi, 2017). A strong internal control system extends beyond mere adherence to policies and applies its elements in guiding an environment where comprehensive risk management practices form part of the culture of the organization. It not only safeguards the assets of an organization but also provides reasonably accurate financial reports and helps to maintain compliance with laws and regulations. Often, development starts by reviewing the procedures in place to identify weaknesses and areas that could be improved. This gives an initial assessment that aids in laying the ground when designing a system to meet organizational needs and risk profile (Tam and Tuan 2021).

An effective internal control system requires explicit commitment from the leadership of the

company (Aladejebi, 2017). That is, the management tone sets the pace at which controls are regarded and observed within a firm. The management should ensure that internal controls are emphasized by relating these controls in strategic decisions and within daily running of operations. The management should outline the various responsibilities and roles played by various levels of employees to make them fully understand what is expected of them in terms of contributing to control practices. The second aspect of sound system design is the adoption of policies that guide necessary operational and financial activities; this would include authorization of transactions, division of duties as a way to prevent conflict of interest, and surveillance and auditing activities to check if irregularities are occurring (Cosmin, 2011).

Monitoring and adapting continue to be main features of a sound internal control system (Nqala and Musikavanhu 2023). Businesses operate within environments characterized by constant change, in which new risks are constantly being established through changes in technology, the market place, or even statutory and other regulations. A system that is static and inflexible risks the possibility of becoming ineffective over time. The establishment of a stronger internal control system, therefore, encompasses the creation of mechanisms for feedback to aid in continuous assessment and adjustment, ensuring the system remains relevant and provides ideal support against potential threats to the organization. Training programs and routine communication can also reinforce the importance of internal controls and ensure that employees at all levels know processes and are following best practices (Ololade, 2024).

Ololade (2024) argued that a sound internal control system emphasizes proactivity rather than reactivity. It does not look in the rearview of what has happened but rather to what might happen, taking certain precautions. This preparatory element enables resilience, therefore aiding the organization to keep operations running smoothly whenever uncertainty or disruption may be felt. Through a culture of transparency, accountability, and watchfulness, an organization safeguards not only its assets but also cements stakeholder confidence. A well-developed system finally contributes to overall health and sustainability in that it supports appropriate governance and strong enterprise

risk management practices (Ghanem and Awad 2023).

### **2.1.3 Asset protection**

Asset protection is any action or strategy that is taken in order to protect the critical assets of an organization from being lost, stolen, misused, or otherwise compromised (Cosmin 2011). These assets can be tangible in nature, including things such as cash, inventory, equipment, and property, or they can be intangible, including things such as intellectual property, customer information, and brand reputation. Any business should, therefore, inculcate asset protection in its operability to ensure that the loss or mismanagement of such vital assets would not seriously dent financial performance and operational stability (Le and Tran 2018). Asset protection strategies are implemented through a combination of physical security measures, internal control policies, and technology-based solutions that monitor and safeguard asset usage.

The concept of asset protection emanates from the idea that the center of sustaining financial health and operational integrity lies in protecting an organization's resources. Without appropriate measures that ensure protection, assets remain continuously exposed to risks related to employee theft and fraud, or attacks from the outside (Ghanem and Awad 2023). Asset protection begins with the understanding of the type of assets owned by an organization, as well as the related risks. This will help determine the level of control required to safeguard each category of asset effectively. For example, financial assets may be safeguarded through strict authorization mechanisms, while protection against the theft or leakage of data assets may be ensured by using encryption and cybersecurity measures.

One of the major features of asset protection is that internal control measures, which implement accountability and transparency within an organization itself, are put into place (Le and Tran 2018). These may include segregation of duties, where no employee has complete control over the life of a financial transaction. Audits and accounting inventory can also be used as a form of theft and mismanagement deterrents since this independently verifies the status of an organization's assets. This has been further enhanced through the integration of technological advancements in asset protection,

where organizations make use of technologically advanced machinery such as surveillance systems, automated tracking, and sophisticated systems of ensuring data security to track and safeguard their assets in real time.

#### **2.1.4 Financial reporting accuracy**

Financial reporting accuracy means the degree of accuracy and reliability of financial statements from an organization that expresses a true and fair view of its financial position and performance (Mwachikoka, 2024). Accurate financial reporting is basic in gaining confidence among stakeholders: investors, regulatory bodies, and business partners. These reports underpin good decision-making as stakeholders base their judgment of an organization's financial health and operational success on such reports. The accuracy of the financials is crucial for maintaining transparency and ensuring legal and accounting standards are upheld (Antwi et al., 2024).

Accurate financial reporting demands the use of standards imposed by either GAAP or IFRS, depending on the jurisdiction (Ricketts et al., 2018). Both of these frameworks prescribe the way in which financial information should be recorded, processed, and portrayed. These are to be instituted into accounting practices to make sure that financial activities are represented accurately in an organization. Comparability between financial periods and across different entities is enhanced by such consistency in the application of the principles, therefore heightening the reliability of financial information (Caylor et al., 2022). Financial reporting accuracy also entails preventing and detecting errors, omissions, or fraudulent activities that may compromise the integrity of such reports.

Establishing effective internal controls is one very important factor for ensuring accuracy in financial reporting (Caylor et al., 2022). The internal controls may include reconciliations, independent reviews, and approval processes, which help identify and rectify misstatements before reporting. Likewise, appropriate information systems in which the collection and processing of data are automated reduce the risk of human errors and increase the accuracy level of the financial statements. Internal auditors also have a significant role in using unbiased judgments about books of account and internal controls to identify liabilities that may impact the accuracy of reporting. External audits further undergird this as far as accuracy is concerned by the

independent check of the financial statements and the appropriateness of its supporting control environment.

Consequences of inaccurate financial reporting can be severe: loss of investor confidence, regulatory penalties, and even losses of a financial nature (Mwachikoka, 2024). It would, therefore, have an even stronger impact on SMEs, given their limited resources to recover from such setbacks. Accurate financial reporting empowers the organization to make strategic decisions, attract better investment opportunities, and maintain healthy relations with financial institutions and regulatory bodies. This instills in an organization the reputation for transparency and accountability, both key components of a successful enterprise in the long term. In a nutshell, the accuracy of financial reporting is one of the major tenets of corporate governance in its support of sustainable growth; it lends more credibility and instills confidence among stakeholders.

#### **2.1.5 Ways by which SMEs can establish effective internal controls to safeguard their ASSETS and ensure accurate financial reporting**

Despite that Small and Medium-sized Enterprises play a crucial role in the global economy, driving innovation, creating jobs, and contributing to economic growth (Abdul-Azeez et al., 2024), these firms often face unique challenges in managing their resources and ensuring accurate financial reporting (Aladejebi, 2017). Oyedokun and Muhammad (2023) submitted that establishing effective internal controls is essential for safeguarding assets, maintaining financial integrity, and fostering long-term success. A number of key strategies through which SMEs can adopt to establish robust internal controls are discussed below:

a) Segregation of Duties: One of the fundamental principles of internal control is the segregation of duties. This involves dividing responsibilities among different employees to reduce the risk of errors and fraud (Adedeji and Olubodun 2018). For example, the person responsible for authorizing transactions should not be the same person who records them. By ensuring that no single individual has control over all aspects of a financial transaction, SMEs can minimize the risk of misappropriation and inaccuracies.

b) Implementing Strong Authorization and Approval Processes: SMEs should establish

clear policies for authorizing and approving transactions (Nakabago and Hofisi 2024). This includes setting limits on the amounts that employees can approve and requiring higher-level authorization for larger transactions. Implementing a formal approval process for expenditures, contracts, and other financial commitments helps ensure that all transactions are legitimate and align with the company's objectives.

c) Regular Reconciliation and Review: Regular reconciliation of accounts is vital for detecting discrepancies and ensuring the accuracy of financial records (Ziorklui et al., 2024). SMEs should reconcile bank statements, accounts receivable, accounts payable, and other key accounts on a monthly basis. Additionally, periodic reviews of financial statements and reports by management can help identify and address any irregularities promptly.

d) Establishing Clear Policies and Procedures: Documenting and communicating clear policies and procedures is essential for maintaining consistency and accountability (Kelebetse et al., 2019). SMEs should develop comprehensive manuals that outline the processes for financial transactions, record-keeping, and reporting. These manuals should be regularly updated and accessible to all employees involved in financial operations.

e) Utilizing Technology and Automation: Ziorklui, Ampofo, Nyonyoh and Antwi (2024) submitted that Leveraging technology can significantly enhance the effectiveness of internal controls. SMEs can invest in accounting software and other financial management tools that automate routine tasks, reduce manual errors, and provide real-time insights into financial performance. Implementing automated controls, such as system-generated alerts for unusual transactions, can further strengthen the internal control environment.

f) Conducting Regular Audits and Assessments: Regular internal and external audits are crucial for evaluating the effectiveness of internal controls and identifying areas for improvement. SMEs should schedule periodic audits to assess compliance with established policies and procedures, verify the accuracy of financial records, and detect any potential fraud or mismanagement (Ziorklui et al., 2024). Engaging an independent auditor can provide an objective assessment and valuable recommendations for enhancing internal controls.

g) Training and Education: Employee training and education are key components of a robust internal control system (Ziorklui et al., 2024). SMEs should provide ongoing training to ensure that employees understand their roles and responsibilities, the importance of internal controls, and the potential risks associated with non-compliance. Creating a culture of awareness and accountability can significantly reduce the likelihood of errors and fraudulent activities.

h) Establishing a Whistleblower Policy: Encouraging employees to report suspicious activities without fear of retaliation is essential for maintaining a secure and transparent work environment. SMEs should establish a whistleblower policy that provides a confidential and anonymous channel for employees to report concerns (Ziorklui et al., 2024). This policy should be communicated clearly to all employees and include procedures for investigating and addressing reported issues.

Thus, effective internal controls are vital for SMEs to safeguard their assets, ensure accurate financial reporting, and achieve long-term success. By implementing strategies such as segregation of duties, strong authorization processes, regular reconciliation, clear policies, technology utilization, regular audits, employee training, and a whistleblower policy, SMEs can create a robust internal control environment. These measures not only protect the company's resources but also enhance financial transparency and build trust with stakeholders.

## **2.2 Theoretical Framework and Development of Hypotheses**

Stewardship Theory originated as a contrast to Agency Theory, offering an alternative perspective on management's motivations within organizations (Davis et al., 1997). The theory was first introduced in the late 20th century, with notable contributions made by researchers such as Donaldson and Davis in 1989 and further expanded in the 1990s (Davis et al., 2007). These scholars sought to redefine the understanding of managerial behavior by positing that managers, when entrusted with responsibilities and autonomy, are more likely to act as stewards of the company rather than as self-serving agents. Unlike Agency Theory, which assumes that managers are motivated primarily by personal gain (Davis et al., 2007), Stewardship Theory emphasizes the natural alignment of managers' interests with those of

the organization and its stakeholders (Davis et al., 1997).

The main postulations of Stewardship Theory center on the belief that managers derive intrinsic satisfaction from successfully performing their duties and contributing to the organization's success (Davis et al., 2007). The theory suggests that managers' behavior is guided by values such as trust, loyalty, and the desire for collective achievement, which lead them to prioritize the long-term success of the organization over short-term personal gains. This approach implies that when managers are given autonomy and supportive structures, they are empowered to make decisions that enhance the overall performance of the company.

Stewardship Theory is particularly relevant to this study as it supports the idea that a well-designed and implemented internal control system reinforces the stewardship behavior of managers, promoting a culture of accountability and ethical responsibility. By aligning managers' interests with those of the company, effective internal controls facilitate better asset protection as managers are motivated to safeguard the firm's resources diligently (Le and Tran 2018). Additionally, Stewardship Theory underpins the idea that managers are likely to commit to accurate financial reporting when they perceive themselves as stewards of the company's well-being, as transparency and reliability are essential components of their stewardship role. Therefore, this theory provides a foundation for understanding how internal control systems can empower managers to uphold practices that ensure both asset security and financial reporting integrity in SMEs. We therefore raise the two hypotheses below:

Ha1) Effective internal control system significantly helps to safeguard assets of SMEs.

Ha2) Effective internal control system significantly enhances the accuracy of financial reporting among SMEs.

### **2.3 Synthesis of Existing Empirical Findings**

The empirical literature on the effect of effective internal control systems highlights their significant role in asset protection and the enhancement of financial reporting accuracy among SMEs. Ololade (2024) emphasises that SME owners often shift to reactive internal

control strategies primarily after experiencing financial losses due to employee fraud. The study's findings reveal a positive correlation between employee fraud incidents and the adoption of reactive strategies, suggesting that proactive control mechanisms may be more effective in mitigating fraud risks and enhancing asset security. This hint emphasizes the necessity of preemptive measures to bolster financial resilience within SMEs.

Onwuchekwa et al. (2024) extend this understanding by linking internal control systems to operational efficiency in supermarkets. Their findings demonstrate that elements such as record retention, job description updates, and restricted access contribute significantly to improved operational performance. The quantitative evidence presented supports the notion that comprehensive control measures not only safeguard assets but also streamline processes, facilitating more accurate and reliable financial reporting. The reinforcement of operational efficiency through effective internal controls suggests a dual benefit: safeguarding physical and financial assets while maintaining transparent financial practices.

Keaunui (2023) provides a qualitative perspective, identifying key themes related to internal control systems among small business leaders. The study's findings highlight the challenges inherent in developing and maintaining effective control strategies, including the role of communication and regular assessment. These themes re-echo the dynamic nature of internal controls and their necessity for continuous evolution to safeguard assets and ensure accurate financial reporting. Such proactive strategies, supported by regular communication and assessments, contribute to better organizational transparency and financial accountability.

Further evidence from Oyedokun and Muhammad (2023) affirms the positive influence of internal control systems on financial performance in SMEs. Their study in Kebbi State, Nigeria, reinforces the importance of key control components, indicating that these systems bolster the financial robustness of SMEs. This link between financial performance and the adoption of internal control measures reiterates the significance of a comprehensive internal control framework, which not only secures assets but also enhances financial statement reliability.



Otoo, Kaur, and Rather (2023) broaden the discussion by evaluating the banking industry's reliance on internal controls for effectiveness. Their findings show that elements like control activities and risk assessment are pivotal for organizational efficiency, a conclusion that resonates with the need for thorough internal frameworks to safeguard financial and physical assets. While monitoring and communication showed less impact in their context, the general emphasis on effective control mechanisms aligns with the goal of promoting accuracy in financial reporting.

Ajala et al. (2023) further validate the positive correlation between internal control systems and organizational performance, specifically within SMEs in Ondo State, Nigeria. Their analysis suggests that robust internal controls contribute to growth, efficiency, and business continuity, reaffirming the idea that such systems are vital for asset protection and reliable financial disclosure. This is particularly relevant for SMEs, where limited resources necessitate an optimized approach to both risk management and financial accuracy.

Ghanem and Awad (2023) highlight similar outcomes in Lebanon's commercial sector, where the division of responsibilities and frequent audits were found to be effective in reducing fraud. Their hints also reveal areas that require improvement, illustrating that while internal control systems can substantially reduce fraud risks, gaps still exist that could undermine asset security and financial accuracy. This suggests that continual refinement of control measures is essential for maintaining high standards in financial reporting.

The emphasis on monitoring systems is echoed in Alayli's (2022) analysis of Lebanese SMEs. The results suggest that effective monitoring frameworks play a critical role in performance evaluations and fraud prevention. This focus on oversight mechanisms supports the conclusion that a well-structured internal control system can significantly safeguard assets and maintain the integrity of financial reports.

Studies such as To and Tuan's (2021) in Hanoi, Vietnam, further indicate the varied impact of COSO's internal control elements on SME performance. Their findings show that while the control environment is crucial, other components like monitoring may have limited influence. This points to the need for SMEs to prioritize specific

control elements that directly contribute to asset protection and reporting precision. Artemieva et al. (2020) in Russia also affirm the significance of internal controls in improving financial performance through fraud reduction and structured control environments.

Ha and Tran (2018) and Adelana and Toba (2011) add to the empirical discourse by confirming the role of internal controls in fraud prevention and asset misappropriation. These studies advocate for measures such as segregation of duties and authorization systems, which significantly enhance asset protection and ensure the accuracy of financial records. Their results reinforce the argument that an integrated internal control system, focusing on various preventive measures, is essential for safeguarding organizational assets and improving financial reporting reliability.

Thus, these empirical findings collectively illustrate the multifaceted benefits of effective internal control systems in SMEs. The common thread across these studies is the recognition that effective internal controls not only mitigate risks related to asset protection but also enhance the accuracy and reliability of financial reporting. This synthesis emphasises the importance of implementing comprehensive and proactive internal control measures, which are crucial for sustaining SME growth and maintaining financial transparency.

### **3. METHODOLOGY**

The design of studying how and to what extent a robust internal control system influences the protection of assets and improves the accuracy of financial reporting in SMEs in Nigeria is based on a survey research design. The present study has adopted this design in order to systematically collect quantitative data from various SME owners throughout different geographical regions to generalize findings within the context of Nigerian SMEs. The survey study focuses on both industrial and commercial SMEs operating in Nigeria, ensuring a diverse representation of sectors within the sample. The respondents include male and female SME owners, managers, and key decision-makers responsible for overseeing financial operations and internal controls. Participants are required to have at least a basic level of education, with qualifications ranging from undergraduate to postgraduate degrees, ensuring they possess the necessary knowledge to provide insightful

responses on asset protection and financial reporting accuracy.

The research has been conducted on a population comprising small and medium enterprises operating in Nigeria so as to ensure that internal control practices were fundamentally comprehended for both different sectors and locations. A sample size of 120 respondents was selected using a purposive sampling technique. Precisely, 20 SME owners were selected from each of the six geopolitical zones in Nigeria, namely: North Central, North East, North West, South East, South South, and South West. The use of such a sampling technique will ensure that responses from each zone are adequately represented to give strength to the findings of this study. The selection criterion focused on those owners that had experience either in managing or overseeing financial and operational control within their enterprises to ensure that the responses are of an informed nature about the effect of internal controls systems on asset protection and financial reporting.

Primary data on internal control systems, asset protection practices, and financial reporting accuracy was solicited with the use of a structured questionnaire. The questionnaire had been pretested for reliability and clarity before distribution. The questionnaire featured closed-ended questions structured on a 5-point Likert scale, providing respondents with a set of predetermined response options. The Likert scale included the following choices: 5 = Strongly Agree, 4 = Agree, 3 = Undecided, 2 = Disagree, and 1 = Strongly Disagree. The Spearman rank-order correlation is used to test the hypotheses after the mean and frequency distribution were used to analyze the research questions in the study. This statistical method was chosen to determine the direction and strength of the relationship that exists between robust internal control systems, protection of assets, and their impact on the accuracy of financial reporting.

## **4. DATA ANALYSIS**

### **4.1 Analysis of Research Questions**

The analysis of responses to the research questions is shown below in Table 1.

Table 1 provides an analysis of responses to research questions concerning internal control systems, asset protection practices, and financial reporting accuracy within SMEs. The first item in

the Table 1 reveals that 87 respondents strongly agreed and 28 agreed that their business enterprise has a well-defined internal control system in place to monitor financial activities, resulting in a mean score of 4.68. This high mean supports the acceptance of the statement, indicating widespread agreement among participants about the robustness of internal control systems in monitoring financial activities.

The second item shows that 70 respondents strongly agreed and 42 agreed that regular audits are conducted to ensure adherence to internal control procedures, producing a mean score of 4.48. This result supports acceptance and highlights that regular auditing is a significant practice among SMEs, underscoring its role in maintaining financial integrity.

For the third item, responses show a broader distribution: 51 respondents strongly agreed, 35 agreed, 18 were neutral, 14 disagreed, and 2 strongly disagreed that their firm's internal control system effectively identifies and mitigates financial management risks. With a mean score of 3.99, the item was still accepted, but the varied responses suggest that while many see the system as effective, some reservations exist regarding its risk mitigation capabilities.

Item four indicates that 44 respondents strongly agreed and 46 agreed that management actively reviews and updates internal control policies to address new risks, while 16 were neutral, and 14 disagreed. The mean score of 4.00 supports acceptance, implying that while a majority acknowledge policy reviews, there is some variability in perceived consistency or effectiveness.

The analysis of asset protection practices starts with item five, which shows that 51 respondents strongly agreed and 45 agreed on the strength of their firm's asset protection policies, minimizing the risk of theft or loss. The mean score of 4.08 confirms acceptance, suggesting that respondents generally view asset protection measures as sufficient.

Responses to item six reveal that 48 strongly agreed and 40 agreed that access to valuable assets is restricted to authorized personnel, while 14 were neutral and 18 disagreed, yielding a mean of 3.98. Although this statement is accepted, the responses indicate some concerns or inconsistencies regarding asset access control.

**Table 1. Analysis of Research Questions**

| <b>S/N</b> | <b>Internal Control Systems</b>   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Mean</b> | <b>Decision</b> |
|------------|---|-----------|----------|----------|----------|-----------|-------------|-----------------|
| 1          | Our business enterprise has a well-defined internal control system in place to monitor financial activities.        | 87        | 28       | 5        | 0        | 0         | 4.68        | Accept          |
| 2          | Regular audits are conducted to ensure that the internal control procedures of our SME are followed.                | 70        | 42       | 4        | 4        | 0         | 4.48        | Accept          |
| 3          | The firm's internal control system effectively identifies and mitigates risks associated with financial management. | 51        | 35       | 18       | 14       | 2         | 3.99        | Accept          |
| 4.         | Management actively reviews and updates the firm's internal control policies to address new risks.                  | 44        | 46       | 16       | 14       | 0         | 4.00        | Accept          |
| <b>S/N</b> | <b>Asset Protection Practices</b>   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Mean</b> | <b>Decision</b> |
| 5          | Our firm has strong asset protection policies that minimize the risk of theft or loss.                              | 51        | 45       | 8        | 15       | 1         | 4.08        | Accept          |
| 6          | Access to valuable assets is restricted only to authorized personnel in our organization.                           | 48        | 40       | 14       | 18       | 0         | 3.98        | Accept          |
| 7          | Physical assets are regularly monitored and safeguarded against potential damage or misuse.                         | 54        | 35       | 14       | 17       | 0         | 4.05        | Accept          |
| 8          | We have established procedures to track and verify our firm's assets effectively.                                   | 52        | 44       | 11       | 12       | 1         | 4.12        | Accept          |
| <b>S/N</b> | <b>Financial Reporting Accuracy</b>   | <b>SA</b> | <b>A</b> | <b>U</b> | <b>D</b> | <b>SD</b> | <b>Mean</b> | <b>Decision</b> |
| 9          | Our financial reports are consistently free from significant errors.  | 86        | 27       | 7        | 0        | 0         | 4.66        | Accept          |
| 10         | Financial reports of our SME are prepared in compliance with established accounting standards and regulations.      | 46        | 41       | 16       | 17       | 0         | 3.97        | Accept          |
| 11         | Regular reconciliations are conducted to ensure the accuracy of our financial records.                              | 67        | 46       | 6        | 1        | 0         | 4.49        | Accept          |
| 12         | Our firm's financial reports accurately reflect our financial position and comply with regulatory standards.        | 71        | 45       | 4        | 0        | 0         | 4.56        | Accept          |

Source: Survey Findings (2024)

Item seven shows that 54 respondents strongly agreed and 35 agreed that physical assets are regularly monitored and safeguarded, with a mean score of 4.05. This positive result supports acceptance, reinforcing the perception that asset monitoring is a standard practice within SMEs.

In item eight, 52 respondents strongly agreed and 44 agreed that there are established procedures to track and verify firm assets, resulting in a mean of 4.12. This high score signifies that asset verification procedures are considered effective and integral to asset protection.

The financial reporting accuracy section begins with item nine, where 86 respondents strongly agreed and 27 agreed that financial reports are consistently free from significant errors, leading to a mean of 4.66. This high level of agreement

supports the acceptance of this item, showing confidence in the accuracy of financial reporting among respondents.

For item ten, 46 strongly agreed and 41 agreed that financial reports are prepared in compliance with established accounting standards and regulations, while 16 were neutral and 17 disagreed. The mean of 3.97 suggests acceptance but points to slight variability in compliance perceptions.

Item eleven indicates strong agreement, with 67 respondents strongly agreeing and 46 agreeing that regular reconciliations are conducted to ensure financial record accuracy. The mean score of 4.49 supports acceptance, highlighting reconciliations as a critical aspect of financial reporting accuracy.

**Table 2. Test of Hypothesis I**

| Spearman's rho | Internal Control System | Correlation Coefficient | Asset Protection |
|----------------|-------------------------|-------------------------|------------------|
|                |                         | .778**                  |                  |
|                |                         | Sig. (2-tailed)         | .000             |
|                |                         | N                       | 120              |

Source: Output from SPSS V. 26 (2024)

**Table 3. Test of Hypothesis II**

| Spearman's rho | Internal Control System | Correlation Coefficient | Financial Reporting Accuracy |
|----------------|-------------------------|-------------------------|------------------------------|
|                |                         | .644**                  |                              |
|                |                         | Sig. (2-tailed)         | .000                         |
|                |                         | N                       | 120                          |

Source: Output from SPSS V. 26 (2024)

Lastly, item twelve shows that 71 respondents strongly agreed and 45 agreed that their financial reports accurately reflect the financial position and comply with regulatory standards, leading to a mean of 4.56. This result supports the acceptance of the statement and underscores the participants' trust in their financial reporting practices.

#### 4.2 Test of Hypothesis I

Ha1) Effective internal control system significantly helps to safeguard assets of SMEs.

The test of Hypothesis I, shown in Table 2, provides a comprehensive understanding of the influence of internal control systems on asset protection among SMEs. The Spearman's rho correlation coefficient of .778 represents a strong, positive marginal influence. This coefficient suggests that improvements in the robustness of an internal control system are associated with significant increases in the level of asset protection within an SME. Specifically, for each enhancement in internal control measures, there is a corresponding substantial rise in asset protection, indicating that SMEs with stronger controls are better equipped to safeguard their assets against potential risks such as theft or loss.

The associated p-value of .000 confirms that this influence is statistically significant at the 5% level. This means there is strong evidence to support that the positive correlation between internal control systems and asset protection did not occur by random chance. Therefore, the hypothesis (Ha1) that a robust internal control system significantly helps safeguard assets of

SMEs is validated by the data. The results imply that SMEs can greatly benefit from prioritizing the development and maintenance of comprehensive internal control mechanisms to ensure the protection of their physical and financial assets.

#### 4.3 Test of Hypothesis II

Ha2) Effective internal control system significantly enhances the accuracy of financial reporting among SMEs.

In Table 3, the test of Hypothesis II evaluates the influence of internal control systems on the accuracy of financial reporting among SMEs. The Spearman's rho correlation coefficient of .644 reflects a moderately strong, positive influence. This coefficient indicates that as internal control measures improve, there is a significant, although less pronounced, enhancement in the accuracy of financial reporting. This suggests that SMEs with better internal controls are more likely to produce financial reports that are free from significant errors and comply with established accounting standards.

The p-value for this hypothesis is also .000, which confirms statistical significance at the 5% level. This ensures that the observed positive influence of internal control systems on financial reporting accuracy is not due to random variation but is a genuine association. Consequently, the hypothesis (Ha2) that a robust internal control system significantly enhances the accuracy of financial reporting among SMEs is supported. This finding emphasizes that effective internal control practices contribute to reliable financial reporting, which is essential for transparent business operations and informed decision-making.

#### **4.4 Discussion of Findings**

The first finding indicates that the internal control system significantly helps to safeguard the assets of SMEs, as evidenced by a Spearman's rho of .778 and a p-value of .000. This strong positive influence suggests that as internal control systems improve, there is a corresponding increase in asset protection within these enterprises. Internal controls such as segregation of duties, authorization procedures, and physical safeguards are integral in ensuring that assets are protected from misuse. This finding aligns with established principles in financial management, where robust controls provide checks and balances that reduce vulnerabilities. The results may reflect the heightened awareness among SME owners about the importance of protecting their physical and financial assets in an increasingly competitive and risky business environment. Furthermore, SMEs that implement proper internal controls are more likely to identify and address weaknesses early, leading to better asset management and protection practices. Several studies support this finding. For instance, Ololade (2024) found that SMEs with effective internal control strategies experienced fewer incidents of employee fraud, highlighting that robust controls can mitigate risks to asset security. Similarly, Ajala et al. (2023) demonstrated a significant positive relationship between internal control and various organizational performance metrics, reinforcing the notion that well-implemented controls contribute to asset protection. Ghanem and Awad (2023) also corroborated this by showing that effective control measures were essential in reducing fraud in Lebanon's commercial sector, emphasizing the need for comprehensive internal controls to safeguard assets. Furthermore, Ha and Tran (2018) illustrated how enhanced internal control measures could significantly reduce asset misappropriation, further validating the assertion that internal controls are crucial for protecting resources.

The second finding reveals that the internal control system significantly enhances the accuracy of financial reporting among SMEs, indicated by a Spearman's rho of .644 and a p-value of .000. This result suggests that improvements in internal control systems lead to better accuracy in financial reporting, which is vital for maintaining stakeholder trust and meeting regulatory requirements. Internal controls help ensure that transactions are

recorded correctly, financial statements are prepared with integrity, and discrepancies are promptly identified and corrected. The presence of checks and balances, such as regular audits, reconciliations, and approval processes, reduces errors and the potential for intentional misrepresentation of financial data. The results are likely due to the direct relationship between proper financial oversight and the reliability of reported financial data. SMEs with robust internal controls are more likely to maintain accurate records, which are essential for informed decision-making and regulatory compliance. Supporting this finding, Oyedokun and Muhammad (2023) found a positive correlation between key components of internal control systems and the financial performance of SMEs, highlighting that effective controls lead to reliable financial statements. Onwuchekwa et al. (2024) assessed the impact of internal controls on operational efficiency and noted that strong internal control measures significantly contribute to accurate record-keeping and documentation, further supporting the importance of controls in ensuring financial reporting accuracy. Additionally, To and Tuan (2021) found that the control environment significantly influenced SME performance, indicating that a robust internal control framework could enhance the integrity of financial reporting. Finally, Keaunui (2023) emphasized that effective internal control procedures not only safeguard assets but also improve overall profitability by ensuring that financial reports are accurate and reliable, thus reinforcing the critical role of internal controls in financial reporting.

#### **5. CONCLUSION AND RECOMMENDATIONS**

In an ideal business environment, SMEs would have an appropriate internal control system that safeguards the assets and ascertains the accuracy and reliability of financial reporting. Such a system allows SMEs to reduce risks, prevent fraud, and maintain integrity in financial operations. It would provide an environment for safe operation wherein the SMEs can attain sustainable growth, comfort investors and stakeholders, and sort out regulatory and compliance matters with ease. Correct financial reporting would strengthen decision-making, attract new investments, and attract funding from outside parties that powers business growth and stability in the long run. Based on the findings of the study, a sound internal control system is an essential tool of asset protection and

improvement of financial reporting accuracy in SMEs. It gives orderly mechanisms for identification and mitigation of risks that can potentially have adverse impacts on the organization's assets as well as the integrity of financial data. With thorough risk assessments, relevant and effective control activities, and proper information dissemination, SMEs can establish a robust framework of operations to counter serious threats. This helps the organization safeguard its resources and informs stakeholders and financial partners of better trust in the organization. This therefore, may act as a link to doors of funding and partnership opportunities that may foster growth and sustainability of SMEs in the increasingly complex business environment. It is clear why internal controls are important; they will enable the SMEs to sail through and safeguard their assets while at the same time ensuring that the stakeholders get access to financial information that they can rely on.

**1) Recommendation for Asset Protection:** It is recommended that SME owners and management implement comprehensive internal control systems that include regular audits and assessments to enhance asset protection measures. This proactive approach will help identify potential vulnerabilities and strengthen safeguards against theft or loss.

**2) Recommendation for Financial Reporting Accuracy:** SME managers should prioritize the establishment of standardized accounting practices and training programs for staff involved in financial reporting. By ensuring that all employees are well-versed in compliance with accounting standards and internal controls, the accuracy of financial reports can be significantly improved, thereby building stakeholder trust.

## DISCLAIMER (ARTIFICIAL INTELLIGENCE)

Author(s) hereby declare that NO generative AI technologies such as Large Language Models (ChatGPT, COPILOT, etc) and text-to-image generators have been used during writing or editing of this manuscript.

## COMPETING INTERESTS

Author has declared that no competing interests exist.

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