

The relationship between internal control system and business survival in the COVID-19 pandemic era

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Abstract: The necessity for survival has grown increasingly prominent as an overriding goal of every corporate organization in this COVID-19 pandemic period. The purpose of this paper was to investigate the relationship between internal control systems and business survival in the face of the current pandemic. A descriptive survey research design was used for the investigation. Primary data were obtained from a sample of 382 SMEs' owners chosen at random from a population of 8,395 registered SMEs in Lagos State using a simple random sampling technique. The data gathering instrument was a five-item Likert scale questionnaire. Two hundred and thirty copies of the scale were returned and used in the study, representing a 60.20 percent survey response rate. Pearson correlation was used to test the hypotheses. The study's findings revealed a positive relationship between internal control systems and business survival in the pandemic era. It was determined that internal control systems were a successful instrument for organizational control and commercial survival during the pandemic era. Accordingly, the study recommended that business owners should ensure that a vibrant internal control system is put in place to aid management in effective control of the organization especially in pandemic era to ensure business survival.

Keywords: Business survival, COVID-19, internal control system, pandemic era.

I. INTRODUCTION

The Corona Virus Disease 2019 (COVID-19) has caused widespread devastation around the world (Bartik, Bertrand, Cullen, Glaeser, Luca & Stanton, 2020; Fairlie, 2020a). The epidemic, with its associated uncertainty and disruption of human and economic activities in all countries throughout the world, has profoundly affected human activities, resulting in a global decrease in commercial and economic activity (Fairlie, 2020b). This position has proven extremely difficult for enterprises, particularly those operating Small and Medium-sized Enterprises (SMEs), which have long been regarded as the foundation of any economy (Bartik et al., 2020).

SMEs in Sub-Saharan Africa (SSA) are struggling to survive due to depleting resources and the continent's government's inability to appropriately support SMEs' activities. In Nigeria, the situation is no different. In addition to a number of operational obstacles in the Nigerian environment, the COVID-19 pandemic has exacerbated the survival challenge of SMEs in Nigeria. As a result, Nigerian SMEs are

confronting new existential challenges. Among these obstacles are the pressures on profitability caused by increased production and operating costs, financial, infrastructural, political, and a variety of ethical issues, including internal control flaws. Businesses, particularly SMEs, would face survival issues as a result of the challenges. Perhaps an effective internal control system could be useful in mitigating these issues.

A control system is essential in any business to safeguard the processing of critical information required for organizational operation, whether in service or manufacturing concerns (Abbas & Iqbal, 2012). Whereas, if an internal control system is effectively activated, there may be cost savings. For example, where there is an appropriate segregation of duties, which is a fundamental control, that is division of labor in SMEs, the risk of stealing, pilfering, or snafu would be reduced to a bare minimum, lowering the cost of production and operations. Prior to the introduction of COVID-19, global patterns linked to organizational failure as a result of internal control failures were extremely concerning. This has increased the importance of internal control systems in commercial enterprises. Internal control systems are defined by the International Standard Organization (ISO 400) as complex and integrated systems of financial control that carry out business in an orderly and efficient manner, ensure adherence to management policies, safeguard company assets, and ensure the completeness and accuracy of records to the greatest extent possible (Ngugi 2011)

1.1 Statement of Problem

Corporate failures in the recent past have resulted in the development of a number of regulatory frameworks to protect shareholder wealth, including the Committee of Sponsoring Organizations of the Treadway Commission, COSO internal control framework, Sarbanes-Oxley Act, and the first corporate governance code, the Code of Best Practices on Corporate Governance in Nigeria.

As a result, internal control systems have been built in order to effectively control an organization and its resources (Al-Hazmi, 2013; Muhunyo & Jagongo, 2018). Internal control systems are essential instruments for reducing operational risk and ensuring the smooth operation of an organization through

policies and procedures (Abbas & Iqbal, 2012). However, a number of recent company failures have been linked to the failure or absence of internal control systems (Ilias, Abdulatiff & Mohamed, 2016). These failures have far-reaching consequences, piquing the interest of stakeholders in both the public and private sectors of the global economy. As a result, responsibility in the management of organizational resources is required in both the public and private sectors (Ilias et al., 2016).

Previous study has emphasized the need for the importance of internal control (Al-Hazmi, 2013; Muhunyo & Jagongo, 2018). From an institutional standpoint, Al-Hazmi (2013) analyzed internal control and accounting rules and procedures practices. Similarly, Muhunyo and Jagongo (2018) investigated the effect of internal control systems on the financial performance of public institutions of higher learning in Nairobi City County, Kenya. The authors focused on three components of internal control systems: the control environment, internal audit, and control activities. Whereas, employees and other stakeholders could use the COVID 19 pandemic as a basis to break internal control systems put in place by SMEs, the effect of this could affect the survival of SMEs. To the best of the study's knowledge, a number of previous research have focused on the relationship between internal control and business performance, with no obvious or practical one addressing this from the standpoint of corporate survival in the midst of the COVID-19 epidemic. The current study aims to fill such void.

1.2 Research Objectives

The main objective of this paper was to evaluate the relationship between internal control system and business survival in the face of the COVID - 19 pandemic while the specific objectives were:

- a. To examine whether there is a relationship between internal control and business survival in COVID-19 pandemic era
- b. To investigate if there is correlation between adherence to COSO internal control framework and business survival in the pandemic era.

1.3 Research Questions

The research questions asked for this work were:

- a. Is there no relationship between internal control and business survival in COVID-19 pandemic era?
- b. Is there no correlation between adherence to COSO internal control framework and business survival in the pandemic era.

1.4 Research Hypotheses

The hypotheses formulated for this research work were culled in null form as follows:

H₀₁: There is no relationship between internal control and business survival in COVID-19 pandemic era

H₀₂: There is no correlation between adherence to COSO internal control framework and business survival in the pandemic era.

II. LITERATURE REVIEW

2.1 Conceptual review

2.1.1 COVID-19

COVID-19 has had a disastrous impact on a number of enterprises around the world (Fairlie, 2020a). Some of these businesses have been forced to close their doors, while others are still dealing with the impacts of the pandemic, while others have been able to expand their operations even in the midst of the present pandemic (Bartik et al., 2020). In Nigeria, the government placed a two-week partial lockdown on some important states designated as high risk during the second quarter of 2020: Lagos State, Ogun State, and the Federal Capital Territory (FCT). Although the government's actions were aimed at reducing and controlling the spread of COVID-19, they had a severe impact on the economy, particularly on the activities of the country's SMEs. When the lockdown and shelter-in-place orders were lifted in the third quarter of 2020, a number of Nigerian SMEs were already tallying their losses.

2.1.2 Business survival

Survival is one of the primary goals of business organizations; other goals that drive corporate operations include expansion, maximizing of shareholder wealth, customer happiness, and market share, among others. The uncertainty in the business environment in this era generates concerns about firm viability (Olughor & Oke, 2014). The necessity to survive, also known as sustainability, denotes the existence of a business in its chosen field of activity for a much longer period of time. This is due to the fact that sustainability is dependent on a company's ability to withstand both internal and external difficulties that are detrimental to its performance (Paul & Eketu, 2018). However, it has been proposed that one of the possible causes of poor performance even among enterprises is a lack of evaluation and control mechanisms (Ilias, et al., 2016).

2.1.3 Internal control system

A number of academics have defined internal control differently (Cetin & Yetis, 2017; Committee of Sponsoring Organization of Traedway Commission COSO, 2019; Jokipii, 2010 as cited in Ilias et al., 2016). "Internal control system has been considered as a tool to better the monitoring and reporting process in the organization and to assure compliance with rules and regulations," writes Jokipii (2010), as cited in Ilias et al. (2016, p.28). According to Cetin and Yetis (2017, p. 3), a "internal control system is a process aimed at ensuring the right level of assurance in enterprise management for the accomplishment of business objectives." Furthermore, "internal control is a procedure carried out by an entity's board of directors, management, and other people to provide reasonable confidence regarding the attainment of operational, reporting, and compliance objectives." COSO (2019)

Internal control is one of the most critical factors to consider when running a corporation (Al-Hazmi, 2013). This is due to the fact that an internal control system is an efficient and effective process by which organizations monitor and control their various activities and operations using effective systems of checks and balances that are put in place to prevent fraudulent activities and detect mistakes that may occur while carrying out organizational activities for the purpose of safeguarding the organization as a whole (Eke, 2018; Kumuthinidevi, 2016). In this vein, Al-Hazmi (2013) proposed that internal control be integrated into business operations. This is consistent with COSO regulations. The internal control-integrated architecture developed by COSO is well recognized and used on a global scale. The framework has grown in popularity over the years, and it is now widely used by accounting professionals, scholars, and practitioners (Abbas & Iqbal, 2012; Cetin & Yetis, 2017; Muhunyo & Jagongo, 2018; Najah & Omar, 2018). The COSO framework includes the following components: control environment, risk assessment, control activities, information and communication, and monitoring activities (Muhunyo & Jagongo, 2018; Najah & Omar, 2018). These components must be present and functioning properly for any internal control system to meet the stated objectives of any business (COSO, 1994 as cited in Muhunyo & Jagongo, 2018).

Control environment

The control environment conveys the attitude and actions of senior management in an internal control system. It is the foundation of the internal control system, and as such, it provides the required discipline and structure for the attainment of the internal control system's key objectives. As a result, a weak control environment indicates that the organization's internal control system is also weak, and vice versa. According to Al-Hazmi (2013), the control environment is an inherent component of an organization's internal control structure and is indicated to be the most important element that moderates the effect of accounting control policies and procedures practices.

Risk assessment

The risk assessment process is triggered by the control environment. Risk assessment entails recognizing, analyzing, and managing uncertainties that may jeopardize the organization's ability to achieve its goals. This will assist the company in detecting and developing suitable responses to these barriers (Isaac 2020).

Control activities

Orders, rules, techniques, choices, policies, and procedures that ensure management instructions are followed in order to maintain reasonable certainty in the firm's operations and activities are included. Control operations adhere to the following procedures: approval and authorization procedures, transaction verification, reconciliation of accounting records, activity evaluations, asset preservation, and segregation of roles (Ayimpoya, Akolgo, Mbilla & Gbegble 2020).

Information and communication

The flow of information and communication from the organization's internal and external environments is a critical component of the internal control system. Timely, suitable, accurate, up-to-date, and accessible information and communication are required for an internal control system to function well. The lack of timely information and communication throughout the business may impede the achievement of organizational goals (Isaac 2020).

Monitoring

The final activity of the COSO internal control framework is monitoring, which is an organization-wide activity that entails observing the organization's internal control system to determine if it is operating in accordance with the organizational standard (Ayimpoya, et al. 2020).

Internal control system and business survival in the COVID-19 pandemic era

In the COVID-19 era, business organizations are more concerned with survival; thus, senior managers rely on relevant information to make decisions that have far-reaching consequences for their company. Internal control systems assist firms in establishing a system that ensures that their activities and operations are carried out in accordance with corporate governance principles and within the existing regulatory framework and provisions of the law of the land. Businesses that lack an internal control system or have a weak internal control system are vulnerable to significant risk and exposure. As a result, it is critical for organizations to adapt to and survive this tumultuous environment by implementing an effective internal control mechanism.

2.2 Theoretical review

2.2.1 Agency theory

Scholars have utilized a variety of theories in the literature to explain how internal control systems serve to improve business performance. However, because of its relevance to the subject, Jensen and Meckling's (1976) agency theory is used in this investigation. Thus, agency theory will be utilized to explain the importance of internal control systems to company operations based on internal control's distinctive contribution to safeguarding the organization's resources vis-à-vis shareholder wealth via effective control mechanisms incorporated in internal control. As a result, agency theory will serve as the theoretical foundation for this investigation.

According to Carausu (2015), there are other theories that define the interaction between the manager (agent) and the shareholders (principals), but agency theory is the most frequently accepted in the business world. The risk relationship between a principle and agents with diverse risk-taking intentions is examined by agency theory (Donnellan & Rutledge, 2016). According to agency theory, the agents are the principal's representatives, and as such, their actions must be in the principal's best interests. The theory argued that

agents typically have information that is not readily available to the principal, and as such, such information should be employed in the interest of the organization rather than for selfish reasons by the agents while managing the organization's resources (Iin, Siti, & Nur, 2016). This implies that applying the provisions of agency theory through advisory services and prudent reporting will enable management to make important and timely decisions that will help protect and safeguard the organization's assets; such action would ensure business survival in difficult times such as the current COVID-19 pandemic.

2.2.2 Stakeholder Theory

In 1984, Edward Freeman proposed the Stakeholder Theory. Despite the fact that it is not a completely established theory, stakeholder theory has garnered broad support due to its simplicity and logical application (Emerson, Alves & Raposo, 2011). No organization lives in isolation; rather, every organization (commercial or non-profit) exists for a variety of people (stakeholders) who have an interest in the organization. Stakeholder theory is thus based on the notion that it is the obligation of the business to consider the interests of other stakeholders, in addition to the shareholders, who have an impact on the enterprise. With this idea in place, all stakeholders would benefit as long as proper internal control mechanisms are in place to ensure the survival of businesses, particularly during a pandemic era.

2.3 Empirical review

Agbenyo, Jiang, and Cobblah (2018) conducted a study on the assessment of the Ghana Revenue Authority's internal control system on financial reporting quality. Quota and simple random sampling techniques were used to select fifty (50) respondents as the sample size of the study on which the research instrument was administered in the study, which specifically surveyed the nature and quality of financial reporting and the impact of government internal control systems on financial reporting quality. The correlation analysis revealed that, contrary to popular belief, monitoring as an element of an internal control system has a negative impact on financial quality reporting, yet it was statistically significant. It was also discovered that a unit increase in collection performance resulted in an improvement in GRA's financial reporting quality.

Cetin and Yetis (2017) conducted research to assess the efficacy of the internal control system used in hotel businesses. A survey research design was used for the investigation. A systematic questionnaire was used to collect data from the management staff of 54 hotels with 4 and 5 star ratings in the Central Anatolia Region that had the most recent tourism management certificate. The paper discovered that the internal control system in hotel enterprises was effectively operated, but the effectiveness of the internal control system did not differ significantly based on the hotel's classes and statuses.

Ibrahim, Diibuzie, and Abubakari (2017) used an ordered logistic regression model to investigate the impact of internal control variables on financial performance in five health facilities in the region. The study's sample size was set at 50 participants. Internal controls and financial performance were found to have a positive link, according to the research. However, only three of the five internal control variables were statistically significant, with P-values less than 5%.

Ilias et al. (2016) investigated the impact of management control systems on performance in Malaysian local governments. A survey research design was used in their investigation. The study's sample size was set at 899 people. Participants in the study were heads of departments from Peninsular Malaysia's local governments. The response rate obtained was 37.26%. (335). To test the hypothesis, structural equation modeling was used. External control and formal internal control were found to be highly associated with all three performance characteristics - financial, service quality, and procedural. The findings also revealed that internal informal control only had a significant relationship with service quality performance, whereas external control, through the presence of formal internal control, had a stronger relationship with all three performance dimensions than the direct relationship between external control and performance.

III. RESEARCH METHOD

The objective of this paper was to investigate the relationship between internal control systems and business survival in the face of the current pandemic. The study adopted a descriptive survey research design. The primary data was collected with a sample of 382 owners of SMEs selected using a simple random sampling technique from the population which was determined through Taro Yamane formula from a population of 8,395 registered SMEs operating in Lagos State. A Likert scale type questionnaire of five items was used as the data collection instrument which achieved a reliability of 0.7 Cronbach alpha which is in line with the acceptable value (Nunally, 1978). Two hundred and thirty (230) copies of the scale were returned and used in the analysis, indicating a survey response rate of 60.20 per cent. The hypotheses were tested with Pearson correlation at 95 per cent confidence interval.

IV. RESULTS AND DISCUSSION

4.1 Descriptive statistics

Table 4.1: Description and Characteristics of Respondents

1	Ownership	Frequency	%
	Sole proprietorship	145	63.04
	Partnership	55	23.91
	Joint Stock	30	13.04
		230	100
2	Liability/Registration with CAC	Frequency	%
	Private limited Liability	30	13.04

	Business Name	200	86.96
	Un-Registered	0	0.00
		230	100.00
3	Main Business Activity	Frequency	%
	Manufacturing	33	14.35
	Services	144	62.61
	Others	53	23.04
		230	100.00
4	Capital Base	Frequency	%
	N10,000 - N250,000	103	44.78
	N250,001 - N500,000	89	38.70
	N500,001 - N1,000,000	23	10.00
	N1,000,001 - above	15	6.52
		230	100.00
5	Ownership/Status	Frequency	%
	Employer	201	87.39
	Employee	29	12.61
		230	100
6	Average Annual Turnover	Frequency	%
	N100,000 - N500,000	34	14.78
	N500,001 - N1,000,000	20	8.70
	N1000,001 - N2,000,000	80	34.78
	N2,000,001 – above	96	41.74
		230	100.00

Authors: SPSS result assisted with excel (2021)

From table 4.1 above, it could be seen that 63.04% of the respondents were sole proprietors, 23.91% were in partnership business while 13.04% of them were in joint stock owners. This implies that a good number of the respondents were sole proprietors. All the respondents were registered with CAC, 13.04% of them were private limited liability companies while 86.96% were business name registers. 62.61% of the respondents were into services business activities, 14.35% were into manufacturing business activities while 23.04% of them were into other businesses other than manufacturing and service. For capital base, 44.78% of the respondents had between N10,000 – N250,000 as capital base, 38.70% had between N250,001 – N500,000 10% had N500,001 – N1,000,000 as capital base while N1,000,001 and above had 6.52%. 88.39% of the respondents were employers while 12.61% were employees. Finally, 14.78% of the respondents has the average annual turnover of N100,000 to N500,000, 8.7% had N500,001 to N1,000,000, 34.78% had N1,000,001 and N2,000,000 while 41.74% had N2,000,001 and above as average annual turnover.

4.2 Inferential statistics

Test of Hypotheses

H0₁: There is no relationship between internal control and business survival in COVID-19 pandemic era.

Table 4.2.1: Relationship between internal control and business survival in COVID-19 Correlations

		Internal control system	Business survival
Internal control system	Pearson Correlation	1	.414**
	Sig. (2-tailed)		.000
	N	230	230
Business survival	Pearson Correlation	.414**	1
	Sig. (2-tailed)	.000	
	N	230	230

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

H0₂: There is no correlation between adherence to COSO internal control framework and business survival in the pandemic era.

4.2.2: Relationship between adherence to COSO internal control framework and business survival in the pandemic era Correlations

		COSO internal control framework	Business survival
COSO internal control framework	Pearson Correlation	1	.463**
	Sig. (2-tailed)		.000
	N	230	230
Business survival	Pearson Correlation	.463**	1
	Sig. (2-tailed)	.000	
	N	230	230

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

The correlation coefficient for internal control and business survival in COVID-19 pandemic era was statistically significant at 0.414 (0.05). Therefore, the null hypothesis is rejected while the alternative hypothesis is accepted, this implies that a significant positive relationship exists between the two variables. Hence the availability of internal control system led to 41.4 per cent increase in business survival. The correlation coefficient for adherence to COSO internal control framework and business survival in COVID-19 pandemic era was statistically significant at 0.463 (0.05). Therefore, the null hypothesis is rejected while the alternative hypothesis is accepted, this implies that a significant positive relationship exists between the two variables. Hence, adherence to COSO internal control framework led to 46.3 per cent increase in business survival. Hence the adherence to COSO internal control framework led to 46.3 per cent increase in business survival.

4.3 Discussion of Findings

The findings of this study revealed that internal control and business survival in COVID-19 pandemic era was statistically significant at 0.414 (0.05) and the correlation coefficient for adherence to COSO internal control framework and business survival in COVID-19 pandemic era was statistically significant at 0.463 (0.05). This was agreed with those of Ibrahim et al. (2017), who discovered a substantial association between internal control and financial performance. Furthermore, the findings are congruent with those of Ilias et al. (2016), who discovered that external control and formal internal control were substantially related to all three performance characteristics - financial, service quality, and procedural. Also the findings of this study were same with Agbenyo, Jiang, and Cobblah (2018) Ibrahim, Diibuzie, and Abubakari (2017), but were not in consonant with Cetin and Yetis (2017) where it was revealed that the internal control system in hotel enterprises was effectively operated, but the effectiveness of the internal control system did not differ significantly based on the hotel's classes and statues.

V. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

In the face of the present epidemic, the study explores the relationship between internal control systems and corporate survival. The primary goal of this study was to look at the relationship between internal control systems and business survival in the face of the current pandemic. According to the findings, there was a favorable relationship between internal control systems and firm survival during the pandemic era. Also in the same pandemic era, there was also a positive relationship between adherence to the COSO internal control system and firm survival. As a result, an efficient and effective internal control system gives the organization and its numerous activities reasonable certainty. It was determined that an internal control system was a successful tool for organizational management and, as a result, corporate survival in the pandemic era.

5.2 Recommendations

According to the survey, business owners should ensure that a vibrant internal control system is in place to assist management in maintaining effective control of the organization. This is possible because internal control mechanisms checkmate the human component, which can jeopardize the efficient operation of organizations owing to errors of judgment or interpretation, misunderstanding, negligence, exhaustion or distraction, collusion, abuse, or override. Also, regardless of the situation, such as a pandemic, the management of entities should guarantee that a good internal control system is in place as staff or employees bridge gaps or break protocols in a pandemic era, as witnessed in the COVID-19 time.

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