



Assessing the Effectiveness of Internal Controls on Revenue Collection & Management. (A Case Study Of Malawi Police Service)

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Abstract

This study was done to establish the relationship between internal control systems and revenue collection in Malawi, through a case study of the Malawi Police Service (MPS) Central West Region Police Headquarters. The objectives of the study were; to find out the relationship between the control environment and revenue collection, to establish the relationship between risk assessment and revenue collection, and to establish the link between control activities and revenue collection at MPS. The researcher used cross-sectional correlational research designs. A sample of 80 respondents was selected to represent the study population. The researcher used both questionnaires and interviews to collect data. The collected data was properly processed and analyzed by using two computer packages; MS Excel and SPSS version 17.0 to generate tables and statistics that enabled the researcher to draw conclusions from the analyzed data. The researcher established that revenue at MPS was increasing every year and they never deposited all revenue into government account number one as per requirement by the government. The study revealed that there was a relationship between internal control systems with revenue collection and management in the Malawi Police Service the researcher, therefore, concluded that the level of revenue collection depended on the control environment and control activities at MPS while management was dependent on monitoring activities.

The study findings also led to the conclusion that there was no significant relationship between risk assessment and revenue collection& management. The researcher further recommended that management of MPS should adhere to the

recommendations made by the Audit department and should strive to make sure that communication is done timely on deficiencies in internal controls to the relevant authorities.

Keywords: 1 Internal control,2 revenue collection, 3 control environment,4 control activities.

I. Introduction

Malawi Police Service is a government department that gets its funding from the government. It is mandated among other roles to collect and manage revenues. Malawi Government relies on revenue collected by the MPS for its national budget. As such collection and mismanagement are very serious issues for the government. As a government entity, it is not spared from audits as it is a requirement for every government department to be audited every financial year. The recent auditor general's report 2019-2020, showed that part of the revenue collected was not fully accounted for. This has negatively affected the government's requirement of ensuring that all revenue collected should be deposited in government account number one. Several officers in the finance department got arrested which gave questions as to whether we have adequate internal controls on revenue collection and management. Internal controls are measures that organizations institute to ensure that the organization's objectives, goals, and mission are met (Trenerry, 2008). They refer to a set of organizational policies and procedures that ensure any transaction is processed in the appropriate way to avoid waste, theft and misuse of organizational resources. Through internal control systems,



organizations achieve performance and organizational goals, prevent loss of resources, enable the production of reliable reports and ensure compliance with laws and regulations.

In the past years, MPS have had more than 3 times appeared before the public accounts committee of parliament to answer questions on the mismanagement of revenue collected. These mismanagements raise questions as to whether institutional internal controls are in existence.

II. Literature review

Theoretical review of related theories

The main theoretical perspectives that have affected internal controls and revenue collection in institutions are the agency, contingency and reliability theories.

Agency Theory

This noteworthy body of work was mainly designed by Jensen & Meckling in 1976. The agency theory therefore determines the agent relationship between two parties, one is the principal party that delegates duties and responsibilities while the other is the agent (Ekanayake, 2004). The agency relationship as provided by its originators tends to have varied disadvantages in relation to the self-interest and level of optimism that lies in an agent. For instance, the agent may choose to act in a manner that is not of principal's best interest, or rather, the agent may act partly in the interest of his principal. On the opposite side, the agency theory posits that a firm mainly embroils a connection of contracts that lies between its economic resources, owners who are considered as the principals, and managers, perceived as the agents given that they are charged with the control of organization's assets (Jensen, 2003).

The concept holds that the agents in several occasions possess the capacity to access more information as opposed to the principals, thus establishing that the information asymmetry mainly impinges on the principals' capacity to assess whether the interests of their organizations are served by their agents. The agency theory operates under the perception that the agents and their principals operate on a rational manner, thus using contracting as an approach aimed at maximizing their wealth (Kenyon & Tilton, 2014). This study is therefore applicable in this context given that internal control remains one of the main mechanisms utilized by businesses in addressing their agency challenges especially through the reduction of agency costs that may have adverse

effects on the performance of the relationships between the two parties.

Contingency Theory

In close association with the situational approach, the contingency theory is a brainchild of Austrian psychologist Fred Edward Fiedler in his milestone 1964. The contingency theory primarily focuses its attention on the significance of the principal's character and the condition or the circumstances whereby the leaders operate. Fiedler and his companions mainly focused their attention on leaders in varied contexts but narrowed down on leaders within the military context. The contingency theory therefore holds that there are provided situational factors that have the capacity to affect the independent and dependent variable relationships in understanding organizational behavior. In this case, the study provides that independent variables are the main cause of change in the dependent variables while variables that are dependent are mainly affected by the variables that are independent. Leadership and motivation are two of the main examples that are expounded as independent variables explained in the contingency theory, turnover and absenteeism as well as productivity are perceived as the dependent variables (Kenyon and Tilton, 2014). The contingency theory in as much as adduced to have several strengths, falls short due to some shortfalls in making efforts to explain the rationale behind leaders with a given leadership style are only effective in some situations but not in others. Researchers allege that Fiedler's theory has broadened the scope used in understanding leadership from varied perspectives in an effort to underpin the best style of leadership within an organization that meets the varied demands within different situations (Fred, 1964). The contingency theory has equally paved way to unravel the predictive powers used in determining the styles and types of leadership that are likely to be effective within varied contexts. The theory therefore expects leaders to ensure that they are effective in varied situations and need to consider operating under optimal conditions that complement their leadership styles. implications of this theory in this study remain evident in its effects driven towards ensuring that the right kind of leadership is employed in meeting varied leadership needs in organizations.

Reliability Theory

According to (Swinkels, 2012), reliability theory describes the probability of a system completing its expected function during an interval of time. According to the reliability theory, each



component of an internal control system needs to be a defined measure of success. Internal control systems should be reliable in the assessment and control of risks. Weak internal control systems result in more substantive work and hence increased costs. Organizations are required to assure the functionality of systems, internal control included. The reliability theory stipulates that an internal control system comprises of components that are interrelated. As such, the state of each component is determined by whether the component is successful or not successful. The reliability of a component is defined as the probability of the component being found in the success state. In addition, the reliability of the entire internal control system is a binary combination with two possible values thus success and failure. This study considered the part of the reliability theory which relates the internal control system to component reliabilities.

The Concept of Internal Controls

Internal control refers to the set of principles, procedures, and practices companies define to ensure they keep a check on risk-causing factors and rectify the same to avoid losses or fraud. It plays a significant role in guaranteeing the accountability of companies, which remain under controlled supervision for correctness and reliability (Arwinge, 2012). They refer to a set of organizational policies and procedures that ensure any transaction is processed in the appropriate way to avoid waste, theft and misuse of organizational resources. This definition of internal control reflects the following fundamental concepts:

Internal control is a process. It is not one event, but a series of ongoing actions and activities that occur throughout each company's operations and should be an integral part of each firm. People are what make internal control work. While the responsibility for good internal control ultimately rests with organization leadership, all organization members play important roles.

Through internal control systems, organizations achieve performance and organizational goals, prevent loss of resources, enable the production of reliable reports and ensure compliance with laws and regulations. Thus internal control is established by the organizational management to ensure that the business of the enterprise is carried out in an orderly and efficient manner. This further ensures adherence to management policies safeguarding the assets and securing the records' completeness and accuracy.

Organizations are constantly and extensively working to improve their internal control systems so as to increase revenue inflow, survive in rapidly changing economic and competitive environments, and adapt to the shifting customer demands and priorities (Government Accountability Office, 2014). Internal control consists of five interrelated components derived from how management runs a business, and are integrated with the management process: control environment; risk assessment; control activities; information and communication; and monitoring. According to (Graham, 2015), under the current operations of organizations in general, the importance of internal control can be divided into six major categories; detecting error and fraudulence, decreasing illegal conduct, improving the competence of the business entity, improving the quality of data, helping to create the business infrastructure, and decreasing auditors fee.

2.2.1 Control environment

The control environment is an intangible factor of an organization that sets the tone of the organization and influences the effectiveness of internal controls within it. It is the foundation for all other components of internal control, providing discipline and structure and encompassing both technical competence and ethical commitment.

Risk assessment

Risk assessment is the process of identifying risks to achieving organizational objectives, analyzing potential events, considering their likelihood of occurring and impact on achieving organization objectives; and deciding how to respond to the risks. Organization Leadership should be aware of potential high-risk areas and should look for high risks where there is a susceptibility to or history of waste, fraud, or errors; changes have occurred in the organization's organizational structure, systems, or personnel and controls have not been reviewed for a substantial period of time.

Control activities

Control activities help ensure risk responses are effectively carried out and include policies and procedures, approvals, authorizations, verifications, reconciliations, security over assets, and segregation of duties. These activities occur across an organization, at all levels and in all functions, and are designed to help prevent or reduce the risk that organization objectives will not be achieved.

Information and communication

An organization's control structure must provide for the identification, capture and exchange of



information both within the organization and with external parties. Information communicated should be timely and accurate.

Monitoring

Monitoring evaluates the effectiveness of an organization's internal controls and is designed to ensure that internal controls continue to operate effectively. Monitoring is effective when it leads to the identification and correction of control weaknesses before they materially affect the achievement of the organization's objectives.

The Concept of Revenue

Revenue refers to the monetary event of asset values increasing in the organization because of the physical event of production or sales of products or services of the organization (Pandey, 1996). Revenue is defined as the inflows or enhancements of assets of a firm or settlements of its liabilities during a period from delivering or producing goods, rendering service or other activities that constitute the entity's ongoing major or central operations (Rittenberg, Gramling, & Johnstone, 2015). In addition, revenue is further described as inflows of assets received for products or services provided to customers. Organizational performance is in terms of revenue generation portrayed by the levels of assets accumulation, wealth created, and the quality services by customer level of satisfaction and customer complaints. For better revenue generation, organizations should critically look at customers and other stakeholders in business and establish how best they are satisfying their needs. Organizations should continuously improve their revenue and have an internal control system that is intervened with the organization's operating activities and is most effective when controls are built into the organization's infrastructure in terms of continuous improvement on performance standards as part of the competitive advantage of the organization.

Relationship between Internal Controls and Revenue

Internal control systems including internal audits are intended primarily to enhance the reliability of financial performance, either directly or indirectly by increasing accountability among information providers in an organization. Internal control, therefore, has a much broader purpose such as those of an organization's level of control problems associated with lower revenues, which explore links between disclosure of material weakness and fraud, earnings management or restatements. Internal controls provide an

independent appraisal of the quality of managerial performance in carrying out assigned responsibilities for better revenue generation.

Empirical review

A study by (Kikonyogo, 2017) on the effect of internal controls on revenue collection whose objectives were to examine the effect of; control environment, revenue reporting and monitoring on revenue collection in Kampala Capital City Authority established that there is a positive significant relationship between control environment, control activities and monitoring with revenue collection but did not specify. The study used a cross-sectional design on a sample of 72 respondents from a population of 95 Kampala Capital City Authority staff that included revenue collectors, treasury staff, auditors and strategists determined using stratified and purposive sampling. Quantitative data was collected by the use of a questionnaire whose validity was determined using the content validity index and reliability. Qualitative data was collected through interviews and analyzed using content analysis forming.

Ewa and Udoayang (2012) carried out a study to establish the impact of internal control design and bank's ability to investigate staff fraud and staff lifestyle and fraud detection in Nigeria. Data were collected from 13 Nigerian banks using a four-point Likert scale questionnaire and analyzed using percentages and ratios. The study found that internal control design influences staff attitude toward fraud such that a strong internal control mechanism is different to staff fraud while a weak one exposes the system to fraud and creates an opportunity for staff to commit fraud (Sigilai, 2016).

Internal control systems are a topical issue following global fraudulent financial reporting and accounting scandals worldwide. As such a more proactive preventive approach to the problem requires a critical evaluation of existing internal control structures in an organization to determine their capacity to ensure that the organization's activities are carried out in accordance with established goals, policies and procedures. (Amudo, Angella, & Inanga, 2009) carried out an evaluation of internal control systems on the Regional Member Countries (RMCs) of the Africa Development Bank Group (AFDB) focusing on Uganda in East Africa. The study proved that some control components of effective internal control systems are lacking in these projects which renders the current control structures ineffective. The study recommended the



improvement of the existing internal control systems in the project (Amudo, Angella, & Inanga, 2009).

An internal control system that is effective offers a coherent guarantee that guidelines, processes, responsibilities, and conducts as well as other organization aspects, collectively, enable its operational efficiency, safeguarding the quality of the internal and external recording, as well as upholding conformity to relevant guidelines. Internal control keeps an entity on track toward its goals as well as the realization of its objective, and reduces risks on the course. Internal control facilitates operational effectiveness, minimizes the asset loss risk, and assists to ensure conformity to relevant guidelines. Theoretically therefore, an establishment with effective internal control system is anticipated to efficiently and effectively accomplish its objectives (Njagi & Mwangi, 2019).

(Ndungu, 2013) carried research to establish the effect of internal controls on revenue generation at the University of Nairobi Enterprise and Services Limited (UNES). The study sought to evaluate the effect of internal controls on revenue generation in UNES. The research design that was employed in this study is descriptive design. The study population was all the employees at UNES Limited during the calendar year 2013. Data were analyzed by use of linear regression. The study found that internal controls contribute to revenue generation at the company. UNES play a number of roles in supporting the systems by ensuring all documents are authentic, and correct and confirming that the relevant officers have signed all documents before processing to prevent the misappropriation of revenues. The company has formalized policies and procedures for all activities which allow for good and efficient communication, control and monitoring of activities. All employees understand the concept and importance of internal controls, including the division of responsibility. Accounting records are limited to employees with designated responsibility for such records. The study revealed that UNES reviews its internal controls when the need arises. Numerous audits are conducted in line with technological changes to ensure the systems' sustainability. The study recommends firms cultivate integrity and ethical values among their employees and management. Effective boards of directors, management, and internal audit departments should be established in organizations.

Management should design internal controls to ensure efficiency and effectiveness, reliability of financial reporting as well as compliance with laws and regulations.

III. Methodology

The research design employed in the study was descriptive design. The design was suited and justified for use in the study because of the variables to be used. The dependent variable was revenue collection and management and the independent variables include; control environment, monitoring of control, internal audit function and risk assessment. A descriptive design is a process of collecting data in order to answer questions concerning the current status of the subjects in the study. Descriptive design furnishes the researcher with an opportunity to gain insight into the problem itself. It also helps the research team to see the need for the research. Descriptive research attempts to build on the groundwork made by exploration, such as providing additional information, filling in gaps in knowledge, or expanding it. Unique to descriptive research is that it also aims to collect as much data and information as possible (Kothari, 2004). The researchers also used a purposive sampling technique to choose specific respondents based on their familiarity with the subject and ability to readily give information since the study requires specific information. Based on the knowledge, skill and experience of internal control systems, the researcher will select 80 staff of the Malawi Police Service specifically from the area of study thus Central west Police Headquarters. The researcher administered 80 questionnaires and only 79 were filled, returned and used for this study. However, the questionnaire was subjected to validity and reliability before the administration process.

IV. Results

The researcher distributed 80 questionnaires and received a total of 79 questionnaires back for analysis representing 98.75% response rate. This was high response rate was due to the personal involvement in the collection of data and the central location of the respondents in one geographical area as the researcher personally visited all police stations where all respondents were geographically positioned.



Descriptive analysis-Internal Control System mechanism

DESCRIPTIVE ANALYSIS OF INTERNAL CONTROL SYSTEMS						
CONTROL ENVIRONMENT						
		SA	A	U	D	SD
1	Good accounting and financial management systems	18	12	5	25	20
2	Formalized policies and procedures	22	28	10	15	5
3	The roles and responsibilities are delegated and follow up made.	10	18	6	18	28
CONTROL ACTIVITIES						
1	Management uses incentives and rewards as well as threats and punishments	15	23	9	13	20
2	Periodic independent reconciliation of revenue collection are done on a regular basis	26	15	13	20	6
3	The guidelines, policies and procedures are properly documented to help determine how the control activities are to be executed	10	15	2	25	28
4	Proper and close supervision is done to the most junior staff	30	20	0	10	20
MONITORING ACTIVITIES						
1	The government carries out independent checks and evaluations of control activities on an ongoing basis	27	23	10	15	5
2	Deficiencies in internal control are communicated to the relevant authority for action in a timely manner	35	20	3	12	10
3	The recommendations of the Internal Audit department are taken seriously by the management	16	20	1	33	10
RISK ASSESSMENT						
1	The management has defined the appropriate objectives of MPS	29	25	6	15	5
2	The MPS staff are adequately involved in the risks management process	33	18	5	14	10
3	Relevant risks that affect the achievement of the organizational goals are identified and analyzed	23	37	0	8	12

Table..... showing respondents on a Likert-scale

Basing on the data captured from the respondents as shown in the table, 22.5 % strongly agreed, 15% agreed, 6.25% undecided 31.25% disagreed and 25% strongly disagreed that Malawi Police Service has a good accounting and financial management system in place. In general On MPS having formalized policies and procedures of internal controls system, the researcher recorded the following responses and thus 27.5% strongly agreed, 35% agreed, 12.5% undecided, 18.75% disagreed and 6.25% strongly disagreed.

Responses on “MPS staff roles and responsibilities being delegated and follow up made” were as follows 12.5% strongly agreed, 22.5% agreed, 7.5% undecided, 22.5% disagreed and 35% strongly disagreed.

On management use of incentives and rewards as well as threats and punishments the researcher had recorded the following responses from the respondents through questionnaire, 18.75% strongly agreed, 28.75% agreed, 11.25% undecided, 16.5% disagreed and 25% strongly disagreed.

On periodic independent reconciliation of revenue collection done on regular basis, the

following responses were made; 32.5% strongly agreed, 18.75% agreed, 16.25% undecided, 25% disagreed, and 7.5% strongly disagreed

On the guidelines policies and procedures properly documented 12.5% of the respondents strongly agreed, 18.75% agreed, 2.5% undecided, 31.25% disagreed and 35% strongly disagreed

Proper and close supervision done to the most junior staff had 37.5% strongly agreeing, 25% agreeing, none undecided, 12.5% disagreed and 25% strongly disagreeing.

On Monitoring activities the variable of government carrying out independent checks and evaluations of control activities had 33.75% strongly agreeing, 28.75% agreeing, 12.5% undecided, 18.75% disagreeing and 6.25% strongly disagreeing.

On the other hand of monitoring activities on whether deficiencies in internal control are communicated to the relevant authority for action had the following responses 43.75% strongly disagreeing, 25% disagreeing, 3.75% undecided, 15% agreeing and 12.5% strongly disagreeing.

On recommendations of the Internal Audit department being taken seriously by management,



the researcher had responses as follows 20% strongly agreed, 20% agreed, 1.25% undecided, 41.25% disagreed and 17.5% strongly disagreed.

Risk assessment was another component of internal controls which was under study and had several variables tested. On management having defined the appropriate objectives of the organization, the following responses were recorded 36.25% strongly agreed, 31.25% agreed, 7.5% undecided, 18.75% disagreed and 6.25% strongly disagreed.

On risk identification and analysis the researcher had 28.75% strongly agreeing, 46.25% agreeing, 10% disagreeing and 15% strongly disagreeing as per figure below. Finally on MPS staff adequately involved in risk management process, the researcher had recorded the following responses from respondents 41.25% strongly agreed, 22.5% agreed, 6.25% undecided, 17.5% disagreed and 12.5% strongly disagreed.

V. Findings

The researchers finding revealed that revenue collection was increasingly annually in all the eight policing station which entails that management of MPS had good strategies of ensuring that more revenues are realized however there was no information as to whether targets were given and if at all were achieved. It was established not all revenue collected were deposited into government account number one as evidenced on the data collected on revenue deposits.

The researcher established that MPS has got no good accounting and financial management system in place and that the management was committed to the implementation of internal control System so as to improve the accounting system. It was also established that MPS had formalized, clear and defined policies, procedures of internal controls system that adequately reflected chain of command. Furthermore, the employees of MPS are well experienced as reflected on the data captured on the work experiences. The study revealed that no roles and responsibilities were delegated and followed up.

The study established that the government was carrying out independent checks and evaluation of controls activities to ensure maximum revenues are collected and deposited to account number one as per requirement though there was no communication of deficiencies in internal controls to the relevant authority as established by the researcher. At the same time, the study revealed that management did not take recommendation of the audit department seriously hence led to recurrence of accounting errors

Risk assessment another component of internal controls system which was under study and it got revealed by the researcher that the management had defined the appropriate objectives of the organization, was doing risk identification and analysis as well as MPS staff were actively involved in the risk management process. This was main driving tool towards efficient and prudence management and collection of revenue.

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