KASU Journal of Accounting Research and Practice (KAJARAP)

Volume 10, Number 2, December, 2025 ISSN: 2360-8889

https://journals.kasu.edu.ng/index.php/accounting

IMPACT OF INTERNAL CONTROL SYSTEM ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM SCALE ENTERPRISES IN BENIN CITY-EDO STATE, NIGERIA

Eke Robert Ike (PhD, FCA)

Department of Accounting and Finance, College of Social and Management Sciences, Wellspring University Benin City, Edo State.

Corresponding Author's email/mobile/robbyeke19@yahoo.com/+2348034712733

Abstract

This study investigates the impact of internal control system on financial performance of small and medium scale enterprises (SMEs) in Benin City-Edo State. Grounded in Agency theory, the research explores how control environment, monitoring activities, and risk assessment impacts on financial performance of SMEs in Benin City-Edo State. Utilizing a descriptive survey design, data were collected from selected representative of 364 respondents using a structured questionnaire. The instrument employed a four-point Likert scale (Strongly Agree, Agree, Disagree, and Strongly Disagree) to capture respondents' perceptions regarding the effectiveness of internal control systems on financial performance of small and medium scale enterprises in Benin City-Edo State. Multiple regression analysis was conducted to examine the relationships between the independent variables—control environment, monitoring activities and risk assessment—and the dependent variable—Financial performance of small and medium scale enterprises in Benin City-Edo State. The study found that the control environment has a positive and significant impact on the profitability of SMEs in Benin City, while risk assessment was found to have a positive but not statistically significant effect on profitability. In addition, the study revealed that monitoring activities significantly enhance profitability. The study recommends that SME owners and managers should establish and maintain a sound control environment by fostering a culture of accountability, ethical conduct, and clear organizational structures to drive better financial performance.

Keywords: internal control systems, control environment, risk assessment, monitoring activities, performance of small and medium enterprises

1. Introduction

Small and Medium Scale Enterprises (SMEs) play a crucial role in economic growth, employment generation, and poverty reduction. In Nigeria, SMEs contribute significantly to the country's Gross Domestic Product (GDP) and provide job opportunities for a large percentage of the workforce (Small and Medium Enterprises Development Agency of Nigeria [SMEDAN], 2021). However, despite their contributions, many SMEs struggle with financial instability, poor financial management, fraud, and inefficiencies that hinder their growth and sustainability (Adebayo & Olayemi, 2021). A major factor

contributing to these financial challenges is the absence of a well-structured internal control system to regulate financial transactions, reduce risks, and ensure operational efficiency.

Internal control system refers to a set of rules, policies, and procedures that organizations establish to safeguard assets, prevent fraud, ensure accurate financial reporting, and promote efficient operations (Okoye & Gbegi, 2013). A strong internal control system enables businesses to monitor their financial activities, detect irregularities, and make informed financial decisions. In contrast, weak or non-existent internal control measures expose businesses to financial mismanagement, errors, theft, and fraud, ultimately affecting profitability and long-term survival (Edeh & Obasi, 2021).

Research has shown that many SMEs in Nigeria, including those in Benin City, lack proper internal control structures, making them vulnerable to financial risks and operational inefficiencies. Poor financial record-keeping, unauthorized financial transactions, and weak financial oversight are common issues among SMEs in the region (Ogundele et al., 2022). Unlike large corporations, where internal control systems are often well-structured and strictly enforced, SMEs frequently operate informally, relying on manual bookkeeping, unregulated cash handling, and limited financial accountability (Adeyemi & Adebayo, 2016).

Recognizing the importance of internal control systems in financial management, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed a framework that outlines essential components of internal control, which are widely adopted for improving financial performance in organizations (COSO, 2013). These components form a structured approach to financial control and accountability.

A strong control environment establishes the foundation for effective control measures. This involves the organizational culture, ethical values, and leadership commitment to internal control policies. When financial discipline is embedded within an organization, accountability improves, and fraudulent practices are minimized. However, in many SMEs, financial controls are either ignored or inconsistently enforced, leading to weak oversight and an increased risk of mismanagement (Olatunji, 2015). Businesses that implement ethical standards and clearly defined financial policies tend to experience fewer cases of fraud and operational inefficiencies (Adeoye & Elegbeleye, 2018).

Risk assessment plays a critical role in identifying and analysing financial risks that could affect a business's sustainability. SMEs often face risks such as fraud, economic downturns, poor credit management, and operational inefficiencies (Ogundele et al., 2022). A well-structured risk assessment process enables businesses to detect potential financial threats and implement preventive measures. Unfortunately, many SMEs lack structured fraud detection mechanisms, making them highly susceptible to financial losses (Adeboye et al., 2020). Without the ability to anticipate financial challenges, businesses may struggle to develop contingency plans, leading to instability and, in severe cases, business failure.

Continuous monitoring ensures that internal controls remain effective over time. Regular financial audits, performance assessments, and corrective actions help businesses detect inefficiencies and make necessary improvements (Edeh & Obasi, 2021). Financial policies may become outdated without proper monitoring, allowing irregularities and financial losses to go undetected. However, many SMEs do not conduct periodic financial evaluations, which makes it difficult to identify weaknesses before they escalate into major financial challenges (Adeyemi & Adebayo, 2016). Businesses that engage in routine

financial monitoring tend to experience better financial health, fewer cases of fraud, and improved operational efficiency.

Despite the proven benefits of internal control systems, many SMEs in Benin City do not adopt structured control measures, leading to high financial risks, business failures, and reduced profitability. Studies have examined the impact of internal control on financial performance, but most research has focused on large corporations rather than SMEs (Adeoye & Elegbeleye, 2018). Additionally, many studies have analysed internal control as a single system rather than examining the individual effects of the COSO components on financial performance.

This study aims to fill this gap by investigating how internal control components—control environment, risk assessment, control activities, information and communication, and monitoring activities—affect the financial performance of SMEs in Benin City. Unlike previous studies, which primarily viewed internal controls as a general concept, this research will break down each component to determine its specific contribution to SME financial success. The findings will provide practical insights into how SMEs can strengthen their internal control systems to enhance profitability, reduce risks, and achieve long-term sustainability.

The broad objective of this study is to examine the impact of internal control system on the financial performance of SMEs in Benin City, Edo State. The specific objectives are to:

(i) evaluate the impact of the control environment on the profitability of SMEs in Benin City.
(ii) examine the impact of risk assessment on the profitability of SMEs in Benin City.
(iii) investigate the impact of monitoring activities on the profitability of SMEs in Benin City.

The study formulated the following hypotheses:

H_{01}: Control environment has no significant impact on financial performance of SMEs in Benin City, Edo State.

H_{02}: Risk Assessment has no significant impact on financial performance of SMEs in Benin City, Edo State.

H_{03}: Monitoring Activities has no significant impact on financial performance of SMEs in Benin City, Edo State.

This study focuses on SMEs operating in Benin City, Edo State. It examines the impact of internal control systems on financial performance, with particular attention to the five core components outlined in the COSO framework: control environment, risk assessment, information and communication, control activities, and monitoring. The study is limited to SMEs within Benin City due to their significant role in the local economy and the unique challenges they face.

The research does not cover large organizations or SMEs outside Benin City, as the aim is to provide a targeted analysis of the local business environment. Additionally, while the study emphasizes internal control systems, it acknowledges that other factors, such as market dynamics and external economic conditions, may also influence SME performance.

2. Literature Review

Conceptual Review

Internal Control System

An internal control system refers to the rules, processes, and measures that businesses put in place to protect their financial resources, reduce risks, and ensure accurate financial reporting. It helps businesses operate in a structured manner, preventing fraud and financial mismanagement. Internal control systems are particularly important for Small and Medium Enterprises (SMEs) because they often face financial challenges such as poor record-keeping, unauthorized spending, cash flow problems, and weak financial accountability (Adebayo & Olayemi, 2021). Without effective internal control, SMEs may struggle with financial losses, employee theft, and difficulty in securing business loans (Edeh & Obasi, 2021).

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed a framework that explains how businesses can create effective internal controls. This framework highlights five key components: control environment, risk assessment, control activities, information and communication, and monitoring (COSO, 2013). Each component plays a crucial role in ensuring financial discipline, reducing fraud, and improving business performance (Okoye & Gbegi, 2013).

Businesses that follow these internal control principles experience better financial stability, increased investor confidence, and long-term growth (Olatunji, 2015). However, research has shown that many SMEs in Nigeria, including those in Benin City, lack proper internal control structures (Adeoye & Elegbeleye, 2018).

Most SMEs operate informally, meaning they do not have strict financial policies, proper documentation, or adequate financial oversight. As a result, these businesses are vulnerable to financial losses, fraud, and poor financial decision-making (Ogundele et al., 2022). By implementing strong internal control systems, SMEs can improve their financial performance and create a more transparent and accountable business environment (Adeyemi & Adebayo, 2016).

This study will examine how each of these internal control components affects the financial performance of SMEs in Benin City. Understanding the role of internal control systems will help SME owners strengthen their financial management, increase profitability, and sustain business growth.

Control Environment

The control environment refers to the overall culture, values, and attitudes within a business that shape how financial operations are managed. It is the foundation of an effective internal control system and determines whether a business operates with accountability, financial discipline, and ethical decision-making (Olatunji, 2015). When the control environment is weak, businesses are more likely to experience fraud, financial mismanagement, and poor decision-making (Adeyemi & Adebayo, 2016).

A strong control environment exists when business owners and managers lead by example and ensure that all employees follow financial policies and procedures. In many SMEs, financial management is informal, and employees are often left to handle cash transactions without strict supervision (Ogundele et al., 2022). This creates opportunities for fraud, theft, and financial mismanagement, leading to significant business losses. A

study by Okon and Etuk (2021) found that SMEs with strong leadership accountability and well-documented financial policies had better financial stability and reduced fraud cases.

One major issue in SMEs is that business owners often do not separate personal finances from business finances. When there is no clear boundary, it becomes difficult to track business expenses and profits, making financial reporting unreliable (Ezekwu & Olatunde, 2023). Many SME owners withdraw money for personal use without proper records, leading to financial instability. Research has shown that businesses with clear financial rules and strong leadership commitment are more likely to grow and attract investors (Ifeanyi & Okeke, 2024).

For a business to have a strong control environment, owners and managers must actively enforce financial policies. Employees must also be trained on the importance of financial discipline and ethical behavior. Without a proper control environment, even the best financial policies will fail because employees and managers will not follow them (Adebayo & Olayemi, 2021). By creating a culture of accountability, SMEs can reduce financial risks, prevent fraud, and improve business sustainability (Adeoye & Elegbeleye, 2018).

Risk Assessment

Risk assessment is the process of identifying, analysing, and managing potential financial risks that could affect a business. SMEs face several risks, such as fraud, cash shortages, poor budgeting, debt mismanagement, and external economic downturns (Adeboye et al., 2020). Without proper risk assessment, businesses may fail to prepare for financial difficulties, leading to poor decision-making and eventual business failure (Olawale & Garwe, 2020).

Many SMEs in Benin City do not have structured risk management procedures. Business owners often make financial decisions without analysing risks, which increases the chances of financial instability (Ogundele et al., 2022). A study by Adeoye and Elegbeleye (2018) found that SMEs that performed regular financial risk evaluations were able to reduce financial losses by 35% compared to businesses that ignored risk assessment. This means that businesses that take time to identify possible risks and create strategies to manage them are less likely to experience financial crises.

One of the biggest financial risks SMEs faces is employee fraud and cash mismanagement. Without strong internal controls, employees can easily manipulate financial records, steal funds, or inflate business expenses (Okoye & Gbegi, 2013). Another major risk is poor financial planning, where businesses fail to budget properly and end up in debt. To reduce financial risks, SMEs must ensure that all financial transactions are properly documented, regularly reviewed, and audited (Adeyemi & Adebayo, 2016).

A well-structured risk assessment system allows SMEs to anticipate financial problems before they occur and take action to prevent losses. Businesses that actively manage risks experience greater financial security, improved decision-making, and long-term success (Adebayo & Olayemi, 2021).

Monitoring

Monitoring activities involve regularly reviewing and assessing financial processes to ensure that internal controls are working effectively. This includes conducting internal audits, financial reviews, and business performance evaluations (Ifeanyi & Okeke, 2024). Without proper monitoring, businesses may fail to detect financial fraud, errors, or weaknesses in their internal controls (Okon & Etuk, 2021).

A business that does not monitor its financial performance may fail to notice unnecessary spending, employee theft, or declining profits until it is too late. Research by Adeoye & Elegbeleye (2018) found that SMEs that conducted regular financial reviews had 30% fewer financial errors and fraud cases than businesses that ignored monitoring activities.

Many SMEs in Benin City struggle with weak financial monitoring systems, making them vulnerable to fraud, financial mismanagement, and business failure (Adeboye et al., 2020). Business owners often assume that once financial policies are in place, they will automatically work. However, without proper monitoring, financial controls may become outdated or ignored by employees, leading to serious financial problems (Olawale & Garwe, 2020).

One of the most effective monitoring activities is internal auditing, which helps businesses review financial transactions and identify errors. Many SMEs avoid financial audits because they believe it is expensive or unnecessary, but research shows that businesses that conduct regular internal audits experience better financial accuracy and higher profitability (Okoye & Gbegi, 2013).

Financial Performance

Financial performance refers to how well a business utilizes its financial resources to generate profits, sustain operations, and achieve long-term stability. It is a key indicator of an enterprise's success and is often measured using profitability, liquidity, solvency, and operational efficiency (Olatunji, 2015). For SMEs, financial performance is particularly critical because they operate with limited resources, fluctuating cash flows, and restricted access to capital (Adeoye & Elegbeleye, 2018). Poor financial performance often leads to business closure, inability to expand, and difficulty in repaying debts (Ogundele et al., 2022).

A well-structured internal control system contributes to improved financial performance by ensuring accurate financial reporting, fraud prevention, and proper resource allocation (Adeyemi & Adebayo, 2016). When businesses have clear financial records and accountability structures, they can track income, control expenses, and make data-driven decisions that enhance profitability (Ezekwu & Olatunde, 2023). Conversely, weak internal controls expose SMEs to financial leakages, fraud, and inefficiencies, reducing their overall performance and sustainability (Edeh & Obasi, 2021).

Research has shown that SMEs with structured internal controls and proper financial management perform significantly better than those that operate informally (Adeoye & Elegbeleye, 2018). Businesses that implement regular financial monitoring, risk assessment, and accountability measures report higher profitability and stronger financial stability (Adebayo & Olayemi, 2021). However, many SMEs, especially in Benin City, struggle with poor financial performance due to inadequate financial supervision, limited accounting knowledge, and cash flow mismanagement (Ogundele et al., 2022). These issues often arise due to the absence of structured internal controls, lack of access to funding, and high operational costs (Edeh & Obasi, 2021).

Addressing these challenges requires SMEs to adopt sound financial management practices, leverage technology for accurate record-keeping, and strengthen internal control frameworks (Okoye & Gbegi, 2013). SMEs encounter numerous financial and operational challenges that hinder their growth and sustainability. These challenges are often related to

funding, poor financial management, lack of skilled personnel, and economic instability (Olatunji, 2015). Despite their contributions to economic development, SMEs frequently struggle to maintain financial stability due to internal weaknesses and external economic pressures (Adeoye & Elegbeleye, 2018).

One of the most pressing challenges is limited access to financing. Many SMEs in Nigeria, including those in Benin City, find it difficult to secure bank loans and external funding due to poor financial records, lack of collateral, and high interest rates (Adeyemi & Adebayo, 2016). Financial institutions often consider SMEs to be high-risk borrowers, making it challenging for them to obtain credit (Ezekwu & Olatunde, 2023).

As a result, many SMEs rely on personal savings, informal lending sources, or daily income for business expansion, which limits their growth potential (Adeboye et al., 2020). To improve financial performance and overcome these challenges, SMEs need to adopt modern financial management tools, such as accounting software and automated financial tracking systems, to improve record-keeping and reporting (Adeboye et al., 2020).

Strengthening internal control mechanisms through financial approval processes, transaction monitoring, and regular financial audits enhances accountability and reduces fraud risks (Olatunji, 2015). Improving financial literacy among SME owners is essential for effective cash flow management, risk assessment, and fraud prevention (Ogundele et al., 2022). Exploring alternative financing options, such as grants, government funding programs, and microfinance loans, can help reduce dependence on traditional banks (Adeyemi & Adebayo, 2016). Ensuring regulatory compliance, including proper tax documentation and adherence to financial regulations, minimizes legal risks and financial penalties (Okoye & Gbegi, 2013).

Despite these challenges, SMEs remain a vital part of Nigeria's economy, driving innovation, employment, and economic diversification. Addressing their financial and operational weaknesses through effective internal controls, improved financial planning, and strategic government interventions can enhance their long-term sustainability and profitability (Edeh & Obasi, 2021).

Theoretical Review

This study is anchored on control Theory. Control Theory provides a fundamental explanation for the role of internal control systems in managing financial and operational activities within an organization. Developed by William Ouchi (1979), the theory suggests that businesses must establish mechanisms to regulate employee behaviour, enforce accountability, and ensure that activities align with strategic financial and operational objectives. The core idea behind Control Theory is that organizations function more effectively when structured control mechanisms guide decision-making, risk management, and resource utilization.

In the context of SMEs, Control Theory explains the importance of implementing well-defined internal control systems to enhance financial performance. SMEs often operate in unpredictable environments where financial mismanagement, fraud, and inefficiencies can threaten business sustainability. Without proper financial oversight and accountability, SMEs face increased risks of losses, errors, and business failure. Control Theory asserts that businesses must enforce structured internal controls, such as financial monitoring, approval processes, and regular audits, to minimize these risks and maintain stability.

One of the critical aspects of Control Theory is the emphasis on compliance and discipline within an organization. By establishing clear financial policies and control mechanisms, SMEs can ensure that employees and managers adhere to financial regulations and best practices. Studies have shown that businesses that implement internal controls based on Control Theory experience lower financial risks and better financial performance (Ogundele et al., 2022). Research by Adeoye and Elegbeleye (2018) found that SMEs with structured financial supervision reported higher profitability and reduced instances of fraud compared to those without formal control measures.

Control Theory aligns with the COSO internal control framework, which outlines five essential components of an effective internal control system: control environment, risk assessment, control activities, information and communication, and monitoring. The control environment serves as the foundation for internal controls by promoting ethical behavior, financial discipline, and a culture of accountability within the organization.

Risk assessment involves identifying and addressing financial threats that could affect business sustainability. Control activities ensure that financial transactions are conducted efficiently and in compliance with established policies, while information and communication facilitate accurate financial reporting. Continuous monitoring helps businesses evaluate the effectiveness of internal controls and make necessary adjustments.

Control Theory serves as the primary theoretical framework for this study because it directly explains the relationship between internal control systems and financial performance in SMEs. By enforcing financial discipline, monitoring business activities, and preventing fraud, SMEs can improve their financial health and sustain business operations. The principles of Control Theory highlight the need for SMEs to develop and maintain robust internal control frameworks to enhance profitability, reduce risks, and achieve financial sustainability.

Empirical Review

Research on the impact of internal controls on SME performance spans various industries, regions, and contexts. These studies highlight both the effectiveness of internal controls and the challenges SMEs face in adopting them. Below is an in-depth review of relevant studies.

Ifeanyi and Okeke (2024) examined the impact of monitoring activities on SME profitability in South-South Nigeria. Using a sample of 150 SMEs, the researchers collected data through structured questionnaires and analysed it using regression techniques. Their findings indicated that SMEs with regular monitoring mechanisms reported a 25% increase in profitability compared to those without such practices. The study also highlighted that businesses with feedback mechanisms were better able to adapt to market changes and optimize operations. Ifeanyi and Okeke recommended integrating monitoring tools, such as performance dashboards, into daily operations to ensure the effectiveness of internal controls.

Ezekiel et al. (2024) investigated the challenges SMEs face in implementing internal controls in a post-pandemic economy. The researchers surveyed 180 SMEs and complemented this with focus group discussions involving SME owners and managers. Their findings highlighted several challenges, including limited access to funding, resistance to change, and lack of technical expertise. The study also found that SMEs that had adopted internal controls before the pandemic were better equipped to navigate

economic disruptions than those that had not. Ezekiel et al. recommended that government-backed initiatives be established to provide financial support and technical assistance to SMEs. Additionally, they emphasized the importance of creating sector-specific training programs to address unique challenges in industries such as retail and manufacturing.

Abubakar and Damilola (2023) conducted a study exploring the relationship between internal controls and financial sustainability in Nigerian SMEs. Their research aimed to address the growing need for accountability and efficiency in the SME sector post-COVID-19. They surveyed 250 SMEs across Nigeria, analysing data using structural equation modelling (SEM). The findings showed that businesses with effective internal controls reduced financial mismanagement by 30% and improved operational efficiency by 25%. Notably, the study highlighted the role of digital tools in enhancing monitoring and reporting, making internal controls more efficient and accessible to SMEs. The researchers recommended adopting cloud-based accounting software and mobile apps tailored for SME operations, noting that these innovations significantly reduced the administrative burden of implementing internal controls.

Onyeama and Bello (2023) examined the role of risk assessment in fraud prevention among SMEs. Using a mixed-method design, they combined quantitative surveys with in-depth interviews of SME managers. Their study focused on 200 SMEs across three states, with data analysed using thematic and statistical methods. The results indicated that businesses that conducted regular risk assessments reported a 30% reduction in fraud cases compared to those that did not. The study also found that SMEs with risk management frameworks were better prepared to handle operational challenges, such as employee misconduct and cash flow inconsistencies. The researchers recommended integrating risk management training into SME capacity-building programs, emphasizing the importance of employee awareness in identifying and mitigating potential risks.

Edeh and Obasi (2021) focused on SMEs in Edo State, examining the effectiveness of internal controls and their impact on financial management practices. Adopting a mixed-method approach, the researchers combined surveys of 150 SMEs with interviews of 20 business owners to gain deeper insights. The findings revealed that over 60% of SMEs in the region operated without formal internal control frameworks, which often resulted in financial mismanagement and reduced profitability. The study highlighted key barriers, such as limited technical expertise, informal business structures, and resource constraints. The researchers recommended that government and private sector stakeholders collaborate to provide training and affordable tools to support SMEs in adopting internal controls. Furthermore, they suggested integrating internal control education into entrepreneurship programs in the region to build long-term awareness.

Ezekwu & Olatunde (2023) explored the link between internal control mechanisms and financial sustainability. The study collected primary data from 350 SMEs through structured interviews and analysed the data using structural equation modelling (SEM). The findings showed that businesses with effective financial policies experienced lower operational risks and better creditworthiness. SMEs that adopted transparent financial reporting practices secured 30% more external funding than those with weak internal controls. The authors recommended that SMEs strengthen their financial documentation practices and engage external auditors for objective assessments.

Okon & Etuk (2021) conducted research on how internal controls prevent fraud in SMEs. The study used quantitative analysis, surveying 400 SME owners across three

Nigerian states. Findings revealed that weak monitoring systems increased fraud risks by 50%. The study recommended installing financial control checkpoints and performing regular audits.

Akinola et al. (2020) explored the relationship between employee training and the effectiveness of internal controls in Nigerian SMEs. Recognizing that employees are critical to the success of control systems, the researchers surveyed 200 employees from SMEs across various industries. Their findings revealed that businesses that invested in employee training experienced a 20% increase in compliance with internal control policies. Additionally, these businesses demonstrated better financial performance and operational efficiency. The researchers emphasized that training not only improves employees' understanding of their roles within the internal control framework but also fosters a culture of accountability and transparency. They recommended that SME owners allocate a portion of their budgets to regular training sessions, particularly focusing on control activities such as cash handling, inventory management, and fraud prevention.

Adeboye et al. (2020) studied the relationship between risk management practices and financial stability in Nigerian SMEs. Using a cross-sectional survey design, they collected data from 180 SMEs operating in sectors such as retail, manufacturing, and hospitality. Their analysis revealed that businesses with structured risk management practices were significantly better at navigating market fluctuations and avoiding operational disruptions. Specifically, the study found that SMEs with proactive risk assessment mechanisms achieved 15% higher financial stability scores than those without. The researchers recommended that SMEs integrate risk management into their internal control systems by conducting regular risk reviews and setting up contingency plans to address potential threats.

Chinedu and Hassan (2020) explored the effect of regular audits on fraud reduction in SMEs. A comparative analysis was conducted between SMEs that performed annual audits and those that did not. Findings showed that businesses that conducted regular audits had a 50% lower chance of experiencing fraud. The study recommended that SMEs should establish routine financial audits to detect and prevent fraudulent activities.

Olawale and Garwe (2019) examined how financial discipline affects SME survival. The study used survey-based research, collecting data from 300 SMEs in Nigeria. Findings revealed that SMEs with structured internal controls had higher survival rates, even during economic downturns. The study recommended that SMEs should adhere to financial discipline by reducing unnecessary expenditures and implementing financial accountability systems.

Gap in Literature

Despite extensive research on internal controls, limited studies focus specifically on SMEs in Benin City. Many studies have examined the impact of internal controls on financial performance at a general level or in large corporations, but there is a gap in understanding how SMEs implement and benefit from financial control mechanisms in this region. Additionally, existing studies have not thoroughly analysed the specific impact of internal control components such as risk assessment, financial monitoring, and fraud prevention. This study aims to address these gaps by focusing on SMEs in Benin City and evaluating how different internal control elements contribute to financial growth and sustainability.

3. Methodology

Research Design

This study adopts a survey research design, which is suitable for collecting first-hand data from respondents. The survey method allows for systematic data collection from SME owners and managers regarding their internal control practices and financial performance. Structured questionnaires will be used to gather quantitative data, which will be analysed to determine how internal controls influence SME financial sustainability. The cross-sectional nature of the survey ensures efficient comparison of internal control practices across SMEs.

The population for this research consists of 4,026 small and medium-sized enterprises (SMEs) operating within Benin City, Edo State, Nigeria (SMEDAN-Benin City, 2024). SMEs were selected because of their crucial role in the local economy and the financial management challenges they often face. The study focuses on SMEs across various industries, including retail, manufacturing, hospitality, and agro-processing. These businesses differ in size and internal control structures, making them an ideal subject for understanding how financial control mechanisms impact performance. The sample size was determined using Slovin's formula, a standard method for determining sample size in large populations is 364.

The study employed primary data. The study adapted the questionnaire of Tharu (2024) with a modification of tax knowledge. The primary data of the study was closed ended questionnaire. The questionnaire was to get the responses from the respondents of the study. The research instrument entails two sections. The first part contains information relating to bio-data of the respondents, while the second part focused on questions relating to variables of the study. The structured questionnaire was used because it allows for high degree of anonymity and the use of standardized question for all respondent. The responses of the respondent in the questionnaire were stated in form of 'Strongly agree', 'agree', 'disagree' and 'strongly disagree'. Therefore, the study adopted a four-point likert scale in analysing the responses of the respondents of the study. Test retest of the questionnaire and cronbach alpha statistics was used to validate and determine the reliability of the research instrument.

The study employed both descriptive and inferential statistics. The descriptive statistics will include frequency and percentage presented in tables. The study employed the deductive approach in which inferential computation was used to explain the impact between variables under investigation. Therefore, Mutiple regression anaysis was used to test the hypotheses and make inference on the study. Analysis was done with the help of Statistical Package for Social Sciences (SPSS) version 26.

Model Specification

The study will employ a multiple regression model to analyse the relationship between internal controls and financial performance. The model is specified as follows:
$FP = \beta 0 + \beta 1CE + \beta 2RA + \beta 3MON + e$; where: FP = Financial Performance; CE = Control Environment; RA = Risk Assessment; MON = Monitoring; e = Error Term. This model will determine the extent to which each internal control component influences SME financial performance. The coefficients will indicate the impact of each factor, while the error term accounts for unexplained variations.

4. Results and Discussion

Using tabular form and a simple percentage analysis procedure, the data gathered from primary sources was presented, examined, and evaluated in this section. This section additionally tests the hypotheses that were formulated.

Table 1

Questionnaire Administration Analysis

Number of Questionnaire Administered	390
Number of Questionnaire Retrieved	364
Response Rate	93.5%

Source: Author's Computation, 2025

The researcher gave out three hundred and ninety (390) copies of the questionnaire to the respondents. Out of the 390, 365 questionaire were completed, returned, and used for further data analysis and computation.

Answers to Research Questions

Table 2

Response Rate to Research Question on Financial Performance of SMEs

Question	Strongly Agree	Agree	Disagree	Strongly Disagree
The implementation of internal control systems has positively impacted the profitability of my SME	102 (28%)	124 (34%)	73 (20%)	66 (18%)
Strong internal controls have helped my SME reduce financial losses and enhance overall performance.	124 (34%)	80 (22%)	99 (27%)	62 (17%
Proper risk assessment and monitoring activities have improved my SME's financial stability.	179 (49%)	73 (20%	60 (16%)	54 (15%)
Effective information and communication systems have contributed to better financial decision-making in my SME	87 (24%)	136 (37%)	102 (28%)	40 (11%)

Source: Author's Computation, 2025

The distribution of responses to the questions on financial performance shows a relatively balanced spread across agreement and disagreement categories. For example, 102(28%) of businesses strongly agree that implementation of internal impacts on profitability of SMEs, while a slightly lower percentage disagrees.

Similarly, about 179(49%) strongly agree that proper risk assessment and monitoring activities improves SME financial stability, while 54(15%) strongly disagree with the same statement. 223% of the respondents strongly agreed and agreed that effective communication system contributed to better financial decision while 40% did not agree.

This indicates varying levels of commitment to financial performance across different businesses.

Research Question One

How does the control environment affect the profitability of SMEs in Benin City?

Table 3

Response to Research Question One

STATEMENT	SA	A	D	SD
A strong ethical culture and leadership within an SME significantly improve its profitability.	186 (51%)	146(40.22%)	15 (4.2%)	18(4.6%)
Clearly defined roles, responsibilities, and accountability structures enhance financial performance.	176(48.2%)	184(50.3%)	5 (1.5%)	0 (0%)
Weak internal control environments have little to no impact on SME profitability.	104 (28.6%)	187 (51.3%)	51 (14%)	21 (5.7%)
Lack of management commitment to internal controls negatively affects profitability	189 (51.8%)	100 (27.3%)	42 (11.6%)	34 (9.3%)
A strong ethical culture and leadership within an SME significantly improve its profitability.	171(46.9%)	145 (39.7%)	31 (8.5%)	18 (4.9%)

Source: Author's Computation, 2025

The research questions as answered using a 4-point likert scale – strongly agree, agree, disagree and strongly disagree. On the first statement that a strong ethical culture and leadership with SME improves profitability, 186 (51%) opine strongly agree, 146 (40.2%) opine agree, 15 (4.4%) opine disagree, while 18 (4.4%) strongly disagree.

On the second statement that clearly defined roles, responsibilities, and accountability structures enhance financial performance, 176 (48.2%) opine strongly agree, 184 (50.3%) opine agree, 5 (1.5%) opine disagree, while 0 (0%) strongly disagree. On the statement that weak internal control environments have little to no impact on SME profitability, 187 (51.3%) opine agree, 51 (14%) opine disagree, while 21 (5.7%) strongly disagree.

On whether lack of management commitment to internal controls negatively affects profitability, 189 (51.8%) opine strongly agree, 100 (27.3%) opine agree, 42 (11.6%) opine disagree, while 34 (9.3%) strongly disagree. On whether a strong ethical culture and leadership within an SME significantly improve its profitability, 171 (46.9%) opine strongly agree, 145 (39.7%) opine agree, 31 (8.5%) opine disagree, while 18 (4.9%) strongly disagree.

Research Question Two

What is the relationship between risk assessment and the profitability of SMEs in Benin City?

Table 4

Research Question Two

STATEMENT	SA	A	D	SD
Regular risk assessments help SMEs reduce financial losses and improve profitability.	89 (51.8%)	100 (27.3%)	42(11.6%)	34 (9.3%)
Identifying financial risks early allows SMEs to make better business decisions.	18 (4.9%)	31 (8.5%)	145 (39.7%)	175(48%)
SMEs can remain profitable even without conducting risk assessments.	16 (4.4%)	16 (4.4%)	147(40.22%)	186(51%)
Risk assessment has minimal impact on SME profitability	180(50.3%)	176 (48.2%)	5 (1.5%)	4(1%)

Source: Author's Computation, 2025

The research questions as answered using a 4-point likert scale – strongly agree, agree, disagree and strongly disagree. On the first statement that Regular risk assessments help SMEs reduce financial losses and improve profitability, 189 (51.8%) opine strongly agree, 100 (27.3%) opine agree, 42 (11.6%) opine disagree, while 34 (9.3%) strongly disagree.

On the second statement that identifying financial risks early allows SMEs to make better business decisions, 175 (48%) opine strongly disagree, 145 (39.7%) opine disagree, 31 (8.5%) opine disagree, while 18 (4.9%) strongly agree. On the statement SMEs can remain profitable even without conducting risk assessments, 186 (51%) opine strongly disagree, 147 (40.3%) opine disagree, 16 (4.4%) opine agree, while 16 (4.4%) strongly agree. Lastly, on whether risk assessment has minimal impact on SME profitability, 176 (48.2%) opine agree, 184 (50.3%) opine strongly agree, 5 (1.5%) opine agree, while 4 (1%) strongly agree.

Research Question Three

How do monitoring activities impact the profitability of SMEs in Benin City?

Table 5

Research Question five

STATEMENT	SA	A	D	SD
Regular monitoring of financial transactions helps prevent fraud and enhances profitability.	177(48.5%)	141 (38.7%)	23 (6.2%)	24 (6.6%)
Lack of financial monitoring does not significantly affect SME profitability.	36(9.8%)	102(27.9%)	93(25.5%)	134 (36.7%)
SMEs that conduct frequent financial audits tend to perform better financially.	159(41%)	208(53.6%)	7(1.8%)	16(3.6%)
Continuous internal audits and evaluations have no impact on an SME's financial success.	80(19.4%)	90(26.8%)	143(42%)	53(11.7%)

Source: Author's Computation, 2025

The research questions as answered using a 4-point likert scale – strongly agree, agree, disagree and strongly disagree. On the first statement that regular monitoring of financial transactions helps prevent fraud and enhances profitability, 177 (48.5%) opine strongly agree, 141 (38.7%) opine agree, 23 (6.2%) opine disagree, while 24 (6.6%) strongly disagree.

On the second statement on whether Lack of financial monitoring does not significantly affect SME profitability, 36 (9.8%) opine strongly agree, 102 (27.9%) opine agree, 93 (25.5%) opine disagree, while 134 (36.7%) strongly disagree. On the statement that SMEs that conduct frequent financial audits tend to perform better financially, 159 (41%) opine strongly agree, 208 (53.6%) opine agree, 7 (1.8%) opine disagree, while 16 (3.6%) strongly disagree. On whether continuous internal audits and evaluations have no impact on an SME's financial success, 80 (19.4%) opine strongly agree, 90 (26.8%) opine agree, 143 (42%) opine disagree, while 53 (11.7%) strongly disagree.

Regression Result and Test of Hypotheses

The model of the study was estimated using the multiple regression analysis. Thereafter, the result of the study used to test the hypotheses of the study.

Table 6

Regression Model Summary

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.899[a]	.808	.785	1.773

a. Predictors: (Constant), Control Environment, Risk Assessment, Information and Communication Systems, Control Activities & Monitoring Activities.

b. Dependent Variable: Financial Performance of SMEs

Source: Author's Computation, 2025

The table above reveals the model summary of the study. The adjusted R Squared stood at 0.785. it implies that about 78.5% of the systematic variation is caused by

independent variable of the study. However, 21.5% of the systematic variation are caused by other variables not used in the model but was adequately accounted for by the standard error of the regression, SE = 1.773.

Table 7

Model Fitness

ANOVA[a]						
Model		**Sum of Squares**	**Df**	**Mean Square**	**F**	**Sig.**
1	Regression	40.968	4	10.242	2.218	.007[b]
	Residual	978.887	212	4.617		
	Total	1019.885	216			

a. Dependent Variable: Financial Performance of SMEs

b. Predictors: (Constant), Control Environment, Risk Assessment, Information and Communication Systems, Control Activities & Monitoring Activities.

Source: Author's Computation, 2025

The ANOVA table revealed that the model was statistically fit, F = 2.218, df = 4, 212, p = 0.007 < 0.05.

Table 8

Regression Coefficient

Model		**Unstandardized Coefficients**		**Standardized Coefficients**	**T**	**Sig.**
		B	**Std. Error**	**Beta**		
1	(Constant)	1.992	.302		3.074	.000
	Control Environment	4.094	.885	.803	5.098	.002
	Risk Assessment	0.850	.513	.209	4.067	.079
	Monitoring Activities	1.173	.805	.115	1.457	.029

Dependent Variable: Financial Performance of SMEs

Source: Author's Computation, 2025

The coefficient table show the relationship between the independent variables and dependent variables. From the result, it was revealed that Control Environment as part of Internal Control has positive impact on effect on tax compliance of SMEs in Benin City with coefficient of 4,094 and probability of 0.002 which is less than 0.05 level of significance.

Risk Assessment has a low coefficient of 0.850 with probability of 0.079 showing that it has a little impact but not significant on the performance of SMEs Monitoring activities as part of internal control process has a positive and significant impact on financial performance with coefficient of 1.173 and a probability of 0.029.

Test of Hypothesis

H_{01}: The control environment has no significant impact on the profitability of SMEs in Benin City.

From the regression result, it was found that Control Environment as part of Internal Control system has positive and significant effect on financial performance of SMEs, in Edo State, $\beta_1 = 4.094$; SE = 0.885, T = 5.098; p = .002 < 0.05. Therefore, this study rejected the null hypothesis stated on the study, that control environment has no significant impact on the profitability of SMEs in Benin City, Edo State.

H_{02}: Risk assessment has no significant impact on the profitability of SMEs in Benin City, Edo State

From the regression result, it was found that Risk assessment has Positive but not significance influence on profitability of SMEs in Benin City, Edo State, $\beta_2 = 0.850$; SE = 0.513, T = 4.067; p = 0.079> 0.05. Therefore, this study accepted the null hypothesis stated on the study.

H_{03}: Monitoring activities have no significant impact on the profitability of SMEs in Benin City.

From the regression result, it was found that monitoring activities as part of control process has positive and not a significant influence on tax compliance of SMEs in Benin City, Edo State, $\beta_4 = 1.173$; SE = 0.805, T = 1.457; p = 0.029 < 0.05. Therefore, this study rejected the null hypothesis stated on the study, that monitoring activities has no significant influence on profitability of SMEs, Edo State.

Discussion of Findings

This study was conducted to evaluate the impact of internal control systems on the financial performance of SMEs in Benin City, Edo State, focusing on five key components of internal control as outlined by COSO: control environment, risk assessment, and monitoring activities. The results obtained from the data analysis were discussed in relation to each specific objective and relevant empirical evidence from previous literature.

Objective 1: To evaluate the impact of the control environment on the profitability of SMEs in Benin City.

The regression result indicated that the control environment has a positive and significant impact on SME profitability (β = 4.094, p = 0.002). This supports findings by Adeyemi and Adebayo (2016), who observed that a well-structured control environment leads to improved financial performance in Nigerian SMEs. The result implies that SMEs with defined organizational structures, ethical values, and clear roles and responsibilities are more likely to experience better financial outcomes. This also underscores the importance of leadership tone at the top and governance practices in fostering accountability and performance.

Objective 2: To examine the impact of risk assessment on the profitability of SMEs in Benin City.

Contrary to expectations, risk assessment was found to have a positive but not statistically significant effect on profitability (β = 0.850, p = 0.079). This finding does not fully align with Onyeama and Bello (2023) and Adeboye et al. (2020), who emphasized the crucial role of structured risk management in fraud prevention and financial stability. The insignificance may suggest that while SMEs in Benin City may perform basic risk identification, they may lack the structured and consistent application of risk mitigation practices necessary to impact financial outcomes measurably.

Objective 3: To investigate the impact of monitoring activities on the profitability of SMEs in Benin City.

Interestingly, the study found that monitoring activities had a positive and statistically significant impact on profitability ($\beta = 1.173$, $p = 0.029$). This supports Ifeanyi and Okeke (2024), who noted that continuous monitoring improves adaptability and profitability. The result implies that regular evaluations of internal controls help SMEs identify lapses early and improve operational efficiency. This also highlights the value of performance dashboards, audits, and feedback mechanisms.

Overall, the study indicates that internal control systems play a crucial role in enhancing the financial performance of SMEs, though not all components are equally impactful. The control environment, control activities, and monitoring activities were statistically significant in influencing profitability, suggesting these areas are well-implemented and understood by SMEs in Benin City. However, the insignificant influence of risk assessment and information and communication systems point to potential weaknesses in SME internal control frameworks that need attention. These findings are consistent with prior empirical literature that highlights the uneven implementation of internal controls across Nigerian SMEs, often due to limited resources, technical know-how, and informal business practices.

5. Conclusion and Recommendation

This study examined the impact of internal control systems on the financial performance of SMEs in Benin City, Edo State. Based on the empirical findings, it concludes that internal control components have varying degrees of influence on SME profitability. Specifically, control environment show a significant positive impact**,** suggesting that SMEs with strong ethical standards, structured governance, and operational controls are more likely to achieve improved financial outcomes. While monitoring activities also show a positive and significant influence, risk assessment demonstrated positive but insignificant effects. These results indicate that although SMEs may be applying internal controls to some extent, the inconsistent implementation of certain components limits their full financial benefits.

In line with the findings, the study recommended the following:

1. SME owners and managers should establish and maintain a sound control environment by fostering a culture of accountability, ethical conduct, and clear organizational structures to drive better financial performance.
2. SMEs should develop structured risk identification and mitigation frameworks. Regular risk reviews and scenario planning will help businesses respond proactively to uncertainties and improve decision-making.
3. Since monitoring was found to significantly affect profitability, SMEs should integrate routine evaluations and performance audits. Using tools such as dashboards and key performance indicators (KPIs) can help detect irregularities and drive continuous improvement.

References

Abubakar, M., & Damilola, T. (2023). Internal controls and financial sustainability in Nigerian SMEs. *Journal of Small Business Management*, *19*(2), 78–96.

Adebayo, O., & Olayemi, T. (2021). The role of financial management in SME sustainability. *Journal of Business and Finance*, *12*(4), 78–95.

Adeboye, A., Ibrahim, K., & Olufemi, J. (2020). Risk management practices and financial stability in Nigerian SMEs. *African Journal of Business Economics, 15*(2), 134–152.

Adeoye, B., & Elegbeleye, F. (2018). Internal control practices in urban and rural SMEs: A comparative study. *Nigerian Journal of Finance and Management*, *10*(3), 203–219.

Adeyemi, A., & Adebayo, K. (2016). Internal control systems and financial performance of SMEs in Nigeria. *Journal of Financial Control and Economics*, *9*(2), 56–72.

Akinola, R., Yusuf, M., & Balogun, T. (2020). Employee training and the effectiveness of internal controls in Nigerian SMEs. *Nigerian Journal of Business & Management Studies*, *14*(3), 211–229.

Aremu, M. A., & Adeyemi, S. L. (2019). SMEs as a survival strategy for employment generation in Nigeria. *Journal of Sustainable Development*, *4*(1), 200–209.

Bianchi, C. (2020). The management of small and medium enterprises: An international perspective. *Journal of Business Strategy*, *17(*3), 112–128.

Central Bank of Nigeria (CBN). (2020). SME finance policy framework for Nigeria. *CBN Publications.*

Chukwuma, E., & Hassan, K. (2023). Challenges of financial record-keeping among SMEs in Nigeria. *West African Journal of Finance*, *19*(3), 55–72.

Committee of Sponsoring Organizations of the Treadway Commission (COSO). (2013). *Internal control—Integrated framework. COSO Press*.

Edeh, J., & Obasi, K. (2021). The role of internal controls in enhancing SME performance in South-South Nigeria. *Journal of Business Studies*, *11*(3), 67–81.

Ezekwu, C., & Olatunde, B. (2023). Internal control mechanisms and financial sustainability of SMEs. *Journal of Business and Economic Development*, 19(4), 89–107.

Ezekiel, F., Nwankwo, S., & Adamu, L. (2024). Challenges SMEs face in implementing internal controls in a post-pandemic economy. *Journal of Entrepreneurship & Financial Innovation, 18*(1), 55–74.

Ifeanyi, T., & Okeke, N. (2024). The impact of monitoring activities on SME profitability in South-South Nigeria. *Journal of Accounting and Business Performance*, *17*(1), 99–112.

Ogundele, T., Adepoju, A., & Salami, K. (2022). Internal controls and financial sustainability of SMEs in Nigeria. *Nigerian Journal of Finance and Management,* 15(1), 32–45.

Okon, B., & Etuk, A. (2021). How internal controls prevent fraud in SMEs. *West African Business Review*, *8*(4), 78–92.

Okoye, E., & Gbegi, D. (2013). An evaluation of fraud and financial control in Nigeria's SMEs. *International Journal of Business and Economics Research, 5*(2), 45–62.

Olatunji, A. (2015). Internal controls and accountability in SMEs: The Nigerian experience. *African Journal of Management and Finance, 13*(2), 45–63.

Olawale, F., & Garwe, D. (2019). How financial discipline affects SME survival. *African Journal of Business Management, 14*(3), 215–230.

Olawale, F., & Garwe, D. (2020). Barriers to SME growth in Sub-Saharan Africa. *African Journal of Business Management, 14*(3), 215–230.

Oluwaseun, A. K., Taiwo, B. J., & Michael, O. A. (2019). The role of SMEs in economic development: Evidence from Nigeria. *African Journal of Business and Development*, 6(2), 88–104.

Onyeama, U., & Bello, H. (2023). The role of risk assessment in fraud prevention among SMEs. *Journal of Risk & Business Strategy*, *16*(2), 132–150.

Oriave, R., & Aigbedion, O. (2020). Financial accessibility and growth of small and medium enterprises in Nigeria. *Nigerian Journal of Economic Policy*, *15*(1), 55–71.

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) & Nigerian Bureau of Statistics (NBS). (2017). *National survey of micro, small and medium enterprises (MSMEs) in Nigeria.* SMEDAN Publications.

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN). (2021). *SME Performance Report 2021.* SMEDAN Publications.

Small and Medium Enterprises Development Agency of Nigeria (SMEDAN). (2024). *SME Population Report 2024.*

Waweru, N., & Riro, G. (2013). Corporate governance, firm characteristics, and performance of financial institutions in Kenya: A review of literature. *International Journal of Business and Management, **8***(2), 101–122.