

# Effect of Risk Management and Internal Controls on Pension Management in Nigeria

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## Abstract

*This study examines the effect of risk management and internal controls on pension management in Nigeria. A Survey research design was adopted. Primary data were sourced by administered questionnaire to 98 respondents out of a total population of 130 comprising permanent staff of the nine chosen PFAs and nine PFCs. Data obtained were analysed using the Linear Regression technique. Findings showed that both internal control and risk management have a significant positive effect on pension administration management in Nigeria, hence providing adequate commendable growth and safety of pension assets. This is supported with coefficient and probity values of ( $\beta_1 = 0.4916845$ ,  $t = 8.02$ ;  $P < 0.05$ ) and ( $\beta_1 = 0.6311685$ ,  $t = 9.90$ ;  $P < 0.05$ ). The study concluded that effective internal control and risk management are catalyst to pension management in Nigeria. The study, therefore, recommended that pension fund administrators in Nigeria should employ robust effective and efficient internal control and risk management in support of practice as these have influence on financial performance in one way or another.*

**Keywords:** Risk management, internal control, pension management, Pension fund, Nigeria

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## 1.0 Introduction

The pension asset in Nigeria is fast growing in size, so as it is associated with risks. Records have it that, there has been considerable progress in the membership and contributions to the pension schemes. Therefore, Pension Administration includes all the procedures involved in managing pension funds by Pension Fund Administrators (PFA) and Pension Fund Custodians are to ensure that the overall aim of helping individuals to save part of their earnings during working life is achieved and are made available to them after retirement.

Saunders and Cornett (2006) view that new financial institutions are in the risk management business as they perform important roles in managing risks on behalf of their customers by gathering of risks and the sale of their services. The alarming rates of incidences of investment failures, operational losses, regulatory lapses, increasing cases of fraud, ineffective pension administration, and diminution of pension asset could be blamed on the absence of control within an

organization and risk administration of the pension business and where it is claimed to be in use, it is highly ineffective.

It is crystal clear that guidelines issuance, offenses and penalties, pension protection as contained in the PRA 2014 as issued by PENCOM, without the adequate engagement of risk administration and controls within organization's support at PFAs and PFCs levels in everyday of the activities of pension business as either as a regulator, as custodian or as an administrator will never guarantee a robust pension administration in Nigeria. The resultant effects of this are; reduced in pension fund assets, negative moral and economic influences on fund account holders and deterrent of prospective companies to the scheme.

Although many researches have been done on the concept of risk administration and internal controls in association with sectors such as banks, insurance, and others, such as Ellul and Yeramilli (2015) examine the stronger risk control and lower risk of bank holding companies in USA. Aebi, Sabato, and Schmid (2012) focused on bank performance while Hasan (2013) also relates risk taking in corporate organisation with performance of Islamic banks. However, little has been done on pension, but few of them had addressed the effects of these services on the administration of pension in Nigeria. The omissions of this in literature, therefore, will forms a major gap in this study. Hence, this study has been able to pinpoint the thin line of difference between risk management and internal controls as it applies to the setting of organizational objectives in the pension industry, risk identification, and mitigation specifically in Pencom, PFAs, and PFCs in Nigeria. This makes the research unique and required. To achieve objectives of this paper, the fundamental questions were examined: To what extent has effective risk management affect the pension administration? To what degree does effective internal control affect the pension administration?

The broad objective of this paper is to appraise the effect of risk management and internal control on pension management in Nigeria. Other specific objectives are to;

- i) Establish the effect of effective risk management on the pension administration
- ii) Examine the effect of effective internal control on the pension administration.

This study grouped into five sections. Section one showed the introductory part of the study. Section two focused on the literature review. Section three presented the research methodology adopted in the study. Section four was dedicated to discuss the relevance of the research findings and result to the existing knowledge in the field while section five covered the conclusions as well as recommendations

## **2.0 Literature Review**

### **Conceptual Review**

Risk is the potential threat to the objectives of an organization. The occurrence of such risk would lead to loss of assets, revenue, or benefits to the organization concerned. In this case, pension risk is the potential threat to the growth and safety of pension assets and eventually a threat to the interests of actors in the industry.

However, risk management is the methodical identification, analysis and economic control of the risks which menace the resources or earning powers of an entities (Raji, 2000). Risk management is procedure established to ensure that all associated and material risks concentrations are identified, measured, controlled, mitigated and reported on a timely as well as comprehensive basis. (Ellul & Yerramilli, 2015). The components of reporting procedures and policy are required to identify measure, monitor, assess, control and report, on a continuous basis are regarded as risk management method.

Risk management method needs to be married to structure of organisation and decision-making procedure of pension fund administration. These methods should be in accordance with the ambit of pension fund administration by showing area of its activities. These good practices aim to showcase the key qualities of risk administration methods that pension funds employed. They cover the functions in terms of risk administration procedure by focus on particular investment and operational risk control as well as risk administration tools that in best position. These practices guide pension fund regulators and supervisors on how to investigate that such method are not only in position but are operating effectively.

Minto, Thailand and William (2014) shared that the risk administration guards and adds value to the entities and its stakeholders via support the entity's objective by providing a support structure for future entity activity to be in a consistent way. The following types of risks that are facing by pension fund

administration include; liquidity; political and regulatory; business and financial; management and people's risk; assets concentration and portfolio selection, information, technological and operational risk (Luka, 2006)

Managing risks is a comprehensive issue that all over organisation or endeavor of life at large. It is important to any entity's survival as a result of if it is not efficiently managed, it can be disastrous to an organisation. We also use it as segment of mechanisms to formulate strategies to mitigate the events if and when they occur. Few of the alternative at minimization includes insurance against the risks, hedging, or using another techniques to conquer this not likely but considered set of occurrences.

### **Techniques for Managing Risks**

Risk avoidance is the strategy in risk management where risk is completely avoided by the organization. Risk abatement is the procedure of combining loss prevention or loss control to mitigate risk. Risk allocation is the sharing of the risk burden with other groups for instance asset allocation to several assets categories i.e. equity, bonds, real estate, private equity, hedge funds, etc. Risk-retention is a good strategy but it is difficult to transfer the risk. Defined benefit pension schemes are a good example of risk retention. However, various risks explicit to retirement benefits schemes include, counter-party default, market, operational, liquidity, legal and regulatory; strategic, contagion and related party, actuarial and record keeping risks.

### **Internal Controls**

Internal control broad method of controls is it financial and otherwise established by management to provide reasonable assurance of effective and efficient operations, financial control and compliance with laws and regulations (CIMA 2006). This is also a management tool that provides the required assurance that the business of the organisation is being done effectively and efficiently way. Internal control defines as a procedure, affected by an entity's board of directors, managers and other employees, designed to provide reasonable assurance in respect to accomplishment of following objectives; effectiveness, and efficiency of operations, reliability of financial reporting compliance in accordance with laws and regulations, and safeguarding of assets against not authorized acquisition or disposition (Olowookere, 2014)

Problems of control within an organisation includes; Lack of qualified staff, Volunteers may resent controls; No segregation of duties- few staff; Less

predictable patterns of sales; Cash transactions harder to control – open to theft; Controls not properly documented; Control could be overridden by the manager; Limited record-keeping and Informal recruitment procedure.

The need for internal controls include; Maintain accurate accounting records and comply with reporting requirements; Accurate info for planning and decision making; Analysis of procedures; Segregation of funds; Need to safeguard assets, and prevent and detect errors and irregularities. Losses would impact the ability to meet objective; If expanding, then controls more controls are needed; Relevance to manager: Benefits of risk management and internal controls include; Business growth; Safety of business assets; Efficiency and effectiveness in the administration of business

### **Pension Fund Management**

Overall goal of pension fund management is to ensure well-funded pension plan sustained and to meet the contractual pension liabilities over time. The contributions from the sponsor and return on investment plan assets have to be met as a pension benefit payments. Appropriate trade-off between return and risk should be a critical decision-making to be considered while conservative approach on investment policy could result in poor investment returns, and force the sponsor to make large contributions of pension funds. However, a very combative investment policy could make the fund more exposed to not favorable investment returns, and affect the financial well-being and security of the plan on pension funds (Rajkumar, 2012)

### **Theoretical Framework**

The theories reviewed here are borrowed from the finance literature related to enterprise risk management. However, this study is anchored on Modern Portfolio Theory (MPT) is a theory of investment which tries to maximize return and minimise risk by carefully choosing different assets (Markowitz, 1952). MPT is a mathematical formulation of the concept of diversification in investing, to select a collection of investment assets that has collectively mitigated risk than any each asset. This is considered, in theory, because different categories of assets often change in value in opposite ways. For instance, when the prices in the stock market fall, the prices in the bond market often rise, and vice versa. A collection of both categories of assets can therefore have lower overall risk than either individually (Mandelbrot & Hudson, 2004). Therefore, the modern portfolio theory has important implications in terms of risk mitigation by investing in

portfolios that have lower overall risks. The pension fund administrations invest on behalf of the pension scheme members and therefore must strive to invest in portfolios that maximize returns and minimize risks.

### **Empirical Review**

Several empirical researches have been carried out to find the nexus between pension fund management and variables such as economic performance, risk management, the standard of living of contributors, among others in this country and or other parts of countries. Studies like Alazzabi, Mustafa, and Karage (2020) examined the effect of top management support and risk management on the internal audit activities and fraud mitigation in the Libyan banking sector. The study showed that there was a significant relationship between risk management and employees' fraud mitigation and top management support. The study also demonstrates a significant mediating effect on the relationship between risk management, fraud mitigation and top management support. Okoye, Adeniyi and Jones (2020) examined the effect of fraud risk management on the corporate performance of deposit money banks in Nigeria. The findings revealed that IFRC has a significant effect on return on the asset while IFRC revealed an insignificant effect on the return on equity of deposit money banks in Nigeria during the year under review. Xu, Liu, Hsu and Lin (2019) evaluated the influence of the public pension governance practices on the public defined benefit pension fund performance. The findings from the study offer insights into recent calls to reexamine public defined benefit pension management practices and to carry out related public pension fund policy reforms. Nwanna and Ogbonna (2019) employed the estimated panel regression techniques to examine the significance of pension administration on Nigerian economy. The study shows that pension administration proxies by retirement savings account and total pension assets have significant influenced on the Nigerian economic growth. Ameh, Ajie and Duhu (2017) found that pension fund assets and pension contribution savings mobilized over the years have a positive but not importantly influenced the economic growth while examine the impact of contributory pension schemes on Nigerian economic growth.

Jeffi- Anyene, Ezu and Ananwude (2017) discovered that the pension contributions have no important effect on national, urban and rural poverty levels while examined the effect of pension scheme contributions on the retirement saving accounts of employees on national, urban, and rural poverty levels. Micah

and Obah (2016) employed the Pearson Products moment correlation to establish the link between pension fund administration and infrastructure financing in Nigeria. The study found that retirement pension account has a significant influence on the social infrastructural financing in Nigeria. Farayibi (2016) used both error correction mechanism and ordinary least square techniques to examine the effect of the operation of the funded pension scheme on Nigerian economic growth. The study disclosed that increased greatly and constituted a huge investment fund in the money markets by the pension fund contributions from both private and public sectors in Nigeria. Zubair (2016) assessed the influence of pension fund investments on the performance of the capital market in Nigeria. He reveals that pension funds' investments has a significant impact on the performance of the capital market in Nigeria post the 2004 major organisation reform. Nwanne (2015) examined the influence of contributory pension scheme on economic growth in Nigeria. They disclosed that pension funds have a negative and significant influence on economic growth while pension savings had a positive and significant influence on economic growth.

### **3.0 Research Method**

The survey research method was used because it is cost-effective, useful in describing a large population, and dependable. Data needed for the study were obtained from primary source via questionnaire administered to the senior management staff of the following PFAs and PFCs: Access Pensions Fund Custodian Limited, Zenith Pensions Fund Custodian Limited, UBA Pensions Fund Custodian Limited, First Pensions Fund Custodian Limited, FCMB Nominees, Stanbic Nominees, AIICO Pension Managers Limited, APT Pension Managers Limited, ARM Pension Managers Limited all in Lagos State and the Federal Capital Territory. Abuja. Therefore, responses of the respondents generated from the questions on the Likert scale rating, ranging from strongly agree (5) to strongly disagree (1). The scale was subjected to items analyse to ensure it is valid and reliable. The total population of the study is One hundred and thirty (130). The researchers used a judgmental sampling technique to select the PFAs and PFCs and derived the sample size statistically by using Taro Yamane. The sample size consists of 98 approximately. This study adopted Ordinary Least Square-Linear Regression method to analyse the data.

### **Model Specifications**

The model of the study established the link between the dependent variable pension administration and independent variables of risk management and

internal control. The model is specified on both functional and stochastic form as stated below

Model 1

$$PA = f(RM, \mu) \dots \dots \dots eq. 1$$

$$PA = \beta_0 + \beta_1 RM + \mu \dots \dots \dots eq.2$$

Model 2

$$PA = f(IC, \mu) \dots \dots \dots eq. 3$$

$$PA = \beta_0 + \beta_1 IC + \mu \dots \dots \dots eq.4$$

Where,  $\beta_0$  = Constant Parameter  $\beta_1$  = Regression Coefficient of Variables

PA = Pension Administration, RM = Risk management IC = Internal control,,  $\mu$  = Stochastic Error term,  $i$  = Cross sectional

#### 4.0 Results and Discussion

##### Table 4.1 Summary of Regression Results

**Table 4.1.1 Regression results of Model 1**

Variable(s)	$\beta$	T-stat	P-Value
C	10.37968	8.23	0.0000
Risk management	0.4916845	8.02	0.0000
<b>F-Statistics 64.39 (0.0000)</b>		R-Square- 0.2807	

**Table 4.1.2 Regression Result of Model 2**

Variable(s)	$\beta$	T-stat	P-Value
C	7.594547	5.82	0.0000
Internal control	0.6311685	9.90	0.0000
<b>F-Statistics = 97.97 (0.0000)</b>		R-Square =0.3725	

**Source: Authors' Compilation (2020)**

Table 4.1.1 showed that risk administration has a positive relationship with pension management as confirmed by ( $\beta$ = 0.4916845,  $t$ = 8.02,  $p$ -value =0.0000).This indicates that the engagement of risk management in everyday activities of pension business has positive effects on pension management in Nigeria. The ( $R^2$ ) suggested that 28% variation in pension administration is

explained by the influence of risk management on pension administration, while  $F= 64.39$  suggest that the model is well fitted as confirmed by  $P < 0.05$

Table 4.1.2 revealed that the engagement of internal control will positively affect pension administration ( $\beta= 0.6311685$ ,  $t= 9.90$ ,  $p\text{-value} =0.0000$ ). This implies that an engagement of internal control in everyday activities of pension business will positively influence the pension administration in Nigeria. The ( $R^2$ ) suggested that 37.2% variation in pension administration is accounted for by the engagement of internal control, while the  $F= 97.97$  suggests that the model is well fitted as shown  $P\text{-value} <0.05$ . This indicates that a positive and significant relationship exists between risk management and pension administration. This indicates that the engagement of the risk management support, will improve pension management in Nigeria. The findings also show that the use of internal control method will positively influence the pension administration in Nigeria. This is consistent with the study by Zubair (2016) who found that pension funds' investments have significant relationship with the performance of the capital market in Nigeria post 2004 major organisation reform.

## **5.0 Conclusions and Recommendations**

Because of the above findings, we can conclude that engagement of risk administration and internal control in the day-to-day running of pension business has positive effects on pension administration in Nigeria. The following recommendations were suggested:

- i) Pension fund management firms in Nigeria should employ robust effective risk management and internal control support practices have influence on the financial performance in one way or another.
- ii) For pension fund management firms to improve on the financial performance, they should forestall effective internal control tools in their business environment and the day-to-day running of pension business as these are likely to enhance the financial performance of these firms.

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