

**KWAME NKURUMAH UNIVERSITY OF SCIENCE AND TECHNOLOGY,  
KUMASI, GHANA**

**KNUST**

**THE EFFECT OF INTERNAL CONTROLS ON CREDIT RISK OF  
COMMERCIAL BANKS IN GHANA**

**By**

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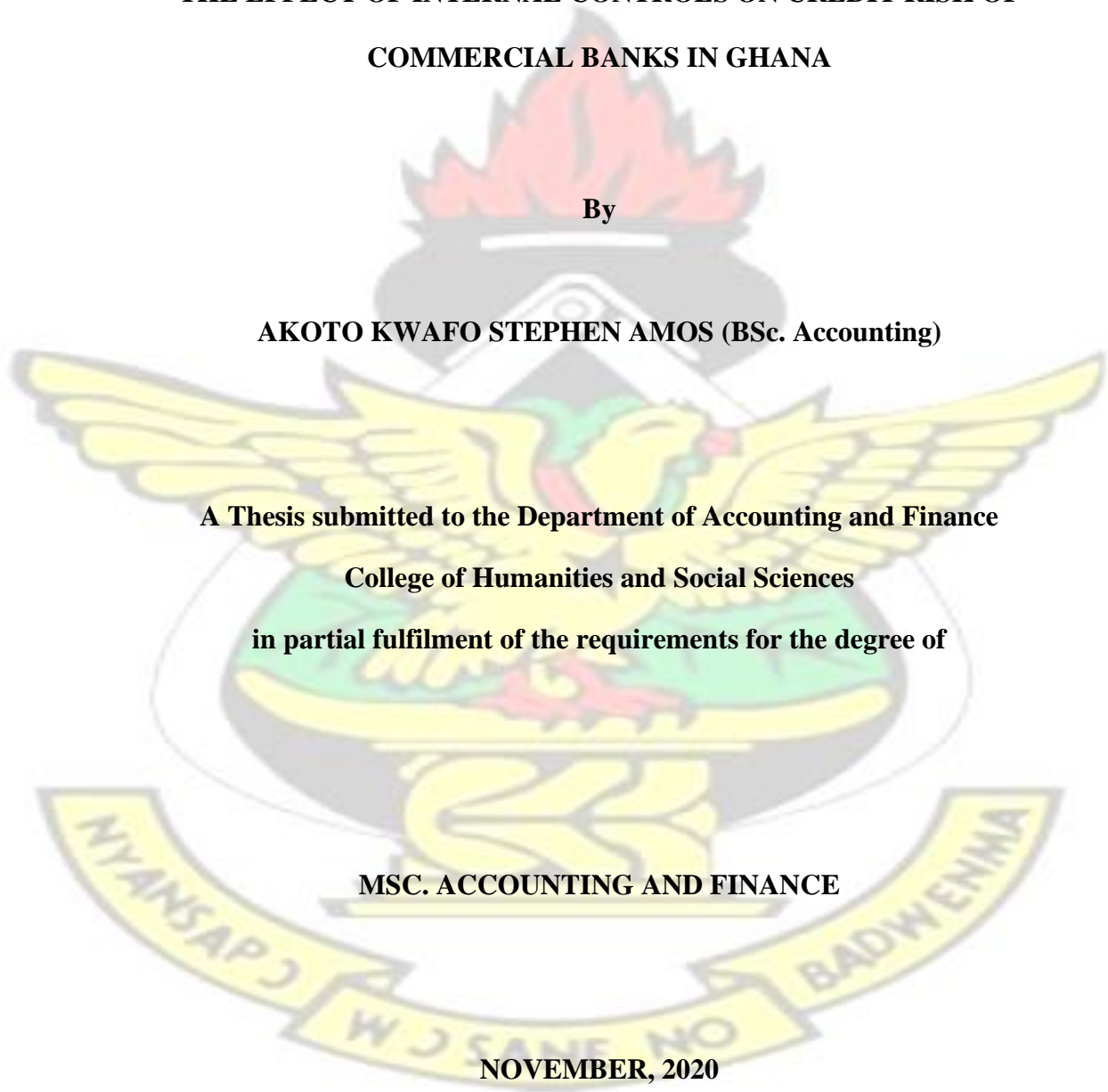
**A Thesis submitted to the Department of Accounting and Finance**

**College of Humanities and Social Sciences**

**in partial fulfilment of the requirements for the degree of**

**MSC. ACCOUNTING AND FINANCE**

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## DECLARATION

I hereby declare that this submission is my own work towards the award of the MSc and that, to the best of my knowledge, it contains no material previously by another person or any material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.

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## DEDICATION

This work is dedicated ultimately to my Lord, Jesus Christ who is the only Lord and Saviour for the world. Also to my grandmother, Madam Mary Ama Nyame and the entire family particularly my children; Desmond Ohene-Gyan, Derick Ohene-Gyan and Prince Ernest Kofi Akuffu. Lastly to my lovely wife to be Miss Diana Addo Dansowaa.



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To God be the glory.

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## ABSTRACT

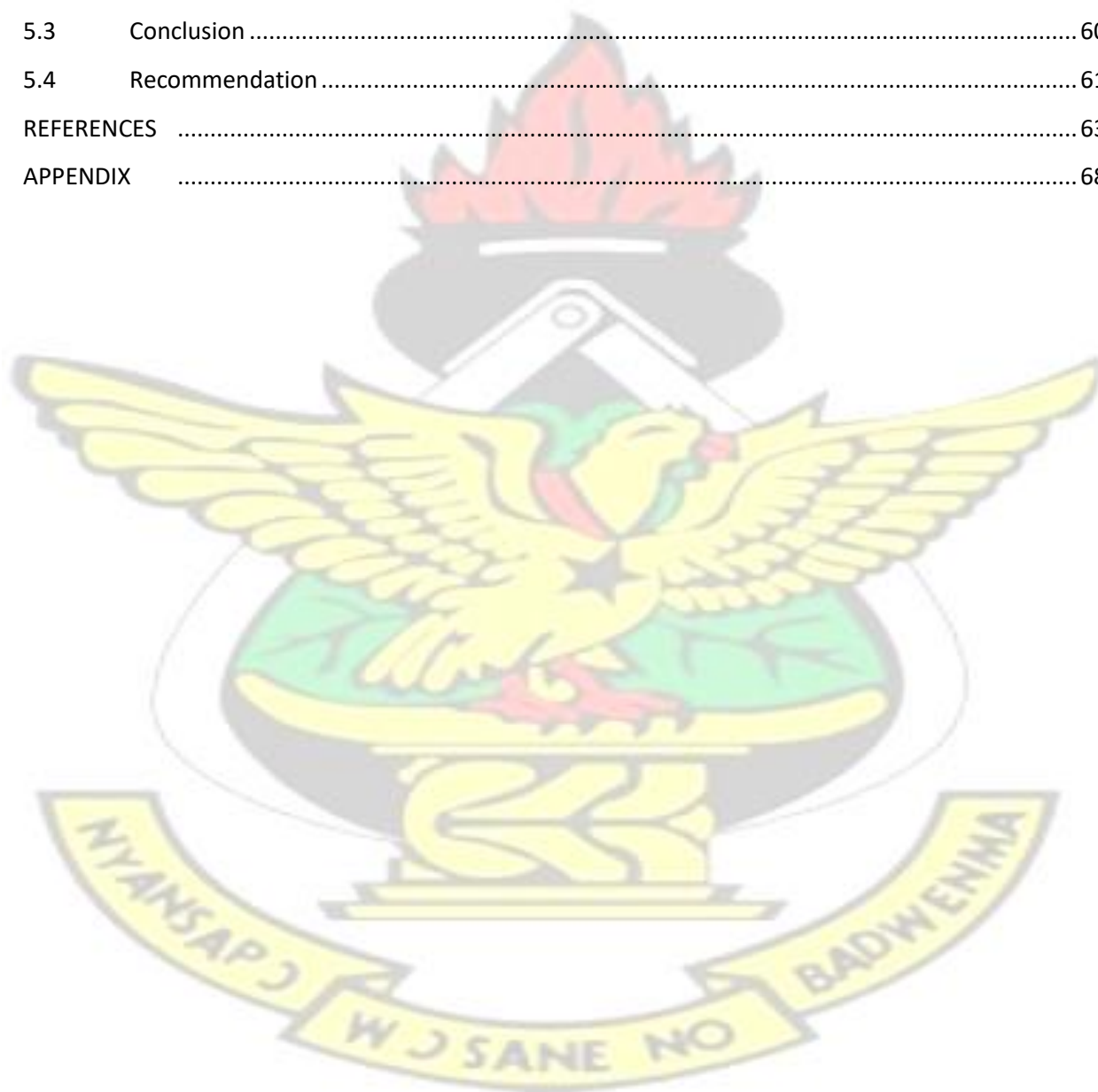
Every business or institution needs to have effective internal controls to give the guarantee that with the internal controls in place, the business or institution will be able to achieve the financial and operating goals in addition to complying with the required regulations. The general objective of this study is to ascertain the effect of internal controls on credit risk in commercial banks in Ghana. The population is made up of all commercial banks in Ghana. In all, there are 23 commercial banks currently in Ghana. The study used quota sampling and purposive. The main data collection instrument was a questionnaire that contained structured questions relating to the research objectives. The study found out that the internal controls covering credit risk in the commercial banks were very strong. The four elements assessed were: control environment, control activities, risk assessment and information and communication. Again, there was a reasonable relationship between credit risk and risk assessment. The study recommended that every staff of financial establishment ought to undergo an annual training on fraud and compliance issues. This is very important because the banking sector and its environment is very dynamic and so it was necessary for employees of financial establishment to be abreast with current issues bothering on fraud and compliance in the banking sector.

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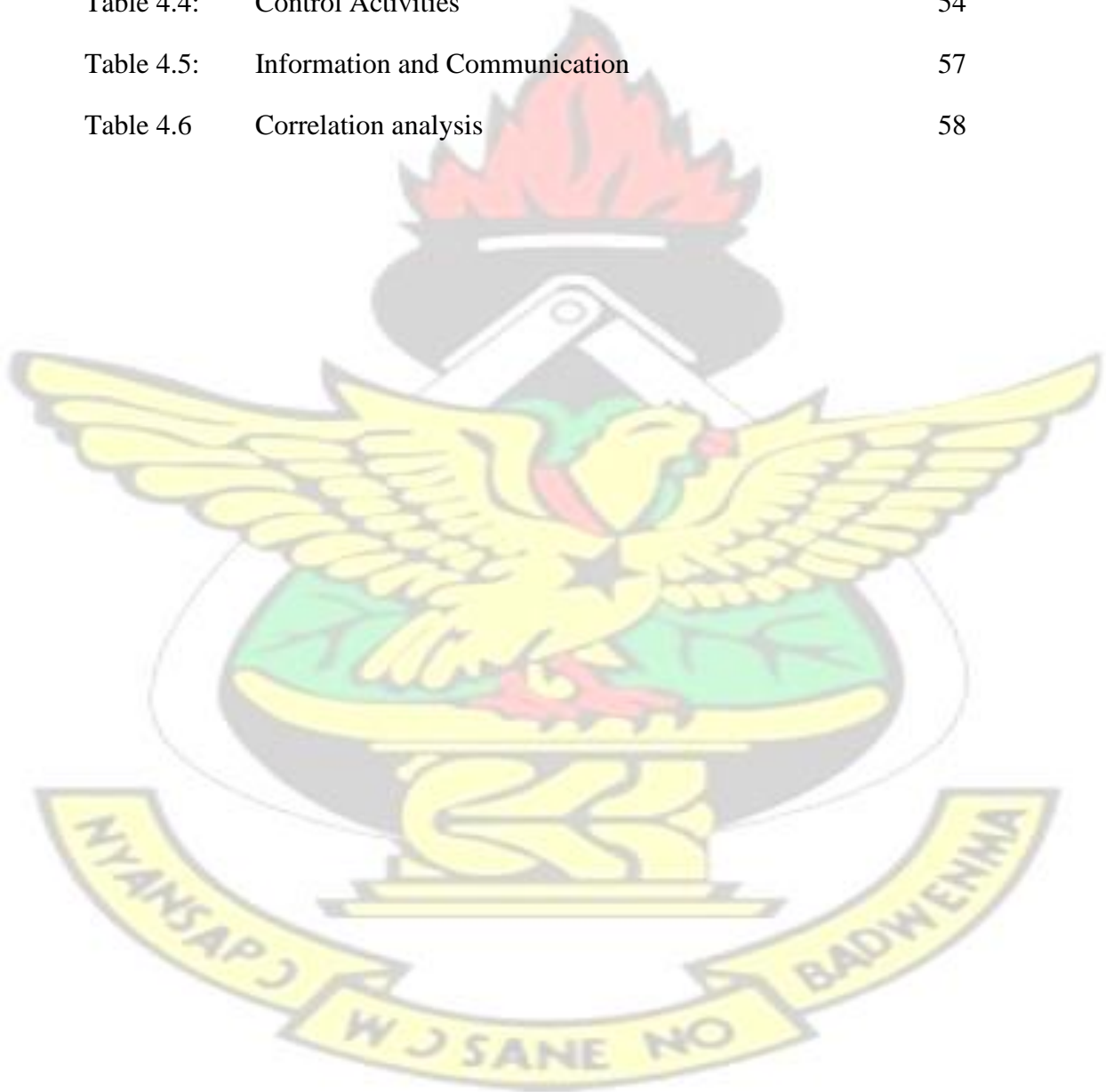
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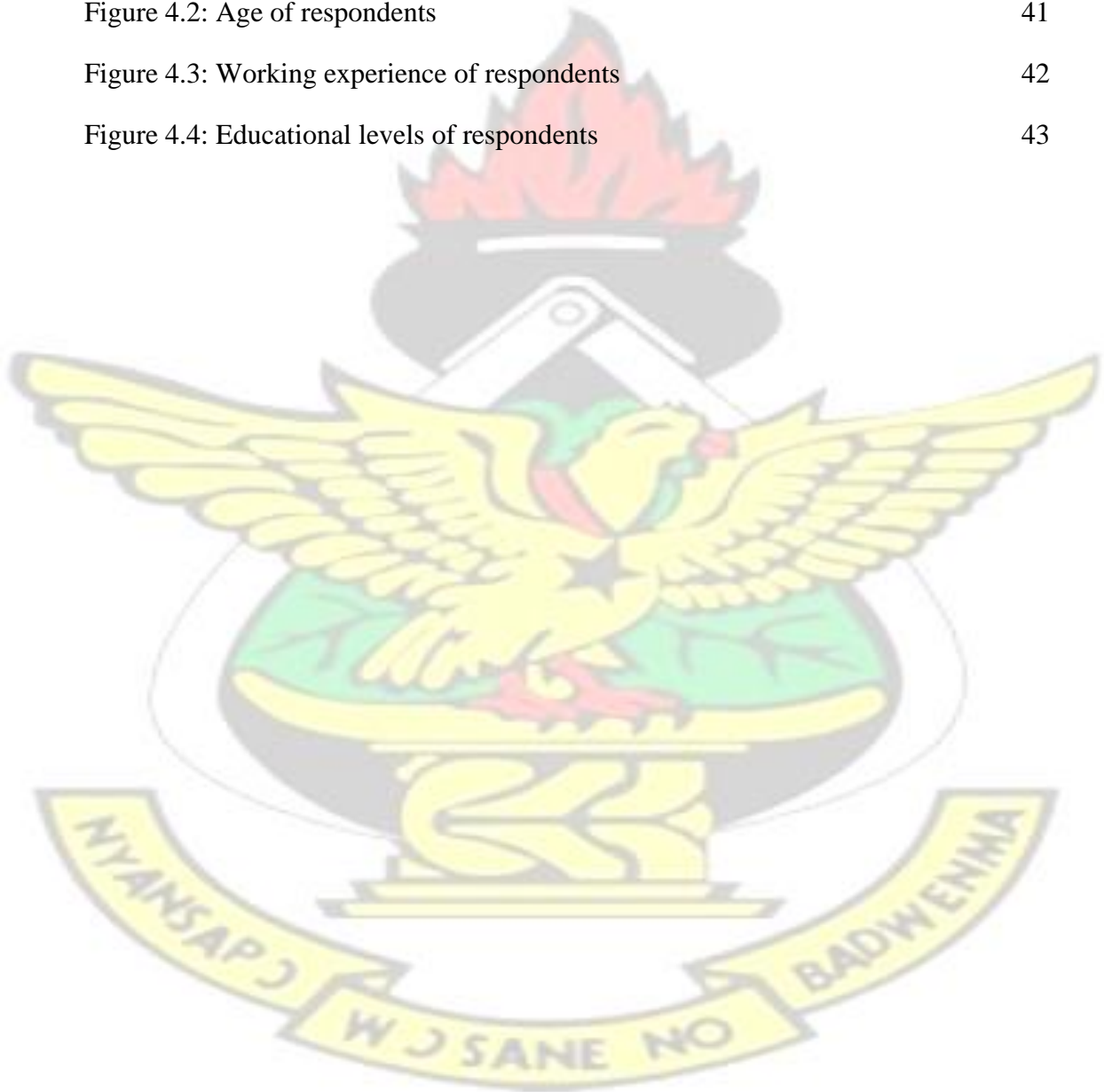
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## LIST OF ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants (AICPA)
BoG	Bank of Ghana (BoG)
ICAG	Institute of Chartered Accountants-Ghana
NPL	Non Performing Loans
COSO	Committee of Sponsoring Organizations of the Treadway Commission



## CHAPTER ONE

### INTRODUCTION

#### 1.1 Background of the study

The adequacy of managing credit risk in financial institutions is very vital for the socio-economic development of nations and the sustainable growth of financial institutions. With respect to banks, the matter relating to default risk or credit risk is a very important issue because the survival of banks depends on the effective and efficient management of the credit risk. Any lapse in the management of credit risk has the potential to collapse the strongest bank. In the view of Basel (2000), loans granted to customers is the number one source of credit risk in the business of financial establishment such as banks. Thus the management of credit risk in the business of financial establishment, such as banks, is described as the core of the business of banking in today's world.

The management of credit risk involves the process of applying policies and procedures to the identification, analysis, assessment, treatment and monitoring of credit risk. The business of banking exposes financial institutions to different types of risk which includes credit risk which is inherent in the business of banking. Credit risk is described as the probability that a customer who has been granted a loan facility by a financial institution, such as a bank, will fall short in meeting terms of the repayment obligations (Ken and Mole, 2012). The concept of credit risk emanates from uncertainty surrounding the customer's capacity, ability and willingness in meeting the terms of repayment agreement of the loan. Credit risk which is also called default risk comprise a range of issues including how to restructure a loan facility, what happens when the client is unable to repay the loan, what happens when the client becomes bankrupt before the final repayment of the loan and

finally, when the client decides to pay off the full loan earlier than stipulated in the agreement (GARP, 2013).

It is a common knowledge that credit risk is imbedded in the assets column of the statement of the financial position of banks. The failure of financial institutions to effectively manage default risk exposes the bank to liquidity problems which also affects the profitability of the bank because there will be an increase in bad debts. Majority of the banks worldwide have various sources of credit risk, such as, loans, banking book, trading book, both on and off the balance sheet. Nevertheless, loans are the main source of credit risk (Akwaa-Sekyil, 2016). Furthermore, banks are not only facing credit risks through loans but are also exposed to credit risk in other financial instruments including trades, foreign exchange transactions, interbank transactions, acceptances, bonds, trade financing, the settlement of transactions, financial futures, options, and in the extension of obligations to customers (Ibrabas, 2015).

In the worst case, lapses in the effective management of credit risk have the potential to affect the going concern of the bank. This happened in Ghana during the banking crisis in which seven commercial banks were liquidated largely due to credit risk in the form of non-performing loans. According to Bank of Ghana Stability Report (2017), the banking industry's level of non-performing loans (NPL) moved to GH¢6.4 billion in February 2017 from GH¢4.7 billion in the first quarter of 2016. The upward movement in the level of non-performing loans, with no corresponding increase in gross advances, resulted in a higher NPL ratio of 17.7% in the first quarter of 2017, compared with 15.6% in the same period in 2016. The worsening situation in the asset quality of banks were largely linked to the

Asset Quality Review of bank loans in 2016 which resulted in the downgrade of some existing loans by banks. The issue of non-performing loans is linked to the effectiveness of internal controls in financial institutions.

Every business or institution need to have effective internal controls to give the guarantee that, the business or institution will be able to achieve the financial and operating goals in addition to complying with the required regulations. Thus for any organization to succeed in achieving its mission, there must be effectiveness and efficiency in its internal controls. Any money related establishment of whichever frame or size ought to set up its own particular system of controls with a specific end goal to accomplish its goals (Kaplan, 2008). A system of successful internal controls is a vital segment of organization management and an establishment for secure and sound operation of companies. Be that as it may, insufficient internal controls result in ineffectual projects and in the end prompting misfortunes (Campbell, 2008).

Every business must have effective internal controls to give more guarantee that, they will accomplish their goals; as that will help the company to achieve its corporate vision and mission. Effective internal control system enables the organization to have crystal clear directions, policies, procedures which are intentionally designed and approved by the board or senior management to be effected throughout the organization. To reduce credit risk in financial institutions, a strong internal control system need to be implemented. The Committee of Sponsoring Organizations of the Treadway Commission (COSO,1992) describe internal control system as a course of action instituted and designed by the board of directors of an organization to give realistic guarantee with respect to the achievement of

corporate goals in the most effective and efficient manner in operations, reliability of financial reporting, and compliance with applicable laws and regulations

## **1.2 Statement of the problem**

In a space of twenty-four (24) months (2017-2018), seven banks collapse in Ghana. In the middle of August, 2017, Bank of Ghana (BoG) declared its approval for GCB Ltd to completely takeover two bank: UT Bank Ltd and Capital Bank Ltd. Just after a year after this takeover in 2018, Bank of Ghana again revoked the licenses of five other commercial banks to form a new consolidated bank to take over the assets and liabilities of five collapse banks. The five banks were: Unibank Ghana Ltd, The Royal Bank Ltd, Beige Bank Ltd, Sovereign Bank LTD, and Construction Bank Ltd. (Ghana Banking Survey, 2019). Non-performing loans was cited as the principal reason for the crumbling of these five banks.

According to BoG, the quality of assets in the banking industry was a major problem with respect to debts that had been written off as bad debt and the problem of non-performing loans. An analysis into the books of the failed financial institutions revealed that these banks had large non-performing loans on their statement of financial positions. Non-performing loans negatively impact the operation of financial institutions by increasing their cost of operation which then reduce their profit margins in the long run (Gwahula et al, 2018). Despite the implementation of credit risk strategies responsible for regulating lending risks; banks are still recording high levels of non-performing assets in their books (World Bank, 2017). This questions the effectiveness of internal controls in the banking sector. The inappropriate manner in which risk linked to credit extension is managed expose banks to increasing levels of non-performing loans which leads to situations where

the non-performing loans are declared as bad debts and subsequently reduce the profit margins of the banks (Kithinji, 2010). In this study, the author sought to ascertain the effect of internal controls on credit risk in Commercial banks in Ghana. To the best of the researcher's knowledge, previous studies assessing the determinants that cause these credit risks have not been directed to the specific components of internal control systems and its effect on credit risks specifically in relation to the banking sector in Ghana. This thus provide a contextual and geographical gap. The aim of the study is to fill these gaps by conducting a research to assess the connection between internal controls and the credit risk within the banking sector in Ghana with particular reference to commercial banks in Ghana.

### **1.3 Research Objectives**

The general objective of this study is to ascertain the effect of internal controls on credit risk in commercial banks in Ghana. The specific objectives are based on the five components of internal controls as propounded by the Committee of Sponsoring Organization (COSO):

- i. To examine the credit risk in commercial banks in Ghana
- ii. To assess the internal controls in commercial banks in Ghana
- iii. To examine the effect of control environment on credit risk in commercial banks in Ghana
- iv. To ascertain the effect of risk assessment on credit risk in commercial banks in Ghana

#### **1.4 Research Questions**

The study seeks to answer the following questions:

- i. What is the credit risk in commercial banks in Ghana?
- ii. What are the internal controls in commercial banks in Ghana?
- iii. What is the effect of control environment on credit risk in commercial banks in Ghana?
- iv. To what extent does risk assessment affect credit risk in commercial banks in Ghana?

#### **1.5 Significance of the Study**

The study findings will be of much importance to various stakeholders such the Government and Bank of Ghana, management of financial institutions, Professional bodies such as Institute of Chartered Accountants-Ghana and academic Institutions. The study will benefit the government and the central bank as it will help them to understand the impact of each of the five components of internal controls on credit risk so as to initiate and implement policies to reduce credit risk and improve the performance and survival of banks in Ghana. The management of financial institutions will also benefit from the findings of this study as it will offer them a deeper understanding of the influence of internal controls on credit risk. This will enable them enact and implement controls akin to each of the five components to reduce the incidence of credit risk. In relation to professional bodies, the findings of the study can be used as a continuous professional development for its members to keep them abreast with dynamics in the banking sector in relation to internal controls and credit risk. For academicians the study will provide them with quality pool of

resourceful knowledge to supplement their further studies in their future endeavors academically.

### **1.6 Scope of the Study**

The focus of the study was to assess the impact of internal controls on credit risk in the Ghanaian banking industry. The study therefore targeted all the commercial banks in Ghana. In relation to the respondents, the study targeted risk managers, compliance and monitoring managers, internal auditors and credit officers/ managers of the commercial banks in Ghana.

### **1.7 Brief Methodology**

The study was quantitative in design. A cross sectional research design was used in this study. Cross sectional research focuses on finding the relationships between variables at a point in time. Hence this study used cross sectional research design because the study sought to assess the association between internal controls and credit risk. The total population include risk managers, compliance and monitoring managers, internal auditors and credit officers/ managers of the commercial banks in Ghana. The technique that was applied to select respondents was purposive sampling technique. This was because the researcher chose the respondents who were appropriate for the study. Questionnaire was the main instrument used to collect raw/primary data. The use of questionnaire are ideal since they are easy to administer and does not consume as lot of time to administer and to be filled (Mugenda & Mugenda, 2003). The data gathered was analyzed using SPSS. Frequency tables, pie charts and bar graphs were used to present the analysis.

## 1.8 Organization of the study

The study is divided into five units or chapters. Chapter one which introduces the study has sub topics such as the study background, statement of the problem, the research objectives and research questions of the study, the scope of the study and limitations of the study. Chapter two captured the conceptual review of relevant literature on the concepts of credit risk and internal controls. The chapter also covered theoretical and conceptual review as well as empirical review on the subject matter. Chapter three focused on the method used in collecting relevant data to answer the research questions. Chapter four covered the results and analysis of the data obtained. Chapter five being the last chapter for the study addressed the summary of the findings, conclusions and recommendations to the findings in the fourth chapter.



## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.0 Introduction**

The chapter reviews literature on internal controls and credit risk management. It outlines the conceptual review, theoretical review, conceptual framework and empirical review.

#### **2.1 CONCEPTUAL FRAMEWORK**

##### **2.1.1 Credit risk management in financial institutions**

Risks as it may be broadly conceived involve the probability of loss as a result of the inability of a borrower in meeting the repayment terms of the loan (Global Association of Risks Professionals, GARP, 2013). In other words, default risk is described as the probability that a customer who has been granted a loan facility will fail or be unable to repay the monthly repayment amount involving the principal and interest in line with the agreement of the loan facility (Ken and Mole, 2012). Credit risk also known as default risk comes up due to the uncertainty about whether the customer can pay the loan facility or not.

Credit risk may be unavoidable in transactions and operations of commercial banks, but they should often be managed consistently to avoid undesirable effects on financial institutions. Therefore, credit risk management requires effective credit risk management. Njanike (2009) notes that the inadequacy of the effective and efficient system of managing credit risk, has been the major cause of the collapse of several financial institutions. Studies have shown that in countries like Venezuela, Zimbabwe and Mexico had many financial institutions but several collapsed in 2003-2004, mainly due to inefficient system of managing credit risk (Njanike, 2009; Gil Díaz, 1994). Therefore, an efficient system for

managing credit risk is one of the vital facets of the overall risk management in financial institutions. Credit risk is the most vital type of risk management pertaining to the banking business, which is a major problem for most financial analysts. In fact, the issue of credit risk remains key in managing banks' finances.

However, defining or formally explaining credit risk management and anything pertaining to risk is not an easy task. Despite this, some researchers have made several attempts to explain the concept of credit risk management. Baesens and Van Gestel (2009) define credit risk management as a process that involves identifying potential risks, measuring those risks, appropriate treatment and actual implementation of risk models. This definition suggests that the issue of credit risk management includes systematic steps from identification, measurement, diagnosis and management as well as the actual implementation of each model or solution established to mitigate risk. Ultimately, the purpose of managing credit risk is to maximize the returns of the loan granted by the bank by keeping the exposure to credit risk within acceptable and tolerable perimeters.

In this way, banks must see to it that the management procedures associated with credit risk covers the entire portfolio in addition to the risk associated with individual loans or transactions. At the same time, financial institutions should consider the correlation between credit risk and other risks such as liquidity risk, market risk etc. The effectiveness in managing credit risk is a very important element of the overall risk management system of a financial institution and is a vital facet for the long-run sustainability of any financial institutions. According to Baesens and Van Gestel (2009), risk management is mainly about reducing profit instability while avoiding large losses. When conceptualizing risk

management, account should be taken of the need to identify risk, measure and quantify it, and then develop a strategy for managing it.

The more risky a product is, the riskier the problem in managing risk. In this sense, previous risk management concerns are in those products that can cause the biggest losses: high exposures with high default risk (GARP, 2013). In fact, credit risk management is a complex and multidimensional problem, resulting in several different approaches, some of which are quantitative, while others require a qualitative assessment. However, regardless of the method used, a key element is understanding the behavior and predicting the likelihood that some loans will not meet their obligations (Ken and Moles, 2012).

In the view of Mwengei (2013), credit risk management is an all-inclusive progressive structure that involves ascertaining the lending rates, and the processes at every stage until the loan is paid. Credit risk is termed as the likelihood of loss due to a customer's inability or failure to repay both the principal and interest of the loan taken. Aduda and Gitonga (2011) posits that banks give loans to boost their revenues, to remain competitive in the market and also maintain good relationships with customers. They use different ways to offer credit to their clients, such as, overdrafts, loans, off balance sheet operations, credit card facilities.

Mwengei (2013) points that financial institutions face extreme challenge in managing credit risk because of various factors which include; government controls resulting from political uncertainties and pressures, monetary limits, market disruptions, untimely production and occasional volatility in the corporate field, production challenges which weaken the financial state of borrowers (Mwengei, 2013). Globally, most of the banks'

failure is attributed to their exposure to credit risk. Evidently, 80% plus of all banks balance sheet transmit to credit. NPLs make issues for the financial division's accounting report on the advantage side, and negatively affect the salary proclamation because of provisioning for credit misfortunes (Kumar and Tripathi, 2012).

### **2.1.3 Internal controls in Commercial Banks**

One of the important facet of banking in the banking industry is the issue of internal controls. The reason is that; internal control is the bedrock upon which the pillars of financial institutions stand. Thus without an effective and efficient internal control structure and system, the survival of any financial institution is in doubt. (Wanemba, 2010).

The numerous bank failures around the world gives credence to the fact that the board of financial institutions ought to design and institute strong system of internal controls as a strategy to competitive advantage over it competitors (Rittenberg & Schwieger, 2005). This is of very much importance because the weakness of internal control systems resulting in unnoticed frauds in financial institutions stands out as the key reason for the bleak financial performance of banks (Etuk, 2011).

From the perspective of management, there is the vital need to be certain that effective internal control systems are instituted and are working efficiently to minimize the incidence of fraud in the banking industry. Internal control is an ongoing activity and process in the banking industry which is very dynamic (Wielstra, 2014). Within every financial institution, products and services are developed to meet the needs of individuals and businesses, however within these products and services are inherent risk. In Ghana, the major reason for the collapse of banks in the last decade and drops in banks profitability

have been attributed to ineffective internal controls (Nyambura, 2013). Internal controls, which guarantees the going concern of all organizations has therefore gained relevance in the operations of corporate institutions (Rezaee, 2002). This is due to the fact that internal controls are the foundation upon which the sustainability of businesses dwell in order to achieve the corporate goals.

The Basel Committee on Banking Supervision (2010) has stated that the board and senior level managers have the responsibility for establishing and maintaining the appropriate, adequate systems for achieving effectiveness and efficiency in the structure of internal controls. The structure of internal controls and processes need to be designed in a way that ensures security in areas covering reports (financial and operational), ensuring that there are compliance with the law, internal laws and policies, operational efficiency and effectiveness and security of transactions of goods and services. Lakis and Giriunas (2012) describes internal controls as a very important facet of the business management system that guarantees achievement of goals, effective economic usage of scarce resources and achieve viable commercial results of the company, compliance with accounting principles and effective control of occupational hazards that allows the organization to eliminate or minimize the frequency and magnitude of deliberate and unintended errors and fraud.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO,1992) define internal control as a system initiated and implemented by the board of an entity to provide practical guarantee with respect the achievement of the corporate goals of the entity. According to Liu (2005) and Rittenberg et al. (2005), as part of the organization's ongoing operations in general, the relevance of the system of internal control can be

categorized into six facets namely: detect errors and fraud, limit unlawful practices, improve the proficiency of a commercial organization, improve the quality of financial data, help create a commercial viable venture and reduce auditor fees. Stratton (2007) also stipulates that process of assessing the structure of internal controls by the board of directors as well as the external auditors is critical. An effective internal control mechanism can boost commercial banks' profits and results by reducing the level of fraud and loss. Sarens and De Beelde (2006) confirm that establishing controls and balances in commercial banks allows management to minimize inherent losses and wasted resources. In general, financial institutions with weak internal control systems are more susceptible to low income due to irregularities and errors.

**The internal control framework**



Figure 1.1: Internal Control Framework Model

Source (COSO, 2013)

The internal control framework, as shown in Figure 1.1 above, applies to the entire control system, both financial and non-financial, established by management to conduct the company's business in an orderly and efficient manner (Okozie, 1999). According to Hayes et al. (2005), internal control consists of five elements; control environment, entity risk assessment process, information and communication systems, control activities and control supervision. Rezaee (2002) adds that effective internal control systems enabled commercial banks achieve their goals in terms of financial results, minimize or prevent the loss of resources, allow the creation of reliable financial data and ensure the activities of the entity comply with law and regulations. As shown in Figure 1.1, there is a strong correlation between the goals pursued by the company, components representing the needed ingredients to attain the goals, and the entity's setup of the entity (operational units, legal entities and others). The illustration can be represented as a cube. Three categories of objectives; Operations, reporting and compliance are represented by columns. The five components of internal controls are represented by rows. The organizational structure of the unit is represented by the third dimension.

#### **2.1.3.1 Control Environment**

The control environment includes the honesty, compliance to organizations ethics and know-how of the organizations staff, the procedures and processes of assigning power and duties to systematize and shape the staff; the way the company directs the activities of the company, as well as the philosophy and operational style of management. A very efficient and effective board must be available to provide oversight. It must accept that the "tone at the top" and the approach to risk control affect the procedures and processes in the company.

One of the responsibilities of the board is to review the procedures and processes in the company with respect to the adequacy and how effective these procedures and processes are in achieving the corporate goals of the company. For example, the council should seek explanations from previous results to determine that the derived actions are effective in achieving the purposes for which they were used. (COSO, 2012). The control environment visualizes the speed of the board's management and bank management, as well as its perspective, assigning a level of importance sufficient for all banking operations. The control environment reveals changes made by the bank's management board and government team to secure and maintain an appropriate internal control structure (Kamuthinidevi, 2016).

The control environment includes creating structures, establishing a commitment to integrity and ethical values, demonstrating authority and responsibility, implementing supervisory responsibilities, demonstrating a commitment to competition, and completing cancellations (Akwaa-Sekyi and Moreno, 2016). The control environment provides an organizational culture that controls employee perception in an organization that is morally honest, has good business conduct, adheres to, and operates within the organization's established practices and standards (Coca-Cola Amatil, 2011). In addition, the internal control environment includes setting the appropriate tone by the senior management of each organization that demonstrates the right approach to internal control (COSO, 2013). By creating the right credit risk environment, Basel (2000) presented three principles.

The first rule demands that the board of the organization takes the responsibility to review and approve on regular basis the strategy and policies for managing credit risk and relevant

bank policies regarding credit risk. The approved strategy to manage default risk should showcase the bank's acceptable and tolerable risk level and the quantum of profit that the organization expects to make in order to bear a series of credit risk from Basel (2000). The second principle is that senior management must bear the responsibility for implementing the approved strategy with respect to credit risk and policies by the board. The senior management in implementing the approved credit risk strategy, they must develop processes, activities, controls and policies to make identification, measurement and monitoring of credit risk easy. The credit risk activities, controls and policies should be part and parcel of all the activities of the banking operations, both at the level of individual loans and portfolio (Basel, 2000).

The last rule to establishing a good credit risk environment demands that the identification and management of credit risk is inherent in all the operations of the bank with respect to the services and products of the bank. The management of the banks should streamline their operations to make sure that the risk inherent in the activities are subject to appropriate risk policies and procedures prior to their introduction or take-up and prior approval by the board of directors or its relevant committee (Basel, 2000). In addition, Fotoh (2005) states that the responsibility for the implementation of the credit risk strategy encompasses making sure that the bank's lending activities comply with the strategy, developing and implementing written procedures, and assigning clear and appropriate responsibilities related to approving and reviewing of loans. Senior management must also ensure periodic independent internal assessment of administrative functions and the granting of credit by banks.

### **2.1.3.2 Control Activities**

The control activities are linked to the processes, measures and methods put in place by the board and implemented by senior management to ensure that activities are working to plan (Aikins, 2011; Rezaee et al., 2001). The precise proper records of procedures and processes goes a long way to determine how the processes and procedures are going to be implemented. It also gives general guidelines to external auditors to enable them assess the overall efficacy of the control activities and the lapses in the internal control structure as part of the audit work (Aikins, 2011). Again the control activities enable the organization to institute the necessary actions to reduce the risk so that the organization's goals are achieved. In the view of Rezaee et al. (2001), internal control covers every facet of the entity.

They cover a variety of activities, such as; approving transactions, authorizing transaction, verifying transactions and documents, reconciling figures and statistics, reviewing operational results, asset security and segregating duties. Majority of them are achievable by courtesy of the internal audit department. Control procedures are orders, rules, methods, decisions, rules and procedures ensuring that executive instructions are executed in a timely and correct manner (Jackson and Stent, 2014). These control activities include information processing, performance reviews, segregation of duties, and physical controls. These tasks and activities are implemented to ensure the achievement of the organization's goal and tasks, as well as risk reduction (Caselli, Gatti and Querci, 2016). Management establish these controls of the various responsibilities to limit the risk or control the risk that could affect the institution in achieving its objectives. Established measures regulating these control activities must also ensure that the team that establish these activities do not analyze

their own work in these areas (Ndenge et al., 2015). Control activities are instituted in the organization to tackle the risk identified by the bank.

The concept of control activities is made up of two steps: (1) the institution of control procedures and policies; and (2) confirmation of the compliance of the policies and procedures instituted in the organization. The control activities cover the entire organization from the top management to the lowest ranked person in the organization. Examples of control activities include: reviews by top managements, controls over activities, physical controls, compliance with exposure limits, approvals and authorizations, verifications and reconciliations. The effectiveness of control activities depends on the posture of management and other personnel towards internal control system in the organization. Where management and other staff see control activities as being an integral part of the organization, the whole community of employees will buy into it. This is because they see the control activities as being part and parcel of the organization and not an additional daily activities required by the organization. When controls activities are seen as add-ons, employees often times see the control activities as not important at all.

This is because if they were that important, then it would have been an integral part and not just an add-on. Another effective attribute of a sound internal control structure is that there is an effective method of segregating duties which is a concept build into the internal control system to ensure that there are no conflicting and duplicative responsibilities.

According to Abbas and Iqbal (2012), control activities include the identification and development of control system activities and implementing measures established throughout the organization. It is about maintaining precautionary measures and

establishing effective risk levels through acceptable levels of risk tolerance through strategies, projects and balances. Akwaa-Sekyi and Moreno (2016) found that bank control activities significantly minimized credit risk among banks in Spain

### **2.1.3.3 Risk Assessment**

According to COSO (2012), each institution whether big or small, profit oriented or non-profit oriented faces various types of risk from the internal environment or from the external environment. Risk is described as the propensity that an entity or process or procedure will not go as planned and the inability for it to go as planned will have negative effect on the organization with respect to achieving the objectives of the organization. Risk appraisal includes a dynamic and iterative process of risk identification and assessment to achieve goals. The risk associated with achieving these objectives in the entire entity is considered in relation to the established risk tolerances.

Therefore, risk evaluation is the starting point for assessing how to manage risk. Risk evaluation is a process and procedure in which an organization identifies and analyzes all risks related to the ability to achieve organizational goals (Cascarino and Van Esch, 2012). Risk assessment covers all processes and procedures that direct the management board and administration of a bank in assessing risk options that could hamper the bank's achievement of its objectives (Kamuthinidevi, 2016). This element focuses on the exact identification of the types of risk that are present in the organization, ways to manage the identified risks and the identification of correct controls should be established (Akwaa-Sekyi and Moreno, 2016). There are many banks that have run into troubles and suffered severely because they failed assess and evaluate the risk associated with the introduction of new products and

services. In some instances, the banks suffered because they fail to updated and streamline the banks risk assessments when the macro and micro variables in the business environment changes.

It must be noted that the fact that control structure or activities works well with traditional or simple products cannot support more sophisticated or complex products. Again the fact the internal control structure was very strong last year or two years ago does not necessary mean that it is currently strong as it used to be some months or years ago. The banking environment is very dynamic and thus banks should continually monitor the effectiveness of the internal control structure. Banks deal with risk-taking (Karagiorgos et al., 2009). Banking is a risk-related activity due to the fact that all of its activities are inherent with risk and uncertainty. Thus risk assessment is a vital activity to be perform by all financial institutions such as banks. This is because risk is found in all the activities of banking. Risking taking is part and parcel of the core business activity of banks. Thus it is very crucial that the risk assessment facet of the internal control system is given a high consideration. From the angle of internal controls, an effective system of risk assessment should have the capacity to make identification and evaluation all the internal and external factors that have the propensity to prevent the organization from achieving its corporate objectives.

The internal factors include the structure of the organization, the nature of the bank's activities, the competency of the employees, the level of changes in the organization and the rate of turnover of staff whiles the as external factors include the unstable macroeconomic conditions, changing trends in the industrial environment and

technological advancement. These factors can hamper the bank from achieving bank's corporate goals. Thus risk assessment process should cover units within the bank and the entire operations of the bank.

#### **2.1.3.4 Information and communication**

According to COSO (2012) information is the blood for the smooth functioning of internal control structure to ensure the achievement of the objectives of the bank. The smooth management of banks or any organization depends on reliable, relevant, timely and high-quality information generated internally or externally. Communication on the other hand is the transmitting, sharing and providing necessary information for the purposes of decision making. There is internal communication and external communication. Internal communication is the sharing of information within the confines of the organization, it could be from top to bottom or from bottom to top or even horizontal communication. External communication is the interaction between the entity and stakeholders and the environment in the outside world.

BCBS (1998) states that a well-functioning internal control system dwells on adequate and complete data and information from the external environment.

The information and communication structure helps incoming employees appreciate their tasks in the control structure, the relationship between their duties and responsibilities (Kamuthinidevi, 2016). Information systems generate various reports on the day-to-day operational activities of the bank and that helps management and board to execute banking processes. Information systems that facilitate these information systems must be physically and logically protected to ensure that stored information is not lost (Dedu and Chitan,

2013). Accounting systems use the methodology used to identify, collect, evaluate, group, record and outline bank transactions (Caselli et al., 2016).

To ensure the operational continuity of banks, it is necessary to implement appropriate support procedures. The banking organization should implement measures ensuring access to all data and information to all players in the bank and on time. This will allow them to perform their tasks (Abbas and Iqbal, 2012). Sufficient facts and mastery of communicating right are very critical for the effective running of the internal control structure. From the bank's point of view, the information must be pertinent, dependable, well-timed, available and presented in a stable format to be useful (Caselli et al., 2016).

The organization's information differs from internal information to external information, i.e. from financial information, through operational, to compliance and finally information about events and conditions. All this affects decision making (Dedu and Chitan, 2013). Internal data is part of the record keeping method, which must include specific record keeping processes. An important element of the bank's operations is the responsibility of GIS, which covers the full scope of its operations, generally provided electronically and non-electronically (Ndenge et al., 2015).

Bank employees who process up-to-date, reliable and fearful information can effectively manage, perform and manage their operations, especially in the area of credit services. The emphasis on information and communication affects the quality and accuracy of information about the borrower. Therefore, it must be timely, appropriate, accurate, current and available (Owusu et al., 2017). These principles are of key importance and should be taken into account when designing the internal control structure not only in banks but also

in other institutions. Without this, the components of the control system cannot function internally as a whole. The information and communication system must be able to identify, register, process and inform (Ofosu-Okyere, 2014).

#### **2.1.3.5 Monitoring**

The last component of the internal control structure is monitoring which is the practice of verifying the capacity of the existing internal controls and the assurance that the existing control system can enable the organization to achieve its corporate goals. The business world is dynamic and thus the control needs to be critically monitored to ensure that the control system is serving its purpose in the organization with respect to its effectiveness and efficiency. Through monitoring, the organization ensures rapid determination of audit results and other reviews (Theofanis et al., 2011; Rezaee et al., 2001). Amudo and Inanga (2009) add that it is the monitoring of the system that determines whether the employees and management are complying with the procedures and practices developed and implemented by the board and senior management respectively. Credit monitoring is an aspect of risk management that is important for the growth and financial stability of banks and their clients.

It was observed that the financial crisis in 2008 provided an important reason why banks need to monitor credit risk. In fact, banks can expect to meet financial requirements and expectations by effectively reducing credit risk (Babel et al., 2012). When a borrower incurs unexpected losses, his probability of bankruptcy increases, and thanks to the family mechanism of moral hazard, his motivation to invest optimally decreases (Myers and Majluf, 1984). While this may seem good and simple, the diversity in bank credit monitoring practices is far greater than one would expect. It has been argued that although

banks with efficient credit monitoring practices and effective early warning systems identify risky customers six to nine months before serious problems, others may only realize this once the customer has expired or ratings have deteriorated significantly (Babel et al., 2012).

This implies, by default, that the later a bank responds to a deterioration in customer credit risk, the less opportunities it can protect this bank against losses. In fact, financial institutions have different strategies for monitoring their clients' credit to ensure that credit risk is minimized. However, differences in the effectiveness of credit monitoring approaches are also evident in the case of credit conversion rates or the extent to which customers have been able to buy unused loans in the past year before they did not apply. It can be said that site visits, customer advice, organization training programs in financial education and continuous verification of business results are some of the traditional means by which banks can monitor the use of effective credit from customers.

#### **2.1.4 Internal controls and credit risk management in commercial banks**

The relevance of the system of internal control is to minimize information asymmetry, enhance transparency in all business transactions and protect shareholders from ruling power (Salhi and Boujelbene, 2012). A careful check on most financial statements often reveals large amount declared as bad debts or non-performing loans. This was indicated by the American Institute of Certified Public Accountants (AICPA) (2006) as the number one bank shortfall. Adherence to strong and effective internal control is an important factor in building investor confidence and provides the entities with a substantial quantum of reputational capital. The negligence with which bank's initiate, finance, manage and

monitor a loan usually leads to bankruptcies, crises and bankruptcies. Jin et al. (2013) discovered that banks with weak, inefficient and ineffective internal control may appear to be doing well but under its sleeves, it will be hot water and may fail in the future. The situation of weak internal controls will affect the going concern of the bank in the long run.

The number one cause of the failure and collapse of financial institutions such as banks is the concept of default or credit risk, which occurs as a result of a borrower defaulting before repayment period ends. The onus always lies with the granting institution and in this case the bank screen potentials borrowers to ensure their credit worthiness in the repayment of the loan. No client is a bad borrower but a granting institutions such as a bank can be term as a bad lender. The trail of the collapse of banks is that default risk results in liquidity risk, followed by default, then bankruptcy and then bankruptcy. When banks collapse, the most affected categories of people are the depositors, investors and external partners of the bank. The Basel Committee on Banking Supervision propounded the credit risk internal control system to ensure there are adequate measure taken by banks to mitigate against the threat of default so as to promote and protect the public confidence in the banking system.

Evidence from the many bank failures around the world all stem from the poor management of default risk. In other words, credit risk is the principal cause of the collapse of banks in the world. Banks benefit from converting their liabilities into assets, so optimal risk-reward behavior is encouraged, but bank managers are required to be cautious with their directors (fiduciary relationships). Moral risks and unfavorable selection result from counterparties' use of the information economies, and can best be minimized if management is extremely cautious in their role in creating assets. There is ample empirical

evidence that loans represent the largest proportion of banking assets (Casu et al., 2006; Mishkin, 2006). Ellul and Yerramilli (2013) discovered that banks with an effective, efficient and strong system of internal controls are able to stand firm in the midst of the worse financial crises. Thus the financial will not be able to affect negatively the operations of the bank.

However, the banks with a weak and inadequate internal controls will fall with the minimal levels of financial crisis. It is not uncommon for bank managers to over-create high-risk assets (lines of credit) in the name of higher return expectations. While there are countless elements that leads to default risk or credit risk, the most sensible solution would be to institute strong system of internal controls and that internal controls must be implemented effectively to ensure the controls are complied with by all employees with the bank including the board and senior level managers.

Most of the challenges or problems faced by banks is attributable to the weaknesses in internal control system with respect to credit risk management. Many credit problems reveal underlying deficiency in the monitoring and lending process. Therefore, many credit problems could be avoided or mitigated through a strong internal control system that includes credit risk. In the case of commercial banks, competitive pressures and the development of syndicated techniques create time constraints that interfere with basic compliance with internal control including credit risk management. Due to weak internal control systems in commercial banks, senior management and board members may override internal controls. This includes lending to companies you own or with whom you

are associated, personal friends, people with a good financial reputation, or pursuing personal goals such as cultivating special relationships with celebrities.

### **2.1.5 An overview of the banking system in Ghana**

The financial sector in Ghana has made a huge contribution to the country's emerging economy. The sector has contributed hugely to the economic development of Ghana by providing credit lines to individuals and commercial companies. The numerous financial institutions located in every city and town in Ghana have afforded individuals and businesses the opportunity to demand for loans for various purposes. Almost every town in the country has a form of financial institutions to satisfy the financial demands of the citizens. The Bank of Ghana which is the central bank is the regulator as far as the banking industry is concern. It has the final say in all banking activities and gives directives of which all players in the banking industry must comply because noncompliance can lead to revocation of the banking license by the central bank. Their role is to ensure a solid and sound environment for the business of banking in Ghana.

Thus all players in the banking industry must comply with the directives of the central bank. The banking sector of Ghana is quite saturated with 23 commercial banks and several other financial institutions such as rural and community, saving and loan companies, micro finance institutions, credit unions. In recent years the central bank enhanced its supervision and monitoring role as a regulator. This has led to the revocation of the banking license of seven commercial banks in Ghana for failing to meet regulatory requirements. Banks in Ghana can offer all kinds of services because they are inspired by the concept of universal

banking. As at the beginning of 2019, there were 23 commercial banks in Ghana. This was after the banking crisis and the increase in the minimum capital by the central bank.

## **2.2 Theoretical Review**

According to Kothari (2008), a mutual relation of facets and propositions that highlight the relationship between variables that aid in predicting an occurrence. Reviews of theories that are related to the study are presented in this subsection.

### **2.2.1 Information Theory**

The theory stresses that debtors should be diligently screened by banks through credit assessment before their issued with loans (Derban, 2005). The theory of symmetric information demonstrates that collecting consistent details from potential borrowers is crucial in order to achieve a perfect screen. Adequate customer information, reviewing of loans and risk rating system allow the personnel behind it to recognize gradual changes in individual credits. Evaluation of borrowers can be done using qualitative and quantitative approaches, although the use of qualitative model is subjective. Nonetheless, different features of borrowers measured using qualitative models can be allocated figures and the sum of the values compared to onset (Derban et al., 2005). This method lowers the cost of production, reduces independent decisions. Any adjustments in the foreseen dimension of credit advance misfortune will make the rating frameworks significant.

Brown (1998) concluded that quantitative models enables banking institutions to numerically ascertain the characteristics that are essential in explaining risk of nonpayment, highlighting all bad loans applicants for disqualification, improving nonpayment risk price, evaluating the level of importance of the elements involved and

calculating reserve required to meet post-loan losses. Default, crisis, and bank failure tend to cause the inaccuracy with which loans are launched, financed, serviced, and controlled. The relevance of this model to the analysis emphasizes strong internal controls especially relating to risk assessment and usefulness of operations, information validity and compliance with set standards that ensures reduction of credit risks and survival of banking institutions.

### **2.2.2 Contingency Theory**

Chenhall (2003); Luft and Shields (2003) posits that every company has to select the most appropriate control system considering its contingency characteristics. Further, Donaldson (2001) emphasize that there exists a correlation between contingency characteristics and internal control structure; contingency features influence internal control structure. In addition, the author asserts that every stage of contingency facets has a fit of the level of the internal control structure. Due to the differences in organizational features, the internal control framework emphasizes the development of contingency characteristics that are different (Girinjnas, 2009). The factors that determine these differences include organization measure, culture, administration theory, destinations, operational condition (Girinjnas, 2009; Lakis, and Girinjnas, 2012). However, these factors vary from one organization to another based on their goals and objectives. 14

Basically, contingency theory approach explains the diversity of internal controls (IC) (Jokipii, 2010). The key fundamentals of contingency theory are chosen to be the backbone of internal control framework of COSO and Basel. Hence the relevance of this model to the analysis provides an approach to research internal control and its effectiveness in

relation to credit risk. This is more so to the banking institutions which are facing constant dynamics in organization's operations that requires new internal controls and also changing times in the business world.

## 2.3 Conceptual framework

### Internal Controls

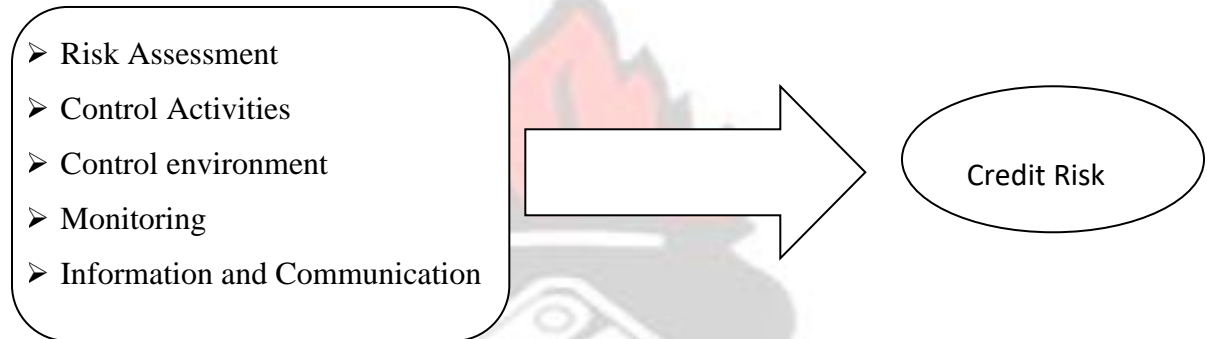


Figure 2.2. Effect of internal controls on credit risk (Author's construct)

The conceptual framework covers the facets of the internal control system and how it relates or affects credit or default risk. Thus how does the elements of control environment, risk assessment, control activities, information and communication and monitoring affects the management of credit risk in the banking sector or industry. The number one goal of internal control are effectiveness and efficiency of operations and in the case of this study the efficiency and effectiveness of credit risk operational management. The study considered these cardinal goals of internal control as well as preventive, detective and curative features.

## **2.4 Empirical Review**

### **2.4.1 Risk Assessment**

In current terms, every financial institution due to the nature of its work or core business is exposed to a certain level of risk. Kessey (2015) also conducted a study to examine the processes and challenges of credit risk management plan in the Ghanaian banking industry. The study reveals that financial institutions face difficulty in managing credit risks especially banks that do not implement the credit policy as indicated in the credit manual policy as well as internal controls.

### **2.4.2 Control Activities**

Tunji (2013) also did a study which focused on quality internal controls system as a remedy for challenges facing the banking sector in Nigeria. The study discovered that most of the banks in Nigeria had Internal Control Systems (ICS)

Cho and Chung (2016) assess the impact of the weakness in universal banks system of internal control bad debts and provisions for bad debt. This inspection showed that banks with poor internal controls combined with good policies gradually lowered their loan loss provisions.

Jin, Kanagaretnam, Lobo and Mathieu (2013) conducted a study to ascertain the usefulness of internal control systems. It inspects whether the agency problem exists among European Union banks. The study revealed that if banks comply with internal controls, the risk will be reduced, thus they will not fail.

### **2.4.3 Control Environment**

Akinyomi (2010) conducted a study to assess the impact of internal control systems on the operations of commercial banks in Ghana. He found out that there is a direct correlation between risk assessment and internal controls. According to Tunji (2013) most of the commercial banks in Nigeria had internal control system but management do not lay much importance on the Internal control systems and as a result there were poor risk assessment measures. The above findings were on a study done by Tunji (2013) on the quality of internal control systems as remedy for challenges facing the banking sector in Nigeria.

In another study done in eastern African, Angella and Eno (2009) examined internal control systems in Uganda, their study focused on accessing the internal control tools that had earlier been approved by countries that are members of African Development Bank Group. They concluded that several elements of the internal control structure needed proper execution.

### **2.4.4 Monitoring Activities**

Abiola and Oyewole (2013), in their study on the impact of the internal control system on credit risk when using certain banks in Nigeria show a strong link between risk assessment and credit risk.

Akwaa-Sekyi and Moreno (2016) conducted a study to assess Impact of internal controls on credit risk among banks in Spain. They established that established that credit risk was heavily impacted by risk assessment.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.0 Introduction**

The chapter focuses on the methodology adopted for this study to gather the data required to achieve the objectives of this research. It covers the research design, population under study, sampling techniques and methods of data analysis.

#### **3.1 Research Design**

The design for a research gives the description of the activities and procedures put in place to gather the needed data to achieve the objectives of the study so as to solve the problem statement (Babbie, 2002). With respect to the strategies for undertaking a research study, there are two methods namely: qualitative and quantitative (Thietart, 2001). The quantitative approach covers studies that deals with numbers and quantities where the statistical analysis are used to present the results of the study (Krishnaswami & Satyaprasad, 2010). This approach deals with tests rather than constructs (Thietart, 2001). Qualitative research on the other hand is the opposite of quantitative and it covers situations where there is emphasis on construct and use of non-statistical data and numbers (Krishnaswami & Satyaprasad, 2010). Yin (1994) stated that the purpose of research is categorized into explanatory, descriptive or exploratory. The research adopted a quantitative approach with a descriptive design. The study adopted a descriptive design so that the researcher could obtained deep level information about the concept of internal controls and credit risk so as to achieve the objectives of the research. The data collected on internal controls and credit risk also afforded the researcher to make useful recommendations to the management of commercial banks in Ghana.

### **3.2 Population**

According to Polit and Beck (2006), study population is described as the total group of individuals, entities or objects of which the researcher has much interest in with respect to achieving the objectives of the study. In this research the population was made up of all commercial banks in Ghana. In all there are 23 commercial banks currently in Ghana.

### **3.3 Sampling Procedure**

Sampling is regarded as a means of selecting the appropriate number of units from a defined population (Kothari, 2012). These units represent people or organizations so that by analyzing the findings of the sample it could be uniformly generalized to represent the entire intended population (Trochim, 2005). The technique that was applied to select respondents was quota sampling and purposive sampling technique. To ensure a fair representation from all the commercial banks in Ghana, quota sampling was used to select five (5) respondents from each of the 23 commercial banks in Ghana. Purposive sampling was used in selecting the five respondents from each bank depending on their suitability for this study. This was because the researcher chose the respondents who were appropriate for the study. According to Marre (2007), purposive sampling is a sampling technique whereby a researcher targets a sample from a population who are most likely to provide best information to satisfy the research study's goal. The target respondents included the risk managers, compliance and monitoring managers, internal auditors and credit managers from the selected banks. These respondents were chosen from the population because they were believed to be knowledgeable with the topic under research. Thus the total sample size was 115 respondents.

### **3.4 Data Collection**

According to Gillis and Jackson (2002), the process of obtaining relevant data from respondents to answer the research questions so as to achieve the objectives of the study is a very crucial component of the research methodology. The instruments used for the gathering the data from the respondents comes in several forms such as observations, questionnaires, interviews, and checklists. In conduction of research, the data which is used is either primary data or secondary data. Secondary data is an already existing data which is produced by another person or entity of which the research was not part. Primary data is an original data first produced or collected by the researcher (Hair et al., 2007). Primary data is the first hand data collected by research to assist the researcher in achieving the objectives of a study while secondary data is an already existing data produced by a person or entity other than the researcher, however the researcher use such data to assist in achieving the objectives of a study. (Ghauri & Grönhaug, 2005; Saunders et al, 2003). In this study, the researcher used primary data. Structured questionnaire was used to gather data from key respondents purposively selected across the 23 banks.

### **3.5 Data Collection Instruments**

Questionnaires have been the main instrument used to collect raw/primary data. They are ideal since they are easy to administer and do not consume a lot of time to administer and to be filled (Mugenda & Mugenda, 2003). The structure of the questionnaire used was based on the objectives of the study. The first section of the questionnaire captured the demographics of the respondents. The rest of the sections were based on the objectives of the study. A five-point Likert scale was provided to respondents where 5 indicated he strongest agreement to the stated question and 1 indicated the lowest disagreement. In using

the Likert scale, the respondents were given statements to which they indicated their level of agreement or disagreement.

Before administering of the questionnaire, an introductory letter was delivered to the heads of the 23 Commercial banks explaining the purpose for the study. The researcher in delivering the letters took the opportunity to familiarize and interact with the Bank Managers and Human Resource Managers as well as observe the staff. The observatory knowledge of the staff came in handy during the purposive selection of the respondents for the questionnaire. The respondents so selected were given ample time to independently complete the questionnaires and return in sealed envelopes.

### **3.6 Validity and Reliability of Instrument**

Selection of instrument requires extensive examination of its validity and reliability (Burns & Grove, 2001). The purpose is to produce trustworthy evidence that can be used in evaluating the outcomes of a research study. Validity is the degree to which an instrument measures what it is supposed to measure (Polit & Hungler, 1999). The questionnaire was constructed by the researcher and carefully scrutinized by the researcher's supervisor who determined the content validity of the items. This was to refine the items on the questionnaire. The instrument was pilot tested with 5 staffs from one of the commercial banks. This was to sharpen up the items on the instrument so that respondents would have no problem in answering the questions. However, the few items which were found to be misleading were reconstructed to facilitate their meaning and understanding before they were taken to the field for the main study.

Reliability is the consistency with which an instrument measures the attribute (Polit & Hungler, 1999). Data collected from the pilot test were coded and subjected to complete item analysis so as to determine the internal consistencies of the instrument. The Cronbach alpha value obtained for the questionnaire items was 0.79. This showed that the items on the instrument were reliable and could be used for the study. As indicated by Pallant (2001), scales with Cronbach's alpha co-efficient of 0.70 or more are considered to be reliable.

### **3.7 Ethical Considerations**

This study required the involvement of human participants and for that matter certain ethical issues were considered. The consideration of these ethical issues were crucial in order to ensure the privacy and safety of the respondents. In view of this, the significant ethical issues well-thought-out in this research process included assent and confidentiality. The researcher made known all relevant details of the study including its aim and purpose to the respondents so as to secure their assent. This coerced the research participants to understand the significance of partaking in the research process. Moreover, names or personal information of respondents in the research were not disclosed in order to ensure the confidentiality of the research participants. Only relevant details required in answering the research questions were included. Nevertheless, respondents were given the option to withdraw from the process if they wanted to which further indicates that respondents were not forced to participate in the research process.

### 3.8 Data Analysis

The research adopted a descriptive design with a quantitative method. Thus questionnaire was the main data collecting instrument. The collected questionnaires were coded and entered into the SPSS software. The data obtained was analyzed descriptively using frequencies, mean and standard deviation.



## CHAPTER FOUR

### RESULTS AND ANALYSIS

#### 4.0 Introduction

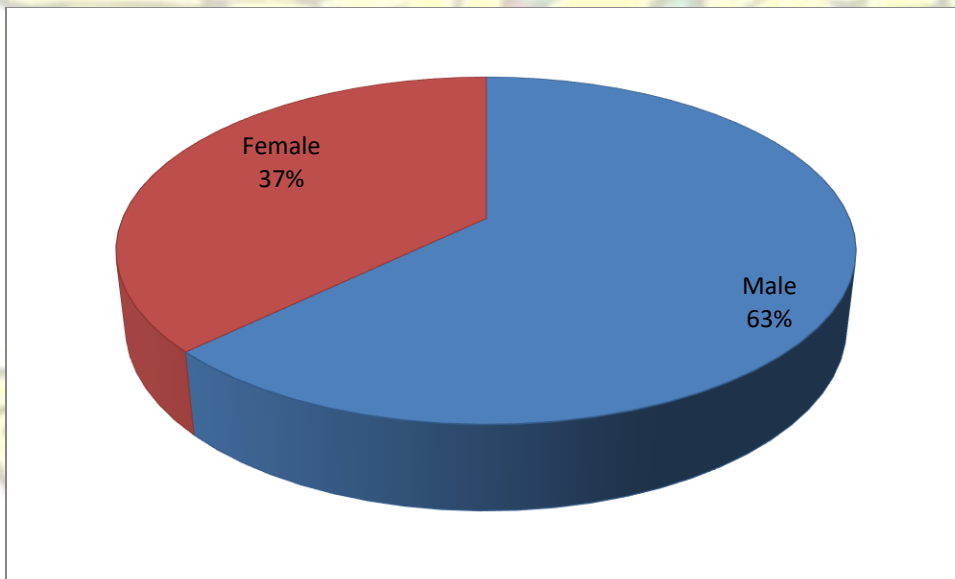
This chapter shows the results and analysis of the data collected through the questionnaires. The chapter also discussed the findings in relation literature. Descriptive data was presented in the form of tables, pie charts and bar graphs.

#### 4.1 Demographics

##### 4.1.1 Gender of respondents

In relation to the gender of the respondents, males were 63% of the total respondents while females made up 37% of the total respondents. Thus there was a mixture of both males and females to give their responses in relation to credit risk and internal controls.

Figure 4.1: Gender of respondents

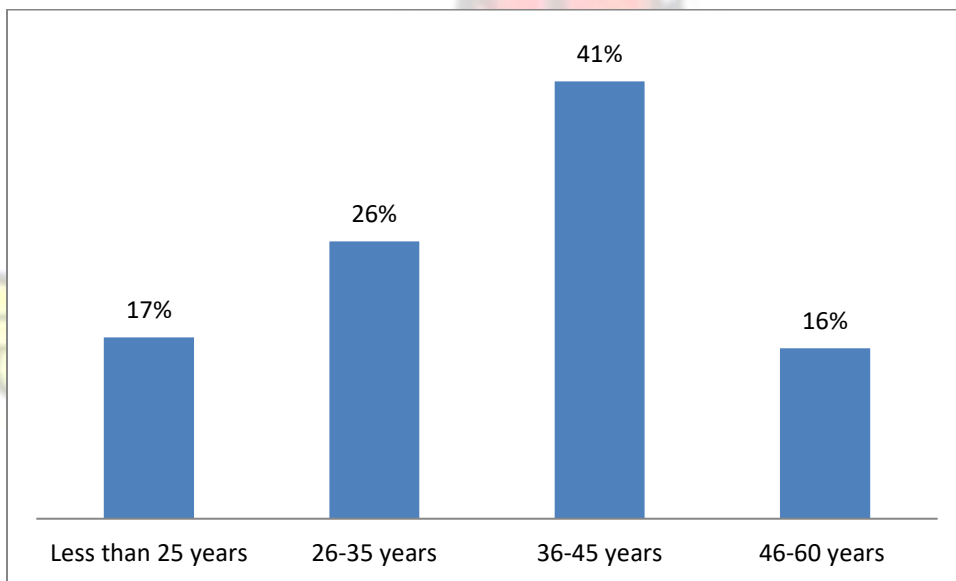


Source: Field work (2020)

#### 4.1.2. Age of respondents

Majority of the respondents, 41% of the total respondents were in the 36-45 age bracket. The age bracket with the least number of respondents was the age bracket of 46-60 with only 16% of the total respondents. Again, 26% of the respondents were in the age bracket of 26-35. Lastly there were 17% of the respondents who are less than 25 years old.

Figure 4.2: Age of respondents



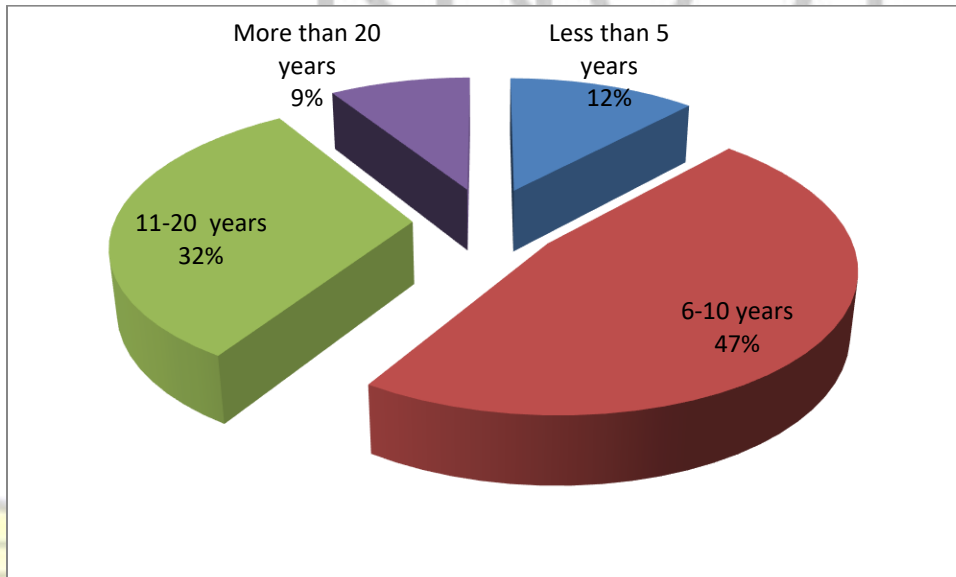
Source: Field work (2020)

#### 4.1.3 Number of years worked

With respect to the working experience of the respondents, 47% of the total respondents had worked for between 6-10 years while another 32% of the respondents had worked for between 11-20 years. Additionally, 9% of the respondents had worked for more than 20 years. Lastly, 12% of the respondents had worked for less than 5 years. This was a

clear demonstration that 88% of the total respondents had worked for more than 5 years. Thus the respondents had the necessary working experience to answer the questionnaire.

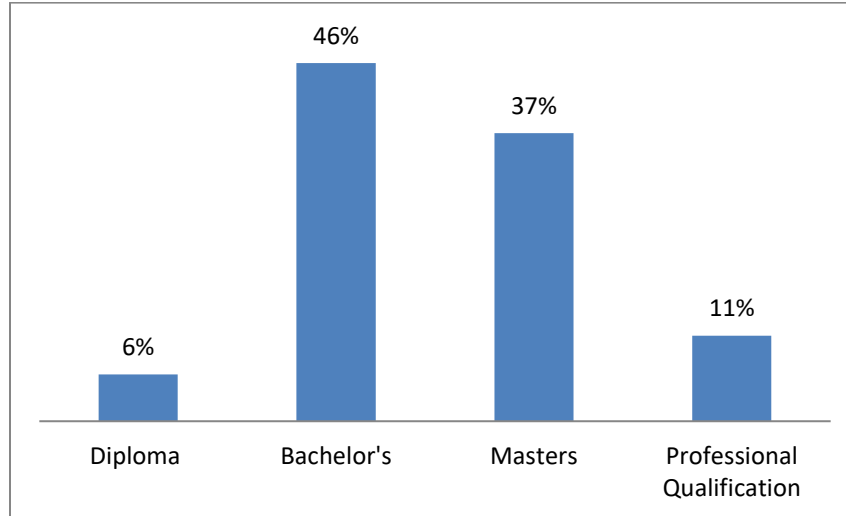
Figure 4.3: Working experience of respondents



#### 4.1.4 Educational level of respondents

In relation to the educational level of the respondents, majority of the respondents being 83% of the total respondents either had a bachelor's degree or a master's degree. Again 6% and 11% of the respondents had diplomas and professional qualifications respectively. Again this demonstrate that the respondents had the necessary educational capacity to respond to the questionnaires.

Figure 4.4: Educational levels of respondents



#### 4.2 Credit risk in commercial banks

The first objective of the study was to examine the credit risk in commercial banks. The results pertaining to the first objective is captured in table 4.1 below. With respect to the table 4.1, The assertion that “The banks had a well-documented credit risk management policy” recorded a mean and standard deviation of 4.34 and 0.78 respectively. A mean of 4.34 on a 5-point Likert scale means that most of the respondents, being 86.8% of respondents, cumulatively agreed that their banks have a well-documented credit risk management policy. This was further confirmed by the median and mode of 4. The assertion that the banks conduct proper credit assessment had a mean of 4.14 and standard deviation of 0.96. Thus majority of the respondents (82.8%) were of the view that their bank conducts proper credit assessment before loans were given out. This was confirmed by the median of 4 and mode 5. The respondents were further asked whether credit controls were being observed appropriately in the banks. The results in the table below (table 4.1) showed that the credit controls were observed appropriately in the banks recording a mean

of 4.22 and a standard deviation of 0.95 which stipulates that 84.4% of the respondents cumulatively agreed that credit controls were observed appropriately in their banks. The respondents were further asked about the existence of credit manual to regulate the credit granting function. As indicated by the table, the assertion that the banks had a credit manual that documented and elaborated on the strategies for managing credit recorded a mean of 4.41 with a standard deviation of 0.74. The interpretation of this statistic is that; 88.2% being majority of the respondents cumulatively agreed that the banks had a credit manual that documented and elaborated the strategies for managing credit. The assertion that the banks had a credit manual that documents and elaborates the strategies for managing credit also recorded a median and mode of 4 and 5 respectively which further showed the level of agreement by the respondents to this assertion.

Table 4.1: Credit risk in commercial banks

	Mean	Median	Mode	Standard Deviation	Min	Max	Count
The bank has a well-documented credit risk management policy	4.34	4	4	0.78	1	5	86
The bank conducts proper credit assessment	4.14	4	4	0.96	1	5	86
Credit controls are observed appropriately in our bank	4.22	4	5	0.95	1	5	86
The bank has a credit manual that documents and elaborates the strategies for managing credit	4.41	4	5	0.74	1	5	86
There is proper underwriting of loans in the bank	3.45	4	4	1.23	1	5	86
Our bank offers more direct lending	3.01	3.5	4	1.55	1	5	86
Credit policies in the bank are inappropriate	2.35	2	1	1.42	1	5	86
The bank adheres to good lending practices	3.90	4	5	1.37	1	5	86

The respondents were further asked whether there was proper underwriting of loans in the banks. The results in table 4.1 above showed that there was proper underwriting of loans in the banks recording a mean of 3.45 and a standard deviation of 1.23 which stipulates that 69% representing 79 of the 115 respondents cumulatively agreed that there was proper underwriting of loans in the bank. The respondents were again asked about the offers of direct lending by their banks. As indicated by the table, the assertion that the banks offered more direct lending recorded a mean of 3.01 and a standard deviation of 1.55.

The respondents were further asked about the adherence to good lending practices by their banks. The results in table 4.1 above shows that the banks adhered to good lending practice recording a mean of 3.90 and a standard deviation of 1.37 which stipulates that the respondents cumulatively agreed that the banks adhered to good lending practices. Lastly, the respondents were asked of the inappropriateness of the banks' credit policies. As indicated in the (table 4.1), the assertion that the credit policies in the banks were inappropriate recorded the lowest mean of 2.35 with a standard deviation of 1.42. The interpretation of this statistic is that majority of the respondents cumulatively disagreed that credit policies in the banks were inappropriate. The assertion that credit policies in the banks were inappropriate recorded a median and mode of 2 and 1 respectively which further revealed the level of disagreement by the respondents to this assertion.

### **4.3 Internal Controls in commercial banks**

The second objective of this study was to assess the internal controls in commercial banks. In assessing the internal control of commercial banks, the study assessed the control environment, control activities, risk assessment and information and communication based on the COSO framework.

#### **4.3.1 Control Environment**

The respondents were asked series of questions to assess the control environment at the banks. The results are indicated in table 4.2. The assertion that the banks board periodically review policies and procedures to ensure that proper controls had been instituted recorded a mean of 4.5 and a standard deviation of 0.57. A mean of 4.5 on a 5 point Likert scale meant that majority, being 90% of the respondents stated that their banks' board periodically reviewed policies and procedures to ensure that proper controls had been instituted. The median and mode of 5 and 5 respectively further corroborated the fact that the banks' board periodically reviewed policies and procedures to ensure that proper controls had been instituted.

The assertion that there was a system in place to monitor compliance with policies and procedures and to report to the board instances of noncompliance in the banks recorded a mean of 4.23 representing 84.6% of respondents with a standard deviation of 0.52. This stipulates that most of the respondents, 97 out of the 115 respondents, agreed to the assertion that; there was a system in place to monitor compliance with policies and procedures and to report to the board instances of noncompliance in the banks. The median and mode of 4 each further confirmed the fact that many of the respondents agreed that

there was a system in place to monitor compliance with policies and procedures and to report to the board instances of noncompliance in the banks.

The respondents were further asked whether the banks had adequate information about the credit risk assessment process. As shown in table 4.2, the assertion that banks had adequate information about the credit risk assessment process recorded a mean of 4.48 and a standard deviation of 0.57 which meant that 89.6% of respondents, being the majority, agreed to that assertion. It meant that most of the respondents agreed that the banks had adequate information about the credit risk assessment process.

Again the assertion that banks board and management were committed to ensuring proper internal controls over a banks operation and credit control had a mean of 4.45 and a standard deviation of 0.75 which signifies that most of respondents (89%) agreed that their bank's board and management were committed to ensuring proper internal controls over the banks' operations and credit controls.

Again the assertion that the banks had set of codes of behavior or moral policies that guides employees in regard to credit risk also recorded a mean value of 4.29 and a standard deviation of 0.96. These statistics showed that most of the respondents agreed to the assertion that the banks had set of codes of behavior or moral policies that guides employees in regard to credit risk. The median and mode of 5 each further corroborated that fact majority of the respondents agreed that the banks had set of codes of behavior or moral policies that guides employees in regard to credit risk.

The assertions that respondents' banks had sufficient personnel who were competent and knowledgeable to manage the credit risk recorded a mean and a standard deviation of 4.30 and 0.97 respectively. Thus most of the respondents agreed that banks had sufficient personnel who were competent and knowledgeable to manage the credit risk.

Again the assertion that the banks had internal and /or external auditors who assessed the adequacy of the banks' internal control systems periodically also recorded a mean value of 4.47 and a standard deviation of 0.79. This statistic shows that most of the respondents agreed to the assertion that the banks had internal and /or external auditors who assessed the adequacy of the banks internal control systems periodically. The median and mode of 5 each further corroborated the fact that majority of the respondents agreed that the banks had internal and /or external auditors who assessed the adequacy of the banks internal control systems periodically.

Lastly, the assertion that there exist clearly defined authority and responsibilities of credit personnel in the banks recorded a mean and a standard deviation of 4.49 and 0.68 respectively. Thus most of the respondents agreed that banks had clearly defined authority and responsibilities of credit personnel in the banks.

Table 4.2: Control environment

	Mean	Median	Mode	Standard Deviation	Min	Max	Count
The banks board periodically review policies and procedures to ensure that proper controls have been instituted	4.5	5	5	0.57	3	5	86
There is a system in place to monitor compliance with policies and procedures and to report to the board instances of noncompliance in the bank	4.23	4	4	0.52	3	5	86
The bank has adequate information about the credit risk assessment process	4.48	4.5	5	0.57	2	5	86
Our banks board and management are committed to ensuring proper internal controls over a banks operation and credit control	4.45	5	5	0.79	1	5	86
The bank has set of codes of behaviour or moral policies that guides employees in regard to credit risk	4.29	4.5	5	0.96	1	5	86
The bank have sufficient personnel who are competent and knowledgeable to manage the credit risk	4.30	5	5	0.97	1	5	86
The bank have internal and /or external auditors who assess the adequacy of the banks internal control systems periodically	4.47	5	5	0.79	1	5	86
There are clearly defined authority and responsibilities of credit personnel in our bank	4.49	5	5	0.68	3	5	86

#### 4.3.2 Risk Assessment

With respect to risk assessment component of the internal control, the results are indicated in table 4.3. The assertion that the banks conducted proper credit risk assessment on borrowers before giving out loans recorded a mean of 4.6 and a standard deviation of 0.57.

A mean of 4.6 on a 5 point Likert scale meant that most of the respondents, that is 92% of the respondents, agreed that their banks conducted proper credit risk assessment on borrowers before giving them loans. The median and mode of 5 and 5 respectively further corroborated this fact.

The assertion that the banks' management were open to all communication about credit risks also had a mean of 3.73 with a standard deviation of 1.08. This stipulates that most of the respondents, being 74.6%, agreed to the assertion that the banks' management were open to all communication about credit risks. The median and mode of 4 each further confirmed the fact that many of the respondents agreed that the banks' management were open to all communication about credit risks.

The respondents were further asked about measures that enabled easy detection of non-performing loans in the bank. As depicted by table 4.3, the assertion that there were measures that enabled easy detection of non-performing loans in the bank recorded a mean of 4.27 and a standard deviation of 0.73 which stipulates that 85.4% representing majority of the respondents agreed that the banks had measures that enabled easy detection of non-performing loans.

Again the assertion that the banks carried out a comprehensive and systematic identification of its credit risk had a mean of 3.80 and a standard deviation of 1.24 which signifies that most of respondents (76%) agreed that the banks carried out a comprehensive and systematic identification of its credit risk.

Again the assertion that the banks' management and the board involved audit personnel or other internal control experts in the risk assessment process also recorded a mean value of 4.28 and a standard deviation of 0.96. This statistic shows that most of the respondents agreed to the assertion that the banks' management and the board involved audit personnel or other internal control experts in the risk assessment process. The median and mode of 5 each further corroborated the fact that majority of the respondents agreed that the banks' management and board involved audit personnel or other internal control experts in the risk assessment process.

The assertion that the management of the banks frequently evaluated the credit risk profile in order to be aware of the credit risk faced by the banks recorded a mean and a standard deviation of 3.69 and 1.58 respectively. Thus most of the respondents agreed that the management of the bank frequently evaluated the credit risk profile in order to be aware of the credit risk faced by the banks.

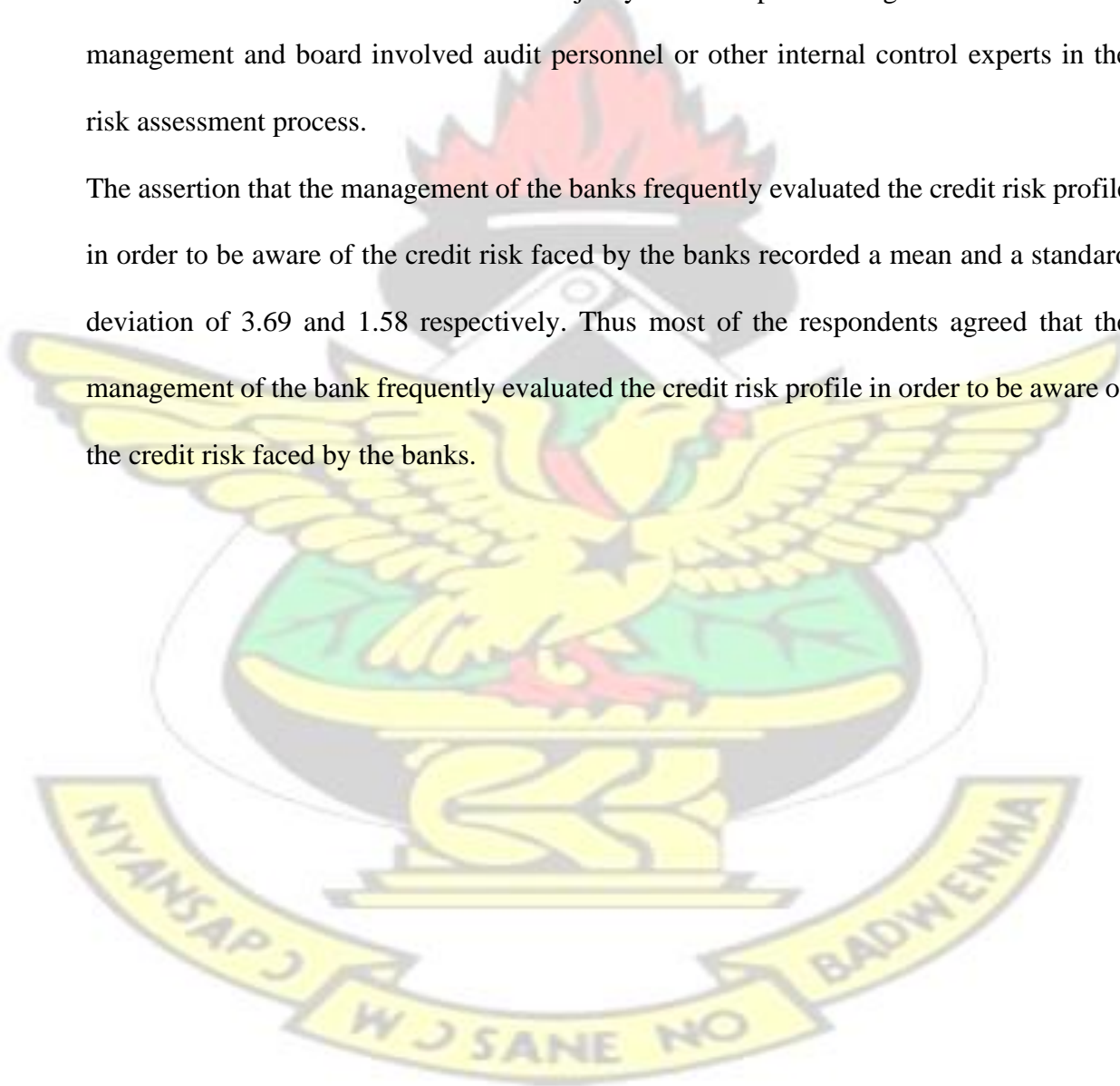


Table 4.3: Risk assessment

	Mean	Median	Mode	Standard Deviation	Count
Our bank conduct proper credit risk assessment on the borrowers before giving loans to its customers	4.6	5	5	0.57	86
The bank management is open to all communication about credit risks	3.73	4	4	1.08	86
There are measures that enables easy detection of non-performing loans in the bank	4.27	4	5	0.73	86
The bank carries out a comprehensive and systematic identification of its credit risk	3.80	4	5	1.24	86
The bank management and the board involve audit personnel or other internal control experts in the risk assessment process	4.28	4.5	5	0.96	86
The management of the bank frequently evaluate the credit risk profile in order to be aware of the credit risk face by the bank	3.69	4	5	1.58	86

### 4.3.3 Control Activities

With regards to control activities facet of the internal control system, the results are indicated in table 4.4. The respondents were first asked about the existence of policies and procedures that ensured credit decisions were made with appropriate approval. As per table 4.4., the assertion that The banks had policies and procedures that ensured credit decisions were made with appropriate approval recorded a mean of 4.14 and a standard deviation of 1.12. A mean of 4.14 on a 5 point Likert scale, accounting for 82.8% of respondents, means that most of the respondents agreed that their banks had policies and procedures that ensured credit decisions were made with appropriate approval. The median and mode of 4 and 5 respectively further corroborated the fact that the banks had policies and procedures that ensured credit decisions were made with appropriate approval.

The assertion that approvals and authorization of credit were clearly outlined in the banks' credit policy also had a mean of 4.13 with a standard deviation of 0.63. This means that most of the respondents agreed to the assertion that approvals and authorization of credit were clearly outlined in the bank credit policy. The median and mode of 4 each further confirmed the fact that many of the respondents agreed that approvals and authorization of credit were clearly outlined in the banks' credit policy.

The respondents were further asked about independent reconciliation of asset and liability balances both on and off the balance sheet. As depicted in the table (table 4.4), the assertion that the processes exist in the banks that ensured continuous and independent reconciliation of asset and liability balances both on and off the balance sheet recorded a mean of 4.22 and a standard deviation of 1.26 which stipulates that majority of the respondents agreed to that assertion that processes do exist in the bank that ensured continuous and independent reconciliation of asset and liability balances both on and off the balance sheet.

Again, the assertion that the banks had systems in place to ensure personnel abide by separations of duty had a mean of 4.03 and a standard deviation of 1.18 which signifies that most of respondents agreed that the banks had systems in place to ensure personnel abide by separations of duty.

Again the assertion that the banks had a well-documented credit risk policy also recorded a mean value of 4.64 and a standard deviation of 0.55. This results show that most of the respondents agreed to the assertion that the banks had a well-documented credit risk policy. The median and mode of 5 each further corroborates the fact that majority of the respondents agreed that the banks had a well-documented credit risk policy.

Table 4.4: Control Activities

	Mean	Median	Mode	Standard Deviation	Count
The bank have policies and procedures that ensure credit decisions are made with appropriate approval	4.14	4	5	1.12	86
Approvals and authorization of credit are clearly outlined in the bank credit policy	4.13	4	4	0.63	86
The bank ensures credit prudence and compliance	4.19	4	5	0.96	86
Processes exist in the bank that ensures ongoing and independent reconciliation of asset and liability balances both on and off the balance sheet	4.22	5	5	1.26	86
The bank has systems in place to ensure that personnel abide by separations of duty	4.03	4	4	1.02	86
Separation of duties and dual control over bank assets are emphasized in the banks organizational structure	4.02	4	5	1.18	86
The bank has a well-documented credit risk policy	4.64	5	5	0.55	86

#### 4.3.4 Information and Communication

In relation to the information and communication aspect of the internal control system, the result is indicated in table 4.5. The table shows that the assertion that the bank information and communication systems properly identified, assembled, analyzed, classified, recorded and reported their institutions' transactions in accordance with the set standards recorded a mean of 4.06 and a standard deviation of 1.24. A mean of 4.06 on a 5 point Likert scale representing 81.2% of respondents means that most of the respondents agreed that the banks information and communication systems properly identified, assembled, analyzed, classified, recorded and reported their institutions' transactions in accordance with the set standards. The median and mode of 4 and 5 respectively further corroborated the fact that the banks' information and communication systems properly identified, assembled,

analyzed, classified, recorded and reported their institutions' transactions in accordance with the set standards.

The assertion that the information and communication systems in the banks ensured that the banks' credit risk-taking activities were within the credit policy guidelines had a mean of 4.02 with a standard deviation of 0.87. This means that 80.4% being majority of the respondents agreed to the assertion that the information and communication systems in the banks ensured that the banks' credit risk-taking activities were within the credit policy guidelines. The median and mode of 4 each further confirms that many of the respondents agreed that the information and communication systems in the banks ensured that the banks' credit risk-taking activities were within the credit policy guidelines.

The respondents were further asked about whether the personnel in the bank understood how their activities related to others. As depicted in the table (table 4.4), the assertion that all the personnel in the banks understood how their activities related to others recorded a mean of 4.29 and a standard deviation of 0.70 which stipulates that 85.8% representing majority of the respondents agreed to the assertion that all the personnel in the banks understood how their activities related to others.

Again the assertion that the credit personnel understood their accountability for the activities they conducted had a mean of 4.09 and a standard deviation of 1.10 which signifies that most of respondents agreed that the credit personnel understood their accountability for the activities they conducted. Again the assertion that the banks had put in place processes which ensured that all relevant and reliable information was communicated in a timely manner to all relevant players within the institution recorded a

mean value of 3.93 and a standard deviation of 1.29 while the assertion that effective channels of communication were used in the banks recorded a mean of 4.01 and a standard deviation of 1.17. Lastly, the assertion that the banks use the latest information and control applications in credit management recorded a mean value of 3.84 and a standard deviation of 1.05. These results show that most of the respondents agreed to the assertion that banks use the latest information and control applications in credit management. The median and mode of 4 each further corroborates the fact that majority of the respondents agreed that the banks use the latest information and control applications in credit management.



Table 4.5: Information and Communication

	Mean	Median	Mode	Standard Deviation	Count
The bank information and communication systems properly identify, assemble, analyze, classify, record and report an institutions transaction in accordance with the set standards	4.06	4	5	1.24	86
The information and communication systems in our bank ensures that the bank credit risk-taking activities are within the credit policy guidelines	4.02	4	4	0.87	86
All the personnel in the bank understand how their activities relate to others	4.29	4	4	0.70	86
The operational. Compliance, managerial and financial reports are sufficient to properly control the bank	3.97	4	5	1.29	86
The credit personnel understand their accountability for the activities they conduct	4.09	4	5	1.10	86
Our bank has put in place processes which ensure that all relevant and reliable information is communicated in a timely manner to all relevant players within the institution	3.93	4	5	1.29	86
Effective channels of communication are used in our bank	4.01	4	5	1.17	86
Our bank uses the latest information and control applications in credit management	3.84	4	4	1.05	86

The data presented in the above figure shows that majority of the respondents perceived the internal control system over the management of credit risk was very effective and functional in commercial banks in Ghana. The high mean figure demonstrates that majority of the respondents strongly agreed that the elements within the control environment were very strong as far as the management of credit risk was concerned.

#### 4.4 The effect of control environment and risk assessment on credit risk in commercial

Correlation analysis is the statistical instrument used to determine the degree of connection between two variables, i.e. to determine how heavily the results of two variables were associated or correlated. The matrix of correlation was used to verify the Multi-collinearity idea, that is, if there is a powerful correlation between two factors of predictors. Association power was measured based on the Pearson correlation scale where values within the 0.0-0.3 interval showed no correlation, 0.3-0.5 showed weak correlation, while 0.5-0.7 meant reasonable correlation, and a correlation value within the 0.7-1 intervals suggested a powerful correlation. A correlation value of 1 shows that the association was absolute (one for one). A correlation value of 1 shows that the variables had perfect association. The association strength (+ or-) shows the nature of the association (favorable or negative association). The significance level was set at 5% with a 2-tailed test. The result obtained is presented in the table below:

Table 4.6 Correlation analysis

	<i>Credit risk</i>	<i>Control Environment</i>	<i>Risk Assessment</i>
<i>Credit risk</i>	1		
<i>Control Environment</i>	0.17	1	
<i>Risk Assessment</i>	0.50	0.48	1

The results in the above table reflects that there is a weak relationship between control environment and credit risk. The coefficient of 0.17 demonstrate the weakness of the relationship. On the other hand, there is a reasonable relationship between credit risk and risk assessment. This is reflected in the coefficient of 0.50.

## CHAPTER FIVE

### SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

#### 5.1 Introduction

This study sought to ascertain the effectiveness of internal controls on credit risk in commercial banks in Ghana. This chapter presents the summary of findings, conclusion from the findings, as well as recommendations aimed at addressing weaknesses in the internal control systems.

#### 5.2 Summary of findings

With respect to the credit risk management in commercial banks, the study found out that the banks had a well-documented credit risk management policy, the bank conducted proper credit assessment, credit controls were observed appropriately. The banks had a credit manual that documented and elaborated strategies for managing credit, there was proper underwriting of loans, the banks offered more direct lending and adhered to good lending practices. Majority of the respondents strongly agreed to the above assertions and thus recorded high means which confirms the level of agreement by the respondents. In relation to the assertion that credit policies in the banks were inappropriate, most of the respondents disagreed to this assertion.

Concerning the assessment of internal controls in commercial banks, the study found out that the internal controls covering credit risk in the commercial banks were very strong. The four elements assessed which are control environment, control activities, risk assessment and information and communication were all strong as far as credit risk management was concerned. The following assertions concerning internal controls over credit risk were strongly agreed to by most of the respondents: The banks' board of

directors periodically review policies and procedures to ensure that proper controls had been instituted. There is a system in place to monitor compliance to policies and procedures and to report instances of non-compliance in the banks to the board. The banks had set of codes of behavior or moral policies that guides employees in regard to credit risk. In addition, the banks had sufficient personnel who were competent and knowledgeable to manage the credit risk. The banks had internal and /or external auditors who assessed the adequacy of the banks' internal control systems periodically and there were measures that enabled easy detection of non-performing loans in the banks. The management of the banks also frequently evaluated the credit risk profile in order to be aware of the credit risk face by the bank. The banks also had policies and procedures that ensured credit decisions were made with appropriate approval and the operational, compliance, managerial and financial reports were sufficient to properly control the bank.

In relation to the effect of control environment and risk assessment on the internal controls, the study discovered that there was a weak relationship between control environment and credit risk. The coefficient of 0.17 demonstrate the weakness of the relationship. On the other hand, there was a reasonable relationship between credit risk and risk assessment. This is reflected in the coefficient of 0.50.

### **5.3 Conclusion**

Based on the above findings, the study concluded that credit risk was an important issue in the banking sector and that there was the need for stringent measures, policies and controls to be instituted to reduce the risk of default. One of the sure ways to manage credit risk was the implementation of strong internal controls in the banking sector to ensure

compliance by all staff. The compliance by staff with respect to internal controls over credit was a sure way to manage credit risk in the banking sector. It must be stated that irrespective of how strong the internal controls of banks were, internal controls could only give a reasonable assurance and not an absolute assurance against credit risk.

#### **5.4 Recommendation**

There are constant changes to economic variables, industry trends, regulatory framework and technological innovations. There is also intense competition with the banking industry as such employees of commercial banks should be regularly trained to be abreast with key changes and trends in the global banking industry. To increase the level of awareness on fraud related activities and violations of internal control systems as well as to minimize fraudulent activities and non-compliance, every staff of financial establishment must be made to undergo an annual training on fraud and compliance issues. This is very important because the banking sector and its environment is very dynamic and so it was necessary that employees of financial establishment to be abreast with current issues bothering on fraud and compliance.

Commercial banks should create and manage a supportive whistle-blowing culture to make employees watchdog over their fellow employees with respect to fraudulent activities and violation of internal controls. Whistle-blowing if designed well can play a significant role in deterring potential fraudsters from perpetrating their crime. The Committee of Sponsoring Organizations (COSO, 1992) specifically accepts whistle-blowing in the arena of creating an effective, efficient and strong internal control structure. Management of corporate bodies must offer regular training to both old and new employees regarding whistleblowing in the company. This will increase the awareness level of ethical compliance and will also send

strong signals to the employees that management is taking the issue of ethical compliance seriously. Management should put in place confidential mechanism to operate the whistle blowing policies such as a toll-free number (hotline) managed by a private company. This will ensure the anonymity of whistleblowers in the company and their anonymity will also increase the rate at which wrong doings are reported for quick actions to be taken.

Further investigations ought to duplicate this study in other institutions especially financial institutions other than commercial banks working in Ghana to generate a comparative report among institutions on the issues of adherence to internal controls. This study could likewise be duplicated in different sectors under different conditions so as to establish a trend that could assume a much wider generalization. In addition, further studies could utilize an alternate technique ideally, the blended strategy approach so as to find out exact reasons why some employees do not adhere to internal controls and what differently could be done to ensure total compliance.



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**APPENDIX**

**QUESTIONNAIRE**

**SECTION A: Bio Data**

1. Gender                      Male [ ]                      Female [ ]
2. Age bracket?  
Between 20 -25 [ ] Between 26-30 [ ] Between 31-35 [ ] Between 36-40 [ ] Between 41-45 [ ] 46 and above [ ]
3. Period of time worked in the bank?  
1-3 Years [ ] 4-6 Years [ ] 7-9 Years [ ] 10-12 Years [ ] Above 12 years [ ]
4. What is your highest education level?  
Diploma certificate [ ] Bachelor's Degree [ ] Master's degree [ ] Doctorate degree [ ]  
Others: .....
5. What is your position in the bank?  
Risk Manager [ ] Compliance and Monitoring Manager [ ] Internal Auditor [ ] Credit Manager [ ]

**SECTION B: CREDIT RISK**

Kindly rate the extent to which you agree or disagree with the following statements relating to control environment. Where, 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree.

	1	2	3	4	5
1. Our bank conduct proper credit risk assessment on the borrowers before giving loans to its customers					
2. The bank's management is open to all communications about credit risks					
3. There are measures that enables easy detection of non-performing loans in the bank					
4. The bank carries out a comprehensive and systematic identification of its credit risks					
5. The bank's management and the board involve audit personnel or other internal control experts in the risk assessment process					
6. The management of the bank frequently evaluate the credit risk profile in order to be aware of the credit risks faced by the bank					

### SECTION C: Control Environment

Kindly rate the extent to which you agree or disagree with the following statements relating to control environment. Where, 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree.



	1	2	3	4	5
1. The bank's board periodically review policies and procedures to ensure that proper controls have been instituted					
2. There is a system in place to monitor compliance with policies and procedures and to report to the board instances of noncompliance in the bank					
3. The bank has adequate information about the credit risk assessment process					
4. Our bank's board and management are committed to ensuring proper internal controls over a bank's operations and credit control					
5. The bank has set codes of behavior or moral policies that guides employees in regard to Credit risk					
6. The bank have sufficient personnel who are competent and knowledgeable to manage the credit risks					
7. The bank have internal and/or external auditors who assess the adequacy of the bank's internal control systems periodically					
8. There are clearly defined authority and responsibilities of credit personnel in our bank					

II] What is your opinion on the overall attitude and awareness of your colleagues concerning the importance of control environment you operate in?

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SECTION D: RISK ASSESSMENT

Kindly rate the extent to which you agree or disagree with the following statements relating to risk assessment. Where, 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree.

	1	2	3	4	5
1. Our bank conduct proper credit risk assessment on the borrowers before giving loans to its customers					
2. The bank's management is open to all communications about credit risks					
3. There are measures that enables easy detection of non-performing loans in the bank					
4. The bank carries out a comprehensive and systematic identification of its credit risks					
5. The bank's management and the board involve audit personnel or other internal control experts in the risk assessment process					
6. The management of the bank frequently evaluate the credit risk profile in order to be aware of the credit risks faced by the bank					

II] What is your opinion on how your organization identifies and analyses risk associated with credit?

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SECTION E: CONTROL ACTIVITIES

Kindly rate the extent to which you agree or disagree with the following statements relating to control activities. Where, 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree.

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	1	2	3	4	5
1. The bank have policies and procedures that ensure credit decisions are made with appropriate approval					
2. Approvals and authorizations of credits are clearly outlined in the bank's credit policy					
3. The bank ensures credit prudence and compliance					
4. Processes exist in the bank that ensures ongoing and independent reconciliation of asset and liability balances, both on- and off balance- sheet					
5. The bank has systems in place to ensure that personnel abide by separations of duty					
6. Separation of duties and dual control over bank assets are emphasized in the bank's organizational structure					
7. The bank has a well-documented Credit risk policy					

II] Do you think all your colleagues enforce all the processes and procedures associated with credit administration without undue influence from management?

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**SECTION F: INFORMATION AND COMMUNICATION**

Kindly rate the extent to which you agree or disagree with the following statements relating to information and communication. Where, 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree.

	1	2	3	4	5
1.The bank’s information and communication systems properly identify, assemble, analyze, classify, record, and report an institution’s transactions in accordance with the set standards					
2. The information and communication systems in our bank ensures that the bank’s credit risk-taking activities are within the credit policy guidelines					
3. All the personnel in the bank understand how their activities relate to others					
4. The operational, compliance, managerial and financial reports are sufficient to properly control the bank.					
5.The credit personnel understand their accountability for the activities they conduct					
6. Our bank has put in place processes which ensure that all relevant and reliable information is communicated in a timely manner to all relevant players within the institution					
7. Effective channels of communication are used in our bank					
8. Our bank uses the latest information and control applications in credit management					

**II]** What is your opinion on the quality of information availed to by your organization regarding credit policy? How does the information affect your view of credit risk?

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