

## **To Ascertain Risk Exposures, Loan Loss Provisions And Significance Of Internal Controls In The Commercial Banking Sector In Zimbabwe During The Multi-Currency Era (2009 2015)**

Itumeleng Magadi<sup>1</sup>, Gibson Blessing Blazo<sup>2</sup>

<sup>1</sup>*Master Of Science In Banking And Financial Services Degree, Bachelor Of Commerce Honours In Banking Degree, An Institute Of Bankers Of Zimbabwe Diploma (Iobz). He Is A Lecturer – Zou Harare Region.*

<sup>2</sup>*Bachelor Of Commerce Honours Degree In Accounting. He Is Into Operations Department At Zimbabwe Open University.*

---

**Abstract:** *The Reserve Bank of Zimbabwe enforced strict adherence to loan loss provisions and standard risk exposures in implementing Basel 11 in the banking sector. This was due to a huge bad debt and non performing loans in the books of commercial banks from 2009 up to 2014. Such a scenario impacted negatively to some closures of indigenous banks in Zimbabwe. The descriptive survey method was adopted for the study. Managerial and non-managerial employees were used as research subjects. The population of the study was on the commercial banks in Harare, Zimbabwe. The main research instruments used in the study were self-administered questionnaires. A representative sample of thirty respondents from the retail and corporate banking departmental functions and the Bankers Association of Zimbabwe was selected to participate in the study of which comprised of two opinion leaders for each commercial bank was considered. The study showed that data was collected using both primary and secondary sources. It was recommended that management of commercial banks should design more effective internal control systems in all aspects.*

**Keywords:** *Commercial banks-Is a type of profit-seeking bank that provides services such as accepting deposits, making business loans, and offering basic investment products. Internal control- Process for achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. Strong internal controls-Policies and procedures put in place by management to achieve orderly and efficient conduct of business, and have to be adhered to by all members of staff. Weak internal controls-Where there are no clear policies and procedures put in place by management to achieve orderly and efficient conduct of business, procedures will be dictated randomly.*

---

### **I. Background to The Study**

The banking sector in Zimbabwe has been operating in a period of economic hardship since the period, year 2000 to 2008 where the economic situation was not favourable for their financial operations given the galloping inflation rate of the Zimbabwe dollar. The situation worsened in 2009 after the introduction of the multicurrency regime which entailed the use of the US dollar, Rand and other international currencies. The introduction of this multicurrency regime exacerbated the financial crisis in the economy which includes liquidity crunch due to lack of credit lines and the function of the lender of last resort by the Reserve Bank of Zimbabwe. The banks struggled to survive in this era as the public lost confidence in the sector thereby circumventing the banks. The situation resulted in the undercapitalisation of the banks as business deteriorated. This was further aggravated by the lack of proper internal controls by the commercial banks, which steered to several frauds, theft of bank assets, money laundering, non- performing loans, great bad debt, systems failures, and shortages of liquid currency, long queues and vandalisation of banks' properties by the members of staff as well by clients. According to Millichamp (2002), internal control systems are the whole system of controls, financial and otherwise, established by the management in order to carry on business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness of control systems and accuracy of the records. Commercial banks play a vital role in the economic resource allocation of countries. They channel funds from depositors to investors continuously. They can do so, if they generate necessary income to cover their operational cost they incur in the due course. In other words for sustainable intermediation function, banks need to be profitable. Beyond the intermediation function, the financial performance of banks has critical implications for economic growth of countries.

#### **Statement Of The Problem**

Most of Zimbabwean commercial banks have incurred some negative balance sheet in the period 2009-2014 owing to vandalization of company assets, misappropriation of funds by the senior management and other

white collar crimes within the banks. Some internal staff members have been conniving with the robbers in stage managed robbery cases of cash resulting in the banks suffering huge losses. All these cases have resulted in a number of commercial banks losing their operators licences and some being placed under curatorship and judiciary management. Now that the banks have adapted to internal controls in a bid to deal with these bank misconducts, the researcher now seeks to measure the effectiveness of internal controls on the financial performance of commercial banks in Zimbabwe.

### **Objectives**

- a. To understand the concept and significance of internal controls in commercial banks
- b. To examine the concentration of risk and large exposures in commercial banks as a control measure.
- c. To ascertain the asset quality and adequacy of bank internal loan loss provisions and reserves.

### **Research Questions**

To achieve the above objectives, the study was guided by the following research questions:-

- a. What do you understand by the term internal controls?
- b. To what extent does the concentration of risk and large exposures influence bank performance?
- c. How do asset quality and adequacy of bank internal loan loss provisions and reserves impact control measures?

## **II. Theoretical Framework**

### **What are internal controls**

According to Millichamp (2002), internal control systems are described as the whole system of controls, financial and otherwise, established by the management in order to carry on business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness of control systems and accuracy of the records. Sawyer's Guide for Internal Auditor (2012) defined Internal control, in accounting and auditing, as a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. A broad concept, internal control involves everything that controls risks to a commercial bank.

DiNapoli (2010), asserted that internal control is the integration of the activities, plans, attitudes, policies, and efforts of the people of an organisation working together to provide reasonable assurance that the organisation will achieve its objectives and mission. Internal controls are processes (including elements such as policies, procedures and systems) that are established, operated and monitored by officers responsible for governance and management of the public authority, to provide reasonable assurance regarding the achievement of the public authority's objectives.

### **Types of Internal Controls For Commercial Banks**

#### **❖ Reconciliations**

Muhota (2005), said that reconciliations come in to confirm that all deposits recorded were made, all bank fees charged were recorded and that, no funds were disbursed from the accounts without being recorded. In an ordinary business, a classical example is bank reconciliation, which reconcile the difference between what the bank reports and what the financial statements show. At many times the bank reconciliation proves that the financial statement amount is not exactly correct (Wells, 2002).

#### **❖ Audit trails**

Committee on National Security Systems (2012) defined audit trail (also called audit log) as a security-relevant chronological record, set of records, and/or destination and source of records that provide documentary evidence of the sequence of activities that have affected at any time a specific operation, procedure, or event. ATIS Committee (2012) asserted that the process that creates an audit trail is typically required to always run in a privileged mode, so it can access and supervise all actions from all users; a normal user should not be allowed to stop/change it. Furthermore, for the same reason, trail file or database table with a trail should not be accessible to normal users.

#### **❖ Technology**

Board of Governors of the Federal Reserve System (2012) alluded that technological change is transforming the interaction between banks and their clients. Banks have been very successful at integrating on-line and mobile technologies with their regular business. Today, mobile banking is rapidly displacing the bank branch as the main channel for interaction between banks and increasingly empowered consumers.

According to the Fed's Consumers and Mobile Financial Service Survey, at the end of 2012, almost two thirds of banked consumers used online banking in a 12-month period, while one third of banked consumers declared having used mobile banking. However, the internet has also brought a new set of disruptive technologies and business models that challenge the common way of doing things.

❖ **Banks Teller's' services**

U.S. Bureau of Labor Statistics (2006) defined a teller is an employee of a bank who deals directly with most customers and sometimes known as a cashier. They further found out that tellers are considered as "front line" in the banking business, because they are the first people that a customer sees at the bank and are also the people most likely to detect and stop fraudulent transactions in order to prevent losses at a bank (counterfeit currency and checks, identity theft, confidence tricks, etc.). Alliance for Telecommunications Industry Solutions (ATIS) Committee (2012) further said that tellers are required to be friendly and interact with the customers, providing them with information about customers' accounts and bank services. Basel (2012) believed that most teller system, which includes cash drawers, receipt validator/printers, proof work sorters, and paperwork used for completing bank transactions which include:-

- Check cashing, depositing, transfers, wire transfers, savings deposits, withdrawals.
- Issuing negotiable items, cashier's checks, traveller's cheques, money orders.
- Payment collecting, cash advances, resolving customer issues.
- Promotion of the financial institution's products, business referrals.
- Balancing the vault, cash drawers, automated teller machines (ATMs), and teller assisted units(TAUs)
- Batching and Processing Proof Work Checks, Payment Coupons, Counter Slips.
- May include ordering products for the customer (checks, deposit slips, etc.)

❖ **Security guards**

Security Guards and Gaming Surveillance Officers(2014) defined a security guard as one who guard, patrol, or monitor premises to prevent theft, violence, or infractions of rules, may operate x-ray and metal detector equipment. Power to Arrest Training Manual (2010) believed that many security firms and proprietary security departments practice the "detect, deter, observe and report" methodology. Bureau of Labor Statistics (2008) elaborated that security officers are not required to make arrests, but have the authority to make a citizen's arrest, or otherwise act as an agent of law enforcement, for example, at the request of a police officer or sheriff.

❖ **Withdrawal limits**

Yorkshire Building Society (2015) described withdrawal limits for security purposes, most banks limit the amount you can withdraw from an ATM on a daily basis. You can make larger withdrawals with your debit card by going to pretty much any bank and asking for a cash advance. Basel (2012) believed that there are initial limits on the amount of money you can withdraw from your PayPal account each month. Until you complete the steps to remove the limit, you may only be able to withdraw \$500.00 per month.

❖ **Authorization checks**

Basel (2012) stated that to ensure that a user has the relevant authorizations when he or she performs an action, users are subject to authorization checks. Verman, Romesh (2005) further reiterate that the authority-check checks whether a user has the appropriate authorization to execute a particular activity.

❖ **Security cameras**

According to Maplin (2014) Complete CCTV kits contain everything you need to set up 'DIY' security surveillance in and around your property, giving you peace of mind whether you're looking to keep your home or commercial property safe from intruders. Roberts, Lucy. (2011), further believed that security cameras are a great way to provide security for your home or workplace. As well as providing you with video footage of any events which may happen, they also act as a visible deterrent to criminals. Verman, Romesh (2005) defined Closed-circuit television (CCTV), also known as video surveillance, is the use of video cameras to transmit a signal to a specific place, on a limited set of monitors. Video telephony is seldom called "CCTV" but the use of video in distance education, where it is an important tool, is often so called.

❖ **Vaults**

"Letters of Note(2010)defined a bank vault (or strong- room) as a secure space where money, valuables, records, and documents can be stored and it is intended to protect their contents from theft, unauthorized use, fire, natural disasters, and other threats, just like a safe. Basel (2012) believed that unlike safes, vaults are an integral part of the building within which they are built, using armoured walls and a tightly

fashioned door closed with a complex lock. UL 608 Burglary Resistant Vault Doors and Modular Panels 2012 alluded that vault technology developed in a type of arms race with bank robbers as burglars came up with new ways to break into vaults, vault makers found innovative ways to foil them and has got a modern vaults may be armed with a wide array of alarms and anti-theft devices.

### **Effect Of Concentration Risk On Internal Controls**

Basel Committee on Banking Supervision (2006) say that a risk concentration is any single exposure or group of exposures with the potential to produce losses large enough (relative to capital, total assets, or overall risk level) to threaten a financial institution's health or ability to maintain its core operations. Basel further elaborated that liquidity concentration risk, associated with large individual depositors, and should be continually monitored in terms of amounts involved and their loyalty to the bank, to control the commercial bank's reliance on them. Basel (2012) further went on to come up with areas requiring attention such as timeliness of remedial action, operational independence concerning issuance of regulations and enforcement, and oversight of concentration risk and related party transactions.

John Wileys (2011), set out to test the success internal controls and stated that, one manifestation of risk concentration was many employers decentralising their location out of major landmark buildings and also out of major cities.

### **The Impact Of Large Exposures On Commercial Banks**

International monetary fund (2012), stated that, there is significant risk that assets will underperform given the large exposures to the highly leveraged public and lesser extent the record with the commercial banks sector investments. They went on to identified that, external auditors are also required to verify compliance with large exposures and concentration rules as an internal control measure.

Basel (2006), undertook similar explore on the core aim of a large exposures regime that is to act as an overlay "to prevent a firm from incurring disproportionately large losses as a result of the failure of an individual client or group of connected clients due to the occurrence of unforeseen events". The objective of ensuring that risks arising from large exposures to individual counterparties or groups of connected counterparties are kept to an acceptable level is part of the overarching principles of prudential supervision, which are to ensure continuing financial stability, maintain confidence in financial institutions and protect consumers, in particular depositors in the commercial banks.

Basel (2014) further pointed out that one of the key lessons from the financial crisis was that banks did not always consistently measure, aggregate and control exposures to single counterparties or to groups of connected counterparties across their books and operations. Throughout history there have been instances of banks failing due to concentrated exposures to individual counterparties (e.g. Johnson Matthey Bankers in the United Kingdom 1984, the Korean banking crisis in the late 1990s). Large exposures regulation has been developed as a tool for limiting the maximum loss a bank could face in the event of a sudden counterparty failure to a level that does not endanger the bank's solvency.

### **Bank Internal Loan Loss Provisions And Reserves.**

#### **Loan Loss Provisions (LLPs)**

According to Asokan Anandarajan (2006) Loan loss provisions (LLPs) are expected to reflect anticipated losses by bank managers. However, federal banks and securities regulators recognize that the provisions cannot accurately match actual losses and can include a margin for imprecision (Kim and Kross, 1998). However, Collins (1995) identified that, the margin for imprecision (referred to as the discretionary component of the allowance) has been exploited by commercial banks. Previous researchers, most of whom concentrated on financial institutions in the United States and Europe, concluded that at one stage or another, LLPs were used as a tool for capital management.

#### **Bank Reserves**

According to Vogel and Harold (2001) bank reserves or central bank reserves are banks' holdings of deposits in accounts with their central bank (for instance the European Central Bank or the Federal Reserve, in the latter case including federal funds), plus currency that is physically held in the bank's vault ("vault cash"). They further asserted that some commercial banks set minimum reserve requirements, which require banks to hold deposits at the central bank equivalent to at least a specified percentage of their liabilities such as customer deposits. Vogel implored that, even when there are no reserve requirements, banks often opt to hold some reserves—called desired reserves—against unexpected events such as unusually large net withdrawals by customers.

IMF (2014), established that in order to increase the availability and transparency of information regarding economic data and policies, developed a Committee to be broadened and strengthened to cover additional financial data, including net reserves, short term debt and indicators of the stability of financial sector

as control measure. Mahadeva and Sterne (2000) alluded that, merely from the standpoint of preserving this national asset, therefore, the management of official reserves is an important one for almost all commercial banks. But beyond this, poor management of the reserves may put at risk other elements of national policy (for example, an official exchange rate policy), and this can cause severe economic damage out of all proportion to the financial loss suffered on the assets themselves.

Costa and Ramón (2011), defined bank reserves as liquid assets held by banks to meet the demand for withdrawals of deposits in domestic and foreign currency. Bank reserves comprise currency held by banks in their vaults and deposits held by banks at the central bank. They further consider an economy with a semi-dollarized financial system; that is, a segment of the financial system's deposits and loans are denominated and settled in a foreign currency, such as the U.S. dollar.

### **III. Research Methodology**

**(This research methodology was adopted in the research paper entitled *Marrying banking structure, security environment and control management in Zimbabwe: The case of commercial banking sector during the multi-currency era (2009 to 2015)*).**

According to Rajasekar, Philominathan, and Chinnathambi (2013) research methodology is a systematic way to solve a problem. They go on to say that essentially research methodology is the procedures by which researchers go about their work of describing, explaining and predicting phenomena.

#### **Research Design**

Burns and Grove (2003) define a research design as a blueprint for conducting a study with maximum control over factors that may interfere with the validity of the findings. Polit et al. (2001) on the other hand described a research design as the researcher's overall for answering the research question or testing the research hypothesis. Crowe et al. (2011) define a case study as a research that is used to generate an in-depth, multi-faceted understanding of a complex issue in its real-life. According to Oladeji (2012) a case study is a detailed analysis of the development changes of a single person, institution, organization, and event or programme whose sample is usually smaller than that of a research. Shuttleworth (2008) on the other hand defines descriptive research design as a scientific method which involves observing and describing the behaviour of a subject without influencing it in any way. Shuttleworth goes on to say that descriptive survey is a precursor to quantitative research designs, the general overview giving some valuable pointers as to what variables are worth testing quantitatively. A descriptive survey has no manipulation or control of variables or conditions, as is the case in experimental research.

The researcher used descriptive survey for this study. To be precise the instruments used were the questionnaire for bank officers from commercial banks under review and interview for expert leaders at Bankers Association of Zimbabwe (BAZ). The interview was used because the researcher felt that the questions asked required further probing. It was not the intention of the researcher to manipulate or control variables but collection of data in its purest condition.

#### **The Population**

A research study population is a well-defined collection of individuals or objects known to have similar characteristics. Biology Online (2012) define a population as a summation of all the organisms of the same group or species, which live in a particular geographical area, and have the capability of interbreeding. Oswala (2001) refer to population as the number of persons or objects covered by the study or with which the study is concerned. In this study the population was made up of all commercial banks officers concerned with retail and corporate banking functions at the following Commercial banks in Harare Province.

**Foreign Owned Linked:** -Ecobank Zimbabwe, Barclays Bank of Zimbabwe, Standard Chartered Zimbabwe, Stanbic Bank Zimbabwe Limited

**Indigenous owned linked:** - Agricultural Development Bank of Zimbabwe (Agribank), BancABC Zimbabwe, CABS, CBZ Bank Limited, FBC Bank Limited, MBCA Bank Limited, Metbank, NMB Bank Limited, Steward Bank, ZB Bank Limited

The study was premised on retail and corporate banking functions because the researcher believed that the internal control variables being investigated were more prevalent in these departments compared to other departments such as Treasury and Information Technology.

#### **Sample**

When conducting research, it is almost impossible to study the entire population one might be interested in and as a result one has to make a sample of the population. According to Crossman (2014) a sample is a subset of the population being studied which represents the larger population used to draw inferences about

that population. Berinsky (2008) defined a sample as a statistics, quality assurance, & survey methodology, and is concerned with the selection of a subset of individuals from within a statistical population to estimate characteristics of the whole population.

In this respect the researcher used purposive sampling to choose commercial banks officials to respond to questionnaires as they were perceived to be knowledgeable about internal controls of commercial banks. From the commercial bank population, the researcher targeted three international banks and three indigenous banks in Harare as shown on the table below: -

**Table 1.1: Targeted sample of Commercial Banks and Bankers Association of Zimbabwe**

	Name of banks	Number of retail banking officers	Number of corporate banking officers
Internationally linked banks	Stanbic Bank	2	2
	Eco bank	2	2
	Standard chartered	2	2
Indigenous linked banks	CBZ Bank Ltd	2	2
	CABS Bank	2	2
	Steward Bank	2	2
	Total	12	12
Banker Association of Zimbabwe-BAZ		6	

Source: Primary data

Given that four banking officers per each bank were chosen, it implies that our total sample was twenty four -24 banking officers. In addition the researcher interviewed six (06) BAZ expert personnel.

### Research Instruments

Pierce (2009) described a research instrument as a survey, questionnaire, test, scale, rating, or tool designed to measure the variable(s), characteristic(s), or information of interest, often a behavioural or psychological characteristic. Research instruments can be helpful tools to your research study.

Wilkinson and Birmingham (2003) cited and listed the following instruments used in research study:

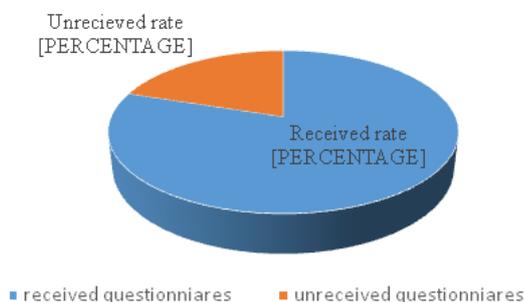
- Questionnaires
- Interviews

## IV. Data Presentation, Analysis And Discussions

### Demographic Data

Data is presented in two sections, the first section comprised of responses from commercial banks' retail or corporate banking department and together with interview responses from the Bankers Association of Zimbabwe (BAZ). Tools used to display the collected data included frequency tables, pie charts, bar graphs, line graphs as well as descriptive analysis.

### Response Rate



**Figure 1.1: Category of Questionnaire Response Rate**

Source: Primary data (2015)

Of the 30 questionnaires that were sent to commercial banks and BAZ for analysis 24 questionnaires were turned back which resulted in an 80% response rate and those which were not turned back are 20% response rate. This was made possible due to a combination of vigorous follow-up and cooperation of the respondents. The response rate was high enough to warrant validity of findings. The 20% response rate for not returned questions reflect that the bank personnel who were excessively busy and some were restricted by their bank's policy towards the oath of confidentiality.

**Respondents by commercial bank and BAZ officials**

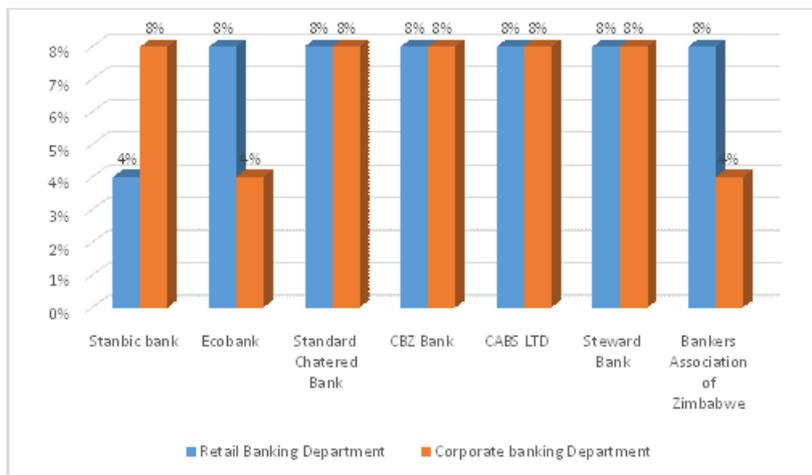


Figure 1.2: Responsiveness for commercial banks against Bankers Association of Zimbabwe

Source: Primary data (2015)

From figure 1.2, showed the distributions of respondents which followed that Standard Chartered Bank, CBZ LTD, CABS Ltd, and Steward Bank accounted to a wholly targeted respondents a total of 64% respondents, while Stanbic Bank, Ecobank and the Bankers Association of Zimbabwe had a total response of 36% respondents. From this trend it's clear that there was a setback in obtaining information from the banks with links to foreign ownership and the Bankers Association of Zimbabwe as their oath of confidentiality was very stringent. However it was easy to obtain information from information from indigenous linked owned banks hence these indigenous banks had relaxed oath of confidentiality. It also tells that the information from the primary source was related to commercial banks and the Bankers Association of Zimbabwe.

**Distribution of Respondents by Gender**

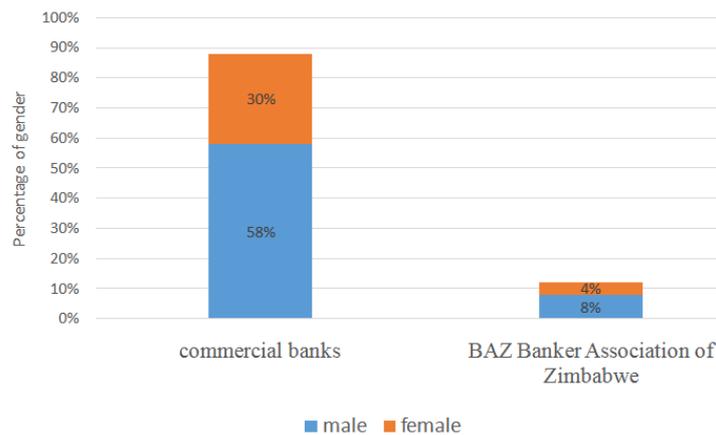
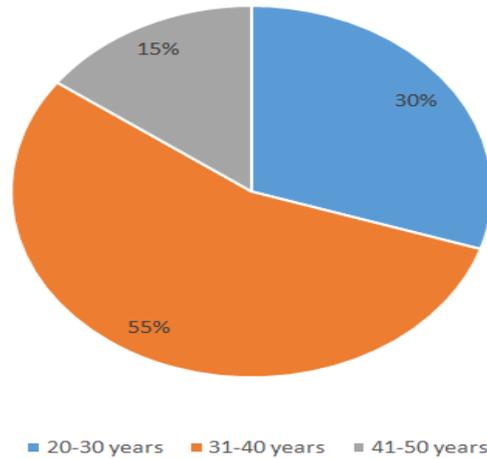


Figure 1.3: Gender of respondents

Source: Primary Data (2015)

Results from figure 1.3 reveals that commercial banks had 58% males and 30% females, while Bankers Association of Zimbabwe had 8% males and 4% females. Thus more males' officer are employed in the banking environment and as well the Bankers Association of Zimbabwe than females' officers. This illustrated that there were still inequalities between female workers and their male counterparts in upper echelons of management in most organisations. This clearly shows that men dominate in the banking industry activities. The results from the commercial banks exhibited that man were more professional qualified than woman because many women aborted school at a tender age to fix and concentrating on their marital issues like nursing babies.

**1.12.4 Distribution of Respondents by age respondents**

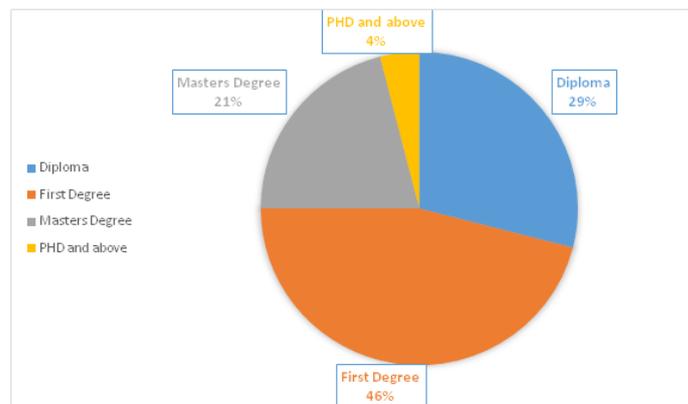


**Figure 1.4: Age of respondents**

Source: Primary Data (2015)

Figure 1.4 obtained a 30% respondents in the age group 20-30 years, while 55% was the ages between 31-41 years, and 15% was obtained on ages between 41-50 years. The analysis of the age trend obtained from the commercial banks and Banker Association of Zimbabwe disclosed that a bulk of banks' personnel were composed of young graduates between 31-40 years. A limited number of personnel were in the age group 41-above 50 years because older people occupy higher positions or simply because they were laid off. The distribution of the respondents also revealed that the top management constituted of a mature, energetic, tried and tested personnel.

### 1.12.5 Highest Educational Qualification Of Respondents

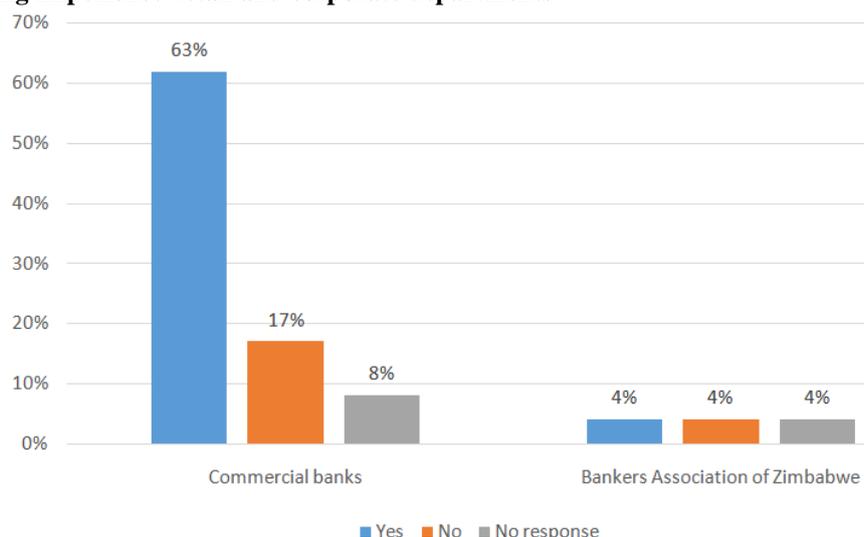


**Figure 1.5: Qualification category trend for respondents**

Source: Primary data (2015)

Figure 1.5 had the following highest educational qualification of respondents were a 29% of respondents had diplomas, 46% had attained first degrees, 21% attained Master's degree and PHD had 4% respondents. Of the respondents commercial bank officers and Bankers Association of Zimbabwe officers had a greater number of first degree personnel. A very little PHD and above personnel was obtained because banks officers had very little time to further their studies, and also the cost of obtaining highest professional qualification was very exorbitant no wonder why most graduates ended up on attaining first degree. However the level of education possessed by respondents enabled the researcher to get reliable data concerning the effectiveness of internal control management for commercial banks, because most personnel of this calibre has got respectable understanding and reasoning to the success of banking activities

### 1.12.6 Working Experience-retail and corporate departments



**Figure 1.6: Working experience in the retail and corporate banking department**

Source: Primary data (2015)

From the figure 1.6 commercial banks had a 63% affirmative respondents, 17% certainly not and 8% no responses; Bankers Association of Zimbabwe accounted for a 4% affirmative respondents, 4% uncertainly response and a 4% no response on the working experience in the retail and corporate banking. This shows that most of the commercial banks officers had good working experience in retail and corporate departments while the response from the Bankers association of Zimbabwe officers revealed that its working staff had partial experience of the retail and corporate departments in the commercial banking environment.

### 1.12.7 Working Experience- commercial banks / BAZ

Table 1.2: Work experience in commercial banks/ BAZ

	Commercial bank officers	BAZ- Bankers Association of Zimbabwe	Total	Percentage
Less than 2 years	2		2	8%
2-5 Years	8	2	10	42%
6-10 Years	6	1	7	29%
Above 10years	5		5	21%
Total	21	3	24	100%

Source: Primary data (2015)

The table 1.2 above indicates an 8% respondents for officers with 2 years and below experience, a 42% for 2-5 years' experience, followed by 29% for 6-10years' experience and a significant number of well experienced personnel of 21% on years of service above 10 years was obtained. Respondents between ages 2-5 years working experience had the most respondents because very little staff were recruited since the introduction of the multi-currency system in Zimbabwe where there has been very little growth in the economy. Hence the banks retained its experienced staff.

### 1.13 Concept and Significance of Internal Controls

Table 1.3: Sawyer Guide for Internal Auditors definition of internal controls.

Category	Reponses	Number of opinions	Percentage % of opinions
1	Yes	24	100%
2	No	0	0%
3	Don't know	0	0%

Source: Primary data (2015)

The opinions of the respondents shows that all the 100% respondents believed in Sawyer's Guide for Internal Auditor (2012) definition that Internal control, in accounting and auditing, as a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies. This means that all the respondents have knowledge on the internal controls of commercial banks in Zimbabwe.

### 1.13.1 Types of internal controls management

Table 1.4: Types of internal control management for commercial banks

	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	No Response	Total
1 Reconciliations	50%	42%	4%	0%	0%	4%	100%
2 Audit trials	58%	38%	4%	0%	0%	0%	100%
3 Technology	54%	46%	0%	0%	0%	0%	100%
4 Banks Tellers' services	34%	38%	16%	8%	0%	4%	100%
5 Security guards	30%	54%	8%	4%	0%	4%	100%
6 Withdrawal limits	38%	42%	16%	4%	0%	0%	100%
7 Authorization checks	63%	37%	0%	0%	0%	0%	100%
8 Security cameras	38%	54%	4%	0%	0%	4%	100%
9 Vaults	54%	30%	12%	0%	0%	4%	100%

Source: Primary data (2015)

- ❖ *Reconciliations.* From the above table 1.4 reconciliations had a 92% affirmative respondents, 4% neutral respondents and a 4% non -respondents. Higher affirmative response produced revealed that reconciliations come in to confirm that all deposits recorded, all bank fees charged and, no funds are disbursed from the accounts without being recorded. It is therefore that reconciliations must be carried out often or daily in order to verify if transaction had no errors or mistakes.
- ❖ *Audit trials.* Audit trials had a 58% of strongly agreed, 38% agreed and a 4% meaning that most commercial banks performs audit trial as an effectiveness of internal control management. This replicate findings by Committee on National Security Systems (2012) who advocated that audit trail is a security-relevant chronological record, set of records, and destination and source of records that provide documentary evidence of the sequence of activities that have affected at any time a specific operation, procedure, or event.
- ❖ *Technology.* Technology accounted for 100% affirmative as internal control measure. This is because most banks have upgraded their technology systems such like the use of fingerprint reader, passwords to databases management and internet banking which is prone to hackings by unauthorized users. Technological change is transforming the interaction between banks and their clients.
- ❖ *Bank tellers' services.* Bank tellers' services had 34% and 38% affirmative respondents, a 16% respondents were neutral and 8% disagree and 4% with no response. The high positive affirmative reveals that bank's
- ❖ teller services was important, thus it is a critical area where officer directly interact with its customers or clients.
- ❖ *Security guards.* Security guards service had proven their importance as an internal control measure on the commercial banks as it accounted to 84% confirmatory, 8% neutral, 4% disagree and 4% of no response. A high response on security guards was because from increase guard, patrol, or monitor premises to prevent theft, violence, or infractions of rules, may operate x-ray and metal detector equipment.
- ❖ *Withdrawal limits.* Withdrawal limits, another variable determined through analysing the internal control of commercial bank, had a rating of 80% affirmative responses, 16% neutral and a 4% disagree respondents. Withdrawal limits illustrated that it is a strong internal control where most commercial banks Automated Tailor Machines (ATMs) and retail banking are set daily maximum withdrawal limits that controls the liquidity and movement of the bank funds.
- ❖ *Authorisation checks .* Authorisation checks had the most favorable response of 100%. This reiterate that all commercial banks employ the verification of authorisation by users or clients. Also entry into the bank's database systems in most banks requires passwords authorization, to checks whether a user has the appropriate authorization to execute a particular activity.
- ❖ *Security cameras.* Security cameras response accounted to 92% affirmative, 4% disagree and a 4% no response. The high response shows that most banks had installed security cameras as an internal control management as a great way for providing security home or workplace.
- ❖ *Vaults.* Vaults has an 84%, positive response of 12% neutral and 4% strongly disagreed. A small decline in the affirmative of this type of internal control was just because many staff has no access to the vaults. However vaults proved that they are strong internal control measure as it is the strong room and secure space where money, valuables, records, and documents can be stored.
- ❖ These internal control types (*Reconciliations, Audit trials, Technology, Bank tellers' services, Security guards, Withdrawal limits., Authorisation checks, Security cameras and Vaults*), that were implemented in most commercial banks, led to most officers responding positively confirming that they are effective in internal control management.

### 1.14 Concentration Of Risk And Large Exposures

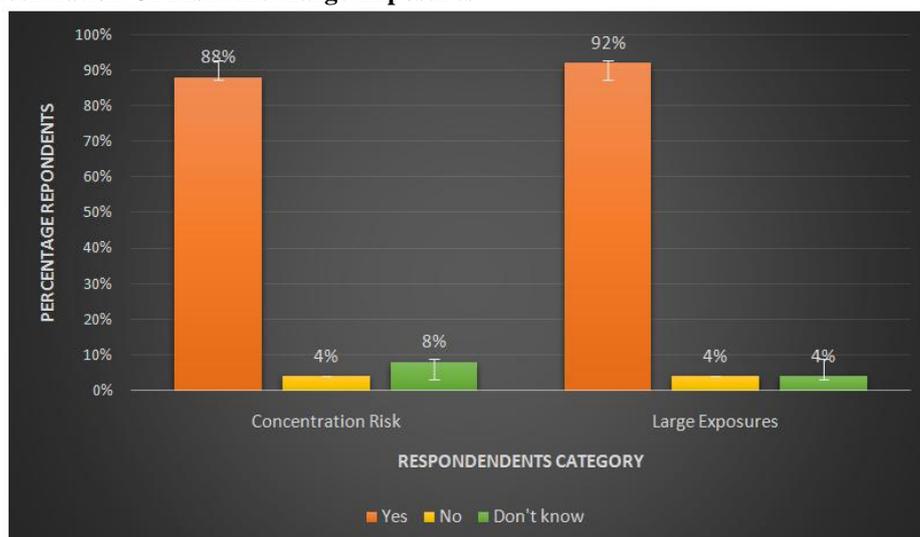


Figure 1.7 Effect of Concentration Risk and Large exposures

Source: Primary data (2015)

Figure 1.7 showed an 88% affirmative, 4% negative and 8% impartial respondents on concentration risk. While high 92% affirmative, 4% on both impartial and a 4% negative response was expressed by various respondents on large exposures. The results of the positive respondents is a clear illustration that many commercial bank has negative concentration risk and large exposures resulted from a bulk of their risky portfolios comprised of non - performing loans

#### 1.14.1 Concentration risks and large exposures

Table 1.5: Extent to which concentration risks and large exposures

CONCENTRATION OF RISK AND LARGE EXPOSURES		7	6	5	4	3	2	1
		Strongly agree	Agree	Uncertain	Disagree	Strongly disagree	No response	total
1	Risk concentration threatens a financial bank's health or ability to maintain its core operations.	24%	56%	8%	4%	0%	8%	100%
2	Concentration employers decentralise their location out of major landmark buildings	20%	34%	38%	4%	0%	4%	100%
3	Banks failing due to concentrated exposures to individual counterparties	30%	50%	4%	8%	0%	8%	100%
4	Large exposures limits the maximum loss and endangered solvency a bank	54%	30%	8%	0%	0%	8%	100%

Source: Primary data (2015)

Results from table 1.5 on the variable, risk concentration threatens a financial bank's health or ability to maintain its core operations indicated an 80% affirmative, 8%, 4% disagreed and 8% no response. The positive responds reiterate that bank concentration risk is too high hence need to be monitored often. The personnel who disagreed resulted from a couple of officers whose departments were not impacted like internal audit committees.

The variables concentration employers decentralise their location out of major landmark buildings accounted for 54% positively respondents, 38% uncertain and 4% for disagree and 4% no response. This variable ascertain that decentralisation is essential for the effectiveness of internal control management, although some officer believed that centralization would be more effective depending on the nature of activity. An 80% affirmative response, 4% neutral, 8% disagree and 8% no response on the variable, banks failing due to concentrated exposures to individual counterparties. A highly positive response was because the inference of large exposures upon commercial banks. The last variable, large exposures limits the maximum loss and endangered solvency a bank accounted for 54% strongly agreed, 30% agreed, and 8% uncertain and 8% no response. A high positive response indicated in the results is a clear indication that large exposures are prone to commercial banks and hence they needed to be effectively managed.

1.15 Internal Loan Loss Provisions and Reserves.

Table 1.6: Internal Loan Loss Provisions and Reserves

		Strongly agree	Agree	Uncertain	Disagree	Strongly disagree	No Response	Total
1	Loan loss provisions (LLPs) are expected to reflect anticipated losses by bank managers	42%	30%	16%	4%	0%	8%	100%
2	Loan loss provisions is used as a tool for capital management.	24%	56%	12%	0%	4%	4%	100%
3	Provisions cannot accurately match actual losses and can include a margin for imprecision	30%	46%	8%	8%	4%	4%	100%
4	Poor reserves management may cause severe economic assets financial loss	42%	46%	4%	4%	0%	4%	100%
5	Commercial banks set minimum reserve assets to meet the demand for withdrawals of deposits	34%	54%	4%	4%	0%	4%	100%

Source: Primary data (2015)

Table 1.6 shows distribution of respondents of internal loan loss provisions and reserves. The bulk of the respondents 72% affirmative while 16% were uncertain, 4% disagreed and 8% had no response to loan loss provisions (LLPs). The bulk of the respondents indicate that most commercial bank expected to reflect anticipated losses by bank managers. The other counter loan loss provisions is used as a tool for capital management had a 80%, positive 12% uncertain and 4% negative and 4% unanswered respondents. A huge positive response was caused by many commercial banks making use of LLPs.

The counter poor reserves management may cause severe economic assets financial loss had 76 affirmative response, 8% uncertain response, 8% disagree response, 4% strongly disagreed response and 4% no response. This is a clear indication that poor reserves management had a negative impact to the functioning of a bank.

The counter commercial banks set minimum reserve assets to meet the demand for withdrawals of deposits had a 34% strongly agreed respondents, 54% agreed response, 4% uncertain response, 4% disagreed response and a 4% non-response. A huge bulk of response was because many commercial banks are setting minimum reserve assets to meet their day to day withdrawals. An example of the effect of loan loss provisions is survey by the Herald of Zimbabwe reporter that, “CABS banks say it will re-launch the balance of the suspended ten million dollars Kureara/ Ukondla Youth fund in the next three months although it will now be more cautious on the lending. When the fund was suspended, CABS had disbursed nearly half of its funds at \$4 898 773 but had NLP amounting to \$3 709 724 which is about seventy five percent.”

V. Summary, Conclusion And Recommendations

The first objective was to understand the concept and significance of internal controls in commercial banks. The research study found out that failure to implement effective strong internal controls would result in the management failing to perform in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness of control systems and accuracy of the records. The research study revealed that some commercial banks were failing to fully effectively implement most of the internal control management and that in turn would cause banks failures or collapse. This affirms the view by most authors who asserted that internal control involves everything that control risks to a commercial bank. The second objective was to examine the concentration of risk and large exposures in commercial banks as a control measure. The findings revealed that risk concentration is a single exposure or group of exposures with the potential to produce losses large enough to threaten a financial institution’s health or ability to maintain its core operations. This was alluded to by Basel Committee on Banking Supervision (2006) who elaborated that liquidity concentration risk, associated with large individual depositors, and should be continually monitored in terms of amounts involved and their loyalty to the bank, to control the commercial bank’s reliance on them. The third objective was to ascertain the asset quality and adequacy of bank internal loan loss provisions and reserves. The findings revealed that loan loss provisions (LLPs) are expected to reflect anticipated losses by bank managers. This was shown by the bulk respondents who considered that provisions cannot accurately match actual losses and can include a margin for imprecision and poor reserves management may cause severe financial loss. However, federal banks and securities regulators recognize that the provisions cannot accurately match actual losses and can include a margin for imprecision (Kim and Kross, 1998).

Conclusions

Based on the above research findings the researcher draws the following conclusions:

1.16.1 The research study revealed that the following types of internal control management; reconciliations, audit trials, technology, banks tellers’ services, security guards, withdrawal limits, authorization checks, security cameras, vaults were effective to the success performance of a commercial bank. This is in line with what Basel (2012) believed, that control check cashing, depositing, transfers, wire transfers, savings deposits, withdrawals

and balancing the vault, cash drawers, automated ATMs, and teller assisted unit and work Checks, Payment Coupons, Counter Slips. Yorkshire Building Society (2015) supported this as they described that most banks limit the amount withdraw from an ATM on a daily basis. However from the researcher's view he suggested the broad widening of these internal controls as most banks are still struggling for example the hiring of extra manpower during the month- ends when business is high.

1.16.2 The research findings revealed that there is need to monitor and control of the concentration risks and large exposures by commercial banks. This was alluded by Wileys (2011) who stated that, manifestation of risk concentration was through employers decentralising their location out of major landmark buildings and also out of major cities. Basel (2014) also pointed out that the key lessons from the financial crisis was that banks werenot consistently measure, aggregate and control exposures to single counterparties or to groups of connected counterparties across their books and operations.

1.16.3 The findings from the research study revealed that the most dominant cause of poor banks capital management was minimal control of asset quality and adequacy of bank internal loan loss provisions and reserves. This was illustrated by Collins (1995) who identified that capital margins for imprecision has been exploited by commercial banks. Vogel (2014) implored that if banks had no reserve requirements, banks often opt to hold some reserves against unexpected events such as unusually large net withdrawals by customers. The researcher also supported the motion by the authors and also advocated for the legalising the minimum reserve requirements by reserve banks of Zimbabwe so as not to inconvenience the customers.

### **Recommendation For Further Study**

The study sought examine the effectiveness of internal controls management for commercial banks in Zimbabwe during the multi-currency era. The study targeted the retail and corporate departments for commercial banks. The study must be extended to other commercial bank departments such like Information Technology and Treasury. Further study would be also on the building societies and insurance companies, to mention a few.

### **VI. References**

- [1]. Alliance for Telecommunication Industry Solutions (ATIS) 2012 - Audit trail. ATIS Committee PRQC.
- [2]. Angst, Lukas and Karol J. Borowiecki (2013). Delegation and Motivation, Theory and Decision, forthcoming
- [3]. Basel Committee on Banking Supervision (2006). Studies on credit risk concentration: an overview of the issues and a synopsis of the results from the Research Task Force project. <http://www.bis.Org/publ/bcbs>. Paper No. 15 [Accessed 21 January, 2015].
- [4]. Basel Core Principles for Effective Banking Supervision (2012). Detailed Assessment of Compliance Report. Washington, DC, USA: International Monetary Fund, ProQuest Web. 6 February 2015.
- [5]. Berinsky, A. J. (2008). Survey non-response. In W. Donsbach & M. W. Traugott (Eds.), *The SAGE handbook of public opinion research* Thousand Oaks, CA: Sage Publications. (pp. 309-321).
- [6]. Blaxter and Loraine (2010) *How To Research* (4th Edition). Berkshire, GBR: McGraw-Hill Education, [ProQuest ebrary. Web. 27 February 2015.]
- [7]. Bloom and Howard (2010). *The Genius of the Beast: a radical re-vision of capitalism*. Amherst, New York: Prometheus Books. p. 186. ISBN 978-1-59102-754-6
- [8]. Bhattacharyya, Dipak K (2009). *Organisational Systems, Design, Structure and Management*. Mumbai
- [9]. Brundtland G.H. (1987). *Our Common Future*, World Commission on Environment and Development, Oxford.
- [10]. Burglary Resistant Vault Doors and Modular Panels (2012). Underwriter's Laboratories.
- [11]. Burns A. & Bush R. (2010). *Marketing Research*. Upper Saddle River, NJ: Pearson Education.
- [12]. Conelrad Adjacent (2010) Letters of Note: Your Products are Stronger than the Atomic Bomb Unbreakable: Hiroshima and the Mosler Safe Company Retrieved 26 August 2010.
- [13]. Creswell, J.W. (2012). *Educational research: Planning, conducting, and evaluating quantitative and qualitative research*.
- [14]. Defense Science Board (2009). Task Force on Department of Defense Policies and Procedures for the Acquisition of Information Technology.
- [15]. Dillman, D, Eltinge, J, Groves, R, & Little, R. (2002). *Survey nonresponse in design, data collection, and analysis*. New York: John Wiley & Sons. pp. 3-26
- [16]. Fayol H (1949). *General & Industrial Management*. New York: Pitman Publishing. p 107-109
- [17]. Greenberg, Michael D (2010). *Directors as Guardians of Compliance and Ethics With-in the Corporate Citadel: What the Policy Community Should Know*. Santa Monica, CA, USA: RAND Corporation.
- [18]. <http://www.snapsurveys.com/blog/advantages-disadvantages-facetoface-data-collection> [Accessed on 09 December, 2014].
- [19]. Kaplan R. & Saccuzzo D. (2009). *Psychological testing: Principles, applications, and issues*. Belmont, CA: Wadsworth
- [20]. King, Gary and Murray, Christopher (2002) 'Rethinking Human Security', *Political Science Quarterly*, p-116.
- [21]. Lang, P. (2012). *Corporate Finance and Governance, Risk-Adjusted Performance and Bank Governance Structures*. Frankfurt am Main, DEU. Volume 12
- [22]. Lavan Mahadeva and Gabriel S (2000). *Monetary Frameworks in a Global Context*, Routledge
- [23]. Merriam-Webster's Online Dictionary (2008), questionnaire, <http://www.merriam-webster.com/dictionary/questionnaire> (accessed March 21 2015)
- [24]. Millichamp A.H. (2002). Oversight of concentration risk and related party transactions. Page85.
- [25]. Mitchael and Balotelli (2014), *National Drug Control Strategy*
- [26]. Mockler R. J. (1970). *Readings in Management Control*. New York: Appleton-Century-Crofts. ISBN 978-0-390-64439-8. OCLC 115076. pp. 14-17. [Accessed 03 January 2015]
- [27]. Moore and Brenda (2014). In-Depth Interviewing in *Routledge Handbook of Research Methods in Military Studies*, (eds.) J. Sorters, P. Shields, S Henriette. New York: Routledge. Pages 115-128.

- [28]. Muaz, Jalil and Mohammad (2013), Practical Guidelines for conducting research. Summarising good research practice in line with the DCED Standard.
- [29]. Muhota K. (2005). Check list for an internal Audit. Giving Hope to World of Need. USA.
- [30]. National Information Assurance (IA) (1996).Committee on National Security Systems. 7 August. Page. 4.
- [31]. Rajasekar, S., Philominathan, P., &Chinnathambi, V. (2013). Research Methodology. Manuscript.
- [32]. Ramos M (2004). Evaluate the Control Environment: Documentation Is Only a Start; now it's All about Asking Questions. Journal of accountingvolume 197
- [33]. Randall S. Kroszner and Raghuram G. (1995). Organization structure and credibility: evidence from commercial banks securities activities.
- [34]. Rizal Commercial Banking Corporation (2014). A member of Yuchengco of Companies.
- [35]. Roberts and Lucy (2011). History of Video Surveillance and CCTV, We C U Surveillance <http://www.wecusurveillance.com/cctv>. [Accessed 16 January 2015]
- [36]. Sawyer's Guide for Internal Auditors (2012). The Institute of Internal Auditors Research Foundation. p. 36. ISBN 978-0-89413-721-1.
- [37]. Sanjeev, William, Clark and Dana (2003). Journal of Human Development Volume 4.
- [38]. Snijkers, Ger, Haraldsen, Gustav, and Jones (2013). Wiley Series in Survey Methodology: Designing and Conducting Business Surveys. Somerset, NJ, USA: John Wiley & Sons. ProQuest ebrary. Web. 27 February 2015.Subramaniam and Rae (2006). The Relationship between Internal Control Procedural Quality, Organizational Justice Perceptions and Employee Fraud.
- [39]. Thomas and DiNapoli (2010). Division of Government & School Accountability Office of the New York State Comptroller Management's Responsibility for Internal Controls.
- [40]. Visser, Wayne, Matten, Dirk, and Pohl, Manfred (2010). A-Z of Corporate Social Responsibility (2nd Edition). p. 5
- [41]. Vogel and Harold L. (2001). *Entertainment Industry Economics: A Guide for Financial Analysis*. New York: Cambridge University Press. ISBN 0-521-79264-9
- [42]. Waddock S and Bodwell C (2007). Total Responsibility Management: The Manual Hardback. <http://www.greenleafpublishing.com/product>, Pages 9-25 (Accessed 15 January 2015)
- [43]. Wiley, Lahsansa and Ahcene (2014).Shari'ah Non-compliance Risk Management and Legal: Documentations in Islamic Finance. Somerset, NJ, USA.