CONTROL ENVIRONMENT AND PERFORMANCE OF GUARANTY TRUST BANK, MBARARA, BRANCH, UGANDA

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Abstract

In the recent past there has been failure of some commercial banks in Uganda. This trend puts into question the ability of the internal control environment and the Bank of Uganda prudential guidelines to steer the commercial banks stability and performance. However, the recent failures have put pressure on the industry regulators and players to rethink how best the institutions can align their internal control environment and compliance as tools of ensuring stability and positive performance. The study sought to assess the relationship between internal control environment and financial performance of Guaranty Trust Bank, Mbarara, Branch, Uganda.Both primary and secondary data was collected. Primary data was for Questionnaire feedback while secondary data was extracted from audited financial reports of Guaranty Trust bank using a case study of Mbarara branch. The research philosophy of the study is positivism. The study used a descriptive research design with census methods being used

. Data was analyzed using SPSS package and descriptive, correlation and regression analysis were carried to establish relationships between the variables. The study findings established a positive and significant relationship between control environment and financial performance of the commercial banks. The study therefore recommends that there is need therefore for the banks to ensure suitable environment where internal controls are supported for the improved performance of the banks. There is need also for proper checks and balances in all financial transactions in the banks. The banks' management should examine the level of employee integrity in allocating them responsibilities especially where employees are to deal with confidential information involving the banks' vital documents.

Background of the study

In internal control, the control environment sets the tone of the organization by influencing the control consciousness of its people (Whittington and Pany, 2021). The control environment is the central component of internal control system. It is made up of aspects such as ethical values, the integrity of personnel tasked with formulating, setting up and administering the controls, the directors, audit committees and the organization structure. The control environment is highly dependent on the effectiveness of the management and the board of directors. The control environment influences the consciousness of personnel (Aldridge and Colbert, 2011). It reflects the attitude and policies of management in regard to the importance of internal controls in banks; performance. Furthermore, the control environment influences the history and culture of the organization; thus it sets the supportive attitude towards internal control and management.

Cases of major loss within banks reflect management's inattention to and laxity in the control culture of the banking institution. Further losses are attributable to laxity by the directors and senior management. These cases also reflect a lack of appropriate incentives for management to carry out strong line supervision and maintain a high level of control consciousness within the banking sector. It is the responsibility of the board of directors and senior management to emphasis the importance of internal control through their actions and words. This includes the ethical values that management displays in their business dealings, both inside and outside the 7 organization. The words, attitudes and actions of the board of directors and senior management affect the integrity, ethics and other aspects of the bank's control culture (Kasekende, 2020)

. **Statement of the Problem**

Despite the guidelines set out by Bank of Uganda in accordance with the Banking Act Cap, there has been numerous cases of bank failures in performance due to fraud and lack of elaborate internal controls as well as compliance with internal and external regulations within the industry (FLSTAP, 2011).

Banking sector in Uganda is fragmented, making it impossible for most of the banks to meet the capital requirements set by the Central Bank (Byarugaba, 2024),The closure of financial institutions in Uganda for various reasons has become a common feature over the last 15 years.

The latest is Mercantile Credit Bank Limited, which was on June 18 2023 placed under liquidation, its licence revoked and an order given for the winding up of its affairs over capitalisation-related issues. The other is EFC Uganda Limited, which was closed by the Bank of Uganda in June for failing to meet minimum capital requirements. These join others such as Greenland Bank, Teefe Bank, International Credit Bank, National Bank of Commerce, Global Trust Bank and Crane Bank, which have been closed in the last 15 years. Uganda's oldest commercial bank, Standard Chartered has also announced plans to exit the Ugandan market.These closures have left many customers and other people worried about the safety of their funds and whether they should continue keeping their money in banks. Commercial banks in Uganda under the supervision of Bank of Uganda are obliged to put in place sound control measures to foster better performance. In lieu of that, the Credit reference bureau (CRB) was introduced as another control aspect. Despite the above, the recent risk trends in Uganda"s commercial banks have been on the increase mainly due to a rise in none performing loans (NPL) which grew from 4% in June 2023 to 8.3% in June 2024. The result has seen a poor return on Assets and declining liquidity levels leading to a sharp deceleration in asset growth of the banking sector (BoU report, 2024). Similarly, Centenary bank has equally seen a decline in major performance indicators where the Non-performing loans grew from 27.4bn in 2023to 35.6bn in 2024 and loan write offs of 11.2bn from 7.4bn from 2023 to 2024 respectively. Equally, interest expense grew from 28bn to 35.3bn during the same period (BoU report report 2024). The above revelations have continued to cast doubt on the effectiveness of numerous interventions hence the researcher"s motivation to examine the effect of internal control environment on the financial performance of commercial banks GT Bank (U) Limited as a case study.

Objective of the study

The main objective of the study was to assess the relationship between internal control environment and financial performance of Guaranty Trust Bank, Mbarara, Branch, Uganda

Theoretical Framework

The Agency Theory

Basic agency paradigm was developed in the economics literature during 1960s and 1970s in order to determine the optimal amount of the problem- sharing among different individuals (Ross, 1973; Jensen and Meckling, 1976). However, gradually the domain of the agency theory was extended to the management area for determining the cooperation between various people with different goals in the organization, and attainment of the goal congruency (Eisenhardt, 1989).

In 1980s, agency theory also appeared extensively in the managerial accounting realms to determine the optimal-incentive contracting among different individuals and establishing suitable accounting control mechanisms to monitor their behaviors and actions (Demski, 1980; Biaman, 1982; Namazi, 1985). It is this last function of the agency theory that will be emphasized in this study. In its primitive form, agency theory relates to situations in which one individual (called the agent) is engaged by another individual (called the principal) to act on his/her behalf based upon a designated fee schedule. Since both individuals are assumed to be utility maximizer, and motivated by pecuniary and non-pecuniary items, incentive problems may arise, particularly under the condition of uncertainty and informational asymmetry.

That is, the objective function of the principal and the agent may be incompatible, and therefore, the agent may take actions which will jeopardize the principal's benefits. In addition, an agency operates under the condition of uncertainty. In effect, the basic agency theory usually assumes that both individuals are problem averse. Under these circumstances, the amount and content of the produced accounting information and other information sources would become a significant issue in problem sharing and controlling the agent's actions (Baiman, 1982, 1990).

The Criticisms of the Theory

Opponents of the theory usually argue that it presents a narrow model of human motivation and that it makes unnecessary negative moral evaluations about people. In particular, the assumptions about selfinterested and opportunistic behavior are considered problematic or even false. Selfinterest, as a sole motivation of human behavior, is criticized for being an overly narrow model of human behavior. According to critics, focusing on self-interested behavior makes it possible that for the wider range of human motives to be ignored, including the need for achievement, altruism, respect and intrinsic motivation towards an inherently satisfying task (Donaldson, 1990; Davis et al., 1997)

Agency theorists examine the structures favored by capitalism and bureaucracy and find much selfregarding behavior; they then assume that this is human nature. They neglect the enormous amount of neutral and other-regarding behavior that exist (and must, for organizations even to function) and the structures that might increase it. Perrow has even concluded that agency theory "may be dangerous", because "theories shape our world; they encourage us to see it in a certain way, and then we exclude other visions that direct our actions" (Perrow, 1986).

The criticism has also been directed on the assumption of opportunistic behavior. This has been regarded as an "overly generalized" and "cynical" conception of human morality (Donaldson, 1990a.). In addition, it is considered that the fact that agency theory lacks perspective on matters such as reciprocity, work ethics, and especially on trust, makes it even less realistic (Donaldson, 1995; Becerra & Gupta, 1999).

Indeed, in situations where the principal is likely to be more trusting and co-operative toward the agent, agency theory"s normative focus on avoiding or mitigating the potential agency problems becomes less relevant, since it has nothing or very little to say in situations of goal congruence (Arthurs & Busenitz, 2003).

A proponent of agency theory, Barney, admits that despite its robustness, the assumption of selfinterest is indeed limited. Thus, he welcomes all attempts to produce a "more sophisticated and complicated model of motivation" by integrating more traditional management and organisations with agency theory.

Indeed, what constitutes the self-interest seems to be problematic from the philosophical perspective. For instance, it seems to be a matter of definition as to whether altruistic behavior is understood as a self-interested pursuit of psychological benefits (e.g. for the sake of good conscience), can this type of behavior be regards as self-interested (Parrow, 1986; Hendry 2005).

The relevance of the Theory to the Study

From the agency theory, managers may engage in actions that perpetuate their personal aggrandizement. Hart (1995) contends that the cost associated with possible conflict of interest between agents and principals are known as agency costs. These according to Hart are traceable to auditing, budgeting, compensation and other forms of internal controls instituted to check management and employee misbehavior. According to Letza, Kirkbride, Sun and Small (2008), the argument underlying the agency theory is that, managers will only act to maximize shareholder value if only it is not in conflict with his or her own personal self-interest. Managers or employees may carelessly initiate, originate and fund potentially unsuccessful loans if internal controls are not religiously adhered to. The many cases of financial performance expressed in form of return on equity, return on investment and net interest margin and all forms of loan structuring which makes the loan books dirty are traceable to poor adherence and noncompliance to established policies and procedures.

Some loan defaults are employee-caused, others are bank-caused and others are client-led. Internal controls seek to ensure that there is increased financial performance in the commercial banks.

Literature review

The Relationship Between Control environment and Financial Performance

A control environment is a term of financial and internal audit. It means the overall attitude, awareness and actions of directors and management (i.e. "those charged with governance") regarding the internal control system and its importance to the entity. They express it in management style, corporate culture, values, philosophy and operating style, the organizational structure, and human resources policies and procedures (Institute of Internal Auditors North America, 2016).

According to Institute of Internal Auditors North America (2016) the control environment is the foundation on which an effective system of internal control is built and operated in an organization that strives to (1) achieve its strategic objectives, (2) provide reliable financial reporting to internal and external stakeholders, (3) operate its business efficiently and effectively,

(4) comply with all applicable laws and regulations, and (5) safeguard its assets.

Within the control environment, there are several factors which include the following:

Ethical value and integrity: management and employees must show integrity. If management displays issues of lack of integrity, it can trickle down to employees causing internal control issues and opportunities for fraud.

Human resource policies and procedure: control challenges can be avoided by adopting sound hiring procedures, training of employees and appropriate discipline.

Participation of those charged with Governance: it is important that those charged with Governance like audit committee, board of directors and others to be involved in regular monitoring of control functions.

Philosophy of management and its operating style: if management incorporates the importance of controls in its operating style, employees will know the seriousness of the matter.

Responsibility assignment: responsibility and authority need to be assigned to different employees throughout the organization. Decision making responsibilities should not be assigned to one individual.

Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013) framework introduced the concept of the control environment as a crucial element of internal control systems. It emphasized that a strong control environment is essential for achieving reliable financial reporting, compliance with laws and regulations, and efficient operations. The Conclusion was, a robust control environment can enhance financial performance by reducing the risk of fraud and errors, leading to more accurate financial reporting.

Al-Rassas, Ahmed and Kamardin, Hashim (2021) carried out a study, focused on companies in Malaysia, and found a positive relationship between the effectiveness of internal controls, including the control environment, and financial performance. The study highlighted the role of internal control in enhancing operational efficiency and financial reporting reliability. The conclusion was strong internal controls, including a well-structured control environment; contribute to improved financial performance by mitigating risks and ensuring compliance.

Jianfeng Wu, Youhong Wu, and Weicheng Liu (2022) carried out a research on Chinese firms found that a good control environment positively influences firm performance, particularly in terms of profitability and growth. The study emphasized the importance of ethical values and a supportive management style in the control environment. The conclusion was a positive control environment promotes a culture of compliance and ethical behavior, which in turn enhances financial performance.

Haidar Naim (2022) examined the effect of control environment, on financial performance in Tunisia. It found that a strong control environment significantly contributes to financial performance by improving transparency and accountability. The conclusion was an effective control environment supports better decision-making and risk management, leading to enhanced financial outcomes.

A research by Ejoh Okpa and Ohagwu (2023) highlighted the positive impact of a robust internal control environment on the financial performance of Nigerian companies. It emphasized the need for ethical standards and competent personnel in creating an effective control environment. The conclusion was a strong control environment promotes better financial performance by ensuring accurate financial reporting and reducing the likelihood of financial misconduct. Mwesigwa (2023), assessed the Impact of control environment on financial performance in Ugandan SMEs. The study found that a robust control environment positively impacts financial performance in small and medium enterprises (SMEs). It highlighted that effective internal controls, such as segregation of duties and regular audits, contribute significantly to financial stability and performance.

METHODOLOGY

The study adopted cross sectional survey design, using qualitative and quantitative data collection approaches. The target population of this study consisted of 50 respondents and sample size was 44 determined using Krejcie and Morgan (1970) table using both purposive and simple random sampling techniques. The main instruments of data collection were a self administered questionnaire, interview guide and documentary analysis.

FINDINGS

Control environment and performance of Guaranty Trust Bank

The objective of this study was to assess the relationship between control environment and performance at Guaranty Trust Bank, Mbarara, Branch, Ugandao. To achieve this, respondents were subjected to 10 statements that describe the control environment in their institution and their opinions were illustrated on the table below;

Table: 1 Descriptive statistics on control environment

Control environment		**Frequencies and percentage responses**				
		SA	**A**	**N**	**D**	**SD**
1.	Ethical values are upheld in all management decisions.	13 (37.1%)	18 (51.4%)	03 (8.6%)	01 (2.9%)	-
2.	The bank has an approved code of ethical conduct.	16 (45.7%)	17 (48.6%)	02 (5.7%)	-	-
3.	Management promotes high integrity standards.	14 (40.0%)	16 (45.7%)	04 (11.4%)	01 (2.9%)	-

4.	Staff is trained in anti ethical practices.	07 (20.0%)	16 (45.7%)	08 (22.9%)	04 (11.4%)	-
5.	Un ethical behaviors are punishable	15 (42.9%)	16 (45.7%)	03 (8.6%)	01 (2.9%)	-
6.	HR goals are in line with those of the bank.	17 (48.6%)	15 (42.9%)	03 (8.6%)	-	-
7.	There is an open communication to and from HR-department.	10 (28.6%)	17 (48.6%)	04 (11.4%)	04 (11.4%)	-
8.	Job description exists in the bank.	15 (42.9%)	14 (40.0%)	04 (11.4%)	02 (5.7%)	-
9.	Job openings are offered to current employees.	09 (25.7%)	18 (51.4%)	05 (14.3%)	03 (8.6%)	-
10.	Turnover rate is monitored by HR	08 (22.9%)	09 (25.7%)	14 (40.0%)	03 (8.6%)	01 (2.9%)

Source: *Primary Data*

Key: SA = Strongly Agree, A = Agree, N = Not sure, D = Disagree, SD = Strongly Disagree

From the table above, it can be said that Ethical values were upheld in all management decisions since majority 31 (88.6%) the respondents stated so. Only 01 (2.9%) respondent disagreed with the statement where as 03 (8.6%) respondents were un decided. This therefore implied that the banks decisions were in line with the approved ethical standards for all commercial banks which have facilitated the bank's better performance. This was supported by the interview findings from one of the managers when he said "*values are like principles and in management a principle is principle you either abide by it in decision making or resign your position*".

Besides that, the bank had an approved code of ethical conduct since majority 33(94.3%) of the respondents stated so whereas 02 (5.7%) were un decided. This implies that there were fewer cases of ethical misconduct since there was a Human resource policy document elaborating the approved code of conduct. This was confirmed by one board member when he said "*by the way I have never called here for any indiscipline case…….it seems here staff work as per their job descriptions following the code of ethical conduct as approved by BOU*" Furthermore, the management promotes high integrity standards since only 30 (85.7%) of the respondents agreed with the statement, 01(2.9 %) of the respondents disagreed whereas 04 (11.4%) of the respondents were not sure. More to that, Staff are trained in anti ethical practices since majority 23 (65.7%) of the respondents agree with the statement, only 4 (11.4%) of the respondents disagree with the statement whereas 08 (22.9%) were not sure. This implied that the staffs at Guaranty Trust Bank, Mbarara, Branch, Uganda have work related skills that are professional and ethically upright which facilitated better performance. This was confirmed by the internal control workshop reports found at the branches. In addition to that, un ethical behaviors were punishable. 31 (88.6%) of the respondents agreed with the statement, 01 (2.9%) of the respondents disagreed with the statement where as 03(8.6%) were not sure. This implied that supervisors at GT Bank consider ethics of the staff to be an engine of performance. This was confirmed by one supervisor when he said that "*un ethical behaviors are categorized under indiscipline and obviously they are punishable since they impede performance*" Further still, HR goals are in line with those of the bank since majority 32 (91.4%) of the respondents stated so, whereas 03 (8.6%) of the respondents were un decided. This implied that strategic management for improved performance was honored. This was supported by the banks operations policy.

There is an open communication to and from HR-department as stated so by 27 (77.1%) of the respondents, disagreed, 04 (13.3%) of the respondents disagreed with the statement whereas 04 (13.3%) respondents were un decided. This implied that information flows very well to and from the HR department as all channels of communication were open which leads to effective communication. This was supported by the banks operations policy.

From the table above, it can be said job description exists in the bank since 29 (82.9%) of the respondents agreed with the statement, 02 (5.7%) of the respondents disagreed with the statement whereas 04 (13.3%) were un decided. Moreover, job openings are offered to current employees since majority 27 (77.1%) of the respondents stated so, 03 (8.6%) of the respondents disagreed with the statement whereas 05 (14.2%) of the respondents were un decided. All these were indicators that each staff knows what he or she is meant to be doing and achieving for the branch. Besides that, turnover rate is monitored by HR since majority 17(48.6%) of the respondents agreed with the statement, 04 (13.4%) of the respondents disagree where as 14 (40%) of the respondents were not sure. This implied that GT Bank carries out human resource forecast to enable the bank be supplied with the human resource required at all time in order not to compromise their performance and also endeavors to facility present employees in order to keep them with institution a period of time. This was confirmed by the banks human resource periodic report of December 2022.

Financial **Performance of** Guaranty Trust Bank

A number of statements were posed to the respondents in regard to the variable above and the responses were given as indicated below;

Table 2 Descriptive statistics on performance

Performance of GT Bank	**Frequencies and percentage responses**				
	SA	**A**	**N**	**D**	**SD**

1.	The bank has a profit target.	22 (62.9%)	09 (25.7%)	03 (8.6%)	-	01 (2.9%)
2.	Profitability reports are prepared.	24 (68.6%)	09 (25.7%)	01 (2.9%)	-	01 (2.9%)
3.	Monthly profit and loss statements are generated from the system.	25 (71.4%)	08 (22.9%)	01 (2.9%)	-	01 (2.9%)
4.	Staff understands their contribution to the overall profit target.	15 (42.9%)	18 (51.4%)	01 (2.9%)	01 (2.9%)	-
5.	Profit and loss statement for a year is displayed.	19 (54.3%)	12 (34.3%)	03 (8.6%)	-	01 (2.9%)
6.	Reporting is done regularly.	16 (45.7%)	15 (42.9%)	03 (8.6%)	-	01 (2.9%)
7.	Financial reports reflect the facts about the institution.	18 (51.4%)	13 (37.1%)	03 (8.6%)	01 (2.9%)	-
8.	Feed back on reports is received at the branch.	13 (37.1%)	15 (42.9%)	06 (17.1%)	01 (2.9%)	-
9.	Reporting is fundamental at the bank	20 (57.1%)	13 (37.1%)	01 (2.9%)	-	01 (2.9%)
10.	Demands for new loans exceed liquidity levels.	08 (22.9%)	11 (31.4%)	05 (14.3%)	09 (25.7%)	02 (5.7%)
11.	The banks liquidity policies and procedures are adequate.	10 (28.6%)	12 (34.3%)	11 (31.4%)	02 (5.7%)	-
12.	The bank has experienced and competent staff to monitor liquidity.	09 (25.7%)	19 (54.3%)	06 (17.1%)	-	01 (2.9%)
13.	Liquidity reports provide meaningful information.	13 (37.1%)	17 (48.6%)	05 (14.3%)	-	-
14.	Management assesses assets liquidity.	11 (31.4%)	15 (42.9%)	09 (25.7%)	-	-

15.	Staff knows how liquidity is measured.	07 (20.0%)	09 (25.7%)	10 (28.6%)	03 (8.6%)	06 (17.1%)

Source: *Field data*

From the table above, majority of the respondents were in agreement with almost all the statements implying that the above statements are indicators of performance at Guaranty Trust Bank, Mbarara, Branch, Uganda that are honored by all the staff irrespective of their positions.31 (88.6%) respondents accepted that the bank as a profit target, 33 (94.3%) respondents agreed that profitability reports are prepared, 33 (94.3%) respondents agreed that profit and loss statements are generated from the system, 33(94.3%) respondents agreed that staff understand their contribution to the overall profit target, 31(88.6%) respondents agreed that profit and loss statements for the year are prepared, 31(88.6%) respondents agreed that reporting is done regularly, 31(88.6%) respondents agreed that financial statements reflect the performance of the bank, 28(80%) respondents agreed that feed back on reports is received at the branch, 33(94.3%) respondents agreed that reporting is fundamental at the bank, 19(54.3%) respondents agreed that demand for new loans exceeds liquidity levels, 22(62.9%) respondents agreed that the banks liquidity policies and procedures are adequate 28(80%) respondents agreed that the bank has competent staff to monitor liquidity levels, 30(85.7%) respondents agreed that liquidity reports provide meaningful information, 26(74.3%) respondents agreed that management assesses asset liquidity and 16(45.7%) respondents agreed that staff know how liquidity is measured.

Hypothesis testing.

To find out whether there was a significant relationship between control environment and performance of Guaranty Trust Bank, Mbarara, Branch, Uganda a correlation analysis was computed, examined and interpreted using
Pearson product moment correlation co-efficient method. The results are elaborated below

Table 3: showing the Correlations between control environment and performance of Guaranty Trust Bank,

	control environment related variables	performance of GT Bank
Control environment Pearson Correlation related variables	1	.410*
Sig. (2-tailed)		.014
N	35	35
Performance of GT Pearson Correlation bank	.410*	1
Sig. (2-tailed)	.014	
N	35	35

Table 4: showing the Correlations between control environment and performance of Guaranty Trust Bank,

	control environment related variables	performance of GT Bank
Control environment Pearson Correlation related variables	1	.410*
Sig. (2-tailed)		.014
N	35	35
Performance of Guaranty Trust Bank, Pearson Correlation	.410*	1
Sig. (2-tailed)	.014	
N	35	35

*. Correlation is significant at the 0.05 level (2-tailed).

The findings in the table above showed that the correlations between control environment and performance of Guaranty Trust Bank, Mbarara, Branch, Uganda. The findings indicated that the

Pearson correlation (r = 0. 410), the significance value p (.014), N represents the number of respondents (35). Control environment indicates a moderate strength of association (r = 0.410) and the correlation was statistically significant (high) because $p = .014 < 0.05$. This implied that control environment was positively related with performance of GT Bank and therefore does support the hypothesis that there was a significant relationship between control environment and performance of GT Bank.

Regression analysis.

On the basis of results above, a regression analysis was done to ascertain the extent to which control environment explains performance of Guaranty Trust Bank, Mbarara, Branch, Uganda. Below is the table indicating the summary of the results;

Table 5: showing a Model Summary of control environment and performance of Guaranty Trust Bank,

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.410[a]	.168	.143	.443

a. Predictors: (Constant), control environment related variables

The Model Summary table above, revealed that correlation coefficient *(R),* using the predictor; control environment, was .410 and the R^2 (.168). The R demonstrated correlation; R^2 demonstrated how a set of independent variable explained variations of a dependent variable on a sample population where as adjusted R^2 demonstrated percentage of variance the independent variable explains on the dependent variable on the target population (Mugenda and Mugenda, 1999). This implied that 16.8% (.168*100%) of performance of GT Bank was explained by control environment on a sample population where as 14.3% (.143*100) of the performance of GT Bank was explained by control environment on the target population, while the remaining percentage can be explained by other factors. Therefore this can be interpreted that if Guaranty Trust Bank, Mbarara, Branch, Uganda can maintain an effective control environment, the bank's performance can be maintained.

From the above finding we accept the hypothesis that there is a significant relationship between control environment and performance of Guaranty Trust Bank, Mbarara, Branch, Uganda.

Recommendations and Conclusion

In light of results of the study, the researcher encourage increased appreciation of effective risk assessment in ensuring working internal controls and improved financial performance in Commercial banks. Whereas an enabling control environment is necessary, it is in itself not enough to spur performance unless its backed up with actual control activities like forming fully-fledged and functional credit committees to critique customers loans applications and prevent delinquency, prompt and timely calling of tellers work and restricting system access by non-staff among others should be strictly observed at all times.

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