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Risk management and control pitfalls of local governments in Ghana

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ABSTRACT

Globally, local governments are required to minimise risks and adopt effective and efficient control structure to enhance delivery of public services to the people. In Ghana, some local governments record risk management and control irregularities that affect public service delivery. This paper examined the components of the risk management and control structure in four local governments in Central Region of Ghana to determine the pitfalls. The study employed a qualitative design to purposively select 14 key informants to provide primary data. They were two Internal Auditors, three Co-ordinating Directors, three Chairpersons of Audit Committees, two District Auditors, one regulator from the Central Region, and three regulators at the national level. Secondary data sources were the District Auditors' and Auditor-General's reports and other documents related to the study. Key informant interview and document review were the data collection methods and interview guide and document review guide were the data collection instruments. Pattern matching and content analysis were employed as the main tools for analysing the primary data. Desk review was used to analyse the secondary data. The study revealed that weak composition of the Audit Committees and management bodies' philosophy and operating style did not help the selected local governments to provide the people's needs to expectation.

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1. INTRODUCTION

Risk management and control structure provides details of components required for effective multi-level governance. Risk is the effect of uncertainty on objectives (ISO, 2009a, b). The effect of uncertainty could either be positive or negative. A positive effect creates opportunities while negative effect culminates in threats. Thus, risk management and control structure is imperative for local governments to meet the aspirations of their citizens. It involves processes and tasks to ensure discipline, order and accountability in their operations.

Baltaci and Yilmaz (2006) noted that Britain, European Union, and United States have examples of good risk management and control structures at the local governments (LGs) to help provide the needed municipal services. However, risk management and control do not seem to be a priority in developing countries because their operations are fraught with irregularities (Auditor-General, 2012). This makes it difficult to meet development objectives. Ineffective risk management and control structure results in fiscal imbalance, weak accountability, political capture, and deterioration in public services (Baltaci & Yilmaz, 2006).

Local governments have access to public funds through transfers from central governments in addition to raising funds locally. These resources need to be tracked for judicious mobilisation and application to ensure sound outcomes. Internal auditing is one of the mechanisms employed to provide oversight responsibilities for the management of local government resources. It delivers processes to check inefficiencies in the LGs.

In shaping this paper, review of related literature focuses on Baltaci and Yilmaz (2006), the Institute of Internal Auditors (IIA) (2013), and the Committee for Sponsoring Organisations of the Treadway Commission (COSO) (2013). Baltaci and Yilmaz (2006) noted that weaknesses in the operations of LGs pose threats to their national economies and cited fiscally distressed LGs of Argentina, India, Brazil, and Columbia as experiencing excessive fiscal deficits because of factors such as weak local political capacity, limited internal control and external oversight. Weaknesses in risk management and control structure result in mismanagement of resources and unproductive outcomes. Table 1 depicts risk management and control practices in LGs of some selected countries.

Table 1: Risk management and control at local levels in selected countries

SN	Country	Nature of weaknesses in risk management and control	Effect of weaknesses in risk management and control
1	Argentina	i. Inadequate legal instruments ii. No political will to improve risk management and control	i. High level of indebtedness in local governments ii. Failure in providing urban services
2	Bosnia	i. Limited contemporary internal control and audit systems	i. Impaired safeguard against irregularities ii. Widespread corruption iii. Misconduct and misuse of public funds iv. Public disaffection for government institutions
3	China	i. Ex ante expenditure control and compliance audits	i. Problems in compliance with laws and regulations ii. Unlawful tax practices
4	Columbia	i. Unclear legal framework defining the functions of fiscal control agencies ii. Ineffective internal control mechanisms	i. Negligence ii. Corruption iii. Misuse of public funds
5	India	i. Inefficient risk management and control structure ii. Old fashioned rule books iii. Untimely and unreliable information iv. No focus on compliance audits v. Inadequate follow-up with audit findings	i. Frequent case of abuse ii. Misuse and fraud iii. Irregularities and malpractices in procurement iv. Weak compliance with the stated rules and procedures
6	Indonesia	i. Weak internal control and audit systems	i. Unethical and uneconomic operations ii. Pervasive corruption iii. Inefficient cash management iv. Collusive practices in procurement
7	Philippines	i. Weak internal control environment ii. Non-existent internal audit iii. Untimely release of financial information	i. Limited compliance with laws, rules and regulations ii. Fraud and irregularities iii. Overpaid public purchase and procurement

Source: Adapted from Baltaci and Yilmaz (2006)

According to the IIA (2013), the Three Lines of Defense Model is an effective tool for managing risk control issues and it is effectively implemented with the active support and guidance of an organisation's governing body and senior management. The model distinguishes among three lines involved in effective risk management and control as follows: (a) the operational management who owns and manages risks; (b) risk management and compliance functions which oversee risks; and (c) internal audit functions which provide independent assurance on risk processes.

The first line is responsible for implementing corrective actions to address control deficiencies, maintaining effective internal controls, and executing risk and control procedures on a day-to-day basis. The second line establishes various risk management and compliance functions to help build and monitor the first line-of-defense controls. The third line deals with the services of internal auditing that provide the governing body and senior management with comprehensive assurance based on a reasonable level of independence and objectivity within an organisation.

The COSO (2013) provides an integrated control measures to be recognised and acknowledged by policy makers, regulators, regulatees, and others in order to have a common background and understanding of the system of internal controls and risk management. It involves five broad areas namely: (i) control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication, and (v) monitoring. The control environment sets the tone of an organisation, influences the control consciousness of its people and it is a foundation for all other components of internal control to provide discipline and direction (Marquette University Risk Unit, 2019).

Literature review brings to the fore six operational components of the standard mix of organisation's risk management and control structure. The standard mix describes the desired mix of basic components which ought to be present and function effectively together to compose an effective and acceptable risk management and control structure. The absence and dysfunction of any of the components pose a danger to the operations of an institution. The six components are as follows: (a) management philosophy and operating style; (b) audit committees; (c) internal control, risk, and/or compliance officers; (d) internal audit functions; (e) legal, regulatory, and policy framework; and (f) political culture.

The management philosophy and operating style assist to set the tone of the institution. These define attitudes and approach that management bodies take towards institutional objectives, minimising risks, and the functioning of internal controls over financial reporting, information processing, accounting functions, and personnel. They cover the actions and inactions of management bodies to lead institutions. Audit Committees are at the apex of the governance structure of institutions. They oversee governance processes and hold individuals or groups accountable for their internal control responsibilities. Internal control, risk, and/or compliance officers are expected to take control of risk situations by assisting to identify, assess, manage, and monitor risks in processes.

The internal audit functions, which report directly to Audit Committees provide monitoring services to management bodies to assist in decision-making. The legal, regulatory, and policy framework provides the blueprint for the day-to-day administration of institutions. It controls irregularities and ensures orderliness in institutions. The political culture shapes the nature and focus of the activities in institutions. Favouritism and patronage contribute to breed indiscipline and wantonness, which hinder progress of institutions. Political culture is an important indicator for assessing the level of institutional risk and how to deal with it. The combination of the six components cut across most risk management and control structures as the least required mix; even though other components could be added on, depending on the gravity of the risk exposure and the nature of the respective institutional environments. An effective risk management and control structure is determined at the point where the functioning of the components achieves the expected objective(s).

The concept of risk management and control is underpinned by the institutional theory where pressures in the environment exert on institutions to operate according to established schemes and norms. The theory posits that organisations survive when structures and laid down procedures have been firmly established and enforced (Meyer & Rowan, 1977; Scott, 2004). It is based on the central assumption that pressures are brought to bear on organisations to be similar (DiMaggio & Powell 1983). Scott (1987) and Zucker (1987) justified the relevance of the assumption by pointing out that internal and external pressures influence organisations. The internal pressures comprise formalised arrangements such as schemes, norms and procedures while the external pressures include state requirements, professional protocols and codes of ethics.

The statement of the problem of the study is occasioned by three issues. Firstly, LGs in Ghana have been accused of mismanaging resources to the disappointment of the local people in some instances because the provision of poor quality of goods and services and inadequate basic amenities (Ayee, 2003). Secondly, it is unclear whether the components of risk management and control structure of the LGs meet the required standard. Thirdly, no such study has been conducted in local governments (also known as Assemblies) in the Central Region of Ghana. This study, therefore, examined the components of the risk management and control structure in four selected local governments. The specific objectives were to: (a) Compare the mix of components of the risk management and control structure of the selected local governments with the standard structure, (b) Investigate the functioning of the components of the risk management and control structure of the selected local governments, and (c) Make recommendations for the purpose of improving risk management and control processes in the selected local governments.

The expectations of the results are that: firstly, a dependable conclusion would be drawn. Secondly, stakeholders would be made to know the circumstances under which the risk management and control pitfalls of the selected local governments occurred. Thirdly, recommendations to deal with the pitfalls would be given.

The paper has four benefits. First, it would help stakeholders to understand the issues involved in risk management and control in local governments. Second, it would expand literature on the risk management and control of LGs. Third, it would provide insights into the workings of local governments. Fourth, it would serve as a foundation for future studies on risk management and control in similar institutions. These benefits are applicable in various fields since the regulations, internal controls and compliance processes follow scientific procedures to enable achievements of strategic goals of local government and other similar institutions.

2. RESEARCH METHOD

Study institutions

The study institutions were the Cape Coast Metropolitan Assembly, Mfantseman Municipal Assembly, Abura-Asebu-Kwamankese District Assembly, and Twifo-Hemang-Lower-Denkyira District Assembly in the Central Region of Ghana (Figure 1). The structure of the local governments in the region in 2012 was one Metropolitan Assembly, seven Municipal Assemblies, and 12 District Assemblies. The structure informed the purposive selection of the four local government institutions; that is, one metropolitan, one municipal, and two district assemblies. The four selected local governments cut across the structure. The size of the researchers' budget influenced the selection of the institutions which shared the same boundaries in order to help reduce travelling expenses.

Research design

A research design is a logical and systematic manner to ensure that the empirical data that have been collected are able to provide answers to research questions (Yin, 2003). The study adopted the interpretivist research philosophy. This informed the choice of a qualitative approach for the paper where non-standardised and non-numerical data (Saunders et al., 2012) were collected for the study. The paper employed the in-depth interview design.

Sampling procedure and sample

Morse (1994) asserted that a qualitative study requires at least six participants to be used. This study purposively selected 14 key informants through the expert method to provide primary data. They were two Internal Auditors, three Co-ordinating Directors, three Chairpersons of Audit Committees, two District Auditors, one regulator from the Central Region, and three regulators from the national level. The secondary data sources were the reports of Auditor-General from 2004 to 2012, and the 2012 District Auditors' reports on the four selected local governments. The others were Government of Ghana (2016 a, b) which deal with Public Financial Management (2016) Act 921 and Local Governance (2016) Act 936 respectively.

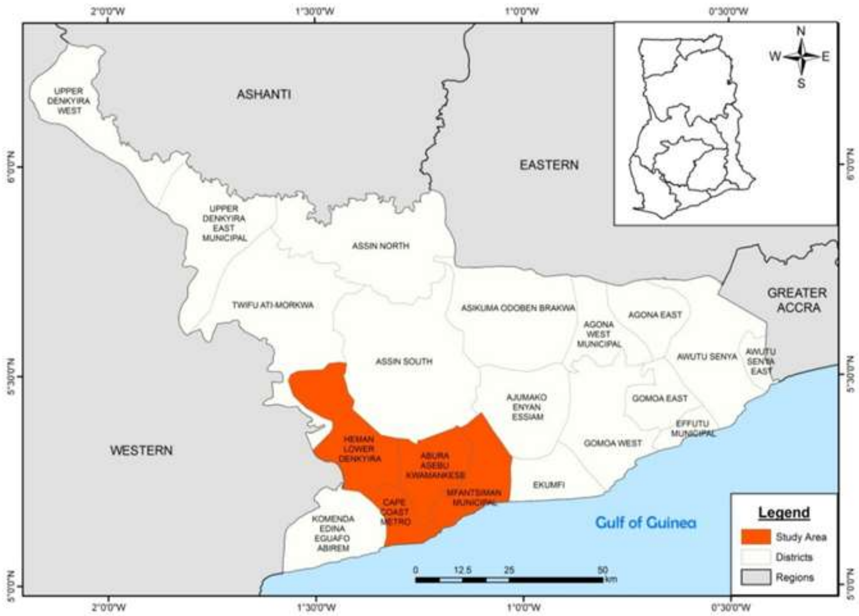

Figure 1: Map of study area in regional context

Source: Department of Geography and Regional Planning University of Cape Coast (2016)

Data collection method and instruments

Five research assistants were recruited and trained to collect the data. The key informant interview and document review were the data collection methods while interview guide and document review guide were the data collection instruments. The interviews were tape-recorded.

Ethical issues

Informed consent was obtained verbally from the key informants prior to be interviewed and tape-recorded. The key informants were told that the study was for an academic purpose and were assured of confidentiality and anonymity. They were also made aware of their willingness to opt out at any stage of the interview if they desired to do so.

Data processing and analysis

The data were processed manually in order to preserve the originality of the information contained in the raw data. The responses were categorised by themes, key informants (e.g. Co-ordinating directors, internal auditors, chairpersons of ARICs, district auditors, and the respective LGs; and coded to aid in the analysis. The responses were summarised to reduce the data. The pattern matching, comparison, and interpretation were employed as the tools for analysing the primary data. The desk review was used to analyse the secondary data.

3. RESULTS AND DISCUSSIONS

The results and discussions presented in this section are guided by the specific objectives of the study.

Comparing the components of the risk management and control structure with the standard structure

The risk management and control structure provides a framework for efficient management of resources to improve operations of organisations. The analysis revealed that, five out of the six components of the standard risk management and control structure were present in the desired and acceptable mix in the selected LGs as shown in Table 2. The finding is consistent with that of Boachie-Danquah (2011 as cited in Alam & Koranteng, 2011) that public institutions in Ghana, including local governments, are seen as dishonest. The indication is that there are some deficiencies and weaknesses in the risk management and control structure of local governments.

Table 2: Standard mix of components in the risk management and control structure of local governments

No.	Standard mix of components	Yes	No	Comments
1.	Managements' philosophy and operating style	X		Available
2.	Audit committees	X		Available
3.	Internal control, risk, and compliance officers		X	Not available
4.	Internal audit functions	x		Available
5.	Legal, regulatory, and policy framework	x		Available
6.	Political culture	x		Available

Source: Authors' compilation from Baltaci and Yilmaz (2006), IIA (2013) and COSO (2013)

Functioning of the components of risk management and control structure

This sub-section covers six essential issues namely; philosophy and operating style of management bodies, audit report implementation committees, organisational independence for internal audit units, internal control, risk, and compliance officers, and political culture.

Philosophy and operating style of management bodies

The study showed that management bodies abused the system by not complying with the laid down procedures as reported by a District Auditor, and a Regulator at the regional level that: *The Assembly does not spend according to the programmes in their Annual Action Plans* (A District Auditor, 12th August, 2016).

Most of the findings we observe cut across the selected local governments and they are as a result of failure to comply with the laid down rules and enactments (A Regulator at the regional level, 10th November, 2016).

The results are consistent with the presence of managements' philosophy and operating style, audit committees, internal audit functions, legal, regulatory and policy framework, and political culture as part of the standard mix of the selected LGs. The standard mix is expected to improve risk management and control structure with the aim of enhancing provision of quality municipal services to the public. The results are also in agreement with the principles of the institutional theory for the reason that, laid down procedures and processes have been followed.

Audit Report Implementation Committees

The analysis indicated that the Audit Report Implementation Committees (ARICs) were made up of mostly management members and, therefore, not fit for purpose as pointed out as follows: The composition is not strong enough to chastise who is doing something wrong. In case the Chief Executive does something wrong who amongst these in-house persons will point it out? (An Internal Auditor, 10th August, 2016). I am not pleased with the composition of ARIC; because you make the Presiding member the chairman of ARIC; if he has no knowledge in auditing/accounting/ finance; then he is just a ceremonial head (A Co-ordinating Director, 11th August, 2016).

However, the law on ARICs had been repealed and replaced with Audit Committees, which were properly constituted to include professionals from outside of the LGs since 2016. Nevertheless, improvement in their performance has not been realised due to irregularities in the operations of LGs in 2017 as reported by Auditor General (2018: 1-2): The significant unresolved and outstanding findings from the routine audits carried out in 2017 were attributed to deficiencies and weaknesses in internal controls in the operations of the Assemblies and were still prevalent as evidenced in the management letters.

The weak composition of ARICs as noted by the internal auditor and the Coordinating Director undermines the risk governance processes of the selected LGs. It indicates that the weaknesses in the local government processes had not been effectively monitored. Thus, recommendations of monitoring and audit service inspections were not implemented. The results confirmed Dawuda (2010) which pointed out that audit committees (ARICs) were not effective. However, the result was inconsistent with the principles of the institutional theory as the required pressures were not put on the processes to generate the expected output and outcomes in the LGs.

By abusing the system for not spending according to the programmes in their annual action plans and repeatedly failing to comply with the laid down rules and enactments, the management philosophy and operating style of management bodies would not support the achievement of local government objectives. Rather, it would provide a recipe for indiscipline and disorder and conditions would be provided for mismanagement of resources. This result was in line with Auditor-General's (2017) report that there were internal control weaknesses due to managerial lapses and non-compliance with procedures. The result, however, contrasted to the principles of institutional theory which establishes that laid down procedures should be followed at all times.

Organisational Independence for Internal Audit Units

The study found that there was no organisational independence for internal audit functions in the LGs. Three key informants reported that:

Internal auditors should not report to management; that is all, and you will not have problems because you will be independent; but if internal auditors should report to management, then you are definitely bound to bend the rules (An Internal Auditor, 1st September, 2016).

The internal auditors are not truly independent because they are under resourced (A Co-ordinating Director, 11th August, 2016).

Internal auditors should be independent but the degree of their independence is what we are not sure of; they are employees of their establishments, and they are writing reports most of which affect management (A Regulator from the region, 10th November, 2016).

The three foregoing responses suggest that the assurance activities on the risk management and control processes in the LGs would not be carried out to expectation. There could be mismanagement of resources which could lead to poor delivery of services to the people. Internal auditors would be subjected to the control of management bodies, thereby impeding execution of objective and independent assignments. The result is in line with that of Barlow et al. (1995), which reveals that internal auditors cannot be independent if they work for organisations that they audit. On the contrary, the result is inconsistent with the institutional theory. The reason is that the stipulated regulations were not followed to promote organisational independence for internal audit functions.

Internal Control, Risk, and Compliance Officers

The study showed that the positions of internal control, risk, and/or compliance officers were not part of the establishment of local governments in Ghana. In situations where these officers were not functioning, the extent of exposure to risks and control deficiencies in the local government system would not be identified, assessed and managed. The result confirmed the finding of

Kangarlouei et al. (2013) that there were deficiencies and internal control weaknesses in operations. The result also agreed with the report of Auditor-General (2017) that there were managerial lapses in the operations of LGs. Nevertheless, the result disagreed with the Local Governance (2016) Act 936 which gives powers to the Head of Local Government Service to recruit and appoint staff to the Assemblies. Similarly, the result did not agree with the IIA (2013) position on the Three Lines of Defense Model which states that there should be internal control, risk, and/or compliance officers to oversee the risk management and control functions of an organisation. Furthermore, the result was inconsistent with the institutional theory because the absence of internal control, risk, and/or compliance encouraged officers to flout laid down procedures and regulations.

Legal, Regulatory and Policy Framework

It emerged from that study that some provisions of the Public Financial Management (2016) Act 921 and Local Governance (2016) Act 936 which support risk management and control in local governments did not address certain pertinent operational issues. These were reported by some key informants as follows: The internal auditor role does not mean you can prevent management from taking a decision; his/her expert advice is only a recommendation and not binding on management to comply (A Co-ordinating Director, 11th August, 2016).

As an internal auditor, you write and they don't seem to mind you. The reports go to Accra, Regional Co-ordinating Council and still the same; so it's like our reports go to the shelf (An Internal Auditor, 10th August, 2016).

The weak provisions of the legal, regulatory, and policy framework undermined the risk management and control structure. The remarks of a Coordinating Director and an internal auditor further support the weaknesses in the system. The non-binding nature of the implementation of internal audit recommendations confirm Kiabel's (2012) observation that management bodies of companies were reluctant to take actions on internal audit reports and recommendations.

Section 83 (2) of the Public Financial Management (2016) Act 921 states that *the Head of the internal audit unit shall report administratively to the Principal Spending Officer and functionally to the Audit committee of that covered entity.* By reporting administratively to the Principal Spending Officer of that covered entity, whose operations, duties, actions, and inactions are subject to appraisal by the functions of the internal auditor, the independence and the objectivity of the internal auditor would be impaired. The reason is that the internal auditor would be subjected to administrative control through instructions and directives which would render internal auditing ineffective. Meanwhile, Section 88 (1) *(a)* of the Public Financial Management (2016) Act 921 stipulates that:

An Audit Committee shall ensure that the Head of a covered entity, to which the Audit Committee relates, pursues the implementation of any recommendation contained in an internal audit report...

As Section 88 (1) *(a)* stands, there is no direct obligation on the Head of a covered entity, and for that matter, management bodies of LGs to implement recommendations in internal audit and other inspection or examination reports. The obligation has been shifted rather to the Audit Committees which are not directly responsible for the actions and inactions of officers in the entity to which it relates. Moreover, the *manner in which the Audit Committee shall ensure* that *the Head of a covered entity pursues* the implementation of any recommendation, as enshrined in the Act, has not been explicitly prescribed or stated.

The framers of Section 88 (1) *(a)* should have laid the responsibility of the actions and inactions of officers squarely on the Head of a covered entity, and for that matter, management bodies who are directly responsible for the operations of the covered entity. Aside from this, they should have clearly and explicitly spelt out the manner in which an Audit Committee should ensure that the Head pursues the implementation of all recommendations in internal audit and other inspection reports. Without making management bodies directly responsible for the operations of an entity by instructing them to pursue the implementation of any recommendation in reports, the irregularities in operations would continue to recur. Objectives would not be achieved while resources would continue to be mismanaged in local governments.

The Local Governance (2016) Act 936 does not cover the recruitment and appointment of internal control, risk, and/or compliance officers to help oversee the risk governance of the Assembles. The result corroborates Ferrazzi's (2006) assertion that slow progress of decentralisation rests on the shortcomings of the architecture and content of the legal framework for decentralised local governance. However, the result was inconsistent with the institutional theory because the weak provisions of the legal, regulatory, and policy framework undermine effective functioning of the components of the risk management and control structure.

Political Culture

The analysis discovered that some political heads interfered with the risk management and control processes as expressed by three key informants as follows: It should be made difficult for political appointees to recommend the transfer of internal auditors to enable them do their professional job without fear (ARIC Chairperson, 22nd September, 2016).

If management perceives you to be difficult by not cooperating with them, you will find yourself 'flying' (posted out) the next morning (An Internal Auditor, 10th August, 2016).

Some heads of department also do not appreciate the work of internal auditors and see them as interfering with their work (A Co-ordinating Director, 11th August, 2016)

The result confirms the finding of Usang and Salim (2016) that there is political interference in the local government performance. The result is, however, not consistent with institutional theory, which encourages cooperation with internal auditors rather than interference.

4. CONCLUSION

The paper has provided evidence that the desired mix of the components of the risk management and control structure of the selected LGs was largely present. However, the functioning of the components in the structure was weak, thereby constituting the risk management and control pitfalls of the LGs. The philosophy and operating styles of management bodies did not support the aspirations of local governments due to non- adherence to the laid down procedures. There was no organisational independence for internal audit functions. Some provisions of the legal, regulatory, and policy framework were weak; and there was a compromised political culture. In addition, the ARICs were not properly constituted and there was no internal control, risk, and compliance officers.

The practical implication of the study is to help address real life situations and problems and improve outcomes. Thus, policy decisions would be informed by providing evidence-based recommendations for LGs. The theoretical implication is that the institutional theory emphasises on the establishment and enforcement of laid down structures of organisations. It also helps to develop and refine conceptual frameworks to enhance understanding of complex phenomena, encourage critical thinking and analysis, and challenge existing assumptions and beliefs, thereby advancing knowledge. The theoretical and practical implications of the findings show that risk management and controls of local governments face potential challenges if control measures are not well implemented.

Recommendations, Three recommendations are made. First, the Head of Service at the Local Government Service should liaise with the sector minister to discuss the possibility of making the internal control, risk and/or compliance officers as part of the establishment of the Local Government Service. Second, the Head of Local Government Service should sponsor the review of aspects of legal, regulatory and policy framework, which are weak. For example, the recruitment and appointment of internal control, risk, and/or compliance officers to conform to international best practices as prescribed by the Three Lines of Defense Model. Thirdly, management bodies who fail to ensure the effective functioning of the components of the risk management and control structure should be sanctioned by the appropriate authorities.

Contribution to knowledge, The paper contributes to knowledge by helping stakeholders to recognise that the mere presence of the desired and acceptable mix of components in a risk management and control structure of institutions do not guarantee the effectiveness of the structure but rather, the effective functioning of the desired mix of components of the structure. Additionally, it has confirmed the usefulness of institutional theory to explain the phenomena that are related to rules, regulations and laid down principles in LGs. The implication is that weak risk management and control structure hinders effective delivery of services by LGs.

Limitation of the study, The limitation of the study is that a large sample was not used. Hence the findings could not be generalised but limited to the four selected LGs. According to Delmar (2010), generalisability in qualitative studies is focused on the researcher's analysis and understanding of circumstances but not the collection of representative data. The findings of this qualitative study can be generalised to cover all LGIs with caution. This paper suggests that future study may employ the mixed methods approach.

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