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# Ethical Values, Integrity and Internal Controls in Public Sector Organisations: A Developing Country Perspective

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## ABSTRACT

*The study established the relationship between the perceived commitment to ethical values, integrity of public sector managers and the internal control system of public sector organisations in Ghana. The study employed Pearson's Correlation Coefficient to explain the association between the ethical environment and the internal control system. Results revealed statistically significant negative association between the ethical environment and three components of the internal control system investigated in the study. The findings of the study should be of concern to policy makers, development partners, auditors, boards of public sector organisations as they play their fiduciary roles in the country.*

**Keywords:** *Ethical environment; Ethical values; integrity; internal controls; public sector organisations*

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## INTRODUCTION

The Public Sector in developing countries has undergone major reforms over the past decades, of which Ghana is not an exception. Ghana in 2003 passed three major financial laws; the Financial Administration Act, Internal Audit Agency Act, and the Public Procurement Act. The aim of all these acts was to enhance accountability and transparency in public sector organisations.

The Internal Audit Agency was set up by an act of parliament in 2003 (Act 658) as an apex oversight body to co-ordinate, facilitate and provide quality assurance for internal audit activities within Ministries, Departments and Agencies and Metropolitan, Municipal and District Assemblies. The Public Procurement Act (Act 663) was also established by an act of parliament to provide for public procurement, establish the Public Procurement Board; make administrative and institutional arrangements for procurement; stipulate tendering procedures and provide for purposes connected with these. The Financial Administration Act, (Act 654) which was likewise, established to regulate the financial management of the public sector, was subsequently repealed and replaced with a new Public Financial Management(PFM) Act in 2016. The new PFM Act was a significant step towards strengthening the PFM systems to ensure fiscal discipline and the effective and efficient use of public resources (Dua Agyeman,2016).

Yet the upsurge of reports of allegations of malfeasance and sheer impunity in the public sector is overwhelming. This is evidenced by the stack of facts revealed from the proceedings of the public accounts committee of parliament and videos from Anas, the famous investigative journalist on the misconduct of public officials in Ghana. Amisah-Arthur, a former vice president of Ghana in his address on the 9<sup>th</sup> annual internal audit forum in Accra made a startling observation. He noted that audit reports published in newspapers revealed that there is breakdown of internal controls in public sector organisations (Ghana News Agency, 2014).

The Auditor-General's reports on the public accounts of public sector institutions in Ghana have always lamented the non-compliance of public institutions with financial regulations. This is the result of systemic weaknesses that have persisted over time and other breakdowns in internal controls of public institutions. Below are a few examples;

It was revealed during one of the sittings of the Public Accounts Committee of parliament that most of the purchases done by the various district health directorates did not follow the laid down procurement rules. The 2013-2014 report of the Auditor-General on the public accounts of polytechnics, revealed similar lapses. The report identified ten polytechnics which faltered the financial regulations resulting in financial irregularities of over 45 million Ghana cedis. According to the report, the irregularities covered three areas: cash, payroll and procurement process. Cash irregularities comprised misapplication of funds, non-retirement of imprest, unapproved expenditure and non-payment of internally generated funds (IGFs) into the Consolidated Fund. Payroll irregularities mostly included the payment of unearned salaries, failure to delete names of separated staff after termination dates and payment of allowances without approval. The report attributed procurement irregularities to intentional disregard for the Public Procurement Act, management's failure to comply fully with the procurement laws, improper procurement planning and a breakdown of the procurement process (Paha,2017), (Ghana Audit Service,2015).

The Auditor General's report of the Ministry of Youth and Sport (National Youth Authority) for 2015, revealed a total disregard for the provisions of financial regulations and a complete breakdown of internal controls. The control deficiencies of the National Youth Authority were mainly in the areas of authorisation, documentation and supervision. Large amount of monies were paid on behalf of the Authority which were not supported by payment receipts. The Auditor General in his report noted that "Examination of the revenue cash book disclosed that three General Counterfoil Receipts (GCRs) books which were used to collect total revenue of GH¢2,150,738.73 were not made available for our examination even though the amount was entered in the cash book and accounted for. We could therefore not satisfy ourselves that the revenue accounted for in the cashbook was genuinely the total amount collected and recorded. The possibility of the GCRs used for other purposes cannot be ruled out. The anomaly could be attributed to poor custody of value books at the Authority coupled with ineffective supervision by the head of Accounts" (Ghana Audit Service,2016).

Paradoxically empirical studies on the effectiveness of internal controls in public sector organisations in Ghana revealed a strong ethical

environment which is characterised by management's commitment to promoting ethics, integrity, competence etc (Ayagre & Victor, 2015) (COSO, 1992). This study is motivated by the above contradictions of perceived commitment to ethical values, integrity in the public sector in Ghana and the breakdown of internal controls leading to fraudulent activities. The paper contributes to the literature by empirically investigating the relationship between the ethical environment and the internal control system of public sector organisations, from the perspective of a developing country.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

### Ethical Climate Theory

Victor and Cullen (1987,1988), combined the moral development theory (Kohlberg,1984) and the organisational work climate theory (Schneider, 1983), to develop the ethical climate theory (Simha & Cullen, 2012). The theory in its simplest form believes that decisions of organisational actors are to a large extent influenced by the type of ethical climate entrenched in the organisation. That individual decisions are based on the dominant ethical climate, be it self-interest, team-interest, company profits, personal morality, rules and procedures, professional codes and laws, efficiency, etc. The ethical climate theory has been used by most researchers to investigate the effects of ethical climate on various organisational outcomes (Martin & Cullen, 2006). Notable amongst the organisational outcomes include: job satisfaction, organisational commitment, employee turnover, ethical behaviour and dysfunctional behaviour. This paper, joins the many researchers by exploring the relationship between the ethical climate of public sector organisations and ethical behaviour of public sector managers in terms of the managers commitment to the proper functioning of internal controls (Simha & Cullen, 2012). This paper adopted the control environment of the internal control system as a proxy for the ethical climate of public sector organisations. Key variables of the control environment include management's philosophy and leadership style, management's support and commitment to integrity and ethical values (COSO ,1992), which relate with an ethical environment (Chen, Sawyer, & Williams, 1997). Rothwell & Baldwin, 2007, looked at the ethical climate and its

influence on employee's decision to report misconduct in public sector organisations. They found out that friendship and team ethical climate had positive association with employee willingness to engage in whistleblowing. However, egoistic ethical climate was found to relate negatively with organisational commitment, while instrumental climates were positively associated with unethical behaviors (Cullen, Parboteeah, & Victor, 2003), (Wimbush, Shepard, & Markham, 1997).

### **Ethical Climate and Internal Controls**

Internal controls may be defined as “the whole system of controls, financial and otherwise, established by management in order to carry out the business of the enterprise in an orderly and efficient manner, ensure adherence to management, safeguard the assets and secure as far as possible the completeness and accuracy of the records” (Robbins, 1982). The Committee of Sponsoring Organisations (COSO) in 1992, defined internal controls as a “process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the: Effectiveness and efficiency of operations, Reliability of financial reporting, Compliance with applicable laws and regulations” (COSO, Internal Control-Integrated Framework, 1992). The framework groups an organisation's internal control system into five integrated components (control environment, risk assessment, control activities, information and communication and monitoring) which must be built into business processes across the entire organisation, in its effort to achieve its objectives.

According to the Cambridge Advance Learner's Dictionary, integrity is the quality of being honest and having strong moral principles that you refuse to change. Integrity is a broader concept and having strong ethical values is part of one's integrity. Integrity and ethical values are part of the elements of the ethical environment (control environment) according to COSO's 1992 internal control integrated framework (COSO, 1992)

The control environment is the bedrock of all the control components, the Board and senior management should be setting the right tone at the top, signaling to the rest of the organization their commitment to effective internal controls. Internal controls are people, process oriented and centered.

Therefore the quality of an organisation's internal control system is a product of the quality of the process and the integrity and ethical values of its personnel (Ayagre & Victor, 2015). The control environment of an organisation's internal control system, as seen in management's tone, value judgments, management style etc. play a significant role in enhancing effective internal controls and achieving organisational objectives (COSO, 1992). Empirical studies have shown that management's ethical leadership (attitude & strict adherence) to corporate ethical guidelines has a positive effect on employee behaviour (Weaver, Trevino, & Cochran, 1999a).

Prior Studies in the developed world have revealed a positive association between the moral atmosphere/ethical climate and employee ethical behaviour. Deshpande (1996), Deshpande & Joseph (2009), in their studies on the effects of the ethical climate on employee ethical behaviour, found a significant positive association between the type of ethical climate in an organisation and the ethical behavior (defined as "doing the right thing") of employees (Deshpande, 1996, Deshpande & Joseph, 2009). Booth and Scholz's (2004) experimental research on the impact of the ethical environment on managers economic decision making found that a strong ethical environment had a direct relationship on managers decisions. The study revealed that managers under a strong ethical environment made decisions that were congruent to organisational interests (Booth & Schulz, 2004).

Risk management begins with risk identification and analysis. As such, management who sets the overall organisational objectives must also identify the risks that may limit the achievement objectives. Kirsten Rae et al (2008), argued that the ethical environment may not influence the risk assessment component since both operate at the broader strategic level (Rae, Subramaniam, & Sands, 2008). Other researchers (e.g. Maijoor, 2000; Geiger et al., 2004; Fadzilet al., 2005) have argued that the components of the internal control system interact with each other, and an increase in the use of one component may lead to an increased or decreased usage of another, cited in (Adebayo & Jokipii, 2009). Therefore, we contend that, a management that is committed to high ethical standards will also be committed to a rigorous risk management process as the two components operate in tandem and impact on the remaining control components. The study, therefore proposes a direct and positive relationship between the ethical environment and the risk assessment component.

Kiziriam and Leese (2004) found a significant association between the ethical tone of management and the quality of security controls. They examined sixty information systems engagements which revealed that the audit client's management ethical tone had a significant impact on the strength of their security controls. (Kizirian & Leese, 2004).

Kirsten Rae et al (2008) argued , that a management committed to fostering a high ethical environment may be less committed to monitoring activities. That a strong ethical environment may be an alternative to the traditional control system which requires more monitoring activities, such as internal audit activities. Their study proposed a direct and negative relationship between the ethical environment and the monitoring (internal audit) activities (Rae, Subramaniam, & Sands, 2008). In this paper, we think otherwise, given Africa's history of malpractices, corruption and fraud. Public sector managers should reinforce the control activities component with strong monitoring activities in public sector organisations, despite the perceived strength of the ethical environment. Therefore we proposed a direct and positive relationship between the ethical environment and monitoring activities.

Based on the above literature, the following hypotheses are tested in the study;

- H1:** There is a positive association between the ethical environment and the risk assessment component of the internal control system.
- H2:** There is a positive association between the ethical environment and the control activities component of the internal control system.
- H3:** There is a positive association between the ethical environment and the monitoring activities component of the internal control system.

## METHODOLOGY

Data for the study was collected from questionnaires administered to managers of public sector organisations (including internal audit managers) in Ghana. Our target respondents were chosen simply because of their knowledge of internal controls through their involvement in setting and reviewing internal control procedures. The sample population of

the study included a cross-section of public sector organisations from Ministries, Departments, Agencies (MDA), and Authorities in Accra and Tema. A total of 110 questionnaires were sent out and 70 were retrieved representing 64 percent response rate. The questionnaire was divided into sections representing the components of internal control system ie control environment, risk assessment, control activities, and monitoring, according to the COSO model. Responses received from respondents were based on a five (5) point likert scale, ranging from strongly disagree to strongly agree, where 1 represented strongly disagree (SD) and 5 represented strongly agree (SA). The study employed Pearson's Correlation coefficient to explain the association between the ethical environment and the other internal control components. In order to gauge the ethical environment in public sector organisations in Ghana, respondents were asked whether management in their organisations demonstrated a commitment to integrity and ethical values. Responses were then correlated with other variables from the risk assessment, control activities and monitoring activities components of the internal control system to establish relationships. The information and communication component of the internal control system was not considered because it influences all other components including the ethical environment. Therefore to avoid the problem of causality, the information and communication component was excluded. An effective information and communication component is necessary for an effective ethical environment, though the ethical environment drives the whole process of internal control in any organisation. A written ethical policy, or the tone at the top embedded into a strategy that is not cascaded effectively to the middle and lower levels, means nothing but a statement of good intention. Reliability test of the risk assessment, control activities and monitoring activities components recorded Cronbach's alphas of 0.911, 0.876 and 0.910 respectively.

## RESULTS AND DISCUSSIONS

Analysis of absolute means of the risk assessment component revealed that most of the respondents on average had confidence in the risk assessment mechanism of their organisations. However, the correlation results as in Table 1, indicated that the variables that measure the risk assessment construct, negatively associated with the ethical environment.

**Table 1: Correlations Statistics (Risk assessment)**

		Your organization demonstrates a commitment to integrity and ethical values
Your organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives	Pearson Correlation	-.242*
	Sig. (2-tailed)	.044
	N	70
Your organization sets clear operations objectives which provides focus for management to commit resources to achieve performance goals	Pearson Correlation	-.320**
	Sig. (2-tailed)	.005
	N	70
Your organization considers the potential for fraud in assessing risks to the achievement of objectives	Pearson Correlation	-.289*
	Sig. (2-tailed)	.015
	N	70

\*\* . Correlation is significant at the 0.01 level (2-tailed)

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

The demonstration of integrity and ethical values weakly correlate with the identification and assessment of risks relating to objectives,  $r$  (i) =  $-.242$ ,  $p = .044$ . The results also show that the demonstration of integrity and ethical values correlate significantly with clearly set operational objectives which provide focus for management to commit resources to achieve performance goals,  $r$  (ii) =  $-.320$ ,  $p = .005$ . The demonstration of integrity and ethical values was also found to be significantly correlated with whether organisations consider the potential for fraud in assessing risks to the achievement of objectives,  $r$  (iii) =  $-.289$ ,  $p = .015$ .

The most serious obstacle to the achievement of millennium development goals (MDGs) in the African continent is corruption (Isa, 2009). Fraud and corruption are serious problems slowing down the process of achieving MDGs in African countries. Consequently, for demonstration of integrity and ethical values to be negatively associated with fraud risk assessment is a worrying finding. Granted that, the ethical environment and the risks assessment components both operate at the strategic level (Rae,

Subramaniam, & Sands, 2008), the inverse relationship between the two variables was not expected. One sure inference from the results is that, public sector managers in Ghana do not lead by example. They do not walk the talk, which breeds distrust amongst employees.

Activities such as approvals, authorisations, verifications, reconciliations, reviews of operating performance, and segregation of duties that help to address risks to achievement of the entity's objectives form the control activities component. The entity's policies and procedures detail the control activities that management must put in place to ensure that directives are carried out. In summary, the control activities component includes policies and procedures designed to ensure that management directives are effectively implemented (Adebayo & Jokipii, 2009).

The mean values obtained from the raw mean analysis revealed that majority of the respondents agreed to the variable evaluated under the control activities within the public sector. Table 2 shows the correlation results between management's commitment to integrity and ethical values and control activities. The results shows that the demonstration of integrity and ethical values negatively correlated with the selection and development of control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels,  $r = -.294$ ,  $p = .014$ . To our surprise, the result again did not support the hypotheses that the ethical environment is positively associated with the control activities. In an environment where high ethical values are encouraged, it is expected that employees would do the right thing by adhering to company policies, rules and regulations. In more ethical environments, employees are more likely to follow accounting control policies and rules as this would be the expected norm at the workplace (Kirsten Rae et al., 2008). This result is at variance with the findings of (Kiziriam & Leese 2004, Kirsten Rae et al.,2008). They found that management's ethical tone (ethical environment) had a significant positive impact on the strength of security controls and the quality of accounting controls, both being elements of the control activities component (Kizirian & Leese, 2004).

**Table 2: Correlation Statistics (Control activities)**

		Your organization demonstrates a commitment to integrity and ethical values
Your organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels	Pearson Correlation	-.294*
	Sig. (2-tailed)	.014
	N	70

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

Monitoring covers ongoing and periodic evaluations of the external supervision of internal controls by management or other parties outside the process. Monitoring ensures that controls are operating as intended and that they are appropriately modified as the business environment changes (Arens, Elder, & Beasley, 2006). The monitoring activities component also was rated high by respondents. The existence of an independent internal audit unit in public sector organisations achieved the maximum mean score. The Internal Audit Agency Act of 2003 requires all public sector organisations to establish independent internal audit units. However, the independence of internal audit units in Public Sector organisations in Ghana is questionable. A survey study which examined the independence of the internal audit function in public sector organisation in Ghana showed that internal auditors did not consider their activities as being independent of political influence ( yagre,2015).

**Table 3: Correlations Statistics (Monitoring)**

		Your organization demonstrates a commitment to integrity and ethical values
Your organization selects, develops, and performs on-going and/or separate evaluations to ascertain whether the components of internal control are present and functioning	Pearson Correlation	-.268*
	Sig. (2-tailed)	.025
	N	70
Your organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action	Pearson Correlation	-.274*
	Sig. (2-tailed)	.022
	N	70
Your organization evaluates and communicates internal control deficiencies in a timely manner to senior management and the board of directors, as appropriate.	Pearson Correlation	-.288*
	Sig. (2-tailed)	.016
	N	70
In organization management tracks whether deficiencies are remediated on a timely manner.	Pearson Correlation	-.270*
	Sig. (2-tailed)	.024
	N	70

\*\* . Correlation is significant at the 0.01 level (2-tailed)

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

From Table 3, four variables used in the study to measure the monitoring construct, revealed negative association with the ethical environment of public sector organisations. Management’s commitment to integrity and ethical values correlated negatively with; i) performance of on-going and/or separate evaluations to ascertain whether the components of internal control are present and functioning;  $r(i) = -.268, p = .025$ . This finding suggests that in more ethical environments, managers are less likely to select, and perform on-going and/or separate evaluations to ascertain whether internal controls are present and functioning.

ii) evaluation and communication of internal control deficiencies in a timely manner to those parties responsible for taking corrective action;  $r(ii) = -.274, p = .022$ , and iii) whether organisations evaluate and communicate internal control deficiencies in a timely manner to senior management and the board of directors;  $r(iii) = -.288, p = .016$ . Management sometimes shows

a lackadaisical attitude when internal control deficiencies are detected and needs to be corrected promptly. Management may not be willing to invest time and resources in remediating these deficiencies because such efforts divert attention and resources from the core businesses. This is the more reason why internal control deficiencies should be communicated in a timely manner to senior management and the boards of directors. Effective audit committees, boards of directors and in the case of Ghana, Audit Report Implementation Committees (ARIC's) can pressure management to invest in remediation efforts, resulting in timely remediation (GOH,2009).

iv) Again the demonstration of integrity and ethical values negatively correlate significantly with whether deficiencies are tracked and remediated on a timely manner;  $r(iv) = -.270, p = .024$ . This finding is disturbing because, Section 30 of the Audit Service Act of 2000 (Act 584), provides that bodies and organisations which are subject to audit by the Auditor-General must establish an Audit Report Implementation Committee (ARIC). The Act mandates the ARIC to ensure the head of the organization pursues the implementation of matters in all audits and other monitoring reports as well as the Auditor-General's reports endorsed by Parliament. One would therefore expect that the existence and activities of ARIC's would compel management of public sector organizations in the country to promptly deal with identified deficiencies during audits. The result is however, consistent with the audit findings of the Auditor-General as contained in the 2015 audit report of public institutions in Ghana. The report indicated that some public institutions did not establish an ARIC as required by the Audit Service Act of 2000. Similarly, the report observed that though most institutions had established ARIC's, they were ineffective (Ghana Audit Service,2016).

The study again, agreed with Kirsten Rae et al.( 2008), argument that a management committed to fostering a high ethical environment may be less committed to monitoring activities (Rae, Subramaniam, & Sands, 2008).

## CONCLUSIONS

The study sought to establish the relationship between the perceived commitment to ethical values, integrity of public sector managers and the internal control systems of public sector organisations in Ghana. The study

results revealed statistically significant (but weak) negative association between the ethical environment and the three constructs. Going by the results of the study, it can be said that, the perceived commitment of public sector managers to ethical values and integrity relate negatively with the other components of the overall internal control system of public sector organisations in Ghana. Management's tone at the top that supports integrity and ethical values adversely affects internal controls and consequently performance of public sector organisations. This may mean that, what is been professed in the public is not carried through to its logical conclusion by public sector managers. This phenomenon, if not checked could become disastrous for the nation, if perpetrators of fraud came to the realisation that management's tone at the top is all but empty rhetoric, all talk but no substance. Again it can be concluded that the type of ethical climate prevalent in Ghana is the egoistic or instrumental ethical climate types. Egoistic ethical climate related inversely with organisational commitment, while instrumental climates were found to relate positively with unethical behaviors (Cullen, Parboteeah, & Victor, 2003), (Wimbush, Shepard, & Markham, 1997).

The demands of national and international regulatory requirements on internal controls suggest that effective internal controls have the potential to reduce internal fraud, safeguard company assets and improve overall operating objectives. It is recommended that policy makers, development partners, boards of public sector organisation should not be satisfied with just announcements of policies, rules and laws being passed but should equally ensure enforcement of such policies, rules and laws. Management of Public Sector Organisations, should demonstrate real commitment to ethical leadership. It is commitment to ethics that improves organisational performance and not just the existence of corporate code of ethics, rules and procedures. For example, Curtis (1998) studied the link between a corporation's Commitment to ethics and financial performance. His study found a statistically significant linkage between a management commitment to strong ethical and socially responsible behavior on one hand and favorable corporate financial performance on the other (Curtis, 1998). However, Brief et al (1996) examined the effects of the presence of corporate code of ethics and the frequency of fraudulent financial reporting by corporate executive which showed no significant results. Their study found high fraudulent financial reporting whether corporate code of ethics existed or not (Brief et al, 1996).

Again it is recommended that auditors should not let a strong control environment of any public sector organisation sway them from performing detailed assessment of the other control components during audits. Future studies should investigate the reasons for the negative relationship between the control environment and the other internal control components of the internal control system of public sector organisations in Ghana.

The following limitations of the study are identified; firstly, the study used one variable to measure the control environment (integrity and ethical values). Using only integrity and ethical values as a measure of the control environment may not be representative of the control environment. Secondly, Pearson's Correlation only shows association and not causation, and the correlation coefficients for the study revealed only weak negative association. In the light of the above limitations, we advise readers to interpret the results guardedly. Nevertheless, the findings of the study would serve as an invaluable resource for policy makers, development partners, boards of public sector organisations.

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