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# **A contingency theory perspective on the risk management control system within Birmingham City Council**

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## **ABSTRACT**

In recent years the topic of risk management has moved up the agenda of both government and industry, and private sector initiatives to improve risk and internal control systems have been mirrored by similar promptings for change in the public sector. Both regulators and practitioners now view risk management as an integral part of the process of corporate governance, and an aid to the achievement of strategic objectives.

This paper uses contingency theory to analyse a case study of the risk management system used within Birmingham City Council. The case assesses the impact of the external environment, technology, strategy and organizational size upon the risk management system. The evidence shows that all four contingent variables exert a significant influence upon the design and operational details of the control system, and also highlights the need to refine the definitions of the contingent variables in a public sector context.

**Keywords:** risk management; case study; contingency theory.

## 1. Introduction

In recent years the topic of risk management has steadily moved up the agenda of both government and industry, to a level where “it is more important than ever before” (Lam, 2006). This development has run parallel with the evolution of regulatory frameworks for corporate governance in response to a series of well publicised corporate scandals and failures across the world (Collier and Agyei-Ampomah, 2005).

Recent governance reforms, such as the Sarbanes-Oxley Act in the US, the Basel II Capital Accord and the revised Combined Code (2003) in the UK have sought to minimise the risk of future major corporate failures via tighter regulation of internal control systems. In the USA, the crisis of confidence in the capital markets that resulted from a series of control failures led to the SEC calling for companies to improve risk control and compliance systems in the belief that strong control systems would serve to strengthen investor confidence.

National and international governance regulations reflect the view that corporate governance, internal control and risk management are inter-dependent. The boundaries between the concepts may appear rather blurred at times, and it is not always clear whether risk management is a sub-division of internal control or vice versa, but the dominant recurring theme is that risk management is an integral part of the process of corporate governance (McRae and Balthazor, 2000). In a private sector context, the primary responsibility for all three rests with the Board of Directors.

Private sector initiatives to improve risk and internal control systems have been mirrored by similar promptings for change in the public sector, where risk management is also seen as an important dimension of good governance as well as a tool to aid the achievement of strategic objectives. Addressing members of a public sector governance and risk forum, the Australian Auditor General observed that: “as corporate governance receives increasing attention—I have heard it referred to as an *‘unrelenting tide’* — it is becoming almost a given that effective risk management, as a corner stone of good corporate governance, results in better service delivery, more efficient use of resources, and better project management.”(Mc Phee, 2005). The Audit Commission in the UK also sees a direct link between risk management and service delivery in arguing that “an authority’s systems of internal control is part of its risk management process and has a key role to play in the management of significant risks to the fulfilment of its business objectives” (Audit Commission 2001, p.7).

The underlying arguments driving the development of formal risk management controls may therefore appear to have strong similarities across both private and

public sectors, but it is simplistic to assume that the resulting systems will be the same. Existing anecdotal evidence suggests that public sector risk management is distinct and different from private sector risk management, (Fone and Young, 2000; McPhee, 2005), but there is a lack of academic literature that tests such views. This paper is a response to this literature gap, as well as the declared need for more contingency based research in not for profit organizations (Chenhall, 2003). The context also shifts the emphasis away from the “narrow financially biased perspective” that “dominates much of the control literature” (Otley et al, 1995).

Using exploratory case study based research, the aim is to extend our knowledge of public sector risk management systems via an in-depth analysis of *how* the management control systems are used, as opposed to *whether* they are used (Tuomela, 2005). The research forms part of a CIMA funded project looking at risk management systems within a range of major UK based organisations across both the public and private sectors.

The paper uses contingency theory to analyse the risk management system used within Birmingham City Council, and the public sector context of the research complements existing contingency based studies. The case assesses the impact of the external environment, technology, strategy and organizational size upon the risk management system. The evidence shows that all four contingent variables exert a significant influence upon the design and operational details of the control system.

The subtleties of the differences revealed by such details would have been difficult to identify without the use of the extended interviews and cross referencing of data that characterises case study based research. Most particularly, the research approach provided the researcher with access to meetings and training sessions that demonstrated how the system is used in practice and helped in the identification of the significance of the contingent variables. In this way the study addresses the paucity of studies of control systems in operation (Otley, 1999).

In a private sector context the external environment refers to uncertainties regarding products, inputs and markets and the environment is generally accepted as being a powerful contingent variable (Chenhall, 2003). This paper repositions the uncertainty into a public sector context and offers insights on the role of political uncertainty and both local and national political pressure as contingent variables. In addition, we show that the non- competitive public sector environment is conducive to the encouragement of a free exchange of knowledge across public sector institutions and this exchange facilitates organizational learning and encourages longitudinal evolution of management control systems.

The public service sector context also adds to the literature by highlighting the importance of information technology, as opposed to manufacturing technology as a specific contingent variable. The case study evidence suggests that information and communication systems strongly influence the operational effectiveness of the risk

management system, and this theory could also be usefully tested in a private sector context.

The role of strategy as a contingent variable (Otley (1999); Chenhall (2003)) is also assessed. The study confirms existing evidence that the extent of formalization of controls and the use of interactive controls is dependent upon strategic characteristics.

Finally, the case confirms existing evidence from the private sector that large organizations are characterized by administrative rather than personal style control systems (Bruns & Waterhouse, 1975) and a tendency to favour divisionalised structures which aid control of diversified operations (Chenhall, 2003). We show that even well defined administrative controls do not, however, entirely eliminate the potential for variation in the level of acceptance of the controls across an organization.

The next section of this paper provides the background to the case study, by summarising the evolution of both thinking and practice in relation to public sector risk management. This is followed by a brief explanation of the research method, and the research site. The analysis of the case study findings is integrated into the case details and we conclude that contingency theory provides a useful framework for the study of public sector risk management control systems, but that the difference in context requires some redefinition of the contingent variables. The paper also concludes that survey based research and case based research can be used in a complementary way to increase understanding of how management control systems work in practice.

## **2. Risk Management in the Public Sector**

The period 2000-2002 marked the publication of a series of government documents that drew attention to the need for better risk management within the public sector and also contained initial guidance on how to set up a risk management system. Within central government, the risk management agenda was initially driven by the publication of a report by the National Audit Office (NAO, 2000). This was rapidly followed by Treasury guidance (HM Treasury, 2001) which provided a basic introduction to the concepts of risk management, and is now commonly referred to as the Orange Book. An update of the Orange Book has since been published (HM Treasury, 2004), and further support and guidance is provided via the Treasury's Risk Support Team as part of "The Risk Programme".

At local government level, risk management forms part of a broader governance framework that was developed jointly by CIPFA (Chartered Institute of Public Finance and Accountancy), SOLACE (Society of Local Authority Chief Executives) and the Local Government Association (CIPFA, 2001). The framework identified risk management and internal control defining principles of good governance and recommended that each local authority should establish systems for the identification,

evaluation and monitoring of risks, and undertake an annual assessment of the risk management and internal control systems.

The same year the Audit Commission published a paper (Audit Commission, 2001) aimed at raising awareness about the need to manage key strategic risks in local government and offering guidance on the development of formalised risk management systems. The paper emphasised the responsibilities of both senior management and elected members in relation to the implementation of a risk management policy, and argued the need to recognise risk as encompassing opportunities as well as threats. Responsibility for providing assurance on the effectiveness of risk management processes and internal controls was placed firmly in the hands of internal audit. The Audit Commission also highlighted how risk management might help in the production and monitoring of the best value performance plans that formed a central plank of the government's agenda for local authority performance improvement.

2001 thus marked a watershed when every UK local authority was given the challenge of developing its own model for risk management and internal control. The CIPFA/SOLACE/LGA recommendation for an annual assessment of risk management processes deepened the challenge, and it is argued served as "the driver persuading many authorities to put in place systematic risk management procedures" (Crawford & Stein, 2004).

The following year saw the introduction of Comprehensive Performance Assessment (CPA). CPA uses an audit and inspection framework to form an overall view of the performance of councils and their arrangements for improving their services to the public. The resulting CPA score, awarded by the Audit Commission is important to a council because it influences access to funding as well as their broader public reputation. CPA directly increased the pressure on councils to introduce formal risk management systems by incorporating risk assessment and management procedures into the CPA judgement.

The CPA framework is continually evolving, but Audit Commission documentation (Audit Commission 2006a and 2006b) shows that the assessment includes a judgment on the extent to which risks and opportunities are incorporated into both strategic and operational decision-making. Under the current CPA regime (2006-7 financial year) audit commission inspectors identify and evaluate evidence to enable them to assess the extent to which the internal control environment enables a council to manage its significant business risks. In order to obtain the highest possible score under the CPA framework, a council must demonstrate that risk management practices and assurance frameworks are fully embedded in the council's business processes and that these are overseen by an audit committee which is independent of the executive function, with terms of reference that are consistent with CIPFA's guidance. The standards are therefore demanding, and strongly mirror the recommendations for good private sector practice that are contained within the Turnbull Guidance on Internal Control.



The historical summary above clearly illustrates the role played by external parties in stimulating the introduction of systematic risk management within UK local authorities. Nonetheless, the emphasis is on the provision of guidance rather than specific requirements, and Crawford and Stein (2004) and the Audit Commission (2001) both point out the level of autonomy available to a local authority in relation to risk management. Each authority must decide the way risks are to be assessed and managed, and account to their stakeholders for how they have done so.

In the UK, there are currently no clear rules on how those charged with governance should act in the interests of their primary stakeholders by establishing systems to identify, evaluate and respond to the entity's risks. Even in Australia where risk management standards do exist (Australia/New Zealand, 1999) there appears to remain a public sector tendency to approach risk management in an intuitive way (McPhee, 2005). The result is huge scope for diversity in style across different local authorities, which also creates the opportunity for information sharing and mutual learning.

The scope for diversity is of interest because it raises two research questions. Firstly, to what extent does an individual local authority (or any other public sector body) copy private sector practice in its approach to risk management? This question encompasses the core issue of whether there are special circumstances that prevail in the public sector which serve to limit the extent of mimicking which may be practiced. Secondly, is there evidence of a diversity of approaches to risk management across the public sector?

The evidence presented below uses contingency theory to answer the first of these questions. The second is deemed beyond the scope of the current paper as it requires multi site survey evidence.

### **3. Research Method and Case Study Site**

#### **3.1 Research Method**

The case study method was adopted for the research on the grounds that it facilitates the development of a deeper understanding of the role of different types of controls and their impact upon organisational performance (Otley and Berry, 1994). Case studies are particularly useful for exploratory research, where an inductive approach can be adopted, using theory to explain empirical observations and also inform refinements and extension of theory (Berry et al, 1991; Otley and Berry, 1994). Researchers have also explicitly recognised the usefulness of case based research in the field of management accounting practice (Scapens, 1990), although the authors face the inevitable challenge of linking multiple detailed experiences back to core academic theory.

A key component of case study research is the interview. In this research, interviews were critical because of the relative novelty of the issues being discussed (Horton et al,

2004), which left the researcher with some initial uncertainties regarding what were the most important questions to ask. Interview questions were developed out of a literature review of the areas of both management control systems in general and risk management in particular. The review findings formed the basis for a series of semi – structured interviews complemented by a less structured discussion. The interview format created a flexibility that enabled interviewees to develop issues and “think aloud” about areas that they saw as being of particular concern. This approach also facilitated the generation of supplementary questions for use in later interviews, based upon key issues identified by staff working within the organisation. In all cases these questions related to matters which had not arisen in the initial literature review.

Yin (1993) describes the interview as the cornerstone of case study research but also acknowledges a need to triangulate evidence by collecting and integrating information from a range of sources. The approach adopted in this instance was the collection, prior to interviews, of as much information as possible about Birmingham City Council and their risk management practice. The sources used were both internal eg the council’s website and internal audit department, and external e.g. the Audit Commission’s reports on the council’s Comprehensive Performance Assessment. The interview time was then able to be used more effectively for discussion and clarification rather than straightforward fact-finding. A total of five interviews were conducted, encompassing the Head of Internal Audit, other members of staff in Birmingham Audit, and the council’s Chief Executive. The interviews varied in length between thirty minutes and two hours, were digitally recorded and then fully transcribed in order to ensure accuracy.

Additional information was collected via attendance as an observer at a meeting of the risk committee of the Use of Resources<sup>1</sup> Directorate within the council, where both policy and operational issues relating to risk were discussed. Understanding of the process of internal communication and training in risk management methods was obtained through participation in a two hour risk training session for new staff in internal audit, and a guided walk through two key pieces of software that support the management control systems within the council. The software that was explained was PEMOS, a project management operating system, and Magique a risk management system purchased from a commercial vendor.

The limitations of case study research, such as a lack of ability to generalise from the findings and dependence upon the knowledge of interviewees are acknowledged. The author’s view, however, is that such disadvantages are outweighed by the resulting empirical richness of the data. More specifically, this case has a role to play in providing analytic evidence that both supports and develops contingency theory.

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<sup>1</sup> Under the Comprehensive Performance Assessment framework, all councils are subject to a performance inspection that includes evaluation of evidence that they are effectively reviewing risks and opportunities when planning and delivering services. Within Birmingham City Council, the responsibility for collection of this evidence rests within the Use of Resources Directorate.

### 3.2 Birmingham City Council

Birmingham is England's second city and largest local authority. The metropolitan authority is located in the West Midlands area, employs 55,000 people and has a budget estimated at £2,682 million for the 2006-7 financial year. The local authority area covers a population of 990 000, which is characterised by its diversity as almost thirty per cent of the population are from minority ethnic communities.

The model of governance (see Figure 1) used by the authority is a leader and cabinet system. The Chief Executive is supported by a corporate management team made up of five strategic directors. The strategic directors head up the five directorates, or divisions, that manage the full range of services provided by Birmingham City Council. The matching of services to directorates varies between different local authorities, but the overall governance structure remains very similar across the sector. Service directors report to their relevant strategic director, and also take responsibility for management of the operational staff. For example, the local services directorate includes several different service areas including parks and events, waste and trading services. The head of the trading standards service is thus answerable to the strategic director of local services, who is in turn answerable to the Chief Executive.

#### **INSERT FIGURE 1 HERE**

Local authority service provision is managed within a political context because councillors, or elected members, determine the pattern of spending and the priorities within the budget. The cabinet based system adopted in Birmingham works through senior, full time members forming a cabinet, with each individual taking responsibility for a specific portfolio. The member portfolios do not necessarily match up exactly with the directorate portfolios, but in practical terms the service provision is the joint responsibility of both politicians and executive staff. An Executive Management Team, comprising both cabinet (portfolio holders) and strategic directors meets once a week for policy review and development. This team is the local authority equivalent of a private sector Board of Directors.

The governance structure means that a good working relationship between staff and members is deemed a prerequisite for effective service provision and budget management. Consequently, this relationship is one of the factors assessed by Audit Commission inspectors when they undertake a CPA visit to a council. In addition, the risk management system in Birmingham explicitly recognises the importance of good communication of risks to both staff and members as an essential part of the control process.

Responsibility for the development of a risk management system is located within the Resources Directorate in Birmingham City Council, but the financial regulations of the council are designed to spread responsibility for the operational management of risk much wider. Section 5 of the council's financial regulations places responsibility upon the strategic directors for risk management and the maintenance of sound systems of

internal control within their area of service delivery. In addition, Section 8 of the regulations requires the directors to issue an annual assurance statement on risk management and internal control (Birmingham City Council, 2005) which is then signed off by the Chief Executive, the Leader of the Council and the Strategic Director of Resources.

In an effort to ensure that all members and employees have regard for risk in carrying out their duties, and that awareness of a risk management philosophy remains high on the corporate agenda, the council has appointed a Corporate Risk Management Group (CRMG). The group of six is made up of three members and three officers who are either Strategic Directors or heads of service. CRMG is chaired by the Deputy Leader of the council, whose role is to champion the risk management cause amongst members. The parallel role of risk champion amongst the council's officers is held by the Strategic Director of Resources. The terms of reference for CRMG are two-fold: firstly, to ensure that risk identification analysis and prioritisation takes place throughout the council and secondly, to review the control processes and ensure ongoing development of the corporate risk management strategy and methodology.

Day to day responsibility for the development and maintenance of the risk management process rests with Birmingham Audit, which is the internal audit section of the council. Staff from internal audit are responsible for revision and updating of the core risk management documents within the council: the Policy Statement, Risk Management Strategy, Risk Management Methodology, and the Risk Management Toolkit. Additionally, they provide guidance and information to operational staff and strategic directors, as well as organising risk training sessions. Working alongside staff from across the council's directorates, Birmingham Audit assist in the development of practical approaches to risk identification and monitoring.

The staff within Birmingham Audit see risk management as being closely interlinked with performance management, because it is concerned with "looking at achieving your objectives and what's going to stop you from achieving your objectives ...that's the way we sell it." With this in mind, the internal audit plan is risk based, with priority being given to directorates which may carry significant "corporate" level risks as well as operational risks. Only 16% of the work of internal audit is now allocated to the audit of financial systems, and the remainder is devoted to risk management, corporate governance and business/operational activities, although the latter will include an element of financial control review.

The link between risk management and performance management for each service area is reinforced by the practice of requiring risks and opportunities to be identified at the operational level within each service, and against the background of the service objectives. Risks are categorised according to their measure of likelihood and expected impact upon the achievement of objectives. Both inherent and residual risks are measured on a four point scale ranging from low to high, yielding a four by four matrix. Inherent risks are those that exist if no controls are in place; residual risk is what remains assuming that existing controls are operating effectively. The residual

risk is then compared to the target risk, which is the long term desired level of risk in the specific service area.

## **INSERT FIGURE 2 HERE**

A traffic light system is used to prioritise risks on the matrix under the headings of severe, material or tolerable. Severe is defined as a situation in which an immediate control improvement needs to be made in order to ensure that business goals are met and service delivery maintained or improved. All risks with a high impact *and* significant or above likelihood are classified as severe, and information about these risks and the related controls are automatically escalated up to the next level in the organisational hierarchy. In other words, if a service manager sees something as a severe risk, this fact will be made known to the service director, who then has a responsibility to ensure that controls and action plans are devised to reduce that residual risk to material rather than severe. The “severe” category represents five of the sixteen elements of the matrix, as per Figure 2, and action plans are required for all risks identified as inherently severe. The action plan includes comments on the effectiveness of existing controls, what additional controls are needed and who is responsible for these. All risks are therefore “owned” by a named member of staff. The risk matrix for each service thus acts as both a feedback and feed-forward control.

Material risks are all the remaining risks with the exception of those of medium impact or below *and* with only a low likelihood of occurrence, which are classed as tolerable. Tolerable risks are regularly reviewed and low cost risk reduction strategies identified where possible, but they are not proactively managed as they are seen as acceptable within the existing management routines.

Risk registers are reviewed at least quarterly to ensure that risks are deleted, added or upgraded as appropriate. The council’s risk management methodology recommends that such a review, along with monitoring of action plans should form part of the regular managerial agenda for each service area. Centralised monitoring of the effectiveness of service level controls is managed via the internal audit process.

Against this summary background of the risk management control system in use in Birmingham City Council we now look more closely at the detail of both the control system components and also how the controls are used, to evaluate the extent to which risk management controls are contingent upon a number of external variables.

## **4. Contingency Analysis**

### **4.1 Non Contingent Aspects of the Risk Management System**

Collier et al (2006) suggest that the basic structures of risk management systems appear to be common across large organisations within both the public and private

sectors, and there is evidence that the basic methods used by Birmingham City Council fit a common form of model. The Institute of Risk Management (2002) identifies a series of core elements (See Figure 3) in the risk management process, which are used in combination. The overall process ensures that risks which may impact upon the achievement of corporate objectives are identified, prioritised, reported and monitored both formally and informally. The core elements within the risk management system in Birmingham City Council, as summarised in the preceding section, reflect this basic model.

### **INSERT FIGURE 3 HERE**

In Birmingham, risk identification and analysis are linked directly to the service objectives, and the likelihood: consequences matrix facilitates an evaluation that is then used to drive the risk reporting/recording process. The classification of a risk as severe, material or tolerable acts as an influence upon the level of control that is required to reduce the residual risk to acceptable levels and also affects the frequency of monitoring. The effectiveness of controls within each directorate and service area is formally audited by Birmingham Audit, and feedback from each stage of the control process serves to ensure continual revision of the perceived risks, thus forming a feedback loop in the controls.

The brief description given above suggests that at the structural level, the Birmingham model seems to fit well with that suggested by the Institute of Risk Management. More detailed investigation, however, reveals that both the *details* of the risk control structure and the *ways in which it is used* in practice are contingent upon four variables- environment, strategy, technology and size. As already discussed, all of these variables have been identified in prior literature as factors influencing the design and operation of management control systems, though not specifically in the context of risk management. A discussion of the significance of each variable upon risk management within Birmingham City Council now follows.

#### 4.2 External Environment

As already indicated, the literature on the private sector characterises the external environment in terms of uncertainty in relation to products, inputs and markets. Changes in the relative level of uncertainty in any of these areas are predicted as leading to revisions to the management control systems.

In the public sector, and particularly in the case of local authorities, there is limited uncertainty in terms of products, inputs and markets because the scale and type of service provision is largely prescribed by regulation. The external environment is, however, subject to potentially highly significant uncertainty because of the influence of politics. Local authorities are susceptible to political uncertainty on two counts. Firstly, they face the risk of a change of power within central government, and the resulting policy shifts that may ensue. Secondly, local elections may result in a change in the balance of power within the membership of the local council, and subsequent

changes in local strategy. In other words, both national and local politics affect the strategic priorities within local government because compliance with political policies is a fundamental component of local government strategy. This means that uncertainty about the future direction of policy can be viewed as a factor that may influence the design of their risk management system.

One example of the way in which the risk management system in Birmingham is responsive to political pressures is illustrated by the significance that the council attaches to the CPA score. The risk of failing to achieve a higher CPA score than under the previous assessment is classed as a key risk, and managed accordingly, with risk representatives in each service area asked to report on any factors that might lead to underachievement, and produce action plans to respond as necessary.

At an even more detailed level, specific Best Value Performance Indicators (BVPI's), which form one element of the CPA process, are very directly risk related. For example, BVPI 76c (ODPM, 2005) covers the management of housing benefit fraud. This performance indicator measures the number of benefit fraud investigations carried out (per 1000 caseload) annually by a council's fraud investigation section. Consequently the extent of work carried out by the fraud investigators is driven, at least partially, by a desire to score highly on this indicator. Such a focus may, however, draw resources away from other possible areas of risk management.

Another political dimension that is seen to influence the design of the risk management system is the governance structure, which creates a need to include elected members, as well as full time staff, in the control process. Once again, central government political pressures are brought to bear in this regard, because one of the key lines of enquiry (Audit Commission, 2006a) used by Audit Commission inspectors in reaching their CPA judgement relates to the creation of a control system that includes members. One aspect of this inclusion is the need to train members in risk issues, in order to ensure consistency of risk perceptions across the whole organisation. Once again, political influences are at work to shape the risk control system.

The last environmental influence relates to the way in which risk impact is measured. It is common in private sector companies to have the key risks ranked in terms of their impact upon the core financial statements. For example, a company may class as a key risk any factor which will reduce Earnings per Share by more than a given percentage. The ranking and measurement method reflects organisational priorities and a similar, but not identical approach is adopted in Birmingham. Instead of ranking risks in terms of financial impact, however, they are ranked in terms of their impact upon levels of service provision i.e. the key strategic objectives. Consequently, impact is frequently expressed in non- financial terms. This leads to the conclusion that the measurement system is contingent upon the environmental context, even though the underlying principle remains the same.

### 4.3 Strategy

Kaplan and Norton (2001) observed that public sector bodies encountered “considerable difficulty in clearly defining their strategy” and this view is echoed by other researchers (Chan, 2004; Wisniewski and Olafsson, 2004), alongside an inability to couple operational performance indicators to strategy ( Johnsen, 2001; McAdam et al 2002). In the UK these shortcomings began to be addressed by local authorities under the Best Value regime, introduced in 2000, which requires them to use strategic planning to develop a performance plan<sup>2</sup>. The Local Government Act 2000 specified that local authorities also had a general duty to promote economic, social and environmental well being in their localities, and the terminology of the act was highly significant in shifting the emphasis away from *specific powers and duties* towards a more *general enabling power*. The aim was to allow local authorities to do what was necessary to achieve this broader objective, but by definition this requires a clear specification of strategies.

Whilst the Local Government Act 2000 gave local authorities greater freedom to define the strategies to be used in achieving economic, social and environmental well being in their locality, it did not grant the level of strategic freedom with which private sector firms are familiar. Most notably, as was observed by the Chief Executive in Birmingham:

“if we do something badly, we can’t stop doing it. We’ve got statutory obligations and duties and responsibilities and we must fulfil them, and so we have to do everything well. Whereas a private company can say ‘well we’re not ... that’s the wrong market to be in, we should get out of that’ or whatever. And they can take actions, which change the nature of the organisation to deal with the environment in which they’re working. We can’t necessarily do that, so it’s an additional dimension to what we have to manage.”

In other words, the lack of strategic freedom means that the risk management control system has to focus attention on compliance with the statutory requirements in terms of service provision. Fone and Young (2000) argue that the limited ability of government organisations to avoid public risks is one of the features that serves to differentiate public sector risk management because the problem faced is similar, but not identical, to the compliance or regulatory risks faced by private sector bodies. Regulatory risk defines the externally imposed rules under which specific activities must be managed, but the option to discontinue certain activities is still present within the private sector whilst it is lost in the public sector. In terms of contingency theory, this means that the risk management system in a local authority must be designed to

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<sup>2</sup> Best Value was developed by the Department of the Environment, Transport and Regions (DETR) and National Association for Wales in response to the White Paper “Modern Local Government: In Touch with the People” and is defined as “a duty to deliver services to clear standards - covering both cost and quality - by the most effective, economic and efficient means available.” (DETR, 1998, paragraph 7).



accommodate for the provision of services which may be deemed very risky from a corporate perspective, but strategically essential due to legislative requirements.

One example of how this directly affects practice in Birmingham relates to the impact of the Bichard Enquiry (2004). This national enquiry was initiated following the conviction of Ian Huntley for the murder of two children at a Cambridgeshire school where he was employed as a caretaker, and it resulted in extensive recommendations regarding the vetting systems to be used for potential employees. The report's recommendations are relevant for police, social services, education establishments, and the government in aiding the design of systems to protect children and other vulnerable members of society. In Birmingham, the enquiry forced changes in vetting practice and a shifting of budget resources to fund these, which could have been avoided if the council were able to opt out of educational and other service provision. Because such an option could not be considered, however, spending and resource priorities in risk management were shifted accordingly. This example is used as evidence that strategy, and a lack of choice in that regard, is a contingent variable in the formulation of risk management policies within local government.

A second example of the contingency link between strategy and risk management strategy relates to current government policy requiring local authorities to engage in working with non governmental partners when providing local services. Partnership working brings with it additional risks, as well as the issue of who bears those risks and how they are managed. Some of the partners with whom the council may work are large and professionally managed organisations such as a local primary care trust, and will have their own risk control systems already in place. Other small community organisations may be run by volunteers for whom the council will need to provide risk training. Monitoring of partnership risks, and the associated training and management commitments clearly impact upon the allocation of resources for different types of risk control within the council, and so the externally imposed strategies become a contingent variable.

#### 4.4 Technology

The contingency theory literature focuses primarily on the impact of production technologies upon control system design (Chenhall, 2003), but there is little discussion of the role of information and communication technology as a relevant influence.

The case study evidence reveals the critical role played by good information systems as tools to support the control process itself. Most importantly, the need for integrated systems is made very clear. For example, the council's intranet is used to post relevant documentation relating to the risk management system, and also offer on line training packages. Purchase of a dedicated piece of commercial risk management software, Magique, also enables staff to use the intranet for real time update of risk registers that can then also be viewed by both internal audit and senior council staff. Unfortunately, however, Magique does not include a facility to enable automatic update of internal

audit planning in response to changes in the service level risk registers. Any updates must be done manually by the internal audit staff. An integrated system would both save staff time and potentially improve the effectiveness of the risk management controls. This leads to the conclusion that access to information systems is a contingent variable that is not presently identified within the literature.

The importance of ICT systems to risk management is highlighted by the fact that the ICT infrastructure is a permanent element on the corporate risk register, with the expectation that it will never be removed. The explanation given by internal audit for this is that good ICT is vital to service delivery.

#### 4.5 Size

The last contingent variable to consider is that of size. In organisational terms, Birmingham City Council is of a size equivalent to some of the largest listed companies in the UK, and contingency theory suggests that large organisations will use formal control systems and be organised on a divisional basis, as a way of improving control.

Birmingham's risk management control system matches these theoretical predictions, as controls are fully documented, formal training processes are used, and risk exposure is regularly monitored via a formal reporting system. Operating on a large scale increases the complexity however, and whilst documented procedures may be uniform across the organisation there is no guarantee that their application will be consistent. Birmingham has found that some departments have responded more favourably than other to the risk management initiatives, and some hardly take any notice at all. The result is what might be described as "cultures within cultures" which serve to potentially undermine control effectiveness.

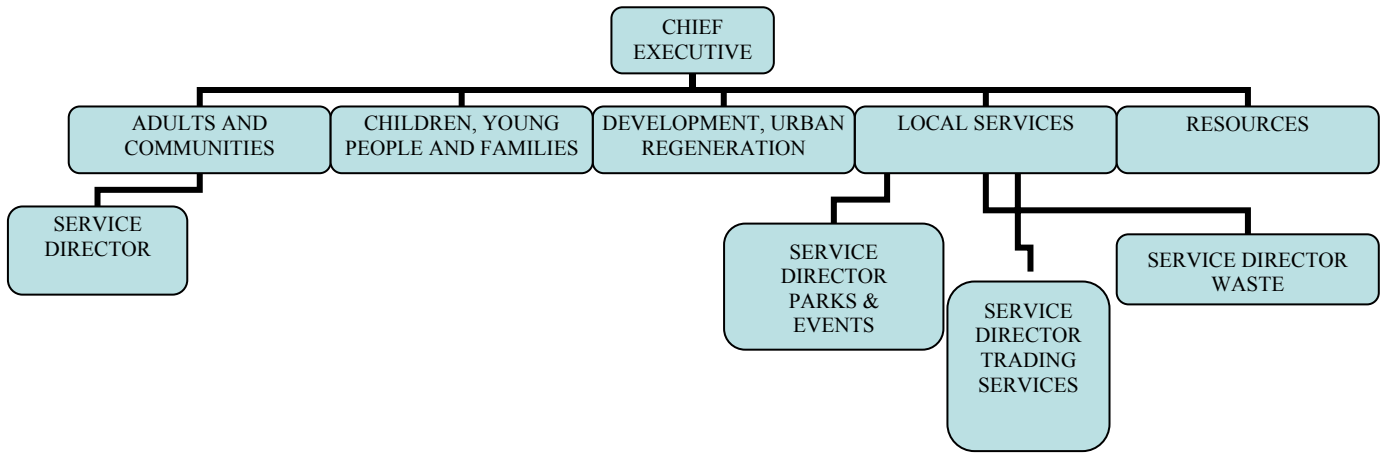
### 5. Conclusion

At the top level of the control system, the evidence presented above confirms the existing literature (Collier et al, 2006) which suggests that the basic structures of risk management appear to be common across large organisations. At the detailed level, however, the structures are fine tuned to respond to specific public sector needs and environmental pressures.

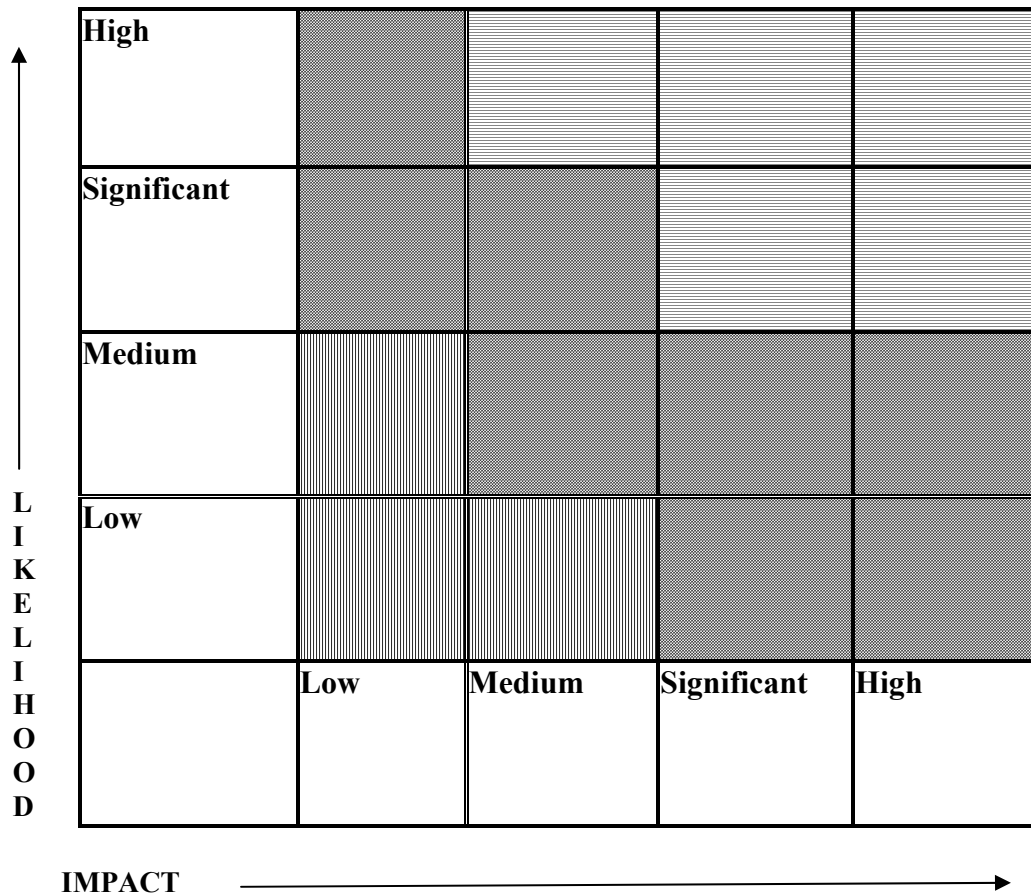
External political uncertainty acts as an important driver of risk management because national policy influences what risks are prioritised, whilst locally elected members determine the resources available for control of risks. Politics also limits the scope for strategic choice, as well as imposing new strategies, such as the requirement for partnership working. Both of these restrictions affect the detail of the design and day to day operation of the risk management system. The control effectiveness is also partly determined by access to well integrated information systems, and the large

organisational size encourages formalisation of the control structure. At the same time, the unique environment of the public sector serves to encourage information sharing across local authorities which engenders a culture of organisational learning and encourages improvements in risk management practice. We therefore conclude that the external environment, strategy, technology and size are all relevant contingent variables. The case also provides evidence of the need to refine the definitions of the contingency variables for use within a public sector context.

The findings highlight the way in which different styles of research can reveal very different stories. Using a survey based approach, as per Collier et al provides the researcher with a sense of the generic picture, but case study research can be used to “fill the gaps” and enrich the findings. It remains certain, however, that there is still a lot of research to be done on risk management systems and the interface between risk management, internal control and governance.



**Figure 1:- Organisation Chart: Council Staff**



**KEY:**

<b>SEVERE</b>	Immediate control improvement to be made to enable business goals to be met and service delivery maintained/improved
<b>MATERIAL</b>	Close monitoring to be carried out and cost effective control improvements sought to ensure service delivery is maintained
<b>TOLERABLE</b>	Regular review, low cost control improvements sought if possible

**FIGURE 2: - RISK/OPPORTUNITY PRIORITISATION MATRIX**

Source: Birmingham City Council Risk Management Methodology, 2005.



**Figure 3: Core Elements of the Risk Management Process**  
**Source: Adapted from Institute of Risk Management (2002)**

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