

## CHAPTER 5

# INTEGRATED RISK MANAGEMENT AND INTERNAL CONTROLS IN THE PUBLIC SERVICE

## 5.1 INTRODUCTION

Policy reforms, including budget reforms, in public services worldwide demand new perspectives of organisational planning and management. The South African Public Service is no exception. Reforms that initially took place after 1994 necessitated a paradigm shift in the Public Service, especially on public finance in order to support and improve service delivery in South Africa. In the process of budget reforms, the culture of risk management is still questionable. With regard to risk management, the Public Service is facing the challenge of managing risk using an integrated approach rather than a 'piecemeal approach'. Official reports have revealed that failing to apply an integrated approach to risk management has weakened departmental internal controls and severely affected service delivery plans. The new accounting and auditing standards, accrual accounting and performance or value for money auditing formats contribute and part of risk management and effective internal controls which all contributes to good governance.

These Public Service reforms create uncertainty and because of uncertainty a number of risks sporadically emerge from departments; internal controls are either not in place or not effective to deal with the diverse forms of risks.

McCloskey and Smith (1998:41) comment that the public sector is faced with a unique set of problems when dealing with issues of risks, in that it is often a regulator and risk generator. This suggests that the public sector and its leadership should take cognisance of its surroundings and the social, political, technological and economic environment. The above diverse forms of risks create uncertainty and risky situations due to the nature and context of public sector reforms taking place globally, and risk management becomes crucial in managing such reforms.

The Constitution of the Republic of South Africa, section 195 in particular, provides principles for public administration that enforces a high level of responsibility and accountability on public servants. Based on these principles, Public Service regulations, which are promulgated in terms of the Public Service Act of 1994, introduce a new management framework to be implemented in the Public Service.

The new management framework is based on the principles of proper or effective planning and accountability. It is therefore paramount for Public Service and departments, both national and provincial, to develop planning tools. Risk management is also regarded as a planning tool to enhance planning processes for service delivery. Most importantly, risk management will make sure that the Public Service delivers services that are of a high quality standard to the public.

It is in this context that the PFMA gives accounting officers responsibilities, in terms of section 38, namely a legal mandate of ensuring that a trading entity or constitutional institution maintains effective, efficient, and transparent systems of financial and risk management and internal control.

## **5.2 BACKGROUND AND DEVELOPMENT OF RISK MANAGEMENT IN THE SOUTH AFRICAN PUBLIC SERVICE**

The development of public finance in the South African Public Service started with the country's democracy in 1994. As indicated earlier in the research, the South African reforms were introduced by a number of policies or legislative documents, notably the South African constitution, which was adopted in 1996, and the draft White Paper on Financial Management and Expenditure Reform, which was released in June 1996. However, it should be noted that these two documents are not the only key documents to pave the way for a proper public financial management system in the South African Public Service but central to this management.

With regard to the draft White paper on Financial Management and Expenditure Reform, Abedian, Ajam & Walker (1997:105) comment that White Paper proposes and adopts a full accrual basis of accounting which is a transition from a cash-based accounting system towards an accrual system in South Africa. On the basis of the accrual accounting system, the

shift could be a reflection of a record financial system of transactions, income earned and expenditures, as they take place, even if they do not immediately generate cash flows (Abedian, Ajam & Walker 1997:141). This form of accounting system instils a culture of good governance, ensuring effective utilisation of public assets, financial management system, and effective management of public funds and instilling a risk management culture within an organisation.

The above transitional change does not take place in a vacuum; a budgeting system must be introduced to be able to deal with the above budget reforms. The current budgeting system, namely performance budgeting system, can manage these budget reforms in South Africa. Therefore, the performance budgeting system and this shift towards an accrual accounting system enable managers to manage risk effectively.

These budgetary reforms have a constitutional mandate, section 215 (1) of the Constitution, states that national, provincial and municipal budgets and the budgetary process must promote transparency, accountability and the effective financial management of the economy, debt and the public sector (The Constitution of the Republic of South Africa, 1996:121). Against this background risk management becomes central in supporting good governance, particularly elements such as accountability and transparency.

In the process of managing risks, policy formulation and management must be transparent and managers must be accountable in order to identify or detect areas or sections that are exposed to risks within a department. Among other things, risk management is able to manage financial risks that are based on poor financial planning, especially with regard to planning for contingency reserves because that could minimise risk on service delivery plans that normally result in unauthorised expenditure.

The development of risk management in the Public Service can prevent fraudulent activities within the Public Service if efficient internal controls are in place.

### 5.3 RISK, UNCERTAINTY, MANAGEMENT AND RISK MANAGEMENT: LINKAGE AND CONCEPTUAL ANALYSIS

It is human to manage risks without any academic discussion or a scientifically tested opinion through research. People manage risks in their daily lives. For example, people budget towards month-end or pay day in order to avoid overspending. Some people decide to use a particular vaccine before winter starts to guard against the chance of getting influenza during the winter season. Some people buy material to fence their yards to minimise the risk of theft.

However, from an organisational behaviour perspective, this human factor integrates itself or fuses within an organisational analysis. In one way or another, the human factor influences how departments or sections within a department conduct themselves. Therefore, personnel within an organisation have to be aware of various forms of risks that could be prominent in their respective departments or sections on a daily basis. As a result of risks, uncertainty might emerge based on a particular event or within personnel, and will automatically affect departmental objectives and service delivery programmes negatively within the Public Service.

It is paramount that risk should not be viewed from a negative angle only. For example, a public servant can review a particular process and identify an area where a risk can be turned into an opportunity or to a competitive advantage. Therefore, risks can create some reward for an organisation or a department. In analysing risks in a department, managers must note the relationship between a risk and a reward.

Smith and Young (1995:10) define *uncertainty* as a doubt about one's ability to predict outcomes. They further argue that uncertainty arises when an individual perceives risks and uncertainty is a subjective concept, so it cannot be measured directly. Because they believe that uncertainty is in the state of mind, it varies among individuals.

From a project perspective, Kliem & Ludin (1997:4) describe *risk* as the occurrence of an event that has consequences for, or impacts on, projects. It is important that the definition of *risk* should be based on a particular context, for example the above project risk perspective might be seen as irrelevant for the study. However, the researcher aims to display different contexts in which risk could be detected and managed. Project risks are also important

because without detecting and analysing them, the objectives of organisations could not be attained.

In analysing a risk, it should be taken into account that the likelihood that a risk might occur could be based on prevailing circumstances within an organisation, either a high turnover, absenteeism, poor internal controls or non-compliance with security clearance regulations.

In response to the above analysis and its occurrence, Knight (1999:4) provides an analytical view of risk, on the basis of having three elements, namely:

- a) The perception that something could happen;
- b) The likelihood of something happening; and
- c) The consequences if it happens.

Given Knights' analysis regarding a risk, it is clear that the analysing and profiling of risks within an organisation could serve as a an early warning system that something could happen or of the likelihood that fraud could be rife and result in negative implications within an organisation.

### **5.3.1 Risk and management**

Linking risk and management is essential to understand the managing of organisational risks. Dillon et al., (1984:50) define *management* as an act of planning, organising, directing and controlling the resources and activities of an organisation. In developing a risk management strategy, some management elements such as planning, organising and controlling are important because to implement such a strategy, a planning and organising process involving all the other branches or sections within an organisation is an important step. This has to be done because it affects everybody within an organisation, from risk managers to those who are involved in risk management strategy. It cannot be left to the technical committee to deal with.

Hanekom & Thornhill (1995:14) also explain *management* as aiming at directing an institution towards its predetermined objective(s), namely keeping the operations of an institution in equilibrium with its environment. Their explanation confirms that in managing risks it is crucial to outline organisational objectives in relation to possible risks that could affect the objectives. Then risk management is able to take into account organisational activities, objectives and an

environment both within an organisation and outside an organisation. As indicated earlier, it is important that strategic management shares a risk management strategy with the entire organisation so that the vision and mission of an organisation are maintained through a co-operative approach.

### **5.3.2 Risk and uncertainty**

Fone & Young (2001:2) draw an explicit line between *risk* and *uncertainty*. According to these authors risk is the variation in outcomes around an expectation. They use a dictionary definition for *uncertainty*, namely that “uncertainty is doubt about our ability to know” and they further note that ‘knowing’ or cognition, requires data, a means of receiving the data, and the capability of processing or converting data into information. Finally, these authors believe that, objectively, risk is the variability of outcomes around an expectation while, subjectively, risk is one’s attitude towards or perception of risk, which is influenced by uncertainty, personal, social and cultural factors, and the risk’s relationship to the larger environment.

The Government of Ontario in Canada (2000: 1) defines *risk* as any potential opportunity or threat that may impact an organisation’s ability to meet its objectives. The government of Ontario further explains that risks encompass all potential obstacles, consequences, and opportunities affecting the ability of the organisation to achieve its objectives. The government also argues that risks can be found externally or internally to the organisation, and can be broadly categorised into environmental, operational, strategic, financial and informational risks.

## 5.4 RISK MANAGEMENT AND APPROACHES

Taking into account the above analytical link between risk and management, and risk and uncertainty, this section deals with the theory of risk management as it is applied in the Public Service.

The King Report II (2002: 73) provides the following three definitions of risk management:

- a) *Risk management* can be defined as the identification and evaluation of actual and potential risk areas as they pertain to the company as an entity, followed by a process of either termination, transfer, tolerance or mitigation of each risk;
- b) The *risk management* process entails the planning, arranging and controlling of activities and sources to minimise the impact of all risks to all levels of an organisation; and
- c) *Risk management* is thus a process that utilises internal controls as one of the measures to mitigate and control risk. Risk, such as political, technological and legislative that cannot be managed through traditional internal control systems, should be dealt with using flexibility, forward planning and similar mechanisms.

Regarding the above, the King committee notes that risk management could serve as a tool to identify risks within an organisation and could be developed in such a way that risks are managed properly. The report also notes that risks occur in different ways, for example they could occur at political, technological and legislative levels. However, in managing these risks, strategic intervention or innovative ways should be used with regard to internal controls, not only focusing on traditional methods that already exist.

The National Treasury (2005:17) defines *risk management* as a continuous, proactive and systematic process, affected by a department's executive authority, accounting officer, management and other personnel, applied in strategic planning and across the department, designed to identify potential events that may affect the department, manage risks to be within its risk tolerance, and to provide reasonable assurance regarding the achievement of department objectives.

Additionally, in his thesis entitled *The development of an integrated model of risk*, Briers (2000:8) states that *risk management* is the process of intervention in economic and behavioural risk dynamics so that the value of the organisation is enhanced. Brier's definition is based on the fact that risk management could serve as an organisational intervention on economic and behavioural dynamics within an organisation, the dynamics could be based on organisational cultures.

Risk management is a process, affected by an entity's board of directors, management and other personnel, applied in a strategy setting and across the enterprise, designed to identify potential events that may affect the entity and manage risks to be within its risks appetite, to provide reasonable assurance regarding the achievement of entity objectives (Committee of sponsoring organisations of the Treadway Commission, 2004:3). In its analysis of the enterprise risk management (ERM) framework, the committee of sponsoring organizations of the Treadway Commission (COSO) correctly believes that risk management is not a once-off exercise; it is a process that has to be applied across an organisation within the context or understanding of organisational objectives, mission, vision, and its strategy.

Ting (1988:35) defines *risk management* as the general process of planning for, controlling, and reducing the impact of the incidence of risk as well as activities and events that could lead to the occurrence of the risk. Ting also believes risk management would include both preventive as well as remedial actions regarding the risk. This gives an extended definition of *risk management*, namely that integrative risk management is preventive, and it includes actions taken to minimise or even prevent the possibility of the incidence of the risk events. Defensive risk management is remedial, and it includes actions taken to minimize the impact of the occurrence of risks.

## **5.5 RISK MANAGEMENT AND INTERNATIONAL MODELS**

Internationally, some countries manage risk by focusing on a particular methodology or model. For example the Canadian government (2000:2) is of the view that in carrying out risk management, a department needs to do the following:

- a) Explicitly state its objectives;
- b) Identify key risks that affect stated objectives;
- c) Assess the potential likelihood and impact of occurrence for each identified risk;



- d) Develop and document a course of action to reduce or mitigate identified risks to an acceptable level; and
- e) Continuously monitor internal and external environments for risks, and the ongoing effectiveness of action plans, adjusting the plans where necessary.

With regard to risk management, the Canadian model suggests a systematic approach that ensures that organisational objectives are attained through government's approach to risk management. However, the Canadian approach is silent about prioritising risk according to their degree of threat within an organisation because risk prioritisation is important and helpful, especially if an organisation is faced with diverse forms of risks. For example, a financial risk might not be a threat as in the case of political and technological risks.

Additionally, according to the Canadian approach (2000:3), *risk management* is based on the following underlying key principles:

- a) Everyone is responsible for sound risk management practices and is held accountable for achieving the results;
- b) Everyone should have the capacity, meaning the skill, training, knowledge, access to information and resources to carry out his or her risk management duties;
- c) Risk management activities should be fully integrated into a ministry's or an agency's planning, monitoring and reporting process and into the daily management of its programs and activities; and
- d) Open communication across all staff levels using a simple, common risk language is essential to ensure that everyone understands, relates to and uses risk management tools and techniques.

From the above underlying principles, it is evident that risk management could serve as a management tool, has to be integrated into daily organisational programmes and it is the responsibility of every public servant or official. This means that risk management should start from a security officer at the departmental entrance to the head of the department and his or her Minister. Therefore, each and every public servant should be responsible and active in identifying risks from his or her section within an organisation.

### **5.5.1 Australia and New Zealand risk management model and its analysis**

In relation to the Australian-New Zealand model on risk management, as depicted in Figure 5.1, it is argued that to manage risks effectively, the context has to be established. Understanding of a context; a risk analyst must understand his or her environment by also looking at the organisational strengths, weaknesses, threats and opportunities (SWOT) of an organisation. In essence, a risk evaluator must apply a SWOT analysis. Among others, the context or environment itself includes the organisational financial position, competition, public perception or image, cultural and legal side of an organisation. Looking at the above diverse environmental or contextual factors within an organisation indicates the diverse nature of risks that need to be covered if an environment is studied and understood correctly.

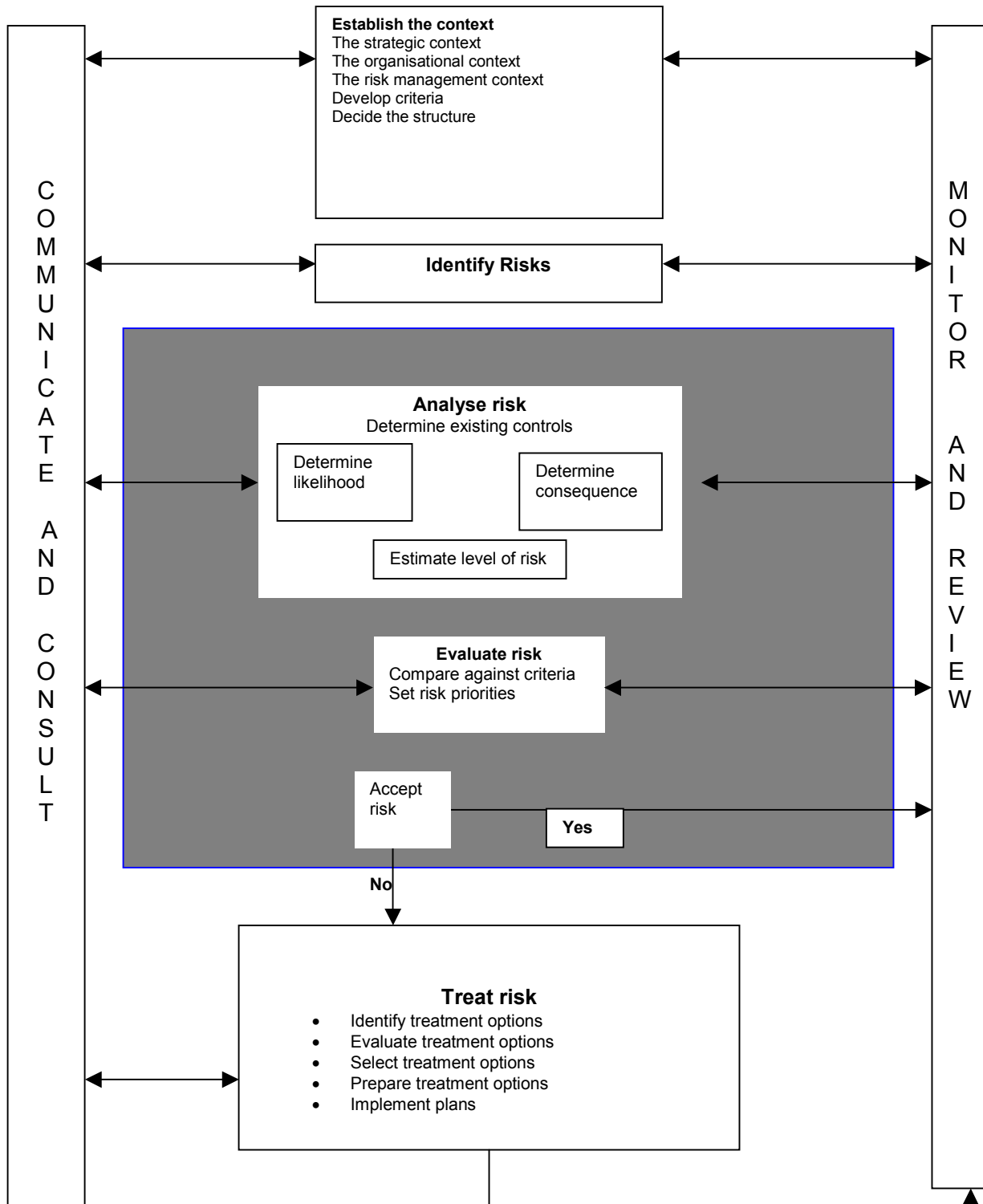
In establishing the organisational context, before conducting any risk assessment or risk management, it is important to understand the organisational ability to manage risks and know organisational goals and objectives and strategies that are in place to such risks. It is in this phase when managers have to be fully involved by identifying their role in contributing to organisational goals, objectives, values and how management decides about managing risks, which is to know managerial commitment in managing risks. Here, the organisational context prevails.

During a risk management process, the risk management context is crucial. During this phase objectives and scope or parameters are crucial because it helps to identify an area or component where a risk management process will take place. In this process, the balancing of costs, benefits, and opportunities become important. It is because a risk management process should be considered whether to focus on the wider organisation or on a specific programme.

Once risks are identified, developing criteria evaluations are also paramount. It is at this stage where a decision is taken as to what criteria to be used against which risk to be evaluated. Decisions are based on financial, operational, legal and technical criteria. The diverse nature of circumstantial decision-making depends on organisational internal policy, goals, interests and interest of stakeholders. At this stage consideration is given to the level of risks the organisation is prepared to accept. Risk criteria are used for the ranking of risks and a decision is taken whether risks are acceptable or not part of risk evaluation. If some of the risks are not accepted, those risks must be treated and implementation plans must be in place

to manage identified risks. Risks identified in the organisation must be communicated and the relevant components and stakeholders must be consulted. Managing those risks is everybody's business. After the identification and treatment of risks have taken place, the monitoring, evaluation and reviewing of the level of risks identified must be in place.

**Figure 5.1: Australia-New Zealand risk management model**



Source: Knight (1994: 14)

The above model illustrates that during risk management, an in-depth analysis of risk should be done; otherwise risks within an organisation and outside organisation will not be effectively identified, and treated if that is an option. There are authors who differ somewhat in their approach to risk management, but not that different from the model sketched above. The following perspectives provide an in-depth analysis of risk identification and risk assessment.

## **5.6 RISK MANAGEMENT STRATEGY**

Other authors provide some insights and comments on risk management strategy, risk assessment in particular because it is a stage where the strengths and weaknesses of an organisation are identified and dealt with on the basis of risk assessment. The three elements of risk assessment, these are:

- a) Risk identification: determining what is at risk and from what sources;
- b) Risk measurement: determining the consequences of the risk; and
- c) Risk prioritisation: determining the appropriate resources to manage the risk (McNamee, 2000).

The above elements support the fact that identifying a source of risks is vital to understand the external forces that impact on an organisation. What is also important is the prioritisation of risks identified. In some situations, an organisation could spend much more time trying to treat a risk than simply accepting the risk as a very low risk. This poor analysis and prioritisation could be detrimental for both an organisation and the Public Service because risky areas could not be treated urgently.

With reference to a risk management process, Pike (2001) maintains that during risk management, risks can be evaluated and assessed. Failure to evaluate and monitor organisational risks could affect the service delivery plan and programmes of government in terms of government objectives, mission and objectives.

## **5.7 TOWARDS AN INTEGRATED RISK MANAGEMENT MODEL IN THE PUBLIC SERVICE**

Various sources such as Presidential Review Commission (1998), Public Service Commission (2004), Exchequer and Audit Act (1975), Mthembu (2001) and the White paper on the transformation of the Public Service (1995) reveal that prior to the South African democratisation in 1994, policy or legislative frameworks and the state of public administration were secretive, non-accountable and not responsible. A culture of financial control rather than financial management was the order of the day. Focus on rules and procedures rather than managerial responsibility and accountability was also prevalent. Departmental weak systems exposed the Public Service to various forms of risk such as social, political and financial risks. As a result of the above, service delivery could be severely affected.

Generally, after 1994, significant transformation took place, Public Service has been and still is in the process of transformation. Due to the transformation agenda in the Public Service, departments tend to develop organisational cultures on the basis of change. Due to the country's history and legacy, in some departments organisational change is very slow; in the process some public servants resist change on the basis of wanting to maintain the status quo. For example, within an organisation, issues like race, people with disabilities and gender tend to form part of an organisational culture and the latter has an influence on governance and service delivery.

Several government policies have been implemented. One of the concerns regarding these policies is poor implementation due to a lack of capacity by officials. In response to the above, particularly matters of governance, risk management became an issue of importance in the Public Service through the introduction of PFMA. Risk Management is also becoming a topical issue and the area of necessity across the public sector, including the local governments.

In South Africa, in terms of the PFMA (1999:45), section 38(i) "an accounting officer must ensure that a department has and maintains effective, efficient and transparent systems of financial and risk management and internal control". Subsection 38 (ii) also states "an accounting officer must ensure that a department has and maintains a system of internal audit under the control and direction of an audit committee". From a private sector perspective, the King report (2002:73) also states that risks as uncertain future events could have an influence

on the achievement of company objectives which could include strategic, operational, financial, and compliance-based objectives. The report is indeed applicable across the public sector, especially in the context of the 'new management model', which has customer or private sector connotations, including the PFMA approach. In this context the mandatory section regarding risk management could be applied, including the lessons from the King Report.

Risk management is fairly new in the South African Public Service. As a result, it has been narrowly based on financial risks. It should be noted that the government's mandate differs from that of the private sector. Departments can differ operationally, but most of them deal with finance, policy or legal framework, regulations, economic factors, technology and information. Without an integrated approach to departmental activities on risk management, the government could be exposed to various forms of risks.

As has been stated in the thesis, public administration takes place or operates within a political, social and economic milieu. Therefore, in managing risk in the Public Service or in public administration in general, an integrated framework and contextual understanding of a particular department is central. Without limiting the scope to the economic, political and social aspects, other elements central to public administration as a discipline are also important, notably finance or public finance, technology and information, economics and legality.

The public sector has a much greater opportunity to have a holistic approach to risk management (Cowans, Deborah and Shalowi, 1997:3). This could enable a risk manager to understand a source of risk in the Public Service and develop a sense of co-ordinated approach to risks. In the Public Service, an integrated approach to risk management has to be viewed as a strategy to enhance management skills because risk management itself is a management tool. During transformation in the South African government in general, in organs of state in particular, a proactive approach management style is critical as it might limit or minimise the chances of exposing citizens to risks. In actual sense, risk management could assist in improving the lives of people through proper planning or reinforce the government's political mandate of improving service delivery.

Simultaneously, a well-co-ordinated and integrated approach could minimise corrupt or fraudulent activities in the Public Service through putting in place strategies entailed in the

PFMA and Treasury regulations promulgated in terms of the Act. It is well documented that risk management in the Public Service must be in place to deal with improper budgetary planning, wastage of assets and other elements that stifle service delivery challenges facing the South African Government. Risk Management cannot be exclusively assessed on financial aspects. As it is a management tool, risk management seeks to ensure that the objectives of an organisation are attained efficiently, as planned. Kloman, (2002:1) alludes to the biggest problem: how to measure all these risks in terms of their potential likelihood, their possible consequences, their correlations and the public perception of them.

In an environment that has diverse risks, COSO believes that an integrated response to multiple risks is of importance because in its analysis, processes carry many inherent risks, and organisational risk management should enable integrated solutions for managing risks (Committee of sponsoring organizations of the Treadway Commission, 2004:3). Therefore, organisations should also apply an integrated approach to the treatment of risk.

It is important that the risk assessment process be based on an integrated approach so that almost all organisational components are able to benefit from such a holistic approach. In his article entitled *integrated risk assessment: current views on risk management*, Kloman (2002:1) argues that:

*Watch a piano player, its keys moving up and down with no visible evidence of control. Risks are like that. They don't appear to be connected, but like piano keys controlled by an unseen paper roll; they produce music when coordinated, and a cacophony when not. Striking a single key produces a single tone. Striking several blindly means dissonance. But striking a group of keys in a coordinated way produces a chord. This is the goal today of managing organisational risk: creating harmony instead of atonality.*

Based on the aforementioned piano analogy, it is evident the managing of risks within an organisation demands an integrated approach, especially in identification and assessment of risks so that treatment becomes effective for the benefit of the organisation.

COSO further notes that ERM is interrelated to corporate governance by providing information about risks to the board and also interrelated to performance management by providing risk-



adjusted measures, with internal controls, which are an integral part of enterprise risk management (Committee of sponsoring organizations of the Treadway Commission, 2004:3).

Departmental performance measurement becomes effective if risk identification and assessment in relation to projects and programme are integrated in order to achieve programme objectives, vision and mission. Therefore, risk management has to be part of the culture of a department or Public Service as a whole. Once it is an organisational culture, it becomes the responsibility of everyone in the organisation or department to manage risk.

In his article entitled *'towards an integrated risk management strategy for the public service'* McNamee (2002:2), is assertive of the fact that integrated risk management requires a flexible approach to management and emphasises the critical importance of effective strategic management for the success of organisations in the contemporary world. He also argues that risk management highlights the importance of the adage 'the learning organisation', which must be an organisation that monitors environmental changes and acts decisively to learn and implement the necessary organisational changes. His analysis illustrates the fact that managers in the Public Service have got a responsibility to strategically plan for the threats and weaknesses, enhance and harness strong points in a department and engage in futuristic planning in order to manage risk efficiently and effectively. The purpose of risk analysis is to make better decisions about future actions in an uncertain world (McNamee, 2002:2).

Additionally, managers must be able to act from an informed position that requires them to constantly learn new ideas, as it is critical in public administration, because public administration does not operate in a static environment. Correct information is essential in risk management both in the public and private sector, especially in this era of globalisation and new technological advancement. A learning organisation could be a flourishing one in this evolving public administration. It is essentially correct that managers must be able to assess and monitor these changes more effectively as they emerge so that any risk that may prevail could be detected or identified.

Kloman (2002:1) maintains that integrated, or holistic, or enterprise risk management is the new objective. He looks at financial, market, political, regulatory, legal liability, and operational risks together, rather than separately, as has been done in the past. This approach challenges risk managers and other officials in national and provincial departments to measure diverse

risks in an integrated approach in the Public Service. Risk management could be used as a way of improving service delivery, public financial management, and enhancing principles of good governance, like ethical standards, accountability and responsibility in the Public Service.

With regard to an integrated approach to risk management, the Audit Commission (1999:7) provides an international model with regard to an integrated approach to risk management. The commission explains different forms of risks and draws a line between strategic and operational risks in order to illustrate the possible hazards that could face an organisation. The commission's analysis is as follows:

## 5.8 FORMS OF RISKS

There are number of risks in an organisation. The following are examples:

### 5.8.1 Strategic risks

- a) **Political:** Those risks associated with a failure to deliver either local or central government policy, or meet the local or people's administration's manifesto commitments;
- b) **Economic:** Those risks affecting the ability of the council, central government or a department to meet its financial commitments. These include internal budgetary pressures, the failure to purchase adequate insurance cover, external micro level economic changes such as inflation control, interest rates and exchange rates or the consequences of proposed investment decisions;
- c) **Social:** Those risks relating to the effects of changes in demographic, residential or socio-economic trends on the council (local government) or central government's ability to deliver its objectives;
- d) **Technological:** Those risks associated with the capacity of the local or central government to deal with the pace/scale of technological change, or its ability to use technology to meet changing demands. They may also include the consequences of internal technological failures or the government's ability to deliver;
- e) **Legislative:** those risks associated with current or potential changes in national or provincial and local law. Non-compliance is also prominent in legislative risks;

- f) **Environmental:** Those risks relating to the environmental consequences of progressing the government's strategic objectives, in terms of energy efficiency, pollution, recycling and landfill requirements; and
- g) **Customers/citizens:** Those risks associated with failure to meet the current and changing needs and expectations of customers and citizens.

### 5.8.2 Operational risks

- a) **Professional:** Those risks associated with the particular nature of each profession, for example housing service concerns as to the welfare of citizens;
- b) **Financial:** Those risks associated with financial planning and control, for example underspending and overspending;
- c) **Legal:** Those risks related to breaches of legislation or non-compliance with a particular legislative framework or policy;
- d) **Contractual:** Those risks associated with the failure of contractors to deliver services or products to the agreed cost and specification;
- e) **Environmental:** Those risks relating to pollution, noise or energy efficiency of ongoing service operations; and
- f) **Technological:** Those risks relating to reliance on operational equipment, for example, IT systems or equipment and machinery.

Ultimately, both the strategic and operational risks need to be integrated organisationally or departmentally in a co-ordinated manner, as outlined above by the commission. The different forms of risks indicated above, namely strategic and operational risks, confirm the fact that focusing only on financial risks is not a practical solution for the Public Service. As a result, a paradigm shift from a financial perspective to a service delivery risk management orientation is important for both the government and citizens. As indicated earlier, the government's role is to provide services to citizens as opposed to the private sector, which is focusing on profit. Some risks could impact on each other during day-to-day operations. For example, political risks could cause uncertainty about the coefficients of sensitivity of cash flows to macroeconomic disturbances (Oxelheim & Wihlborg, 1987:115). Therefore, risks have to be identified and managed daily so that the impact does not become severe and affect the government's plans, vision and mission.

For example non-compliance with PFMA is a legal risk. A department can have unplanned expenditure due to non-compliance with the Act. Such expenditure continues to appear unnoticed and could also be regarded as ‘hidden expenditure’ and could be costly to a department. Rosen (1985:15) also believes that issuing regulations *per se* is not very expensive, but compliance with the rules can be very costly. Non-compliance with the PFMA could also expose a department to financial risks and ‘hidden’ costs could prevail if not identified in time and analysed properly. Therefore, Rosen’s assertion could suggest that public servants should comply with the PFMA in order to improve governance in the Public Service. However, other policies like Public Service regulations and Treasury regulations, including the constitution, must also be used as compliance measures. Table 5.1 illustrate the level of non-compliance with the PFMA in the Public Service, with specific reference to certain provisions stated in the PFMA, which is used as a governance model in the Public Service.

**Table 5.1: Departmental non-compliance with Public Finance Management Act (1999) provisions**

NATIONAL DEPARTMENTS	AUDIT REPORT (Year-End 31 March 2003)
Environmental Affairs and Tourism*	Internal audit function: in terms of the Treasury regulations, an internal audit must be conducted in accordance with the standards set by the Institute of Internal Auditors. Work evaluated did not comply with these standards. As a result the contract of the head of internal audit was terminated on 31 March 2003. Accordingly, no reliance was placed on the internal audit section.
Health *	No reliance could be placed on the work of internal audit as the internal audit component did not fully comply and execute the audit plan and the audit work was based on ad hoc tasks which were the result of a fraud line.
Housing	The internal audit function: no reliance could be placed on the work of internal audit as no internal audits were finalized and presented to the audit committee. Fraud prevention plan: Non-fraud prevention plan had been compiled in terms of the requirements of the PFMA, 1999.
Independent Complaints Directorate*	Limited reliance was placed on the work of the limited audit due to different focus areas. Non-compliance with the PFMA, 1999. An amount of R1,587 million appropriated for capital expenditure was utilised to defray current expenditure.

NATIONAL DEPARTMENTS	AUDIT REPORT (Year-End 31 March 2003)
Land Affairs*	The internal audit section was not functioning effectively and did not comply with PFMA requirements and reliance could not be placed on the work of internal audit.
Presidency	Disclosure of unauthorised and irregular expenditure: Contravention of section 43 (4) (c) of the PFMA: this contravention related to an amount of R1,4 million savings on capital expenditure in programme 1 which was used to defray current over expenditure on the same programme.
Provincial and local government	Internal audit function: No reliance could be placed on the work of internal audit as no reports were finalised and presented to the audit committee.
Public service Commission	The audit committee that was instituted did not function effectively and was basically non-existent for the financial year.
Statistics South Africa	Risk management strategy: No formal risk management strategy as required by Treasury Regulation 3.21 submitted for the year under review.
Safety and Security*	Due to the limited extent of work performed by internal audit, limited reliance was placed on the work of internal audit.
Science and Technology	Internal audit: No internal audit work was performed at the Department of science and technology for the period 1 August 2002-31 March 2003. This is due to separation of Science and Technology between department Arts, Culture, Science and Technology on the 1 August 2002-31 March 2003.
Sport and Recreation	The internal audit reports were not issued on the planned dates, as management did not submit management comments on the findings timeously.
Water Affairs and Forestry*	Late submission of financial statements and supporting documentation represented non-compliance with PFMA, 1999. Reliance on internal auditors due to the different focus areas.
Communications	Limited reliance was placed on the internal auditors due to the different focus areas.
Correctional services*	Reliance could not be placed on the work performed by internal audit.

**\*Reported in the 2001-2002 financial year**

Source: Auditor-General: General audit outcomes Report (2003)

As indicated in the research methodology, the Department of Water Affairs and Forestry is used as a case study, risk management in particular as an element of governance. The

following section in Table 5.2 reveals some deficiencies with regard to governance, such as risk management and internal controls, managerial leadership, decision-making, financial management and compliance with PFMA and Treasury regulations.

## 5.9 DEPARTMENT OF WATER AFFAIRS AND FORESTRY: RISK MANAGEMENT AS AN ELEMENT OF GOVERNANCE

### 5.9.1 Risk assessment

The table below (Table 5.2) displays risks identified by Department of Water Affairs and Forestry (DWAF) in its risk assessment review and long-term audit plan report (2003).

**Table 5.2: Risk assessment: Department of Water Affairs and Forestry**

	STRATEGIC RISKS	SPECIFIC RISKS
1.	Inability to provide basic water services	<ul style="list-style-type: none"> <li>➤ Changing global climate including droughts and floods</li> <li>➤ Cholera epidemics and toxic spills in the water supply or sources</li> </ul>
2.	Water service delivery strategies are not cost-effective	<ul style="list-style-type: none"> <li>➤ Pricing strategy is not implemented effectively (includes non-payment for services)</li> </ul>
3.	Environment	<ul style="list-style-type: none"> <li>➤ Changing global climate including droughts and floods</li> </ul>
4.	Lack of internal capacity and direction	<ul style="list-style-type: none"> <li>➤ Clarity in terms of roles and responsibilities</li> <li>➤ Strategic development of HR capacity in conflict with Labour Relations Act</li> <li>➤ Lack of human resources capacity</li> <li>➤ Lack of skills and capacity to deliver services, especially at regional level</li> </ul>
5.	Lack of co-operation with all spheres of government and role-players and stakeholders.	<ul style="list-style-type: none"> <li>➤ Dependency on other institutions to achieve department's objectives</li> <li>➤ Relationships with external stakeholders are not managed</li> </ul>
6.	Non-compliance with legislation	<ul style="list-style-type: none"> <li>➤ Court or constitutional challenges to the National Water Act, National Forests Act, National Veld and Forest Act, Public Finance Management Act of 1999</li> </ul>

	STRATEGIC RISKS	SPECIFIC RISKS
		and Public Service Regulations of 1999.
7.	Changing strategic direction and policy	➤ Possible changes in policy direction resulting from 2004 national elections
8.	Procurement	<ul style="list-style-type: none"> <li>➤ Reliance on consultants</li> <li>➤ Lack of value for money</li> <li>➤ Lack of effective skills transfer</li> <li>➤ Ineffective management of consultants by DWAF, for example, fleet management procurement</li> </ul>
9.	Expenditure control	<ul style="list-style-type: none"> <li>➤ Lack of financial management skills</li> <li>➤ Government not seen as a business resulting in a 'spending' mentality.</li> <li>➤ Individual level of skill and experience required does not match size of budget controlled and managed.</li> <li>➤ No financial analysis, for example, cost-benefit and feasibility analysis.</li> </ul>
10.	Asset management	<ul style="list-style-type: none"> <li>➤ Ineffective internal systems and procedures</li> <li>➤ Lack of discipline</li> <li>➤ Lack of control over assets (physical and value)</li> <li>➤ Duplication of acquisitions</li> <li>➤ Lack of tracking of issues, particularly deductions and queries</li> </ul>
11	Internal systems	<p>Policies and procedures</p> <p>Unclear delegations</p> <p>Poor division of responsibilities</p> <p>Lack of tracking of issues /decisions/queries</p>

Source: Department of Water Affairs and Forestry (2003:10)

Regarding the above risk assessment, it is clear that the department is faced with a number of diverse risks and the above picture could easily affect service delivery and governance in general. The above table shows that its strategic mission and vision are not geared towards

departmental objectives so that the departmental internal operations could take place within the mandate of the department. For example, the inability of a department regarding the lack of internal capacity and direction could be attributed to a lack of leadership and basic management skills. Again, poor management of the restructuring process resulting in conflict with unions, duplication of activities and loss of assets, could also be attributed to lack of strategic planning, as the management is unable to anticipate threats facing the organisation.

Regarding financial management, procurement is ranked as high risk because the value for money principle is poorly applied. There is an inability of the department to manage consultants and there are no transfer skills. This poor management of consultants has a bearing on the financial management because continuous hiring of consultants without transferring skills could raise personnel expenditure or costs and lower employees' morale. Again, internal controls are ineffective because there are unclear policies and procedures, unclear delegations, poor division of responsibilities and inability to track issues and decisions. This state of affairs could affect departmental daily operations because a poor or lack of policy and unclear delegations are indeed the management's responsibility. The management has to establish internal control and monitor those internal controls.

Expenditure control and asset management are also faced with a risky environment. For example, with reference to expenditure control there is a gap between the skill and size of the budget and there is poor financial decision-making. As a result, there is poor financial analysis or application of cost benefit analysis and due to such situations financial decisions could lead to poor financial management. Assets are also poorly managed, there is no control and the fact that there is duplication of acquisitions is an indication of the absence of internal control.

It has been noticed that non-compliance with a procurement system, no detection of fraud, under-collection of revenue and a lack of asset management could be attributed to the inability of management to manage the affairs of a department. It is reported that non-compliance with a procurement system, non-detection of fraud, under-collection of revenue and asset management are high risk areas and represent 60% of the total inherent risk identified during the risk identification process. Specifically, non-detection of fraud, lack of asset management and under-collection of revenue represent 50% of the total risk identified (Department of Water Affairs and Forestry, 2003:10).



The procurement system could be regarded as a high risk as the researcher identified that there was no precise and clear policy on procurement except fragmentation and unclear procedural procurement guidelines. In the period of the study there was no policy on debt management, yet the department is mandated among others to deliver water to the public and manage forestry and most of those activities are at local government level.

The department should have noted that in some cases the local government is unable to collect services from the people. The department should have had a strategy to overcome such a situation with the spirit of co-operative governance between spheres of government. It is clear that the department lacks risk management skills, there are poor basic management skills, poor financial management and a very poor control environment. The above risky areas could have a negative effect on service delivery.

In the study, almost all the respective departmental interviewees (SMS officials) from DWAF reported some organisational problems forming the basis of governance matters that are related to institutional deficiencies.

The deficiencies originate from risk management, non-compliance with legislative frameworks, organisational instability, lack of vision from managerial leadership, poor decision-making, especially on financial matters, poor planning and budgeting, poor management and overuse of consultants, poor lines of accountability, poor management of risks, non-compliance with procurement legislative procedures and inability to track and identify 'hidden costs' during the financial year. The above governance matters exposed DWAF to various forms of risks and most risky areas are reflected in Table 5.1 above. During the research the interviewees reported the following:

- a) The culture of risk management within the department was minimal and not everybody participates in risk management. They only participate when requested by internal audit unit just to comply with PFMA and Treasury regulations. This implies that the department does not look at the PFMA as a 'management tool' but as a 'compliance tool'. This means that the department does not use PFMA as a vehicle towards financial management, improving accountability, responsibility within the public service but as a tool of 'compliance' to avoid organisation crisis rather than managing organisational risks. It is because risk management is a management tool.

- b) DWAF faced organisational instability which was caused by the fact that the department was involved in ‘endless transformation’ by focusing on organisational design and later redesigning the same departmental structure. As a result, departmental officials were not sure about their future and reported that, that had an effect on organisational performance.
- c) A lack of vision from the strategic level within the department was reported as a major problem and it was linked to the ‘endless transformation’ because the interviewees strongly believed that departmental vision and the mission and might not be attained. Summarily, the departmental vision and mission read as follows:

*Vision*

*“We have a vision of a society in which all our people enjoy the benefits of clean water and hygienic sanitation services. We have a vision of a land in which our natural forests and plantations are managed in the best interests of all”.*

*Mission*

*“Ensuring that water services are provided to all South Africans in an efficient, cost-effective and sustainable way and managing and sustaining our forests, using the best scientific practice in a participatory and sustainable manner”*  
(Department of Water Affairs and Forestry, 1:2006).

On the basis of the above, interviewees were pessimistic about the attainment of both the vision and mission if ‘endless transformation’ is not effected. It is in this context that leadership has to share an organisational vision and mission with the entire organisation. It could be deduced that transformation within DWAF took place without other members or officials of the department. In some situations, once other members or officials of an organisation or department feel detached from the organisational plans and processes, a culture of non-compliance with the legislative framework could emerge because they feel that they are not part of the organisational strategy. This can expose a department to various forms of risks like the ones mentioned in the text.

It is important for the managerial leadership to ensure that services are delivered efficiently, effectively and economically, by the effective implementation of policy frameworks like PFMA,

procurement policies and their guidelines. This will result in achieving the government's broader mandate of delivering services to the people. Therefore, implementing the vision and mission of an organisation becomes paramount. This serves as a broader strategy of a department, and managerial leadership has the responsibility to implement such a strategy alongside all the members of an organisation.

The interviewees also reported on poor decision-making, especially on financial matters. This was reported as a major problem and was confirmed by a number of qualified reports from the Auditor-General reporting about the same matter for two or three consecutive years without any action from the department. Such indecisiveness regarding financial matters does not only impact negatively on the department in terms of poor financial management, but it also affects the image of both a department and its personnel, and exposes a department to reputational risk.

Poor decision-making in an organisation could originate from a lack of skills or a lack of strategy to manage organisational affairs, absence or poor systems for financial management. The latter is crucial because in the process, public monies are wasted and not accounted for. Overuse of consultants was also reported and during research there was no clear policy framework, taking into account the evolving procurement system in the Public Service along the lines of SCM policy or framework. The departmental internal audit unit also confirmed the poor management of consultants. Poor management of consultants could be as a result of human resources deficiency if skills are not transferred to the department. The research reported that the lines of accountability were undermined and this effects on governance. The research indicates that the departmental head of the internal audit unit reported directly to the chief financial officer (CFO), such reporting lines are not in line with Treasury regulation 3.2.9, which states that *"an internal audit function must report directly to the accounting officer and shall report at all audit committee meetings and the function must be independent of activities that are audited, with no limitation on access on its access to information"* (Treasury Regulations, 2005:10).

The situation at DWAF, regarding the lines of accountability and reporting was also not in line with what is called 'corporate governance' principles encouraged and supported by the PFMA.

Based on the above organisational matters, it is clear that the department lacked systems of governance and managerial leadership to implement for its mission and vision. At the same

time the evolving public finance management system in the public service and the PFMA principles were not upheld, especially accountability and sound financial management.

Fone & Young (2001:42) in their model on risk management, argue that an organisational risk management model has to enable an entity to progress towards its goals in the most direct, economical and effective path. In response to Fone and Young's observation, it takes very a strong and committed managerial leadership to effectively implement the mission and vision of an organisation without exposing an organisation to all forms of risks due to a lack of managerial skills, and the inability to integrate organisational goals and objectives within the strategic plans of a department.

Therefore, a risk management culture must be inculcated throughout the organisation so that the management of risks becomes everybody's responsibility and every individual becomes a risk manager. In this way the so that different forms of risks are easily identified and accessible.

As the King report (2002:74) on corporate governance suggests, "risk management should be practised throughout the company by all staff in their day-to-day activities". Once risk management becomes a daily exercise of all employees within an organisation, almost all forms of risks could be easily identified and managed effectively in an integrated approach, not in silos.

## **5.10 INTERNAL CONTROLS AND THEORETICAL ANALYSIS**

*Internal control* is defined as a process designed to provide 'reasonable assurance' regarding the 'achievement of objectives' in the following categories: reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations (Changchit, Holsapple & Madden 2001:438).

The above definition suggests that internal controls within an organisation function as a 'process', measure and an organisational tool in providing a 'reasonable' control in making sure that an organisation accomplishes its obligations, objectives and mandate, particularly reporting on authentic and reliable financial information, inefficiency and effectiveness of organisational operations and compliance with relevant laws and regulations.

With regard to internal control, reasonable control suggests that internal control could not provide absolute control over an organisation. Among others, it could depend on the culture of an organisation and human element. With regard to organisation culture, the effectiveness of internal controls could depend on management commitment and zeal to take strategic decisions in order to maintain an effective internal control system within an organisation. As a process, internal control is a means to an end not an end itself. It is in this context that internal controls should be monitored and evaluating. Such an evaluation and monitoring should be periodically applied so that internal control's weaknesses and strong points are assessed on interval bases.

The government defines *internal control* as a process put in place by management and other stakeholders, which are designed to:

- a) provide reasonable assurances that the organisation's objectives are achieved effectively and efficiently, in compliance with applicable laws and regulations; and
- b) ensure reliable financial reporting. Effective internal control ensures that an organisation delivers service efficiently and effectively based on its strategic objectives. Effective internal controls also support accountability by assisting in providing reliable financial information through effective accounting standards (National Treasury, 2002:28).

Most importantly, any weakening aspect regarding internal controls should be attended to, because it might expose an organisation to risky situations, like fraud, corruption and organisational reputation risks.

The International Organization of Supreme Audit Institutions (INTOSAI) also adds that internal control, or management control, helps to provide reasonable assurance that the organisation:

- a) adheres to laws, regulations, and management directives;
- b) promotes orderly, economical, efficient and effective operations and achieves planned outcomes;
- c) safeguards resources against fraud, waste, abuse, and mismanagement.
- d) provides quality products and services consistent with the organisation's mission; and
- e) develops and maintains reliable financial and management information and fairly discloses that data through timely reporting (International Organization of Supreme Audit Institutions, 2005:1).

Research also shows that an internal control system encompasses the policies, processes, tasks, behaviours and other organisational aspects in order to:

- a) facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud, and ensuring that liabilities are identified and managed;
- b) help to ensure the quality of internal control and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation; and
- c) help to ensure compliance with applicable laws and regulations, and also with internal policies (Pickett, 2003:184).

The government also defines *internal controls* as systems, procedures and processes that are implemented to minimise the risk (any financial consequences) to which the department might otherwise be exposed as a result of fraud, negligence, error, incapacity or other cause (National Treasury, 2002: 28). Clearly, the government believes that internal controls should minimise risks in government due to other factors like fraud and incapacity.

### **5.10.1 Objectives of internal control**

Applegate & Wills (1999:1) state that according to the committee of sponsoring organizations of the Treadway Commission (COSO), the three primary objectives of an internal control are to ensure:

- a) efficient and effective operations;
- b) accurate financial reporting;
- c) compliance with laws and regulations.

The above internal control objectives are critical because they strengthen governance. Once internal controls become effective, they assist a department in running its own day-to-day operations effectively and a department is also able to clear accounting operations and comply with legislative framework.

## 5.10.2 Characteristics of internal controls

- a) **Timeliness:** An internal control system should detect potential or actual deviations early enough ensuring management can take corrective action timeously and limit unnecessary cost.
- b) **Economy:** Although an internal control system should provide assurance that the objectives of an institution are achieved, this should also ensure minimum cost and the least undesirable side effects as possible.
- c) **Accountability:** An internal control should ensure that staff is held accountable for their assigned responsibilities and tasks. This is achieved by applying prescribed procedures.
- d) **Flexibility:** Changing work environments are inevitable, particularly as politics dominates the approach to service delivery in the public sector. Internal controls are preferably designed to accommodate changes without themselves requiring change.
- e) **Appropriateness:** Internal controls should be designed to meet the needs of management in achieving objectives. Internal controls should fit into the personnel and organisational structure of the institution (Visser & Erasmus, 2002:294).

The management should make sure that systems are in place to safeguard department's assets and assist a department in attaining its objectives.

### 5.10.2 Internal control: Public Finance Management Act, 1999 and Treasury regulations provisions

The following PFMA provisions have been discussed earlier in parts of the research. Alluding to them is not a repetition of the assertions stated earlier, but a more relevant and contextual-based discussion that should emphasise internal controls especially and the role of managerial leadership in implementing the PFMA.

In insuring good governance and the management of risks in the Public Service, Treasury Regulation 3.1.10 states that the audit committee must:

- a) review the effectiveness of the internal control systems;
- b) review the institution's compliance with legal and regulatory provisions (Treasury Regulations, 2005:8).

Similarly, in terms of section 38 (i) the accounting officer for a department, trading entity or constitutional institution must ensure that the department, trading entity, or institutional institution has and maintains effective, efficient and transparent systems of financial and risk management and internal control (Public Finance Management Act, 1999:45).

The above PFMA provisions support the governance philosophy, especially on risk management and internal controls. The relationship between an accounting officer and an audit committee is very crucial especially on the basis of the sharing of valuable and credible information on organisational systems. The relationship between the two is also at the accountability levels because an audit committee is accountable to an accounting officer. For example, Treasury Regulation 3.1.12 states “an audit committee must report and make recommendations to the accounting officer, but the accounting officer retains responsibility for implementing such recommendations” (Treasury Regulations, 2005:9). Additionally, an accounting officer can also work together with a chief financial officer (CFO) on the basis of Treasury Regulation 27.3.2 that an accounting officer may delegate specific responsibilities to the CFO (Treasury Regulation, 2005:82). However, the accounting officer remains accountable for the delegated responsibilities such as financial management because accountability cannot be delegated.

#### **5.10.4 Components of internal controls**

With reference to internal control system, the system consists of five components that are interrelated to each other. For these components to be effective, they have to be integrated to organisational objectives, vision and mission. Of paramount importance is the fact that they have to be integrated with basic managerial processes and principles, like planning, organising, leading and evaluation.

King committee on corporate governance and committee of sponsoring organizations of the Treadway commission (COSO) provide the following components by explaining their contribution in managing the risks within an organisation:

##### **a) Control environment**

The *Control environment* sets the tone of an organisation and influences people within an organisation. In this particular component, internal control is displayed, discipline and structures are provided. Within this component, integrity, ethical values, competence of the



personnel, management philosophy, operating style and the way management assigns authority and responsibility are important.

On the basis of compliance and eagerness to create an environment that support regulatory frameworks and create a culture of good governance, strategic managers or top management must establish a control environment because it reflects the following:

- (i) a) It sets the tone and provides the necessary discipline and structure. This is seen as the foundation of all other components of risk management and control;
- b) It should include factors such as the integrity, ethical values, organisational culture, competence of the company's people, authority and responsibility; and
- c) The control environment must have some common applications that include a written code of conduct for all employees, training programmes that meet management's expectations and corporate values (King committee, 2002:78).

#### b) Control activities

At this level, policies and procedures that help to ensure management directives are carried out. They are formed to offset risks that help an organisation to achieve its objectives. The control activities occur throughout an organisation, at all levels and all functions. These activities include approvals, authorisations, verifications, reconciliations, reviewing operating performance, security assets and segregation of duties;

#### c) Information and communication

It is paramount that relevant information regarding the controls is shared within an organisation at periodic intervals so that people are able to carry out their responsibilities. It is very important for organisations to have effective information systems that are able to produce reports, contain operations information and compliance-related information. Personnel must continuously get information from top management that the control responsibilities must be observed at all times. People within an organisation must be motivated and informed of their role in the internal control system and how individual activities relate to others. This form of communication needs a strong, effective communication and information system; and

#### d) Monitoring

The internal control system must be monitored. This is a process that assesses the quality of the system's performance over time. To accomplish the monitoring process, there should be

ongoing monitoring activities and separate evaluations or both. The monitoring process should be on going and should also take place in the course of operations. Monitoring includes regular management and supervisory activities and other actions personnel take in performing their duties. Any scope and frequency of separate evaluation will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Once internal deficiencies have been identified, they should be reported to the top management or the board (Committee of Sponsoring Organisations of the Treadway Commission, 2005:2).

COSO acknowledges the fact that the above components of internal controls, link to each to form an integrated system that is able to react to dynamic conditions. Therefore, all the above components must be present and functional in order to make sure that internal controls over operations are effective. To have a risk management strategy, effective internal controls within an organisation must be instituted and supported by a positive organisational culture and a strong team of visionary managerial leadership that is prepared to inculcate a culture of risk management.

Fundamental to the above components is the fact that internal controls should be established in an environment that is conducive for them to function effectively. It is in this context that a control environment must be established. It takes basic management skills and leadership in developing internal controls. The most important aspect is the fact that internal controls must be monitored.

As a result, Changchit, Holsapple & Madden (2001: 437) comment that the evaluation and design of internal control systems is of crucial importance to management and yet, it is a subject that receives too little attention in the management literature.

The management of internal controls should be at a reasonable acceptable standard by making sure that the integrity of an organisation is not undermined in order that internal controls will also have standards.

#### **5.10.5 General standards of internal controls**

According to Apostolou & Crumbley, (1992:17.6, 17.12) the standards for internal control are:

- a) Management attitude

Management and employees should maintain and demonstrate a positive and supportive attitude toward internal controls at all times. If employees sense a lenient attitude toward procedures and controls, then the effectiveness of these controls is weakened;

b) Competence and integrity

Personnel should have and maintain appropriate education and experience to perform assigned duties. Employees and managers should have personal and professional integrity;

c) Audit resolution

As evidence of its supportive attitude toward internal controls, management should ensure that audit findings and recommendations are promptly and appropriately resolved; and

d) Organisational structure

The function must be organised to facilitate the work. Lines of responsibility and communications should be clear so that people know who is responsible for what and how to report deficiencies;

On the basis of the above standards, it is important that internal controls must be checked whether they are still of acceptable standard or effective. Risks could be easily detected and managed if internal controls are effective. Management must be active in setting up internal controls;

Locatelli (2002:13), cautions that a company, department or agency without management interest and support and regular communication to the rest of the organisation, is unlikely to have adequate internal control. Locatelli's comment regarding managerial commitment is crucial because the stronger the managerial commitment towards internal controls, the stronger the organisation and its systems.

To have effective standards of internal control, the managerial leadership must be supportive of internal controls within an organisation. It is important to have competent staff to perform the job, otherwise internal controls will also be affected or not implemented. This could affect systems in an organisation, be it financial or organisational systems in general.

### **5.10.6 Internal control assessment**

In an assessment of internal control, either by internal or external auditor, the failure of controls could be detected due to the following:

- a) lack of segregation of powers;
- b) poor communication and poor discussion about rules and consequences of rules and laws about fraud;
- c) lack of audit trail;
- d) ineffective supervision;
- e) lack of transaction authorisation;
- f) poor accounting records; and
- g) breakdown of procedures, for example inappropriate computer access and ineffective physical inventories (Hillison, Pacini & Sinason 1999:354).

Regarding the above aspects, it is important to assess internal control to see if they are reasonably effective. Failure to assess internal control could lead to organisational ineffectiveness, poor performance and poor financial management.

### **5.10.7 Limitation of internal controls**

Research reveals that internal controls can only provide reasonable, not absolute, assurance in achieving organisational objectives and maintaining standards within an organisation. As a result, the International Organization of Supreme Audit Institutions (INTOSAI) provides an outline of some of the limitations of internal controls:

- a) An effective system of internal control reduces the probability of not achieving the objectives. Therefore, there will always be the risk of internal controls being poorly designed or failing to operate as intended;
- b) Internal controls depend on the human factor. Therefore, it is subject to flaws in design, errors of judgement or interpretation, misunderstanding, carelessness, fatigue, distraction, collusion, abuse and override;
- c) The design of an internal control system faces resource constraints. Personnel must consequently consider benefits of controls in relation to jobs. Maintaining an internal control system that eliminates the risk of loss is not realistic and would probably cost more than is warranted by the benefit derived; and

- d) Organisational changes and management attitude can have a profound impact on the effectiveness of internal control and the personnel operating the system. It is therefore important that management is continuously reviewing and updating controls, communicating changes to personnel, and setting an example of adhering to those controls (Internal organization of supreme audit institutions, 2004:12).

The human factor has been a major problem regarding the limitations of internal control. It is because people within an organisation sometimes prefer a short cut at operational level by undermining internal systems or procedure. It is important to monitor internal controls because the human factor is able to affect internal controls negatively and this becomes detrimental to an organisation.

It has been deduced that risk management and internal controls are not seen as management responsibilities but the function of an internal auditor or a risk management unit if it exists within a department. Internal organization of supreme audit institutions (2005:5) also adds that internal control should not be looked upon as separate, specialised systems within a governmental organisation, but rather as an integral part of a system that management uses to guide its operations.

Furthermore, managers are responsible for establishing an effective control environment in their organisation and this is part of their stewardship responsibility over the use of government resources (Internal organization of supreme audit institutions, 2005:1). However, within the South African Public Service, it becomes evident that risk management and internal controls are not becoming a culture of management on daily operations and this creates very poor monitoring of internal controls and management of risk management in general. In its observations, the PSC (2003) believes that risk management cannot be a success if other management systems are not co-ordinated and integrated together with it and cautions that risk management is not something that has to be undertaken in isolation with other organisational systems. PSC's analysis also suggests that co-ordination of activities within a department or in government generally is of paramount importance because working in silos could affect an integrated approach in risk management. Therefore, PSC supports the systems approach in improving governance.

## 5.11 CONCLUSION

Risk management as a management tool is fundamental within a department to early detect any form of risk that could affect departmental operations. It is the responsibility of everyone in a department to manage risks because risks could be found in almost all components within a department. Risk management is a skill, therefore risk managers and other officials within a department must have a skill for risk management. It should be noted that risk management should not be an exercise for the finance management unit only or a tiny specialised unit within a department that is only charged with the responsibility of managing risks within a department. Sometimes, internal controls are poorly managed because there are no systems for monitoring and evaluating them. Changes in government policies and other changes like redesigning an institution could change internal controls too. Therefore, constant monitoring and evaluation of risks and internal controls are necessary because it assists an organisation to cope with the environment that could affect a department and service delivery programmes in general. The public finance management system in South Africa and its evolution are beginning to shape towards an integrated approach to risk management, but such culture has to be inculcated within government departments. Risk management as a component of governance could assist departments to develop a culture of good governance in the Public Service and it is the managerial leadership's responsibility to ensure that 'good governance culture' is maintained.

The following chapter provides conceptual and theoretical perspectives and elements of governance. The analysis of governance is within the context of public finance, taking into account the evolving public finance management system in the South African Public Service and the role of the managerial leadership in ensuring that governance and systems are maintained.