

FINANCIAL CONTROL MEASURES ENHANCING GOOD GOVERNANCE

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ABSTRACT

Sound public financial management supports aggregate control, prioritisation, accountability, the efficient management of public resources and the delivery of services. Good governance depends on accountability since accountability is one of the prerequisites of democracy. One of the key elements of good governance is a sound system of internal financial control. This control system incorporates rules, procedures and practices through clearly stated policies. The absence of a clearly defined system of financial control could lead institutional corruption, theft and fraud.

INTRODUCTION

A fundamental role of the state is the allocation of resources to acquire public goods and services. The redistribution of income, stabilisation of economic activity and promotion of economic growth and employment could also be seen as additional roles. The manner in which public resources are used can be considered as a critical determinant towards the achievement of public policy objectives. The public sector is the instrument that facilitates the formulation and ultimately the implementation of public policy. For any organisation in the private or the public sector it is important to implement efficient and effective internal financial control measures. In this regard effective public sector governance and accountability will rely on the internal financial control systems since forces in the external environment demand enhanced service delivery.

Government has to fulfil its responsibilities without leaving a major financial obligation as a legacy to future generations. This implies that decisionmakers will demand more and more meaningful information to decide amongst competing courses of action in discharging their accountability in a more appropriate manner. Accountability demands an effective and efficient control system as determined by the financial legislation concerning public affairs.

THE CONTEXTUALISATION OF THE CONTROL PROCESS

The functions and powers of the government departments on national, provincial and local spheres entail *inter alia* the rendering of services to the citizens by putting legislation in place to ensure that services are rendered in an effective, efficient and economical manner. The services should be equitably provided to all citizens, and the delivery of the services should meet the demands and compliance standards as set out in legislation. In order for government departments to exercise these functions and powers, they utilise the generic processes (later called functions) of public administration as set out by Cloete in 1981.

The government finds a mechanism through the *Constitution of the Republic of South Africa, 1996* to compel government departments to implement effective and efficient control measures, which is one of the generic administrative functions. With the implementation of the *Public Finance Management Act, 1999* (Act 1 of 1999), more emphasis is placed on effective governance in the public sector. In terms of the nature of control it is important to understand that control is the function to prevent deviations from the planned activities and standards, to ensure that the objectives of the organisation are obtained with the least possible problems. Control requires to focus on factors such as the purpose of the system, the objectives of a department, the basis of standards, the assumptions behind the figures, and the methods used in collecting and disseminating information.

The control function consists of the following stages (Schutte, 2000: 7):

- the creation of achievement standards;
- the measuring of actual achievement;
- the evaluation of deviations; and
- the implementation of corrective actions.

In terms of financial control measures to enhance good governance managers of a department should focus on the available resources such as physical, human, information and financial resources (Smit and Cronje, 1992: 433. *Cf.* also Schutte, 2000: 102-103). Financial management is pivot on which the control process hinges. The budget and financial analysis are viewed as the two tools with which control over financial resources can be exercised successfully. In addition, internal financial audits as well as formal external audits form a basis for control purposes.

THE PUBLIC FINANCIAL MANAGEMENT SYSTEM

The annual budget is a key public policy document setting out the government's intentions for raising revenue and utilising the allocated resources during the financial year. Public financial management relates to both aspects and is thus a key instrument of public policy. Public financial management deals with the integral relationship between revenue (money collected directly or indirectly from the citizens and in most developing countries received from aid donors) and the expenditure of that money in a manner that

reflects most closely the people's preferences. Financial management is a critical component in public administration and plays a major role in implementing government's policies to promote national economic, social and other developmental goals (Cloete, 1998: 45).

The broad objectives of public financial management are to achieve overall fiscal discipline, allocation of resources to priority needs, and effective and efficient delivery of public services. A sound public financial management system supports aggregate control, prioritisation, accountability and efficiency in the collection, safeguarding and spending of public resources for the delivery of services, which are critical in the achievement of public policy objectives.

Sound public financial management requires a firm foundation in financial information, which can be achieved by creating an integrated system of budget formulation, budget execution and accounting, focussing on the cost of the past and future decisions. The public financial management system refers to the structures and procedures through which decisions are made and implemented regarding the allocation and management of public resources. These decisions are normally made in relation to the annual budget allocation processes. The decisions are however influenced by a wider policy process and by the institutional and legal framework of government (Shafiriz and Russel, 2005: 472-475).

The core of public financial management is generally taken to be budget planning and preparation, appropriation by the legislature, budget execution, accounting and financial reporting as well as audit and evaluation (Pauw, et al. 2002: 92-96). The public financial management system thus includes the statutory arrangements and processes regarding the following financial management activities (Coe, 1989: 1-3):

- forecasting revenues and expenditures;
- formulating medium term expenditure frameworks;
- linking the budget to policy making;
- preparing the executing of the budget;
- managing cash and monitoring expenditure;
- performing internal control and audits;
- accounting and reporting;
- procuring public goods and services and managing assets;
- conduction external audits; and
- ensuring oversight by the legislature.

The *Public Finance Management Act, 1999*, (No. 1 of 1999) (As amended by Act 29 of 1999) (PFMA) is aimed at modernising financial management in government, which represents a paradigm shift from the old *Exchequer Act, 1975* of the past, which was more concerned with procedural accountability. The new Act concentrates on regulatory accountability and the acceptance of responsibility in respect of funds allocated (Ajam, 2000: 6-7).

The PFMA is an outcome-based piece of legislation and places more emphasis on accountability, efficiency, effectiveness and the most economical utilisation of resources for the achievement of results, i.e. outputs and outcomes. Instead of focusing on expenditure only, emphasis has increased to include revenue management and the

transparent management of assets and liabilities. It is evident that the PFMA strives to introduce uniform norms and standards of financial management and endeavours to ensure transparency and expenditure control (Du Plessis, 2000: 16-17). The Act has to be supported and kept viable by the public officials since rules and procedural prescripts alone cannot ensure that good governance will be realised.

FINANCIAL CONTROL IN PUBLIC FINANCIAL MANAGEMENT CONTEXT

Parliament requires assistance to enforce managerial accountability. To this end, Parliament will rely on the Auditor-General to audit the financial affairs of a department and report thereon to Parliament. In turn Parliament delegates the analysis and scrutiny of the report to the Standing Committee on Public Accounts (SCOPA). This Committee has the power to call accounting officers to appear before it and account for their actions, as stipulated in Section 45 of the PFMA. The Committee can make recommendations, such as the authorisation of unauthorised expenditure and actions to be taken against an accounting officer to Parliament.

It is against the abovementioned backdrop that an accounting officer will develop internal financial systems to prevent deviations from the planned activities and standards in order to ensure that the objectives of an institution are attained with the least possible deviations. In this case the correct and up to date information is of vital importance to exercise effective control. The control system provides the public sector manager with the necessary information to determine if the departmental activities are operating according to the pre-determined plans (Coe, 1989: 121-122).

It should be noted that the control process is comprehensive covering both the approach to establish a system for effective control and an approach to exercise control once the system has been developed and approved. The management control process is not a simplistic step-by-step procedure that can be rigidly and mechanically applied to every control system (Mockler, 1972:18-19).

In comparing the *old* versus *new* public financial management the old system of management focused on the control of inputs. These inputs are the conventional budgeting and resource allocations, performance monitoring and lastly presentation and reporting. Little attention was devoted to the outputs or results. In contrast the modern system of governance concerns the single most significant innovation in contemporary reform of the public sector (Abedian, 2000: 8).

The elements of the control framework as determined by the PFMA to enhance good governance are as follows:

Internal control measures

The prerequisites for an effective internal control system hinges on the following (Abedian, 2000:8-9):

- sound expenditure management system;

- effective external control system;
- embedded culture of sound public finance; and
- effective management information system

Section 38 of the *Public Finance Management Act, 1999*, deals with the general responsibilities of the accounting officer. According to the Act, internal control procedures should be developed to limit fraud, incorrect allocations, irregular, unauthorised, fruitless and wasteful expenditure and to create procedures for transparent financial systems. Officials can use the policies and financial procedures as guidelines in fulfilling their daily activities to adhere to Section 76 of the PFMA dealing with the Treasury Regulations. The risk of inadequate control measures can result in the probability of an event or action that may adversely affect the department, including exposure to financial loss, non-ethical conduct, loss of reputation and non-compliance with legal requirements and operational guidelines. Current or potential future symptoms, events, actions or characteristics, which, on their own or in a combination, may hamper or prevent the achievement of set objectives. The following procedures and policies form critical aspects towards financial internal control:

- financial delegation which determines the level of a rank and the amount that a person can authorise for disbursements;
- fraud prevention plan to determine what control measures are needed to minimise the risks;
- financial internal control procedures captured in a manual, including all relevant policies that have a financial impact;
- responsibility managers to trace accountability regarding the areas of responsibility;
- programme managers to trace the accountability of responsibility managers;
- management Supply Chain procedures indicating the procedures to be followed for procurement and the functioning of the Bidding Committee;
- payment checklist to ensure that the procedures for a disbursement are followed and authorised correct; and
- expenditure reports as well as the detail expenditure reports to enhance budget control regarding under- and over-expenditure against the budget as well as correct allocations.

In reporting on the effectiveness of the organisation's framework of internal control a statement in the annual report is required to the effect that the framework of internal control that has been established and maintained are both appropriate to the nature of the organisation and effective in practice. Care needs to be taken to provide employees with the skills required to implement and maintain an internal control system and to ensure that staff responsible for securing major changes in the system are suitably experienced. It should also be noted that objectives change over time and therefore management needs to periodically assess the effectiveness of control in the organisation and communicate the results to the relevant institution, i.e. National Treasury or Auditor-General.

Budgeting

The legislature is responsible for the sanctioning of the overall public sector budget and for authorising the executive to incur expenditure within the overall level of expenditure. Budgeting is a critical component of the financial planning, control and evaluation process of public sector entities. By its nature it is a tool for the allocation resources towards achieving the pre-determined objectives of a public sector entity, it is a management tool for planning, and also a mechanism for controlling funds to ensure that the stated objectives are met. In order to be effective, budgeting needs to be integrated with the accounting systems. If a similar basis of accounting is adopted for budgeting purposes and financial reporting, it will provide a framework for accounting information resulting in a more rational basis for planning and controlling expenditure and for decisions regarding financing activities. Even if the accounting system functions on an accrual basis of accounting, cash flow budgeting is a critical component of effective cash management, and therefore a forecast of the timing of cash inflow and outflow will always be needed (Pauw, *et al.*, 2002: 140).

The regular monitoring against the budget is vital when the revenue or expenditure reported against budgets need to be reliable and readily available for analysing, discussions, management action and revisions where necessary.

In terms of the World Bank's *Financial Accounting and Auditing Handbook* (1995) budget problems in developing countries relate to:

- a lack of appropriate feedback systems;
- a failure to integrate budgeting with accounting and cash management functions;
- a lack of comprehensive coverage where particular programmes may be excluded from the budget;
- focus on one year instead of following a multi-year approach;
- classifications or budget categories not being fully useful for expenditure planning and control;
- lack of focus on goals and programmes;
- lack of clarity and accuracy in defining recurrent and development expenditures; and
- over-emphasis on sophisticated concepts beyond realistic capacity.

Expenditure management

Budgeting and expenditure management complement each other in the way that the allocation of funds are done with the expectation that the funds are being utilised efficiently and effectively, for the purpose for which they were provided. Budgets are strategic planning instruments which, if not properly constructed, will result in a misallocation of funds that will prevent the effective realisation of specific projects, activities or programmes.

Expenditure control ensures that the funds allocated are allocated for specific and earmarked activities. In this case Section 45 of the PFMA details the responsibility of departmental officials for overseeing and monitoring financial management in the

public sector institution. The purpose of a financial management system in the public sector is to support management in the deployment of limited resources with the aim to ensure economical and efficient delivery of outputs (services/goods produced by public sector entities in terms of quantity, quality, cost and time) required to achieve desired outcomes (effectiveness) that will satisfy the needs and aspirations of the citizens. Financial management embraces daily cash management as well as the formulation of medium and long-term financial objectives, policies and strategies towards the manifestation of the operational plan of the organisation. It includes the planning and control of capital expenditure, working capital management, funding and performance decisions (Du Plessis, 2000: 17 & 28). Furthermore financial management supervises the supporting of the financial and management accounting functions and the internal control environment.

It is important that management should have useful and reliable information in order to evaluate the operations of the structure. The information system and its operators need to ensure that full and proper records are kept of the affairs of the public sector entity. Information systems needs to be designed in such a manner that it measures costs and the key performance indicators considered essential by management in their assessment of the entity's success or failure. The accounting system that produces financial statements needs to complement other management systems such as the cash management, budget and debtors' management (Shall, 2000: 13-14).

Risk management

According to Naidoo (2002: 117) risks are uncertain events which, left unchecked, could have a negative effect on the performance of the department. Therefore departments need to ensure that effective systems of risk management are established as part of the framework of control. Risk can be explained as a measurement of uncertainty, and comprises those factors that can facilitate or prevent the achievement of the department's goals. Risk management can be viewed as a process of:

- understanding the departmental objectives;
- identifying the risks associated towards the achievement of the objectives;
- assessing the risks, including the likelihood and potential impact of specific risks;
- developing and implementing programmes/procedures to address identified risks; and
- monitoring and evaluating risks and the programmes/procedures in place to address risks.

It should be noted that control is not static and as the environment in which the department operates changes the risks will change and thus the systems for control should adapt to the changes. The application of a risk management process as part of the control system to ensure an accountable and transparent process should comprise the following:

- risk identification;
- risk assessment;

- risk prioritisation and treatment approach;
- implementation of risk treatment plans; and
- continuous monitoring and review.

The application of the formal risk management process as a control system is essential. It has to be documented properly with due consideration to the set objectives, available information resources, assumptions and decisions.

Internal audit and Audit Committee

The internal audit function forms part of the framework of control and supports accountability and good governance. The establishment and functioning of the Internal Audit and Audit Committees are determined in the PFMA and Treasury Regulations. The purpose of the internal audit function as part of the control system is to assist the accounting officer in maintaining efficient and effective control by evaluating those controls to determine their effectiveness and efficiency, and by developing recommendations for enhancement or improvement. This function is seen as auditing the various control systems to ensure that fraud and losses for the department are minimised. The Audit Committee evaluates the effectiveness of the internal audit procedures and evaluates their findings as well as the evaluation of the existing internal control measures within the government department as mandated by the PFMA (Pott, 2000: 21 & 30 cf. also Woods, 2001: 20–21). In terms of National Treasury Regulations Section 3 (1) (10) the functions of the Audit Committee are to determine:

- the effectiveness of the internal control systems;
- the effectiveness of the internal audit function
- the risk areas of the institution's operations to be covered in the scope of internal and external audit;
- the adequacy, reliability and accuracy of the financial information provided to management and other users of information;
- any accounting and auditing concerns identified as a result of internal and external audit;
- the institutions compliance with legal and regulatory provisions; and
- the activities of the internal audit function, including its annual work programme, co-ordination with the external auditors, the reports of significant investigations and the response of management to specific recommendations.

The objectives of internal control are to assist the members of the department in the effective discharge of their responsibilities. Internal control provides them with analysis, recommendations (guidelines, processes, procedures) and information regarding the activities reviewed. The finance section of a department will issue the procedure manuals and policies that have a financial impact. This will be followed by a change in control measures of systems to ensure that compliance of the newly changed policy did take place.

EFFECTIVE GOVERNANCE AND ACCOUNTABILITY

Government reform is a world wide phenomenon. In this context good governance gained prominence during the eighties which was shaped by international agencies such as the World Bank and IMF report (1994) highlighting the economic crises confronting the *Third World* countries and specifically the sub-Saharan Africa (Fourie, 2006: 43). Three phenomena with reference to good governance have emerged (Rhodes in Pierre, 2000: 57):

- *Systematic utilisation* of governance is broader than government covering the distribution of both the internal and external political and economic power.
- *Political utilisation* of governance refers to a state enjoying both legitimacy and authority as derived from the democratic mandate.
- *Administrative utilisation*, which refers to an efficient, open, accountable and audited public service.

A number of institutions have been established in terms of the *Constitution of the Republic of South Africa*, 1996 to strengthen the constitutional democracy and to enhance governance. These institutions are for example the Public Protector, Human Rights Commission, Commission for Gender Equality, Auditor-General, and courts of law. It not the purpose of this paper to analyse the functions of the aforementioned bodies in terms of governance but rather to acknowledge them as critical external role-players in the strengthening of democracy.

The antithesis of good governance is corruption which manifests itself in a number of ways such as bribery, embezzlement, fraud, extortion, abuse of power, conflict of interest, favouritism, nepotism (Public Sector Anti Corruption Strategy: Public Service Commission, 2003). Poor financial management includes corruption in all its manifestations as reflected above, since corruption either results in public funds being misused; applied to benefit a select individual or entity; or results in potential public funds diverted away from the national revenue to private income. Public financial management is not confined to those funds appropriated to render particular public services or goods but to all transactions where financial value is prevalent. Nepotism, favouritism, abuse of power and insider trading are equally contrary to good governance in public financial management as is embezzlement and extortion (Fourie, 2006:437).

In order to ensure effective and efficient expenditure, accountability is a key component. Accountability is one of the prerequisites of democracy and good governance that compels the state, the private sector and civil society to focus on results, seek clear objectives, develop effective strategies and monitor and report on performance. It implies holding individuals and organisations responsible for performance measured as objectively as possible. There are three dimensions applicable (Du Preez, 2000: 25-26):

- *Financial accountability*. It implies an obligation on the part of the person(s) handling resources, or holding public office or any other position of trust, to report on the intended and actual use of the resources.

- *Political accountability.* This means regular and transparent methods of sanctioning or rewarding those who hold positions of public trust through a system of checks and balances among the executive, legislative and judicial branches.
- *Administrative accountability.* This implies systems of control, which are internal to government, including public service standards and incentives, ethical codes, and administrative reviews. Accountability requires that decision makers be held responsible for the exercise of authority invested in them. Not only must officials involved in budgetary matters answer for the use of funds but also face consequences for the misuse of public funds.

Accountability as one of the prerequisites of a democracy is applicable where an elected office bearer or appointed officials charged with a public mandate is responsible and answerable for his/her actions, activities and decisions. Accountability seeks to determine who is liable for what and what kind of conduct is illegal. Every political office-bearer and every public official should display a sense of responsibility when performing official duties. The official's conduct must be above reproach so that it will be accountable in public. Furthermore it would seem natural that every political executive will in turn be held accountable for official actions performed by officials under his/her control (Cloete, 1998: 3).

To secure accountability, it is important to establish an effective framework of control and to produce timely, objective, understandable and balanced reports to the relevant stakeholders. Furthermore, it is important to keep proper records and accounts and maintain an effective system of financial control. Information is a public resource and is not owned by a public entity. The Standing Committee on Public accounts (SCOPA) is Parliament's watchdog that ensures accountability on behalf of the public (Woods, 2000: 9-10).

CONCLUSION

Good governance requires clear areas of responsibility and a clear understanding of the relationships between the department's stakeholders and those entrusted to manage the scarce resources and deliver outcomes. Financial internal control systems can reduce risks by ensuring that participants in the financial control process are clearly aware and responsible for their roles, responsibilities and accountabilities.

A well-managed government department will provide the necessary security to the accounting officer, political head and other stakeholders that the objectives of the department have been met effectively, efficiently and economically and account for.

It should be noted that many elements of financial control such as strategic planning, budgeting process, internal control systems, risk management as component of the good governance structures have been put into practice in departments during the implementation of the financial legislation. The real issue and ultimate challenges are to implement and manage these identified elements and to ensure that their logic and interrelationships are made clear to everyone in the department. This will require strong leadership and commitment of the top management structures.

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