# INTEGRATED RISK MANAGEMENT: A MECHANISM TO MINIMISE RISKS FOR LOCAL GOVERNMENT: A CRITICAL PERSPECTIVE

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# **CERTIFICATION**

I, THE UNDERSIGNED CERTIFY HEREWITH THAT THE CONTENTS OF THIS DISSERTATION REPRESENTS MY OWN ORIGINAL WORK, WHICH WERE NOT SUBMITTED IN FULL OR IN PARTIAL TO ANY OTHER UNIVERSITY FOR THE OBTAINMENT OF A DEGREE.

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With sincere thanks to:

- the Almighty and Graceful Heavenly Father who created the opportunity, provided me with strength and perseverance to complete the dissertation under difficult circumstances;

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## ABSTRACT

The absence of an integrated risk management programme in local government in South Africa creates the danger that these risks are not identified, which could be catastrophic, and opportunities to minimise losses are not utilised. A further problem is that common risk-management terminology is lacking and management are dependent on diverse legislation as a guide to developing and implementing risk management.

In order to achieve the strategic and operational objectives of local government in an effective and efficient manner, a pro-active identification and evaluation of potential risks should be established to minimise their impact. Officials on every level need to be informed about processes and techniques for managing risks and recalibrating activities to enable management to operate more effectively in risk-filled environments.

Problems were identified that prevent management from providing reasonable assurance to stakeholders that the most significant risks are being addressed. These problems are as follows: the lack of applying risk management in an integrated manner; the enforcement of integrated risk management due to the lack of relevant legislation; a lack of training in risk management, ethics and risk response plans; a lack of practical techniques to assist officials in taking remedial action to prevent recurrence of risks; the absence of a risk-sensitive organisational culture; and a lack of commitment and leadership from politicians and management.

Relevant legislation on integrated risk management should assist in embedding a culture where everyone in local government is obliged to adhere thereto and to conduct their day-to-day activities accordingly. A mission and vision statement needs to be developed and implemented with the consent of all stakeholders. Integrated risk-management processes, which are generally lacking or incomplete in local government, should be aligned with generic public management functions.

An integrated risk-management programme can be enhanced by establishing a risk organisational structure within local government. The establishment of a risk-

management department and risk committee is essential to the enhancement of corporate governance and the management of risks that might have a negative impact on local government.

Internal and external controls should be evaluated regularly to facilitate the risk-management programme. An Integrated Risk Monitoring Technique is proposed as a technique to assist stakeholders in identifying root causes of risks and the management thereof. A model of integrated risk management was designed to assist academics and practitioners to get a holistic perspective on integrated risk management and to assist in the management of risks.

## OPSOMMING

In die afwesigheid van ’n geïntegreerde risikobestuursprogram in plaaslike owerheid in Suid-Afrika bestaan die gevaar dat sodanige risiko’s nie geïdentifiseer word nie, wat katastrofies kan wees, en dat geleenthede om verliese te minimaliseer nie benut word nie. ’n Verdere probleem is die gebrek aan ’n gemeenskaplike terminologie vir risikobestuur en die feit dat bestuur slegs op uiteenlopende wetgewing kan staatmaak as raamwerk vir die ontwikkeling en implementering van risikobestuur.

Om die strategiese en operasionele oogmerke van plaaslike owerheid op ’n effektiewe en doeltreffende wyse te kan verwesenlik, behoort potensiële risiko’s proaktief geïdentifiseer en geëvalueer te word om die impak daarvan tot die minimum te beperk. Amptenare op elke vlak moet op hoogte wees van prosesse en tegnieke vir die bestuur van risiko’s en die herinstelling van aktiwiteite om bestuur in staat te stel om meer effektief in omgewings vol risiko’s te werk.

Probleme wat verhoed dat bestuur redelike versekering aan rolspelers kan gee dat die grootste risiko’s aangespreek word, is geïdentifiseer. Dit sluit in: die gebrek aan die geïntegreerde toepassing van risikobestuur; die afdwing van geïntegreerde risikobestuur agv die gebrek aan toepaslike wetgewing; ’n gebrek aan opleiding in risikobestuur, etiek en risikoreaksieplanne; ’n gebrek aan praktiese tegnieke om amptenare te help om remediërende stappe te doen om die herhaalde voorkoms van risiko’s te verhoed; die gebrek aan ’n risiko-sensitiewe organisasiekultuur; en ’n gebrek aan toewyding en leierskap aan die kant van politici en bestuur.

Toepaslike wetgewing oor geïntegreerde risikobestuur behoort daartoe bydra dat ’n kultuur in plaaslike owerheid geskep word waar almal verplig word om dit na te kom en hulle daaglikse aktiwiteite dienooreenkomstig te reël. ’n Missie- en visieverklaring moet met die konsensus van al die rolspelers ontwikkel en geïmplementeer word. Geïntegreerde risikobestuursprosesse, wat oor die algemeen nie in plaaslike owerheid teenwoordig is nie, of onvoldoende is, moet in lyn met generiese openbare bestuursfunksies gebring word.

’n Geïntegreerde risikobestuursprogram kan versterk word deur ’n organisatoriese risikostruktuur in plaaslike owerheid te vestig. Die vestiging van ’n risikobestuurs-departement en risikokomitee is noodsaaklik om korporatiewe regering te versterk en daardie risiko’s wat ’n negatiewe impak op plaaslike owerheid kan hê, te bestuur.

Interne en eksterne beheermaatreëls moet gereeld geëvalueer word om die risikobestuursprogram te fasiliteer. ’n Geïntegreerde risikomoniteringstegniek word voorgestel as ’n tegniek om rolspelers te help om die fundamentele oorsake van risiko te identifiseer en te bestuur. ’n Model van geïntegreerde risikobestuur is ontwerp om akademici en praktisyns te help om ’n holistiese perspektief op geïntegreerde risikobestuur te kry en met die bestuur van risiko’s te help.

# CHAPTER 1

# A MACRO APPROACH TO RISK MANAGEMENT

## 1.1. Introduction

Risk management is an interactive process consisting of well-defined steps. If these steps are taken in the correct sequence, they support decision-making by providing an insight into risks and their impacts. The risk-management process refers to the establishment of the context and identifying, analysing, evaluating, treating, monitoring and communicating risks associated with any activity, function or process. The risk-management process can be applied to any situation in which an undesired or unexpected outcome could be significant. Management should know about possible outcomes of a potential risk as well as take preventative steps to limit the impact of risk.

Risk management should become part of an organisation's culture and the responsibility of everyone in the public sector. This can be achieved by integrating risk management into the organisation's philosophy and practices, rather than viewing or practising it as a separate programme. The objective in the implementation of a risk-management programme is to enhance efficiency in the local government sector and to create a risk-management culture. The macro approach in this Chapter refers to risk management; the distinctions or similarities between risks; public management and risk management; weaknesses in risk-management processes; the development of risk management in the public sector; integration of risk management into the day-to-day activities of the public sector; the development of capabilities to enhance risk management; and techniques and role players to enhance the risk-management process and its monitoring.

## 1.2. Risk – a definition and description

Risk is defined in the "Australian/New Zealand Standards For Risk Management" (1999:4) as "the chance of something happening that will have an impact upon objectives and it is measured in terms of consequences and likelihood of an incident happening."  A distinction is made between pure risks and speculative risks. Pure risks concern the possibility of either loss, or no loss but without gain.  Speculative risks, on the other hand, are those risks that offer a chance of gain or loss (Geldenhuys, 1993:10).

Pfeffer (1956:42) defined risk as "a combination of hazards measured by probability", meaning that there is always the possibility that a hazard, such as lack of financial controls, could cause an incident of corruption or some form of loss to the organisation.  Denenberg (1974:4-5) defined risk "as uncertainty of loss, where the term risk is implicitly understood as uncertainty of financial loss."  Greene *et al.* (1983:24) stated that there is no single definition for risk which is universally employed, but the term is understood to mean mainly the uncertainty of the occurrence of economic loss.  Athearn *et al.* (1984:4-5) define risk simply as "a condition in which loss or losses are possible."

According to the description given by Deloach (2000:48), risk is defined as "the distribution of possible outcomes in a firm's performance over a given period of time due to changes in key underlying variables."  The definition continues that the greater the dispersion of possible outcomes, the higher the organisation's level of exposure to uncertain returns.

Thus, from the above it can be deduced that it is problematic to define risk in a universally accepted manner, because the contexts within which risk can be viewed are diverse.  This gives rise to interpretations and definitions suited only to specific areas of study or disciplines.  In an actuarial context risk is given a statistical interpretation, whilst in the world of insurance the term risk may be used to describe the subject of the policy or the peril that is insured under the contract.  Risks should be managed for organisations to be competitive in an ever-changing environment and therefore the principles of public management should be understood.

## 1.3. Public management – a definition and description

The Illustrated Oxford Dictionary (1998:495) describes public management as the "professional administration of public concerns". This definition implies that public managers should manage professionally to address public concerns with a view to rendering effective, efficient and sustainable services. The public manager should therefore be focused on the environment in which the organisation operates with a view to identifying and assessing the risks that could influence the professional nature in which public organisations should be managed. Koontz in Fox *et al.* (1991:13) draws the attention of the public manager to the forces of the environment in which the organisation operates and states that, although little or nothing can be done to change the forces, the public manager needs to respond to them by identifying and evaluating the forces of the environment that may prevent the public sector from achieving its objectives and standards. Schwella in Fox *et al.* (1991:15) refers to the implications for public management and alerts the public manager to the reality that failure to recognise the challenges of public management will result in a high probability of management failure by public managers. Failures could cause stakeholders to lose confidence in the assurances provided by management that, for example, sustainable service delivery will be achieved.

Pettigrew (1985:44) refers to management as a value process to create legitimacy for one's actions, ideas and demands as well as to delegitimise the demands of competitors. Pettigrew's statement confirms that public management, with strategy formulation and planning, should be focused ensuring long-term sustainability, a reputable image and the application of best practice techniques and managerial practice in order to be competitive in a complex environment. Punch's (1996:5) view is that the complex environment shapes management, but that management is also reconstructing the environment to achieve sustainability. Reed (1989:84) latches on to this view and states that management is referred to as a group of executives attempting to secure long-term sustainability in the face of environmental and organisational uncertainty.

Public officials involved with risk management issues participate in managerial functions and therefore these officials should have knowledge of, and be skilled in, public management functions. Fox *et al.* (1991:25-132) describe five public management functions, namely (a) policy-making, (b) planning, (c) organising, (d) leadership and motivation, and (e) control and evaluation. The public management functions are briefly described below.

### 1.3.1. Policy-making

Various definitions can be used to describe policy-making, but Wissink in Fox *et al.* (1991:27) concludes that policy-making refers to public policies as those policies that government develops to achieve its objectives in the most beneficial manner. Policy-making is dependent on accurate and relevant information. Policy-making should eliminate the risk that any of the activities that form an integral part of the policy-making process may be overlooked. Wissink in Fox *et al.* (1991:33) describes the following activities that should be considered during the policy-making process: initiation; agenda-setting; processing the issue; considering the options; making the choice; publication; allocation of resources; implementation; adjudication; impact evaluation; and feedback.

### 1.3.2. Planning

Planning involves the steps that should be followed to achieve the objectives declared in the policy statement of an organisation in the most beneficial way. Proper planning should indicate to management the risks that could disrupt the achievement of the objectives of an organisation. Schwella in Fox *et al.* (1991:49) mention specific benefits that could derive from the planning process. These benefits include the effective handling of change, and the provision of direction and a unifying framework for the organisation as well as opportunities for stakeholders to participate in the planning process. Planning also facilitates control and it creates higher levels of predictability, mitigating the risk of uncertainty in the achievement of objectives to an extent. To achieve these benefits Schwella in Fox *et al.* (1991:60) proposes that the planning processes should be followed to prevent the risk that the objectives of an organisation may not be effectively and efficiently achieved. These planning processes include the assessment of circumstances and the establishment of objectives; forecasting and the determining of alternative courses of action as well as the evaluation and selection of alternatives; linking plans to budgets and programmes; and evaluating progress with the plan by means of controls. The implementation of a proper planning process should mitigate risks such as the non-reporting or concealment of corruption, because proper controls should either prevent corruption or ensure that it is identified quickly and mitigated.

Planning is a method to approach future problems which may have an impact on the achievement of the objectives of an organisation. Planning embraces the forecasting of incidents and depends upon certain presumptions and limitations. Forecasting is based on the analysis of available and relevant information, and attempts to forecast circumstances by analysing this information to mitigate risks. Presumptions affect the forecasting of future outcomes and the circumstances or risks that might influence planning negatively. These risks set the parameters within which planning must take place, for example, the quality and quantity of scarce resources and the attitudes of officials towards management and stakeholders (Terry, 1978:37; Cloete, 1986:58 and Koontz, 1980:156).

### 1.3.3. Organising

Organising implies the implementation of a formalised and dynamic structure of roles and positions in an organisation, which is aimed at the accomplishment of the objectives of the organisation. For organisations to organise successfully, management needs to reflect objectives and plans, delegate authority entrusted to officials, and have knowledge about the environment in which the organisation is operating and the deliverables that are expected from officials (Fox in Fox *et al.*, 1991:87). Organising also entails the classification of officials as individualists and as groups to direct their behaviour in a predetermined direction. The organising of officials is a challenging function and management should develop mutual relationships in the organisation with the intention of enhancing the accomplishment of objectives and the benefits resulting from organising (Cloete, 1986:79 and Robbins, 1980:36). The provisioning of officials in correct quantities and with the relevant qualities and skills is important for the risk manager in order to enable him or her to determine the number of officials capable of rendering an effective risk-management process. The number and kind of officials necessary to do the work in such a way that the objectives will be achieved efficiently should be analysed as should the experience needed to perform risk management (Gerber *et al*., 1987:131).

### 1.3.4. Leadership and motivation

It is expected that leaders should be competent in their functional area and they should possess personality traits that will motivate subordinates to respect and follow instructions from their leaders. It is expected of leaders that they will guide subordinates to such an extent that they will perform optimally to mitigate the risk that the objectives of the organisation will not be achieved effectively and efficiently (Fox in Fox *et al*., 1991:91).

The risk manager as a leader should meet certain requirements to motivate subordinates in achieving the objectives of an organisation. These requirements are:

- *rigorous thinking* to identify risks associated with a particular course of action and also to identify opportunities to improve organisational efficiency and effectiveness;
- *forward thinking* because organisations are encouraged to manage proactively rather than reactively;
- *responsible thinking* to improve performance and accountability in decision making; and

- *balanced thinking* to strike a balance between the costs of managing risks and the benefits to be gained.

According to International Risk Control Africa (hereafter referred to as IRCA) (1998:14) and Marsh (2004:7-11), an effective risk manager should be able to:

- Identify and understand the public management functions to obtain optimum results;
- Identify, clarify and specify what is expected from officials for optimum results;
- Understand and apply the performance standards for risk management;
- Effectively communicate to officials the performance standards for risk management;
- Use performance measurements to gauge and guide performance;
- Measure as objectively as possible the performance of officials;
- Evaluate what must be done to reach and/or maintain the performance standards for each task; and
- Determine what officials should do to reach and/or maintain the performance standards for their work to mitigate the risk that performance is not properly measured.

Therefore, if these minimum requirements are met, the risk manager should be able to manage the risk function and to predict the impact of risks. Knowledge about controls and their evaluation should assist the officials to identify deviations and problems, which should assist in managing risks proactively.

### 1.3.5. Control and evaluation

Control is defined by Robbins in Fox *et al.* (1991:119) as a process that needs to be followed to determine if organisational resources are being utilised efficiently to accomplish the objectives of the organisation and to implement corrective action where the objectives are not being achieved. It is necessary to monitor the activities of the organisation to ensure that all the activities are running according to plan as well as to take remedial action proactively before a risk materialises (National Treasury, 2002:18-20). Risk management can be used as a mechanism to evaluate the effectiveness of the practice of control by rating the perceived effectiveness of controls attached to an identified risk. The motivation for the control of activities in an organisation arises from the complaints received from the stakeholders because of weaknesses in public programmes, which could result in non-efficient local government. A lack of control creates the risk that sub-standard services might be rendered (Anthony and Dearden, 1980:19; Henry, 1980:186 and Robbins, 1980:376).

To overcome ineffective controls, Fox *et al.* (1991:121-122) suggest qualities for effective control. These qualities include the ability to identify deviations in time to prevent the risk of infringements on organisational performance; controls should be flexible to adjust to the changing internal and external environments in which the organisation operates; the cost to implement controls should not exceed the benefits derived from the controls; stakeholders should understand the reason for controls; the controls should cover the critical operational activities and be enforced at all levels of an organisation to mitigate the risk of any occurrence that could lead to a failure to achieve organisational objectives effectively; and management should realise that it is not possible to control all activities, but measures should be put in place to control exceptions, for example, a monitoring device to identify toxic substances that might be released by a factory into the sewer system that leads to a treatment plant – an over-dosage of toxic substance could kill all organisms in the water at a treatment plant, which could wipe out the operations of the plant. As public management relates to risk management, the relationship between them needs to be clarified.

## 1.4. Risk management – a definition and description

Risk management is a managerial function that involves processes and functions that are essential to determine and accomplish the objectives of the organisation. Risk management encompasses managerial activities such as risk analysis to identify and rate the effect that hazards, uncertainties and opportunities might have on the achievement of the objectives of an organisation.

Although there are many definitions of risk management, the definitions referred to below should provide a good understanding of what is meant by the term risk management. The following definition of risk management is offered by Dickson (1989:18): "the identification, analysis and economic control of those risks which threaten the assets or earning capacity of an organisation". According to Fayol (1949:3-6) and Kloman (1984:33), risk management is a professional management function in an organisation, because it contributes to the objectives of an organisation. Valsamakis *et al*. (1996:14) adopt the following definition: "Risk management is a managerial function aimed at protecting the organisation, its people, assets and profits against the consequences (adverse) of pure risk, more particularly aimed at reducing the severity and variability of losses."

Risk management is defined in the "Australian/New Zealand Standard for Risk Management" (1999:4) as "the culture, processes and structures that are directed towards the effective management of potential opportunities and adverse effects". The view of PricewaterhouseCoopers (1998:2) about risk management is that it is a "central strategic function focused as much on opportunity, or the upside, as on hazard, or the down side." Monash University (May 2000(a):2-4) refers to risk management as "the culture and process for the systematic application of management policies, procedures and practices." From these definitions it could be argued that risk management is a professional managerial function aimed at achieving the objectives of an organisation in the most efficient and effective ways.

Risk management focuses management's attention on identifying risks that could prevent the organisation from achieving its objectives proactively as well as on opportunities to enhance the functions and activities of organisations (AIRMIC *et al*., 2002:3-4 and McNamee *et al*., 1999:38).

Thus, risk management complements public management and it is viewed as a mechanism to assist in ensuring that policy matters such as statutory requirements, legislation and procedures are enforced to protect the organisation from loss and prosecution. Risk management assists the planning process in an organisation by developing plans to mitigate and manage risks as well as to manage the organisational activities in a specific framework, whilst cognisance is taken of the environment that could influence the activities of an organisation. Leadership and motivation are essential elements of the risk-management process and therefore commitment from the executive management team is a necessity to ensure an effective and efficient risk-management process (Knight, 2000:15). Every official in the organisation should be involved in the risk-management process, which would necessitate a culture change in many public sector organisations. Control and evaluation are important elements of the risk-management process, which evaluates the likelihood and impact of incidents as well as the effectiveness of controls to mitigate the risk of an incident materialising. Risk management is described above as a process to assist the public manager in achieving the objectives of the organisation. The following paragraph describes what is meant when reference is made to the objective of risk management.

## 1.5. Objective of risk management

The word objective is defined as: "to determine and understand what should be sought or aimed at" (Illustrated Oxford Dictionary, 1998:563). Objectives should be practical, clear, specific and achievable to serve as instruments of motivation and for monitoring the degree to which the objectives have been achieved. If the objectives of risk management are not met, the focus of officials and the organisation will be influenced negatively (Farrell, 2003:89 and Terry, 1978:15). The following example should contribute to a better understanding of what is meant by the objective of risk management. If local government should decide on a project to build 10 000 sub-economic houses in a financial year, then management should ensure that the project is reasonable and that the resources – for example, manpower, material, land, expertise and skills – are available to reach the objective of 10 000 houses within the preset time constraint. Management should engage with officials, motivate and convince them to commit to the challenges of the project and to mitigate the risks that could be stumbling blocks in the achievement of the objectives. When risks are controlled, the likelihood as well as the impact of losses will diminish, and this will contribute to lower financial expenditure (National Treasury, 2002:19).

The objective of risk management entails the planning of sourcing resources that are essential to obtain financial balance and operational stability as soon as a risk has occurred. The objective includes the attainment of short-term stability of the cost of the risk as well as the minimisation of risks over the long term to enhance efficiency in the operations of an organisation (Denenberg *et al*., 1974:80; Greene *et al.*, 1983:4-6; National Treasury, 2002:59; Valsamakis, 1996:61; Van Niekerk, 2000:15 and Terry, 1978:15).

A recurrence of the loss over the long term should be prevented or if possible be eliminated to achieve the objectives of risk management effectively. As stated in the title of this dissertation, the objective of risk management is to serve as a mechanism or catalyst to minimise risks in the public sector or any other organisation where it is implemented.

## 1.6. Organisational culture

Integrated risk management is dependent on a cultural change to bring about a revised perspective in achieving the objectives of an organisation (Smithson *et al.*, 1999:3). Cultural changes are important in that most significant advances begin with a break from traditional thinking. The shift towards integrated risk management is described as a natural evolution, responding to the environment's risk drivers (causes of risk) and the emergence of advanced risk-management tools and processes. The following general environments have an influence on the organisational culture.

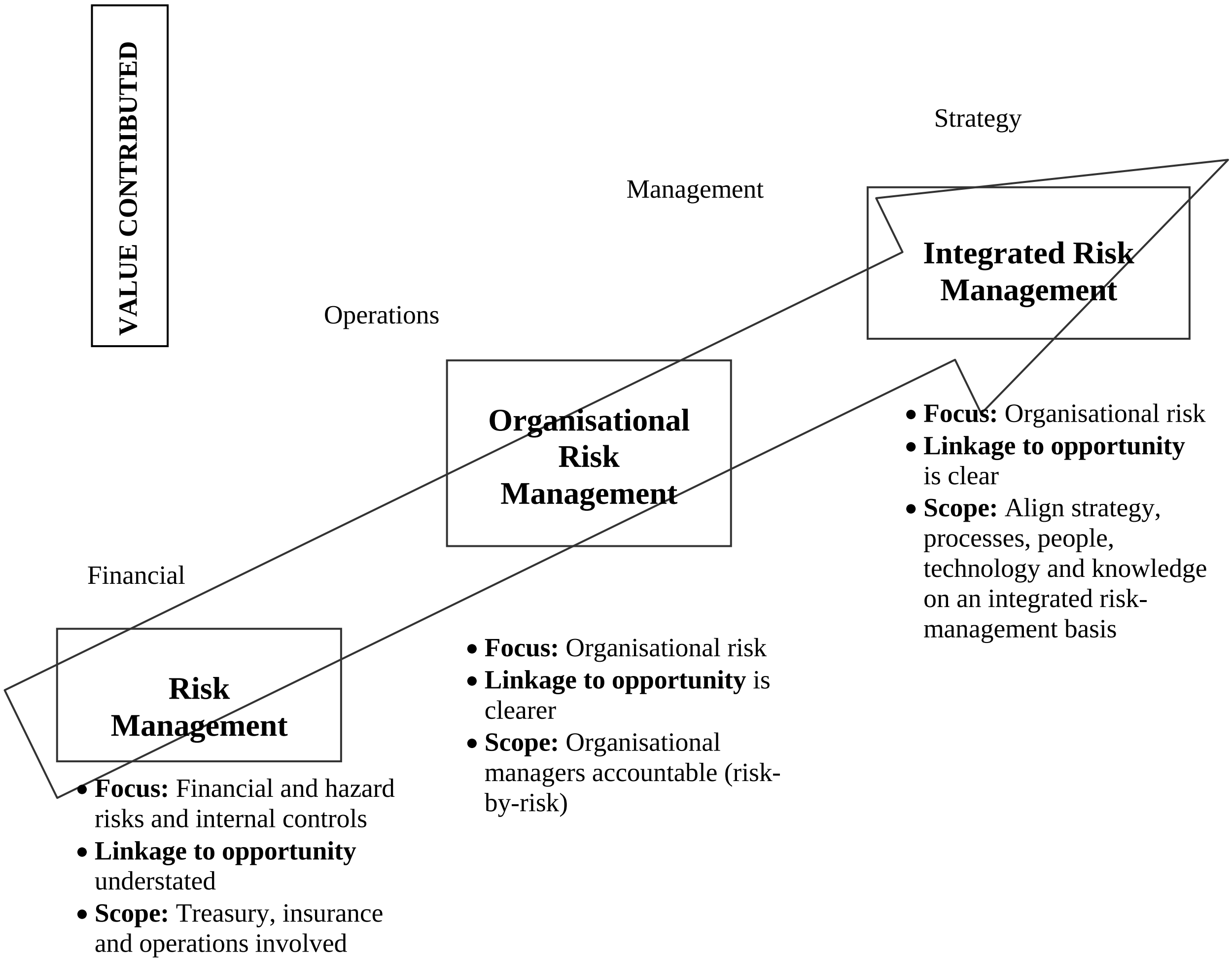
- Political environment – Schwella (in Gildenhuys, 1991:61) states that, with reference to South African public institutions, attention should be given to the levels of legitimacy. The risk exists that deficient legitimacy could contribute towards officials not rendering optimal services to stakeholders. If a low-legitimacy political environment prevails in the public sector, which is shared by officials and other stakeholders, the risk that organisational objectives might not be achieved will amplify. This risk should be identified in its earliest stages and should be mitigated by developing and instituting an organisational culture that is legitimate.

- Economic environment – Transformation in the public sector holds the risk that officials might lose their position of power and benefits. The risk of diminishing standards in service delivery and the abuse of positions could be the cause of officials receiving commensurate benefits as a result of transformation to the detriment of the reputation of the public sector. A culture that is depleting the resources of an organisation from within will soon create an environment in which it is impossible to deliver sustainable services (Schwella in Gildenhuys, 1991:62).

- Socio-cultural environment – Organisations are at risk in an environment where the different social cultures set conflicting demands, because of a lack of collective responsibility for organisational activities. This risk should be mitigated by restoring the effectiveness of social structures by means of negotiating an acceptable partnership between all the cultures in the organisation. The restoration of the social-cultures should create the proper actions and attitudes needed for an effective organisational environment (Schwella, 1989:62 and Du Toit, 1991:65-67 in Gildenhuys).
- Administrative environment – An environment in which mechanisms are lacking to hold officials responsible for their administrative actions creates the risk that responsibility may be negated. Controls should be put in place to mitigate the risk and to create a sound administrative environment that is built on trust and responsibility (Schwella in Gildenhuys, 1991:62).

Organisations function in specific environments, which have an influence on decision-making and which consequently affect the culture of the organisation. Three key stages of the enhancement of risk management in a strategic process have been identified. The first stage is where insurance is bought to address financial risks and hazards. At this stage risks are not regarded as possible opportunities. The second stage is where the focus of risk management is on the organisation holistically and not on segments of the organisation only. The linkage to opportunities becomes clearer and management is held accountable for risks. The third stage is where everyone in the organisation takes responsibility for risks and risk management then becomes an integral part of the strategy setting of the organisation. These three stages are depicted in Figure 1.

**Figure 1 The enhancement of risk management**




**Deloach (2000:24)**

Organisations around the world have re-evaluated the managing of risks. The role of risk management in achieving objectives should be redefined, with the ultimate goal being to increase stakeholder value. The main goal is not to eliminate risk, but rather to be proactive in assessing and managing risk for the advantage of an organisation (Maynard, 1999:24). Organisations are seeking a comprehensive, integrated approach to identifying and managing risks with a view to building risk-management processes to enhance risk management and stakeholder value. The categorisation of risks can be of assistance in this regard (Global Risk Management Solutions Group, 1999:7).

### 1.6.1. Categorisation of risks

Risk is present in all the activities and processes that constitute the manner in which an organisation operates and it needs to be managed effectively. Some of the more commonly referred to categories of risk are the following:

- Strategic risk – This refers to risks encountered in a competitive environment and includes elements such as new competitors in the marketplace, strategic opportunities, optimisation of capacity and efficiency;
- Financial risk – This refers to changes in value as a result of changes in external financial markets, for example, foreign exchange, interest rate and liquidity;
- Operational risk – This refers to the risk of loss as a result of inadequate internal processes, people, technology or from external events. Operational risk is shaped by factors such as sales practices, criminal activities, information technology, human resources and disasters.

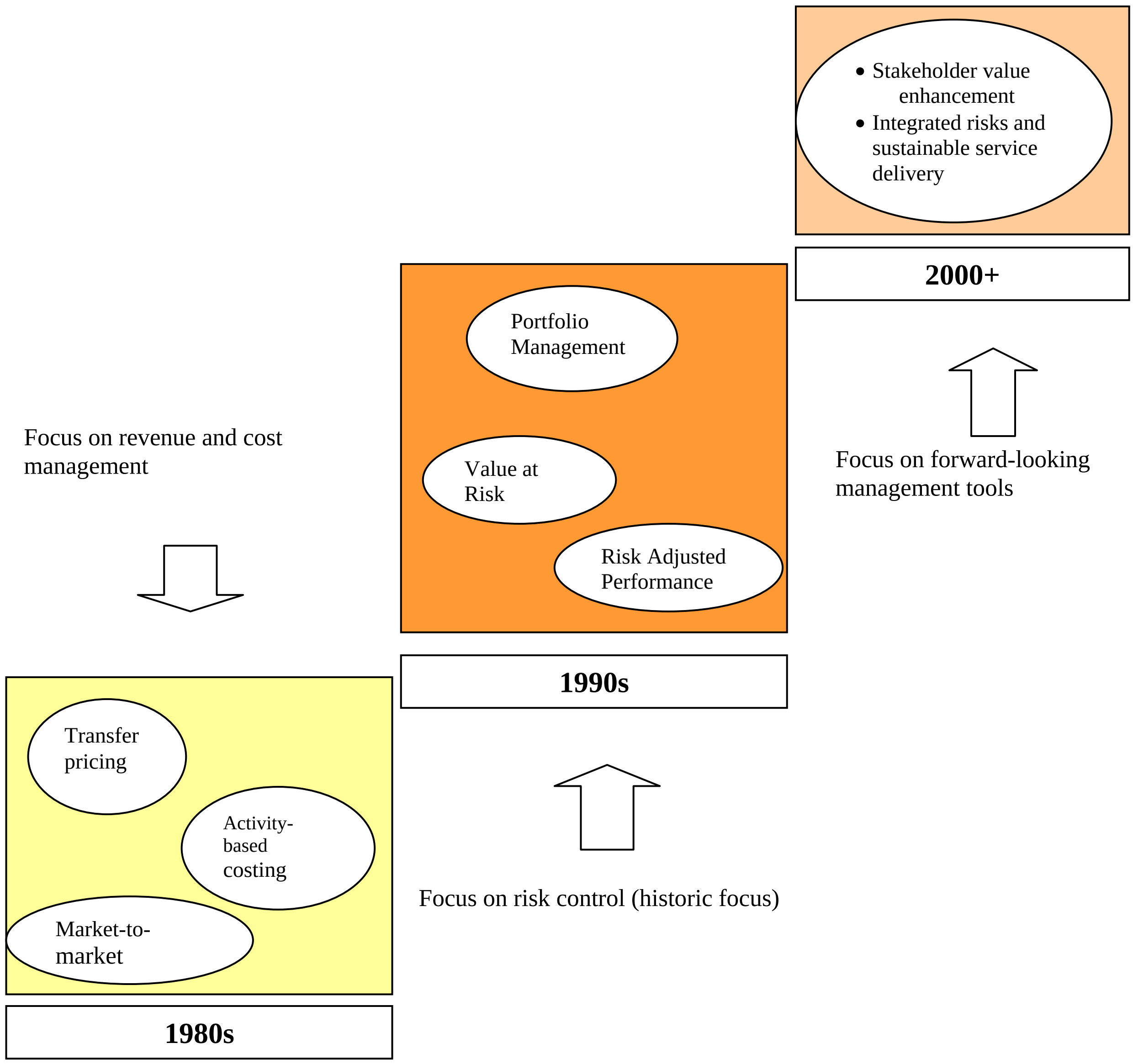
Thus, new trends in the market need to be viewed holistically in order to facilitate decision-making. The categorisation of risks plays an important role in integrating risks and to generate stakeholder value to facilitate decision-making.

### 1.6.2. Change in focus on risk decision-making

In the past most organisations have focused on an analysis of historical information to manage risk, but leading organisations are using future analysis to allocate their capital strategically, while facilitating the creation of stakeholder value. Figure 2 complements Figure 1 and indicates the change in decision-making from risk decisions that were taken for an activity only to integrated decision-making incorporating risks for the organisation.

The aim is to develop a culture in which decisions are taken in the interests of stakeholders and sustainable service delivery.

**Figure 2 Change in focus of risk decision-making**




**PricewaterhouseCoopers (2001:9)**

In the 1980s the focus was placed on revenue and cost management with the intention of increasing revenue and minimising cost. Organisations concentrated on the cost aspect only and not on the risk attached to the activities of the organisation. During the 1990's the focus in decision-making changed to include risk control in portfolio management.

Organisations applied more attention to determine the value of activities that are at risk and to adjust performance accordingly. From 2000 onwards organisations realised that risk management needs to be integrated holistically into an organisation's strategy to enhance stakeholder value and sustainable service delivery. Organisations became future orientated and applied managerial techniques to assist in the enhancement of stakeholder value and sustainable service delivery.

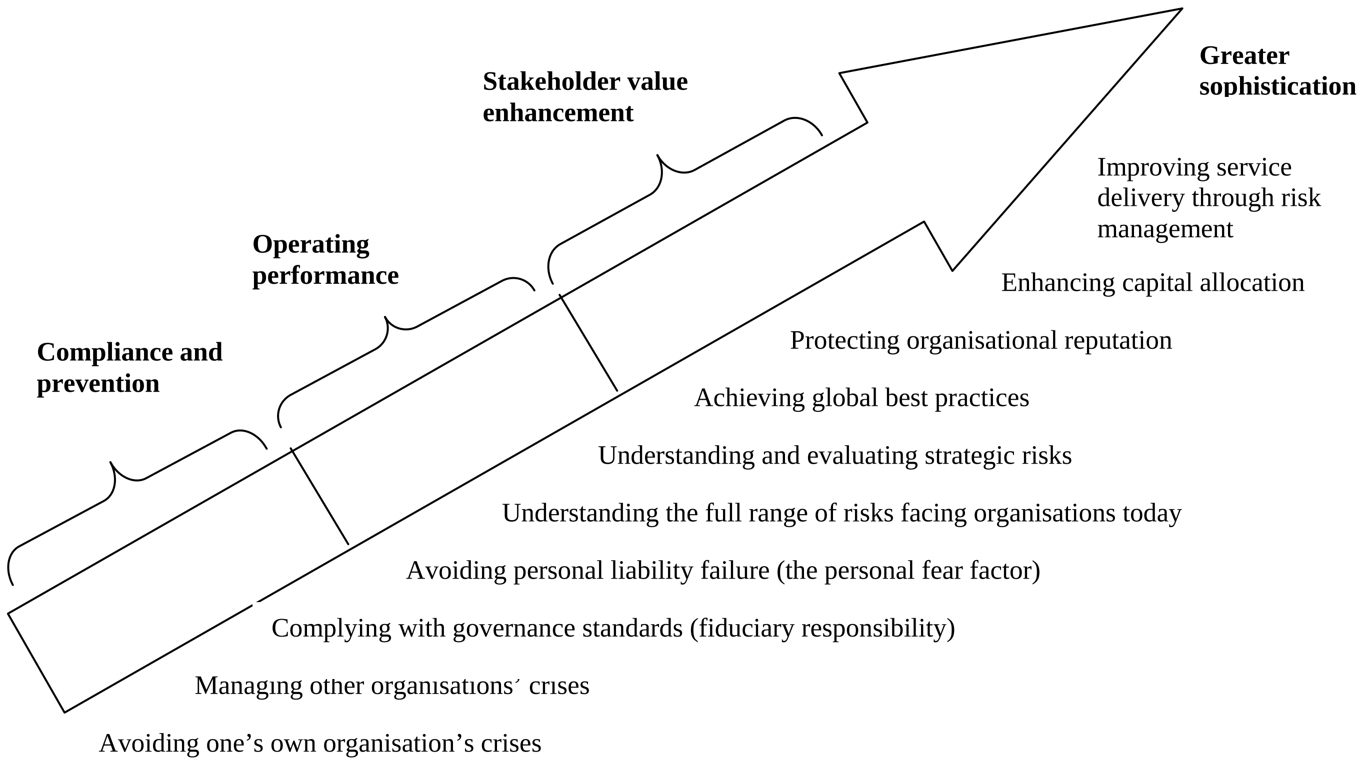
Thus, if organisations desire to create competitive advantage by taking risk management to an integrated risk-management level, they must be committed to realise this desire. The prescription is a comprehensive, transparent, consistent and continuously improved approach that aligns strategy, processes, people, technology and knowledge. The goal is to optimise risk, service delivery, growth and capital for the organisation, and to enhance risk management and stakeholder value. Risk management is about seeking the best practices and opportunities (upside) and managing risk exposures from materialising (downside) to the detriment of an organisation. Executives should understand that successful organisational cultural change is closely tied to attitudes toward risk.

### 1.6.3. Attitudes toward risk

Risk management in organisations is evolving along a continuum of increasing sophistication. Figures 1 and 2 depict the evolvement from risk management to integrated risk management and the role that decision-making fulfils in the enhancement of stakeholder value. Figure 3 depicts another approach, indicating that attitudes should change from merely avoiding organisational crises due to unforeseen risk to a greater level of sophistication, where integrated risk management stimulates the proactive identification of risks, which should improve service delivery. This indicates that management realises that an organisation must evolve from a situation where criseses are managed to a situation where risk management will assist the organisation's management to evaluate and identify potential risks proactively (Institute of Internal Auditors (2003) – Practice Advisory 2100-

4; Morley, 1993:77-86 and Osborne, 1993:349-356). Risk management will put management in a position to understand the risks of an organisation better. Once attitudes change, risks should be proactively managed, resulting in the improvement of the reputation of an organisation, which should enhance greater sophistication in service delivery. Figure 3 depicts what is meant by this statement.

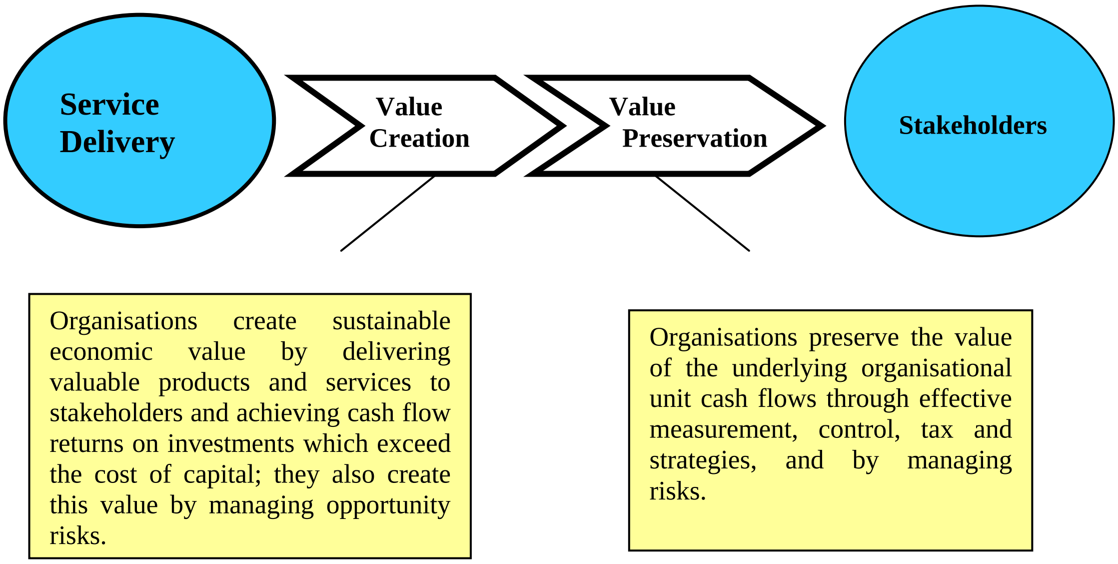
**Figure 3 Attitudes toward risk**




**PricewaterhouseCoopers (2001:11)**

The diagram above demonstrates the natural progression from managing the risks associated with compliance and prevention through the various levels of attitudes toward risk management to minimise the risks of uncertainty in respect of operating performance, and then moving to the higher level of managing opportunity risks, which need to be taken in order to grow sustainable stakeholder value. Such an evolution in organisational attitudes toward risk will lead to greater sophistication in the risk-management process, ensuring improved service delivery. An improved organisational attitude toward risks will realise value for stakeholders. Value realisation is depicted as follows:

**Figure 4** **Value realisation**




**Value realisation for stakeholders**

**PricewaterhouseCoopers (1999:10).**

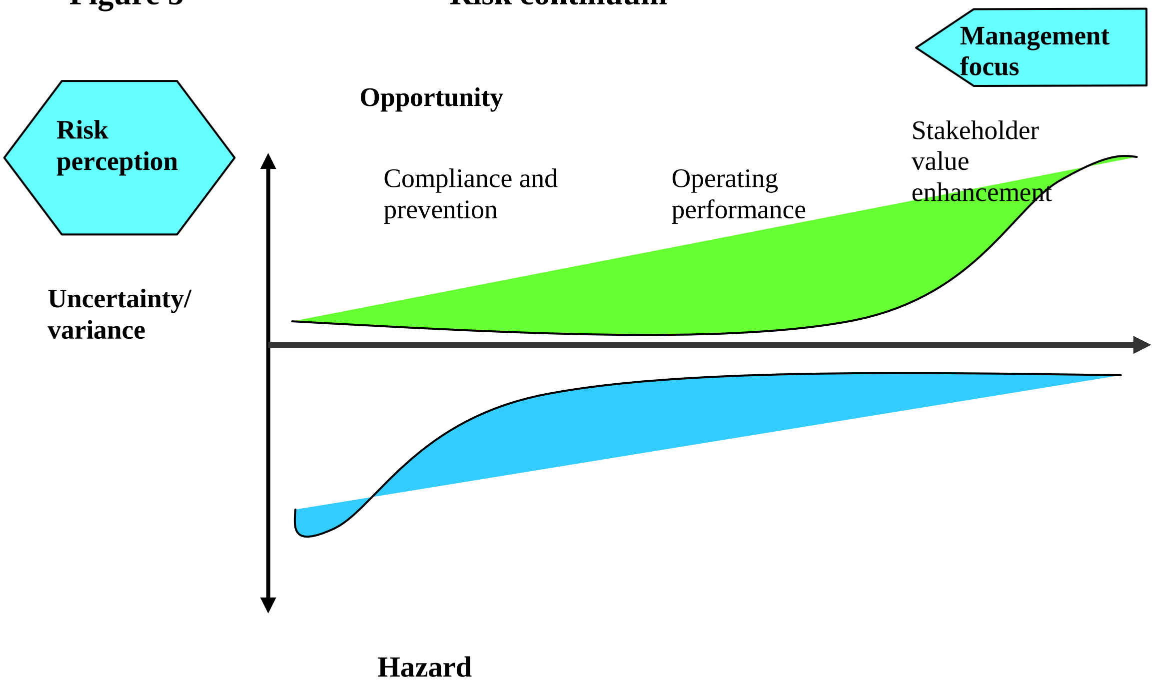
It is important to establish the risk continuum in which local government finds itself, as the composition of the continuum in which an organisation operates could impact on the sustainability of value created and preserved.

### 1.6.4. Risk continuum

The risk continuum as depicted in Figure 5 represents the view of another author to enhance value for stakeholders. As opposed to Figures 1, 2 and 3, Figure 5 establishes the extreme scenarios between risk as an opportunity and risk as a hazard, thereby confirming the perception of the uncertainty of risks. The risk continuum along which organisations operates consist of three elements, namely hazard, uncertainty and opportunity. Risk as hazard mean that there is a chance that risks will materialise (bad things will happen) and it focuses the attention of management on crisis management and compliance. The second element is the uncertainty about meeting the objectives of the organisation. This element refers to the protection of continuity of the operations in the organisation. The third element is opportunity, which is focused on exploiting the opportunities and best practices, and managing risk exposures to enhance stakeholder value, for example, the implementation of financial control to prevent corruption or sub-standard work.

All the mentioned elements determine an organisation's risk continuum and can be illustrated as depicted in Figure 5.

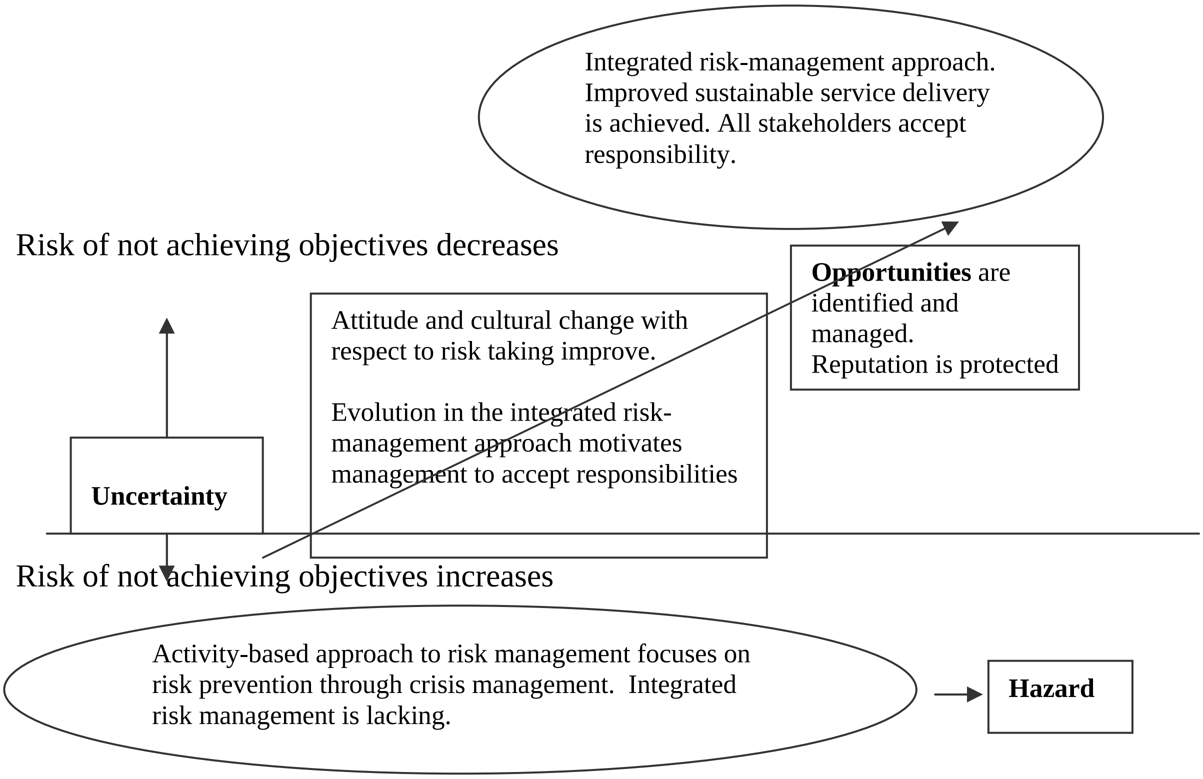
**Figure 5** **Risk continuum**




**PricewaterhouseCoopers (1999:7)**

Figure 6 below (developed by researcher) depicts the evolution of the integrated risk-management process, which is complemented by a change in the organisational culture based on a combination of the author's analysis. The purpose of Figure 6 is to depict the evolution of the integrated risk-management process from an undesired hazard approach through to a desired integrated risk-management approach. With the hazard approach the risk of not achieving the objectives of the organisation increases and it is common in an activity-based approach to risk management versus an integrated risk management approach. The hazard approach focuses on the prevention of risks by means of a crisis-management approach. The next level in the evolution of the integrated risk-management process is the uncertainty that exists in achieving of the objectives of the organisation. As the level of certainty in achieving the organisational objectives increases, the risk of not achieving the organisational objectives decreases. Evolution in the integrated risk-management approach brings about a cultural and attitude change toward risk taking, which is complemented with the acceptance of greater responsibility by management. The progress made on the integrated risk-management evolution continuum stimulates the identification of opportunities, which should lead to a rise in the reputation of an organisation. The complete integration of the evolution in the integrated risk-management process facilitates improved and sustainable service delivery to the advantage of all stakeholders.

**Figure 6 Evolution of the integrated risk management process**



Thus, the occurrence of hazards on a regular basis indicates that proper risk management is lacking and this in turn limits the objective of the organisation to enhance stakeholder value. If the perception is that opportunities are exploited and objectives reached, stakeholder value will be enhanced, as stakeholders will believe that the continuum on which the organisation finds itself is well controlled.

The process of risk assessment can contribute towards the integrated risk-management process and bringing about an organisational cultural change. Although the involvement of all the stakeholders attached to an organisation is important to integrate risk management, there are specific role players in organisations who are responsible for the governance process of the organisation to achieve the objectives of the organisation. These role players are also referred to as agents.

## 1.7. Classification of role players in achieving organisational objectives

There are four major role players involved in the governance process within an organisation. These role players exert power with a view to achieving the objectives of the organisation. Le Roux (1999:2-2) refers to these role players as follows:

**Figure 7 Classification of role players**

Oversight role players
Non-Executives (Board of Directors/
Audit Committee)

Stewardship role players
Executive Management

Performance role players
Operating/Support

Assurance role players
Internal Auditors
Consultants

Risk Managers

**Le Roux (1999:8)**

The role that the four major role players play in the governance process indicates that an inter-relationship between all the role players as well as a commitment from them is needed to achieve the objectives of the organisation. These role players have to ensure that:

- the rights and interests of the stakeholders are protected, particularly in areas where those rights and interests may conflict with the interests of officials;
- the Council and City Manager properly fulfil their primary responsibility to direct the strategy and monitor the performance of the organisation, particularly with regard to assessing the performance of officials; and
- reporting procedures are reliable to provide a realistic, timely and up-to-date assessment of the organisation's results (Global Risk Management Solutions Group, 1999:29 and Walker *et al*., 2003:53).

Officials should consider the cost-of-risk to the organisation in the process of risk mitigation to avoid resources not being utilised effectively and efficiently.

## 1.8. Minimisation of cost-of-risk

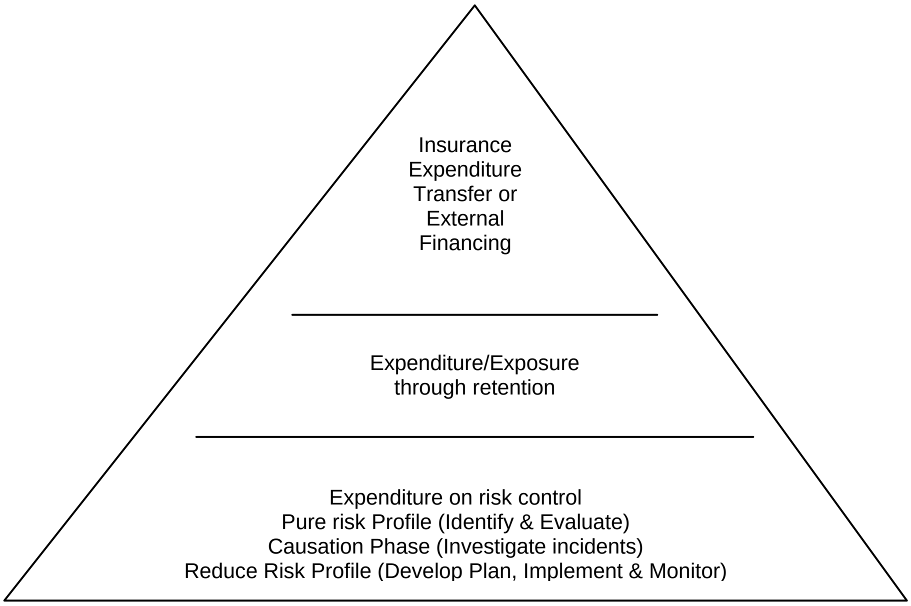
The utilisation of scarce resources is important when it comes to the financial aspects of running a department with the multiple functions of the organisation. It is good practice for the public official to remain informed about how to ensure efficient and effective expenditure to mitigate risks. Risk management entails any activity aimed at reducing the impact and likelihood of losses that may arise from the risks facing an organisation. Gleim (1999:210) and Ozog (1985:161) state that through the systematic identification, evaluation and control of organisational activities, the factors that may cause losses could be eliminated or reduced. The risk-management process is incomplete until one also considers the element of cost-of- risk

(Doherty, 2000:65-67). Risk financing refers to the provision of funds to recover from losses that do occur and the risk-financing function comes into play when consideration is given to the pursuit of minimising the ‘’cost-of-risk’’ to an organisation.

The cost-of-risk concept is a useful measurement device for evaluating and reporting the results of a risk. Genis (1995:4-5) referred to ‘’cost-of-risk’’ as a performance indicator of the risk-management process or the loss history of an organisation. Cognisance should be taken of different costs that arise when measuring the cost-of-risk for an organisation and include costs, including the following: administration costs such as salaries and wages for officials, outside services and consultants’ fees, claims preparation costs and opportunity costs; training costs; maintenance costs of risk-management programmes and insurance premiums comprised of asset, non-asset and broker fees. When the costs become too high, the risk exists that management is over-controlling a potential risk instead of managing the risk effectively.

Valsamakis *et al*. (1996:244) point out that the central issue becomes one of financing the cost-of-risk. Williams and Heins (1981:16) concur with Valsamakis on this when they stated that risk management has to do with the minimisation of the adverse effects of risk at minimum cost. The cost-of-risk is depicted in Figure 8:

**Figure 8** **Cost-of-risk**




**Valsamakis *et al*. (1996:247)**

The cost-of-risk depicted in Figure 8, where reference is made to cost-of-risk aspects such as insurance to cover risks, external financing (for example, bank loans to cover risks that have materialised), exposures to the organisation if risks are retained; expenditure on risk control to identify and evaluate risks; investigation of risks; and the development of plans to mitigate risks. To be effective, officials should also be encouraged to move away from the traditional culture, which buys insurance cover for all types of risk instead of managing risks with the possibility of capitalising on opportunities. Young *et al.* (2001:324) state that the broadening of the definition of risk management has tended to push the role of insurance aside somewhat, which could leave the impression that insurance is of marginal importance to organisations. However, there should be no doubt that insurance remains a critical feature of risk-financing programmes. Insurance, in conjunction with an effective integrated risk-management programme, could assist organisations in managing the weaknesses and strengths of the risk-management programme.

Five categories of losses which have an effect on the cost-of-risk are outlined by the Society of Risk Managers - South Africa (2000:21). They state that the cost of the losses –which are the adverse effects of risks that should be minimised, as stated by Williams *et al.* (1981:16) – normally falls into one of the following categories:

- Property loss or damage, e.g. damage to vehicles and buildings;
- Consequential losses, e.g. losses to equipment as a result of improper maintenance;
- Cost for paying for liability claims, e.g. as a result of potholes in roads damaging vehicles;
- Costs associated with injury to, or death of, employees; and
- Pure financial or economic losses due to corruption and improper financial systems.

Sullivan (2001:10) reported that the cost-of-risk in the United States dropped to its lowest point in a decade in 1999, down to $5.20 per $1,000 of revenues although no reasons are given. This decline could be a result of the effective minimisation of the cost-of-risk.

Thus, the cost-of-risk concept includes the costs associated with an organisation’s risk-management functions. In particular, cost-of-risk reflects costs such as insurance premiums, retained losses, internal administration and outside services. The intention is to focus on the improvement of risk management in the public sector. This focus is necessary to identify risks timeously, to take remedial action and to optimise the benefits of the risk-management function, thereby reducing the cost-of-risk.

The minimisation of the cost-of-risk should contribute to the achievement of the objective of risk management effectively. The promotion of efficiency is aimed at assisting management to accomplish objectives in the public sector with minimum waste or effort (Illustrated Oxford Dictionary, 1998:259). Risk management is a process that management can implement to facilitate the accomplishment of objectives through efficient working procedures.

The risk management process can be strengthened by mitigating the weaknesses of the risk management process. Management should therefore be aware of all possible risks that may occur in the functions that are performed by organisations. Management should ensure that approaches are embedded in the organisation to enhance the effectiveness of risk management in the public sector to secure the achievement of its objectives (Institute of Risk Management – South Africa (hereafter referred to as IRMSA), 2004:8).

## 1.9. Approaches to enhance the effectiveness of risk management

The success of risk management depends on management's commitment to the establishment and development of the risk-management process in the public sector. The ignorance of management about the approaches creates the risk that the objectives of risk management will not be achieved. Management approaches to enhance the risk-management process in the public sector are described below.

### 1.9.1. Advanced public management

Advanced public management refers to the utilisation of a particular style of management. Its initiatives are essential to obviate risks in public organisations. Advanced public management will only be achieved through the vision, ingenuity and creative ability of *inter alia* political office-bearers and administrative officials. The success of public organisations will depend largely on the professional integrity with which officials apply their knowledge and work.

Advanced public management is known for its ability to cut costs, improve efficiency, promote managerial autonomy and foster performance appraisal and measurement. The assumption is made that advanced public management is a means to attain a particular standard in service delivery whereby the risk of organisational failure is reduced. It is essential to introduce an improved organisational culture to render services to stakeholders and to enhance the accountability of public managers (Carstens *et al.*, 2000:187; Kickert, 1997:18 and Minogue, 1998:23).

Thus, success in the implementation of advanced public management will facilitate organisational culture change, which should in turn enhance the implementation of the risk-management process. If the change is managed properly, resistance to an advanced style of management will be overcome. To facilitate the management of change, the input of a change catalyst, namely a public manager, is needed.

### 1.9.2. The management of change

The successful public manager is regarded as the change agent for facilitating the management of change. The change agent is responsible for anticipating and stimulating change in the organisation; such change is a prerequisite for the implementation of a risk-management process in the public sector.

The management of change consists of three stages: unfreezing, changing and refreezing. Unfreezing is aimed at increasing the awareness of the need to change. The status quo is disturbed by the reduction of the strength of current attitudes, behaviours and/or values. Changing reflects the action-orientated phase. Developing new attitudes, behaviours and/or values brings about explicit changes. Lastly, refreezing stabilises the change that has been brought about. The new state, which has been reached, becomes the *status quo* and must be sustained (Fox *et al.*, 1991:164). Management should ensure that the change that was brought about through the refreezing stage should be supportive of the implementation of a risk-management process. This change could be such that it reinforces the commitment by officials to the risk-management process and it should provide momentum to the integrated risk-management process.

Thus, it should be realised that no change is likely to occur unless there is motivation to change that will benefit the organisation and stakeholders. Where such motivation is not already present, the introduction of that motivation could be the most difficult part of the change management process. Organisational change, such as introducing new structures, processes and reward systems, occurs mostly through individual changes in key officials of the organisation. Organisational change is mediated through individual changes and includes administrative reform.

### 1.9.3. Administrative reform

The Illustrated Oxford Dictionary (1998:690) describes reform as: "to abolish or cure an abuse or malpractice". This description represents a clear and direct understanding of what is needed to achieve reform in the public sector. The implementation of risk-management processes will assist management to identify abuse and imperfections timeously and to take remedial action. Administrative reform should create the opportunity to incorporate risk-management principles in the public sector.

To be successful the reform process should be led or supported by politicians and public officials on a continuous basis. Two changes seem to be necessary for administrative reform, namely changes in the structure and procedures of the public sector, and changes in the attitudes and behaviour of the public officials. The attitudinal aspect of change lies the root of reform and is the most difficult to achieve. The reason is that human nature and culture are difficult to change. Successful change in culture could be facilitated through appropriate leadership by management (Carstens *et al.*, 2000:177-190; Karim, 1992:31 and Quah, 1992:121).

### 1.9.4. Leadership

Valuable criteria can be developed from Hood's (1991:5) account of how to effect reform in the public sector. The introduction of advanced public management and administrative reform interventions will require strong leadership. Strong leadership should keep subordinates focused on rendering services as efficiently and effectively as possible. This would reduce the risk of low morale, malpractices and attitudes that are not focused on proper service delivery. The following aspects should be cultivated through leadership to effect efficient risk management in the public sector:

- The assignment of responsibility for action and the acceptance of accountability;
- The clear statements of goals are a requirement to hold officials accountable. A "hard look" at objectives is required to enhance efficiency;
- The bureaucracy should be broken up;
- The creating of manageable units is needed to gain advantages through contract arrangements inside as well as outside the public sector;
- Greater competition in the public sector and a move to contracts and public tendering procedures to create competition. Competition is regarded as the key to lower costs and improved standards;
- The resource demands of the public sector need to be continuously evaluated, and improved service delivery has to be achieved with fewer resources.

Thus, management approaches to effect efficient management in the public sector must utilise a style of management directed at achieving improved service delivery, and they must be applied within a framework where the goals are clear and senior management and politicians are leading the process. Organisational change needs to be managed properly to obtain buy-in from all officials, who need to be committed to integrated risk management, which should reduce the risk of not achieving organisational objectives as planned. This is regarded as a cornerstone in the achievement of efficiency and sustainability through risk management in the public sector. The way in which an organisation is changed could have a detrimental influence on the change-management process as well as the risk-management process in an organisation.

### 1.9.5. Organisational change

Schwella (in Fox *et al*., 1991:240) refers to scarce resources such as skilled people, capital and management initiative that the public sector needs to discharge their function and to develop the public sector. The way in which these scarce resources are managed has an effect on the overall wellbeing of stakeholders. Restrictive organisational structures stifle officials' initiative by, for example, providing a disincentive for accepting responsibility, demotivating officials and impeding organisational development, which could lead to a risk-management process that is managed in a sub-standard way. These factors may lead to serious manifestations of psychopathology amongst public sector officials, with a resultant effect that service delivery is hampered. Risk management should overcome restrictive bureaucratic structures as it forms part of an advanced style of management to achieve goals and objectives (IRMSA, 2004:14). The achievement of efficient organisational change will contribute towards enhancing the process by which organisations are managed. Efficient and effective governance needs to prevail in the public sector to achieve sustainable improvement. Therefore, a change in the organisational culture is a prerequisite for an efficient risk-management system (IRMSA, 2004:30). The essential qualities of governance will be discussed below.

### 1.9.6. Governance

The concept of governance has grown in prominence in the public sector as a result of the increasing involvement and interest of stakeholders (King, 2002:19 and Newsome, 2004:26-31). Stakeholders include officials, vendors and the public sector. The public sector should have, as its strategic intent, the creation of processes to provide the assurance that the public sector is well managed in accordance with generally accepted organisational principles. It is important that the public sector create a culture in which any stakeholder can, without fear of retribution, expose any immoral or unethical conduct by any other stakeholder (Bhagwandass, 1998:2-3). Le Roux (1999:2-6) states that managers seek reassurance that their organisations are protected from any major losses resulting from deliberate corruption or inappropriate working practices. He criticised organisations and their management for dealing with risks in an *ad hoc* manner with no systematic approach.

The public sector should manage itself and its relationships with its stakeholders with greater care and diligence for the sake of its reputation. A process of integrated risk management in an organisation should assist to manage within a framework of governance (IRMSA, 2004:11). A cultural change in the public sector is required to accept the implementation of an integrated risk-management process. Risk management therefore has to be integrated into all the activities of an organisation.

## 1.10. An integrated risk-management process

Deloach (2000:5) and Doherty (2000:10-11) point out that integrated risk management means the elimination of functional, departmental or cultural barriers as the process embraces the total organisation and not only certain departments, functions or officials. Integrated risk management is not a "one-size-fits-all" solution for all organisations, but there are elements that need to be implemented consistently by organisations undertaking this process. Integrated risk management requires a cultural change that is based on the commitment of each official to risk management. The process should be driven by senior management and be customised for an organisation (Institute of Internal Auditors, 2003 – Practice Advisory 2100-3).

Mitigating risk is the shared responsibility of all officials in an organisation, but management is responsible for applying methodologies and techniques appropriate for managing risks. The most challenging responsibility that management faces is to decide how integrated or dispersed its risk management process should be (Davis *et al*., 2002:38). This involves designing and implementing organisational structures, systems and processes to manage risk. A decision should be taken to implement either an integrated or a dispersed risk-management process; they may be distinguished as follows:

- An integrated risk-management process is based on a universally accepted language, methodologies and periodic assessments of the entire organisation. An integrated risk-management process is particularly effective when risk factors are common across organisational units, when organisational units are highly interdependent and when methodologies developed in one unit can be readily applied to other units. Integration of a risk-management process is crucial when management strives to achieve an integrated vision of risk management across the organisation. However, it must be understood that integration does not just happen, but it is the result of deliberate management strategy to embed risk management in the organisation.

- A dispersed approach to the risk-management process allows each functional unit to create its own language for risk management and its own methodologies. No structured effort is made to examine organisational risk collectively or to share practices across units. The dispersed approach is typically used when risk factors vary substantially across functional units and/or when functional units operate independently.

An integrated risk-management process involves the following:

- capturing risk as an opportunity rather than a threat to be avoided;
- leveraging competitive advantage by focusing on the key success factors and through improved management of operations;

- enhancing stakeholder value by reducing the adverse impact of down-side risk or losses and maximising up-side potential or opportunities;
- all organisational activities: integrated risk management is focused not only on, for example, development and infrastructure or finance, but spans the full scope of an organisation's activities.

Thus, the managing of risk is a shared responsibility of all the officials in an organisation. Management should decide on the types of risk-management processes or combinations of them that will be most effective for the organisation to enhance the competencies available in the organisation.

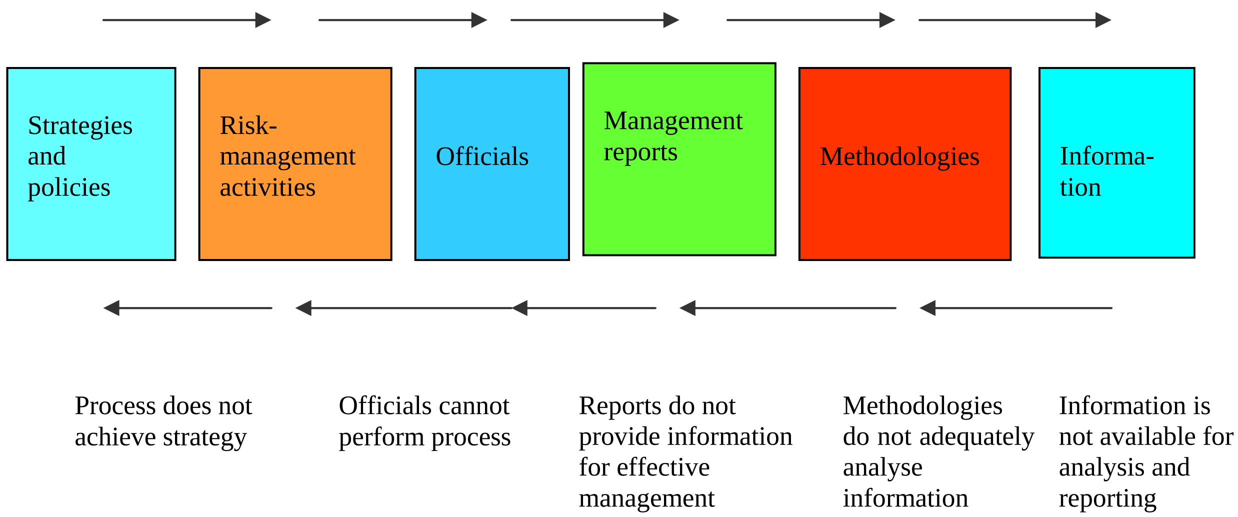
### 1.10.1. Competencies needed to enhance the risk-management process

Deloach (2000:146) refers to managing risks as a core management function in organisations. To obtain and maintain support for the risk-management process it is necessary to understand the integrated risk-management process, verify performance and improve the components of the risk-management process.

1.10.1.1. Six components of the risk-management process

The risk-management process contains six components. These components are depicted in Figure 9.

**Figure 9 Components of the Risk-Management Process**




**Deloach (2000:146)**

The key components comprising risk management should be implemented in sequence. The importance of doing this is to ensure that the risk-management process is developed to ensure conformity to strategies and policies. Officials need to be committed to ensure that risk-management activities are undertaken and reports should be made to management to evaluate the risk-management process. Deviations in the risk-management process should be brought to the attention of management and methodologies should be developed and implemented to ensure that strategies and policies are adhered to. The information available to monitor progress should be reliable, regularly updated and available for prompt decision-making. Should these components not be undertaken in sequence, the possibility that information that is needed for analysis and reporting purposes may not be regularly available or reliable. A lack of information may lead to inadequate analysis of methodologies, which will in turn reflect negatively on reporting, as reports will not be substantiated with information that will enhance effective management of an organisation. The effect of inefficiencies in the risk-management process will result in officials not being in a position to perform effectively, and that, consequently, the objectives set for strategies and policies will not be achieved.

It is essential that the effectiveness of the risk-management process, officials, methodologies and technology should be verified on an ongoing basis to provide assurance to stakeholders that risks are properly mitigated.

1.10.1.2. Verification

The following aspects need to be verified:

- Emerging risks – Changing conditions and circumstances externally (environmental risks) and internally within the organisation (operational risks) should be identified on a timely basis. Significant changes within the organisation warrant additional assessment of risks, so that the appropriate mitigation options can be evaluated (Bahar *et al*., 1997:55).
- Performance – Trend analysis assists management in verifying whether the established risk-management process is performing as intended and allows management to take timely corrective action when appropriate.
- Specific measures, policies and procedures – In this regard, activities such as auditing, supervision and inspections provide assurance, by means of internal reports, whether risk measures are reliable and whether established policies and procedures are being complied with (Bell *et al*., 1995:33).

Thus, the verification of the risk-management process entails the identification of changing circumstances that would create risks for the organisation. It includes the measurement of performance of the risk-management process through specific measures, policies and procedures to ascertain whether the officials comply with them. Verification will reflect signs of deterioration in the components of the risk-management process. Therefore verification should be conducted on a continuous basis to ensure the effectiveness of the risk-management process.

1.10.1.3. Continuous improvement of the risk-management process

The need for improvements to the risk-management process, training of officials, reports, methodologies and technologies that are identified through verification should be evaluated consistently and on a continuous basis. Management faces two challenges in sustaining a dynamic mindset of continuous learning and renewal in its risk management. The first challenge is to prioritise risks, to document processes and to train officials. The second challenge is to stimulate continuous improvement (Deloach, 2000:175) to ensure a continuous improvement through benchmarking against international best practices. Interactive communications and knowledge sharing with stakeholders and integrating the organisation's risk-management process into its learning programmes for officials are also necessary to ensure continuous improvement of the risk-management process.

Thus, integrated risk management is a truly holistic, integrated, forward-looking and process-oriented method to manage all key risks and opportunities and not just financial ones, with the intent of maximising stakeholder value for the organisation. Integrated risk management redefines the value proposition of risk management by providing organisations with the processes and tools needed to become more anticipatory and effective at evaluating, embracing and managing exposures to uncertainty as organisations create sustainable value for stakeholders and establish competitive advantage (Walker *et al*., 2003:52). Inasmuch as an integrated risk-management environment provides better information for decision-making, performance variability and exposure to loss are reduced and opportunities can then be optimised.

Organisations operate in labour markets that are unstable and technological advances increase ever more rapidly. These changes might be detrimental to the existence of an organisation (Grove, 1996:3 and Stewart, 2000:202-206). The integrated risk-management process is dependent on a complementary generic process to identify the root causes of incidents to mitigate a possible recurrence. The mitigation of root causes should enhance an organisation's position in a competitive environment.

## 1.11. Generic process to identify causes of incidents

When a risk has materialised, it is necessary to determine the root cause(s) that allowed a risk to arise. Although other techniques like "Fault Tree Analysis" can also be used to determine the root cause of incidents, the "Generic Process" refers to a technique that will minimise the chance of a major or catastrophic loss for an organisation; it involves five steps. The acronym I-E-D-I-M is used when reference is made to the five steps. This technique is regarded essential to introduce concepts that might not be familiar to readers in general and is outlined below.

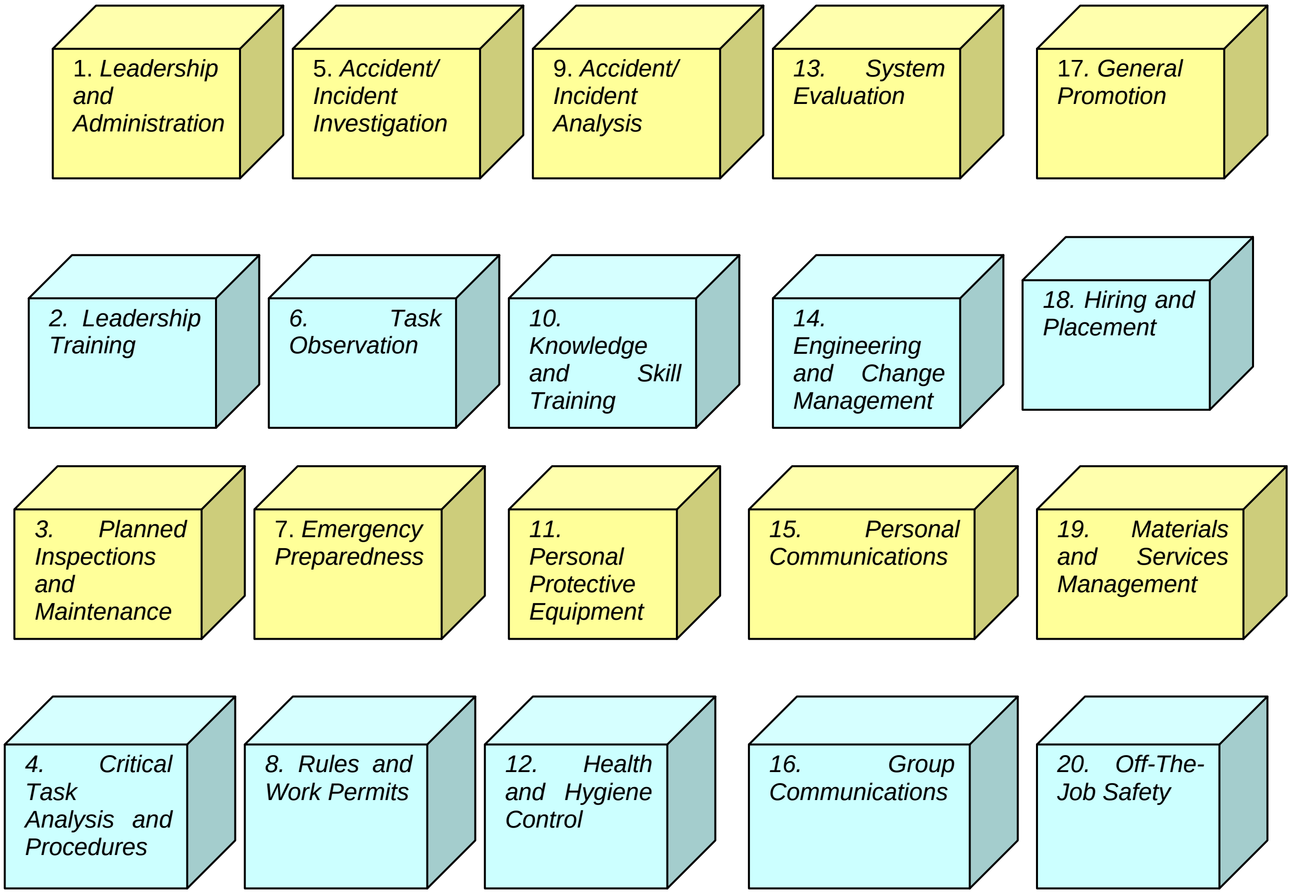
- The five steps in managing risk, according to I-E-D-I-M, are: (1) **identify** all risk exposures; **(2) evaluate** the risk in each exposure; **(3) develop** a plan; **(4) implement** the plan; and **(5) monitor** the process.

- Identify all risk exposures – The identification of risk exposures that face the organisation, which could prevent the organisation from achieving its objectives.

- Evaluate the risk – For determining the criticality of loss incidents and setting priorities for action, it is essential to evaluate each risk according to the likelihood and impact of an incident.

- Develop a plan – To prevent a risk incident, the first attempt should be to develop a plan to mitigate the risk (Committee of Sponsoring Organisations (hereafter referred to as COSO), 2003:53-58). The risks can then be mitigated through risk-management activities, some of which are depicted in Figure 10.

**Figure 10 List of some activities to manage risks**




**IRCA – Scientific Cause Analysis Technique (1998: 9)**

- Implement the plan – A plan yield results only when it is converted into action and put to work. To achieve this, officials need to be trained, resources allocated and equipment bought.

- Monitor the process – It is essential to ensure that the objective to measure, evaluate, commend and correct officials and organisational performance is achieved. Monitoring should therefore be conducted at regular intervals, depending on the importance of a risk and to uphold the risk management function (IRCA, 1998:7).

Thus, the steps as indicated with the acronym I-E-D-I-M, which represent the activities to manage risk, should be implemented and communicated in the public sector to make officials aware of the weaknesses and strengths in the risk-management process.

## 1.12. Weaknesses and strengths in the implementation of a risk-management process

It is imperative to identify and analyse both the weaknesses and strengths of a risk-management process to rectify the weaknesses and capitalise on the strengths in order to achieve optimal benefit for the organisation.

### 1.12.1. Weaknesses in the risk-management process

Greene *et al.* (1983:4-5) recommend that the management of risks should be incorporated into all the activities in an organisation. In the past the scope of risk management in organisations was limited and it was primarily the responsibility of the risk manager to transfer suitable risks to professional insurance brokers (IRMSA, 2004:14).

Deloach (2000:249) refers to a research study with the title “Managing business risk: An integrated approach” that was conducted in 1995. This worldwide survey determined that:

- less than 50% of senior executives had so-called “high confidence” that their risk-management process are identifying and managing all potentially significant risks;
- recent significant changes in risk-management processes had been implemented by more than 50% of the companies; and
- approximately 60% of the companies planned significant changes in risk-management processes within the following three years to enhance efficiency in organisations.

The following weaknesses were highlighted:

- Goals, objectives and oversight – The goals of risk management are not adequately articulated, understood or expressed in the public sector. There is no clear articulation in written policies of an organisation-wide strategy linking risk management to organisational strategy. It has also been identified that a lack of a common language to improve communication is a significant hindrance.
- Risk assessment – In general risk assessment methods are *ad hoc* and inconsistent throughout the organisation or are not well developed. Risk measurement needs improvement and risk-management activities need to be linked to organisational performance.
- Risk-management strategies – The formulation strategy for individual risks needs a more rigorous approach. It was established that when an unpredicted risk has been identified, an accountable official, called a "risk owner", for managing and monitoring that risk should be appointed. This does not happen generally in the public sector.
- Monitoring – The reporting on risk and risk management is sporadic and inconsistent, and does not assist management in understanding the impact of risk on the organisation's operating performance.
- Continuous improvement – Instead of programmes to enhance continuous improvement, risk-management efforts are often narrowly focused on internal control. There is little benchmarking activity and sharing of best practices with what is done in other organisations globally.

### 1.12.2. Strengths in the risk-management process

IRMSA (2004:8) and King 2 (2002:73-74) addresses critical success factors that should be present in an organisation to overcome the weaknesses, as well as to sustain the strengths, of the risk-management process. The success factors referred to are:

- Commitment by everyone in the organisation;
- Maintain momentum in the process of risk management;
- Define clear roles and responsibilities;
- Enhance the risk-management process through continuous training;
- Remove silos and integrate risk management in strategies and planning;
- Create and develop corporate governance; and
- Develop and implement realistic and achievable plans to mitigate risks.

The following list of strengths, which is not exhaustive, is offered by IRMSA (2004:11-18):

- Corporate governance – Stakeholders require that management has taken the necessary steps to protect their interests and risk management implies that reasonable assurance is provided that significant risks have been identified, evaluated and managed by the organisation (Mark, 1997:145).
- Strategic planning – Management can use the deliverables of a risk assessment in formal strategy planning to achieve the goals of the organisation.
- Capital allocation – The allocation of capital and resources to balance risk and opportunity is best achieved with prioritised risk information derived from the risk-management process.
- Change in corporate risk profiles – Integrated risk management should provide the organisation with the ability to track new risks, threats and opportunities on a systematic basis as well as to shape the strategic direction of the organisation.

- Risk finance – The development of a risk strategy that has embraced most risks is generally accepted to place the organisation in a stronger negotiating position with insurers.
- Change management – The pervasiveness of integrated risk management means that it can be used as catalyst of change.
- Compliance – The demands and complexities of the regulatory environment requires management to develop management systems for compliance. Integrated risk management equips management with the skills to adopt a risk-based approach to focus on the identification of potential non-compliance to regulatory expectations (Leithhead, 1999:68-69).

The challenges that face organisations are the implementation of principles and practices to manage risk as well as to move away from the traditional approach to risk management. Carey (in Lawrie *et al.*, 2003:4) calls on organisations to identify risks that are significant to the fulfilment of the objectives of the organisation and to implement a sound risk-management process to manage risks effectively. It should be realised that risk management competencies are not "a nice to have" but "a must have" in a competitive environment.

For the public sector to grow, management should move away from the traditional "silo"-driven attitude (Aggarwal *et al.*, 1996:40-44 and Lawrie *et al.*, 2003:2). Management should determine "what has to go right" instead of "what can go wrong" to succeed in optimising the prevention of risk realisation. The general lack of an appointed Chief Risk Officer in public organisations increases the need to implement integrated risk-management processes. The appointment of Chief Risk Officers should be considered by management to drive the risk-management process and to embed it in the organisation.

Thus, the current situation in the public sector should be assessed to establish what should be done differently by management with respect to risk management (Van Niekerk, 2000 and Van Wyk, 2000:8). A combination of management's commitment to an organisation's risk-management process and a move away from the traditional approaches should enhance the risk-management process in organisations as well as organisational controls to prevent the risk of procedures and activities not being applied and executed in the interest of service delivery.

Should controls be omitted, the risk exists that the weaknesses and strengths may not be managed properly, with the consequence that organisational objectives may not be achieved. There are two international risk-management models that are used to evaluate and improve controls to enhance risk management.

## 1.13. Risk management evaluation and control models

A distinction is made between "soft" and "hard" controls by The Committee of Sponsoring Organisations (COSO). The Criteria of Control Model (hereafter referred to as COCO) describes control as elements that focus on the achievement of the objectives of an organisation. The distinction between the COSO and COCO models is described below.

### 1.13.1. Controls in the COSO model

Often the identification of "soft controls" is lacking, which could jeopardise the identification of the risk to which an organisation is exposed. The COSO model refers not only to the evaluation of "hard" controls such as segregation of duties to prevent the risk that one official can manipulate a process by taking responsibility for all the activities in a particular process, but includes "soft controls", such as the competence of officials to manage effectively the activities that the officials are responsible for. An organisation's objective and the environment in which it operates are continually evolving and as a result the risks it faces are continually changing. A sound system of risk management therefore depends on a thorough and regular evaluation of the nature and extent of risks to which the organisation is exposed. Since service delivery is the reward for successful risk taking, the purpose of internal control is to help manage and control risks rather than to eliminate them (Le Roux, 1999:3-5). The assurance has to be provided that generally accepted organisational control is maintained in organisations to prevent the risk of organisational failure.

The COSO model describes three means to achieve objectives as per Figure 11 that are designed to provide reasonable assurance that the objectives of an organisation will be achieved.

**Figure 11** **Three means to achieve objectives**

**Effectiveness and Efficiency**

- Service Delivery
- Safeguarding or Resources
- Profitability
- Identify & Manage Liabilities

**Reliability of Internal and External Reporting**

- Maintain proper records
- Protect records against two main types of corruption, i.e. concealment of theft and distortion of results

**Compliance with Laws and Regulations, and Internal Policies**

To ensure that an organisation's service delivery is conducted in accordance with legal principles and approved policies

**Le Roux (1999:15)**

Thus, the COSO model assists management in the performance of their activities by managing risks. The effective management and regular evaluation of controls contributes to the prevention of organisational failure.

The Criteria of Control Model (COCO) focuses on the elements for achieving an organisation's objectives.

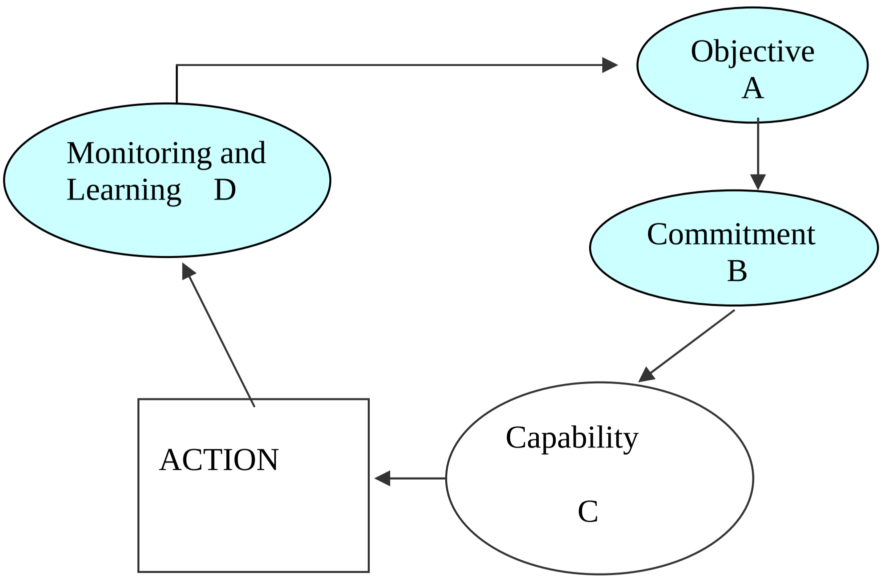
**1.13.2. Controls in the COCO model**

The COCO model describes controls that assist officials and stakeholders to focus on achieving the organisation's objectives. The elements include resources, systems, processes, culture, structure and tasks; it also addresses how these elements are inter-related and aligned with the objectives. Control elements include the identification and mitigation of risks with the potential to influence the viability and success of an organisation, namely;

- failure to maintain the organisation's capacity to identify; and
- failure to maintain the organisation's resilience – referring to the organisation's capacity to respond to unexpected risks and opportunities, and to take decisions to adapt.

The essence of the COCO model is depicted in Figure 12.

**Figure 12 Criteria for Control Model**




**Le Roux (1999:19)**

With reference to Figure 12 the following descriptions are provided - A – Objective to be achieved; B – Commitment to perform task well over time; C – Information, resources, supplier, skills; and D – To do task better and to change over time

Thus, the essence of the COCO model is to focus officials and stakeholders on the achievement of the objectives of an organisation. The COCO model should assist in facilitating reporting and accountability to the organisation's stakeholders, which will create an organisational culture where risks are identified in good time. The objective of both models appears to be sound, but it could be criticised for not exploring the causes for the failure of controls. Proper guidelines are lacking which should be used by officials to identify the risk of failure proactively.

## 1.14. Summary

Risk management is an interactive process that should be followed to gain insight into risks and their impacts, and to base improved decision-making on those insights. Risk management is recognised as an integral part of good management practice and should become part of public sector culture in order to be more effective. To facilitate this practice, risk management should be integrated into the organisation's philosophy and practices rather than be viewed or practised as a separate programme. This can be achieved by involving risk management in the activities of each department in an organisation and not only in certain activities or departments. Risk management is also regarded as a mechanism that will enable organisations to minimise losses and maximise opportunities.

The risk management objectives should be clear, practical, achievable and specific to motivate officials and to monitor the degree to which the objectives of the organisation were achieved. If the objectives of risk management are not met, the focus of officials will be influenced negatively, which could in turn result in the non-achievement of organisational goals in an efficient and effective way.

Integrated risk management is dependent on a cultural change to bring about a revised perspective in achieving the objectives of the organisation. A cultural change is described as a natural evolution, responding to the environment's risk drivers and the emergence of advanced risk-management tools and processes. The following general environments have an influence on the organisational culture:

- Political environment – The level of legitimacy in the political environment could determine the measure in which officials will contribute to rendering optimal services.
- Economic environment – Transformation holds the risk that officials might have the perception that they are worse off after transformation, which could be the cause of officials receiving commensurate benefits to the detriment of the reputation of the public sector.
- Socio-cultural environment – Organisations are at risk in an environment where the different social cultures set conflicting demands, because of a collective responsibility for organisational activities.
- Administrative environment – In an environment where mechanisms are lacking to hold officials responsible for administrative actions, the risk is created that responsibility could be negated.

The specific environments in which organisations function have an influence on their decision-making, which consequently affects the culture of the organisation. In an environment in which the total focus is activity based in order to prevent risks by means of crisis management, the risk of not achieving organisational objectives will increase. In an environment where the attitude and culture change with respect to risk taking are improving, the risk of not achieving objectives decreases until an environment is created where an integrated risk-management approach improves sustainable service delivery and the stakeholders accept responsibility. An evolution on the continuum to an improved level of risk management should ensure that opportunities are identified and managed, and the reputation of the organisation is protected.

Stakeholders, also referred to as agents, have a role to play to ensure that the rights and interests of stakeholders are protected. The minimisation of the cost-of-risk should be ensured through: (i) the implementation of effective, efficient and transparent systems of risk management; (ii) the use of organisational resources; and (iii) the prevention of unauthorised, irregular, fruitless or wasteful expenditure. Through the systematic identification, evaluation and control of organisational activities, the factors that may cause losses should be reduced or eliminated.

Management should consider approaches to enhance the effectiveness of risk management in the public sector, the failure to do so might create the risk that the objectives of organisations will not be met. The following approaches were described: advanced public management, management of change, administrative reform, leadership, organisational development and governance. The objective of these approaches is to ensure that the public sector manages itself as well as its relationships with its stakeholders with greater care and diligence to uphold and improve its reputation. The approaches to enhance the effectiveness of risk management should assist management to manage effectively within a framework of governance. Risk management should be integrated into all the activities of the public sector and, when stakeholders accept their responsibility for risk management, the endeavours of the organisation to achieve its objectives in the most cost-effective manner should be facilitated.

An integrated risk-management methodology has been adopted internationally. This methodology has to do with the elimination of functional, departmental or cultural barriers, but it is not a “one-size-fits-all” solution. The integrated risk-management methodology has also been described as a process that requires a cultural change. Integrated risk management does not represent a change that can happen instantly and it is also not a product that can be bought, because its implementation requires an effective change process that must be driven from the top of the organisation. Integrated risk management has been described as a truly holistic, integrated, forward-looking and process-orientated methodology to manage all key risks and opportunities, and not just financial risks. It has been stated that, inasmuch as an integrated risk-management environment provides better information for decision-making, performance variability and loss exposure are reduced, as opportunities are optimised.

An integrated risk-management methodology appears to be more proactive and is representative of emerging best practice. Based on this argument, managements have realised that the full spectrum of risks cannot be assessed in isolation and they have therefore developed integrated risk-management frameworks to assist in pursuing organisational objectives. Dynamic risk-management frameworks will enhance stakeholder value.

A five-step approach, which is referred to as the generic process, to identify the causes of incidents can be put into practice to minimise the chance of a catastrophic loss for an organisation. These steps include the identification and evaluation of risk exposures, the development and implementation of a plan, as well as monitoring the system. Progressive activities to control risks attached to an activity can also be put into practice to minimise the chance of losses. These activities include the identification of work to be performed, the development of standards for the work at all levels; the measurement and evaluation of the performance level with reference to the standards; compliance with standards; and constructive correction of sub-standard work.

It is imperative to identify and analyse both the weaknesses and strengths of a risk-management process with the view to rectifying the weaknesses and capitalising on the strengths to achieve optimal benefit from a risk-management programme. The following weaknesses were highlighted:

- The goals, objectives and oversight of risk management are not adequately understood, articulated or expressed in the public sector;
- Risk assessment methods are *ad hoc* and inconsistent, and not well developed;
- Risk-management strategies need a more rigorous approach;
- The reporting of risk management information is sporadic and inconsistent, and this does not assist management in understanding the impact of risk on the organisation's operating performance; and
- Continuous improvement is lacking in that there is little benchmarking activity and sharing of best practices with what is done in other organisations globally.

The following strengths were highlighted:

- In support of corporate governance, assurance is provided that significant risks have been identified, evaluated and managed;
- Strategic planning is facilitated by the deliverables of risk assessments;
- Risk-management processes enhance the expenditure on capital allocations and directs the corporate risk profiles;
- Financial benefits could be negotiated when risks are embraced by the organisation; and
- Risk management acts as a catalyst of change for change management and it equips management with the skills to adopt a risk-based approach to focus on the identification of potential non-compliance with regulatory expectations.

Controls should not be neglected as they enhance risk management. The primary objectives of internal control can be described as the safeguarding of assets; compliance with policies, plans, procedures; the accomplishment of objectives and goals for operations; ensuring the reliability and integrity of information; and the economical and efficient use of resources. In this regard, reference was made to the COSO model, where a distinction is made between "soft" and "hard" controls and three means to achieve objectives, and the COCO model, which endeavours to apply controls such as commitment, capacity, and monitoring and learning to achieve the objectives of an organisation. The purpose of control measures is to identify risks proactively and facilitates risk management. Control measures include the identification and mitigation of risks that have the potential to influence the viability and success of an organisation, namely – failure to maintain the organisation's capacity to identify and exploit opportunities, and failure to maintain the organisation's resilience.

In Chapter 2 the importance of an ethical organisational culture will be described. The aim is to limit unethical conduct through the establishment of an ethical culture in an organisation. An ethical culture should make it easier to integrate risk management in an organisation, because an ethical culture should make all stakeholders aware of the consequences of material risks materialising and the effect of this on their careers, the reputation of the organisation as well as the sustainability of the organisation. The risk-management process will be described in more detail in Chapter 3 of this dissertation, but it is argued that an understanding of the prevailing ethical culture in an organisation is important to project the level of success that the integrated risk-management process can bring about in an organisation.

# CHAPTER 2

# AN ETHICAL ORGANISATIONAL CULTURE TO MITIGATE RISKS

## 2.1. Introduction

Ethics differentiates between good or bad, right or wrong, and it is concerned with the development of human behaviour according to certain moral norms. If good moral philosophies are not part of the culture of an organisation, the risk exists that ascertaining the true causes of incidents in service delivery could be hampered. Morality may be described as the practical manifestation of ethics. The question could, for instance, be asked if it is ethically correct to approve a tender from a vendor based on price, knowing that the vendor does not have the equipment to execute the tender and the organisation then supplies the equipment to the vendor to do the job. The risk exists that competitors can regard such a practice as unfair, if they have tendered to use and maintain their own equipment for the job. Ethics strives to maintain a level of ethical behaviour within a human being, which is a necessity in the public sector to obviate the risk of service delivery deteriorating because of a lack of ethical human behaviour (Attwater, 2001:59, De La Rosa, 2005:13 and Pride *et al*., 1996:34).

The public sector is at risk of rendering inefficient services as a result of a loss of confidence in the manner in which this sector is managed because of unethical practices. It therefore needs to implement risk-management processes to create efficient governance to prevent a decline in the confidence in the public sector. A decline in confidence in the manner in which the public sector is managed will be explained in this Chapter as well as the danger of a corrosion of ethical practices and the influence of this on the prevention of risks. Aspects that lead to unethical practices and thereby corroding ethical behaviour will also be explained.

To achieve an ethical organisational culture it is necessary to reduce the risk of self-enrichment. Officials should be informed about ethical conduct in an effort to render effective public services. There is a need to cultivate values such as honesty to embed an ethical culture in the public sector. This Chapter will explain the causes of corruption and suggest solutions to mitigate corruption. Knowledge about, and the effective management of, the causes of corruption and the pressures that could increase corruptive practices, and the solutions that could mitigate the risk of corruption should enhance an ethical culture in the public sector. Leadership exercised by management should be of such a nature that public ethics is not neglected and confidence is restored in the management processes of the public sector. Management should encourage ethical conduct amongst officials on an ongoing basis so that they may fulfil their activities in an honest manner. Solutions to reduce the risk of a decline in ethical behaviour need to be identified.

## 2.2. Definitions of unethical conduct

To demonstrate what is meant by unethical conduct, the definitions of corruption and maladministration are discussed and the distinctions between these concepts are outlined in order to understand the differences between them.

### 2.2.1. Corruption

Writers on the topic of corruption offer various definitions. The Illustrated Oxford Dictionary (1998:188) defines “corrupt” as “morally depraved and influenced by fraudulent activity”, and “corruption” as “moral deterioration and the use of corrupt practices like fraud”. Other examples of corruption such as theft, collusion, misrepresentation and bribery were not described in detail, because this dissertation focuses on risk management.

Powell (2000:2) defined corruption as the giving of direct or indirect compensation to whom it is not due, for something that the official should not do or for not doing something that the official should actually do. Black’s Law Dictionary (1979:311) defines “corrupt” as “spoiled, tainted, depraved, debased, morally degenerate” and a corrupt action as “an act done with an intent to give some advantage inconsistent with official duty and the rights of others". Corruption consists of an intentional illegal act, the concealment of that act and deriving a benefit from that act. Murray (1997:81) and Salierno (2003:15) explain that corruption entails the intentional offering, giving, soliciting or acceptance of inducements, which may influence person's actions.

Fraud is regarded as a manifestation of corruption and is described in the Illustrated Oxford Dictionary (1998:320) as "criminal deception, a dishonest artifice or trick, a person not fulfilling what is claimed or expected of him or her". Powell (2000:2) describes fraud as an act where both parties are knowingly involved and both parties benefit in the same way from the agreement. He further describes fraud as an "off-book" entry, which is seldom detectable, for example, the issuing of fictitious invoices for work not done. To meet the definition of fraud, there must be damage, usually in terms of money. There are four general elements, all of which must be present for a fraud to exist, for example, (a) a materially false statement, (b) knowledge that the statement was false when it was uttered, (c) reliance on the false statement by the victim, and (d) damages as a result (Coderre, 1999:9; Elliott, 2000:9 and Henderson, 1999:53).

Thus, corruption consists of an intentional illegal act by offering some form of compensation to officials which may influence the official's actions to the detriment of the organisation.

### 2.2.2. Maladministration

Maladministration cannot be easily defined and therefore it is best to describe maladministration by way of examples. Gildenhuys (1991:44) endeavoured to sum up maladministration instead of defining it by stating that it refers to everything that is wrong in the administration of an organisation. The following examples can be offered: unnecessary delays in service delivery, discourtesy and disrespect by officials as well as ignorance and arrogance in exercising official duties. King (2002:6) and Wheare (1973:10) share the Gildenhuys's view and refer to examples such as failure to answer a letter, the disappearance of records and delaying decision-making.

Although the examples of maladministration do not necessarily indicate the intent to do or omit to do something for personal gain, the risk still exists that the services that officials are suppose to deliver might fall behind or lack the prompt attention that they should receive (Carozza *et al*., 2000:32 and Kennedy in Mavuso *et al*., 1999:14). The execution of functions in a wrong or undesirable manner could lead to risks such as (a) fruitless and wasteful expenditure, meaning that the expenditure was made in vain and could have been avoided had reasonable care been exercised; (b) an irregular expenditure, which includes expenditure made in contravention of an act, policy or delegation; and (c) an unauthorised expenditure, which includes the overspending of a budget or vote (Local Government: Municipal Finance Management Act, (Act No. 56 of 2003), 2003: 16-20).

Maladministration is not always simply due to the personal moral shortcomings of public officials. In certain instances it could stem from problems with associated with an erosion of legitimacy; this usually happens when officials have no commitment to the kinds of objectives, moral norms and values which led to the establishment of the organisation.

The kind of ethical culture which prevails in the public sector depends on what stakeholders permit the public officials to get away with. Stakeholders which does not show public moral protest and who do not appreciate the importance of maintaining ethical norms will have public officials without a great sense of responsibility and integrity. Such officials can create the risk of maladministration in organisations.

In an attempt to obviate the risk of decline in ethical behaviour, the public sector cannot shelter behind networks of restrictive measures with respect to information and secrecy. Schwella (in Fox *et al*., 1991:52) also refers to maladministration when he states that public officials have to direct their actions at the promotion of the public interest and general welfare. These officials are given authority and public resources to pursue these aims and they are to do so not for personal gain. He came to the conclusion that public officials have to act with justice and fairness towards the organisation and the stakeholders that it serves because these officials are in the position of trustees. Any deviations from this expectation create the risk of immoral and unethical actions. The expectations of the public sector are unique and stakeholders do not want to be at risk of public officials not acting with greater fairness, responsiveness, responsibility, accountability and honesty (Schwella in Fox *et al.*, 1991:52).

Thus, maladministration creates the risk that the services that officials are supposed to deliver might fall behind or lack the prompt attention that they should receive. The consequence of the risk of maladministration could be fruitless and wasteful expenditure, irregular and/or unauthorised expenditure. Stakeholders should be educated about the risks attached to unethical conduct and they should be made aware of the manifestations of unethical conduct as well as that the degree of unethical conduct that is present in organisations may differ.

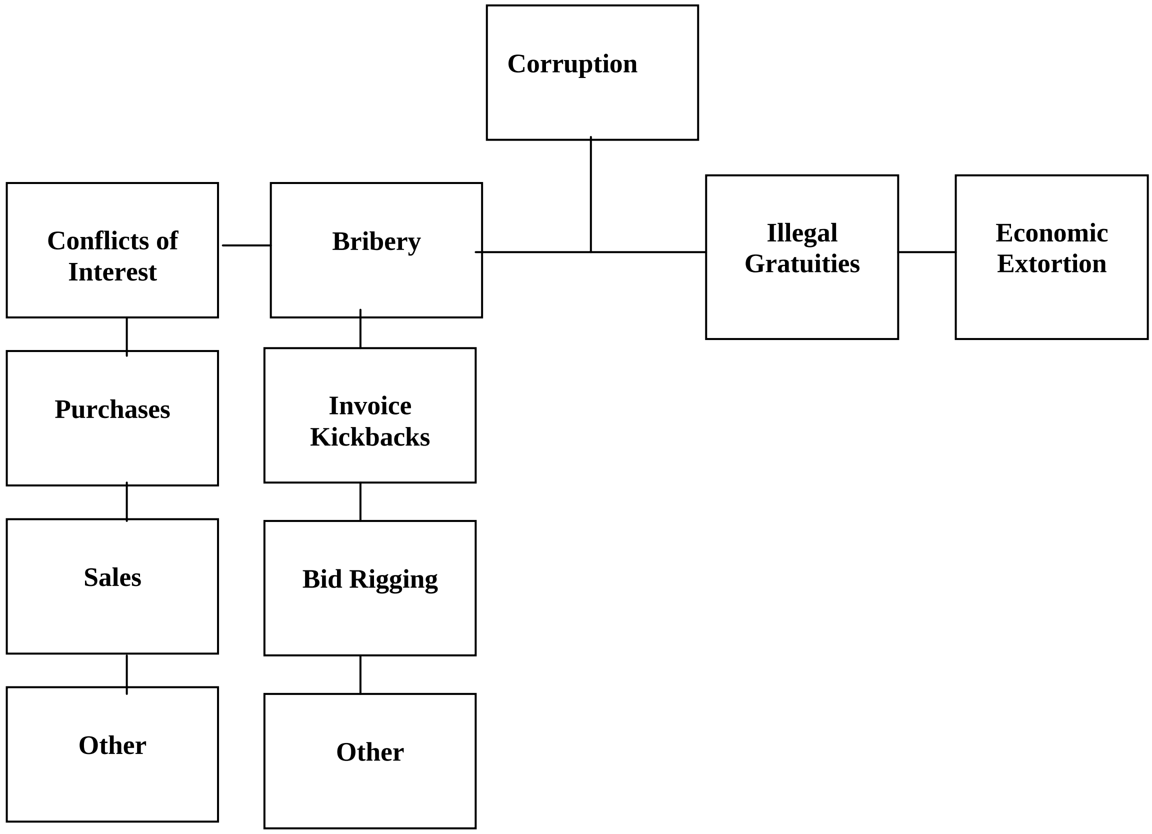
## 2.3. Manifestations of unethical conduct

Wells (1997:342) states that unethical conduct can be broken down into four manifestations, as depicted in Figure 13, namely:

a) Conflicts of interests;
b) Bribery;
c) Illegal gratuities; and
d) Economic extortion.

The four manifestations are described to indicate the possible causes that stimulate the various risks to materialise. The materialisation of the risks could have a negative impact on the establishment of an ethical organisational culture as well as on the effectiveness of risk management.

**Figure 13 Four manifestations of corruption**




**Wells (1997:342)**

## 2.3.1. Conflicts of interest

A conflict of interest arises where an official is tempted to take personal considerations into account when assessing the public interest. Conflicts of interest will arise not only when an issue benefits any official, but also when it benefits their family, friends or any organisation with which they are associated to the detriment of the organisation in which they are employed. Public officials are encouraged because of, for example, inadequate salaries to engage in private activities that are in conflict with official duties, with the risk that conflicts of interest can undermine efficiency. The risk of conflict of interests is that officials may unduly favour the organisations in which they have a self-interest as a result of the lack of proper procedures (Sullivan, 2001:412 and Williamson, 2000:36-37). Other organisations that could perform public tasks more inexpensively or competently will suffer, because of officials receiving personal gain. Where conflict of interest exists, no bribery is actually necessary because officials simply follow their own economic self-interest (Adamolekun, 1993:39 and Punch, 1996:1). Therefore, public officials should be forbidden from involvement in making decisions in which they have a financial self-interest. Public officials and political appointees should disclose their financial interest. The acceptance of gifts and honoraria should also be regulated. To deal with these complexities, reference is made (Salierno, 2005:38) to three risks that need to be balanced :

- Retention of public trust in the officials and the functions of the public sector;
- Maximising opportunities for officials to enhance the work for which they are responsible; and
- Simplicity and clarity in the operation of the Code of Conduct to prevent misunderstanding about the interests and responsibilities of the officials toward the organisation.

The requirement that officials act honestly has to be seen as paramount to prevent officials from engaging in activities that will constitute a conflict of interests. Officials in the public sector have to serve in such a way that the potential to become involved in conflicts of interest – for example, where an official is attached to a private company that obtains a contract to do work for the organisation that employs the official – will not arise. The risk is that the official might use the material, labour or other resources of the organisation that employs the official, instead of the resources from the company that the official has an interest in. If the risk of conflict of interests is contained and the following criteria are met, stakeholder value will increase.

The criteria referred to are as follows:

- to strive to achieve the objectives cost effectively and in the public's interest;

- to be creative, seek innovative ways to solve problems and enhance effectiveness and efficiency within the context of the law;
- to be punctual in the execution of duties and to do so in a professional and competent manner;
- to refrain from engaging in any transaction or action that is in conflict with or infringes on the execution of official duties;
- to withdraw from any official action or decision-making process which may result in improper personal gain, and this should be properly declared by the official;
- to be honest and remain accountable in dealing with public funds;
- to promote sound, efficient, effective, transparent and accountable administration; and
- to report to the appropriate authorities the existence of conflict of interest which is prejudicial to the public interest (International Federation of Accountants, 2000:51 and Report of The Auditor-General of Canada, 1995:6-8).

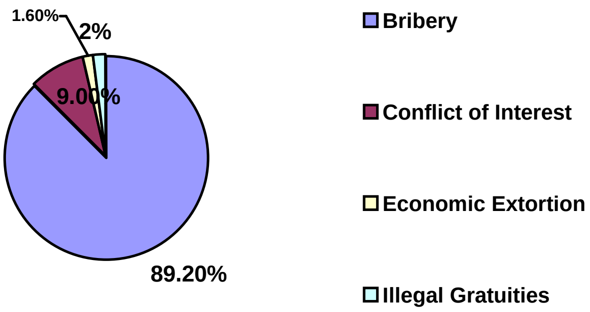
Any behaviour that does not conform to the above-mentioned criteria should be detected timeously to avoid it from becoming potential risks to the organisation. Organisations should realise that they are not immune from corruption and should put controls in place to detect corruption.

### 2.3.2. Bribery

The statistics referred to below were obtained during a survey conducted by Wells (1997) with the aid of 10000 fraud examiners during 1993-1996. The survey covered 2000 organisations in the USA and the reason for the research was to determine how organisations were victimised by their officials.

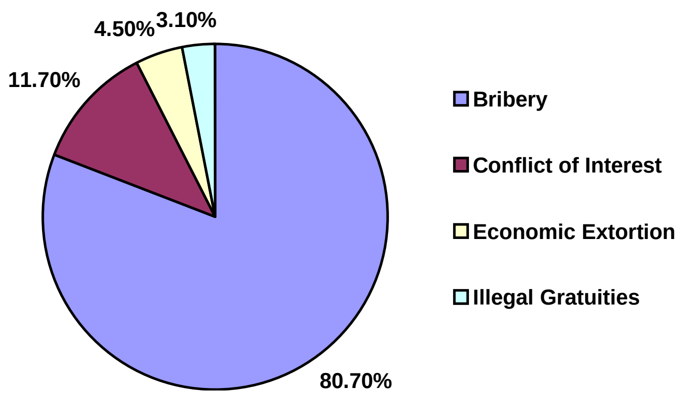
Figures 14 and 15 illustrate that bribery accounted for the majority of losses, namely 89,2% (Figure 14) and 80.7% (Figure 15) with reference to the number of cases. In addition, with an average loss of $500,000 per annum in the organisations surveyed, bribery and conflicts of interest represent the two most expensive types of corruption on average, as shown in Figure 16.

**Figure 14 Corruption – Comparison of number of losses**



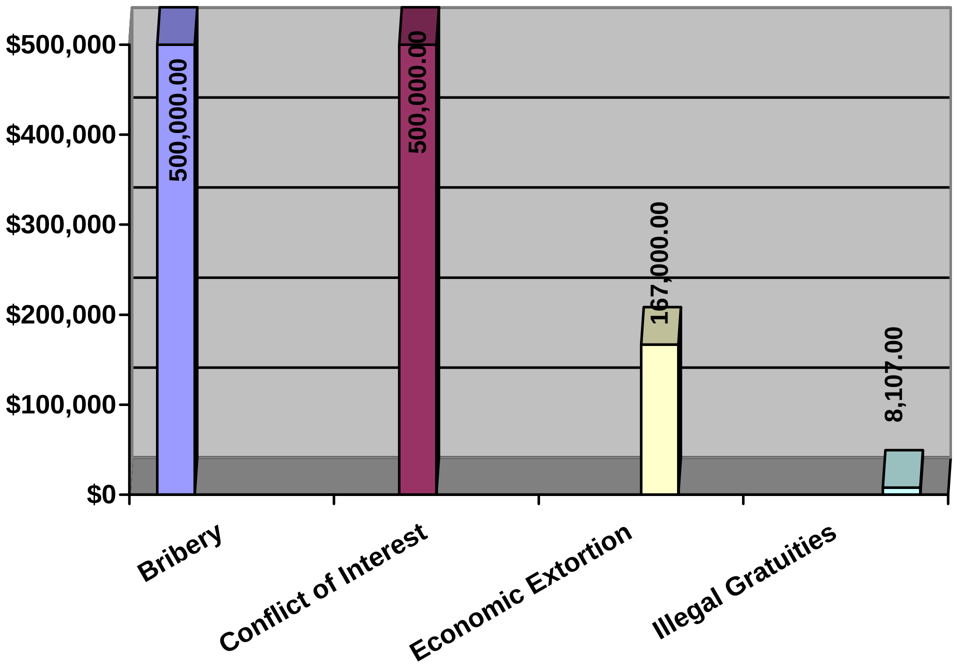

**Wells (1997:353)**

**Figure 15 Corruption – Comparison of number of cases**




**Wells (1997:354)**

**Figure 16** **Corruption – Comparison of average annual losses**




**Wells (1997:354)**

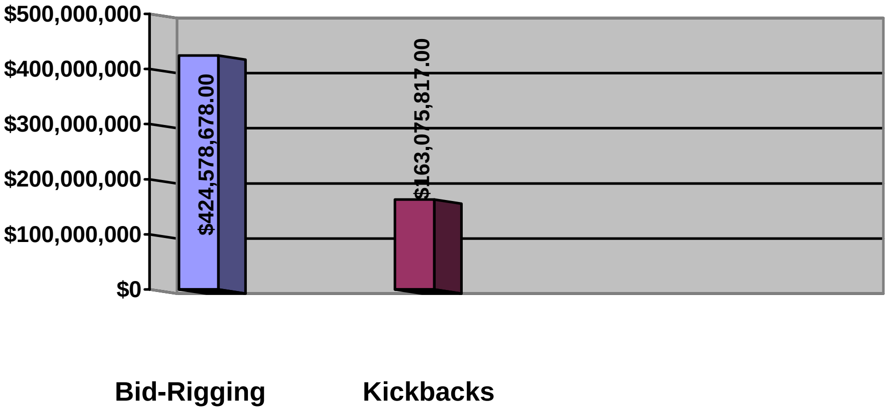
In bribery schemes an official receives the payment without his employer's consent in return for influencing the outcome of a transaction. Bribery generally falls into two broad categories, namely kickbacks and bid-rigging.

- Kickbacks represent undisclosed payments made by vendors to officials in organisations. The purpose of a kickback is usually to enlist the corrupt official in an over-billing scheme. The effect of over-billing is that, with the assistance of corrupt officials, the organisation to which the service is rendered pays more for a service and in fact receives less than it is entitled to. Vendors pay kickbacks to officials to get work from the purchasing organisation.

- Bid-rigging schemes occur when an official assists a vendor in an unethical manner in winning a contract through the competitive bidding process. An example is where an official, in turn for an illegal or irregular benefit, allows a vendor to submit false quotes to assist the vendor to be seen as the most favourable bidder and the vendor then obtains the contract as a result of the false quotes.

Wells (1997:363) pointed out that bid-rigging accounted for over $424,000,000 in losses, almost three times the amount of losses caused by kickbacks (see Figure 17).

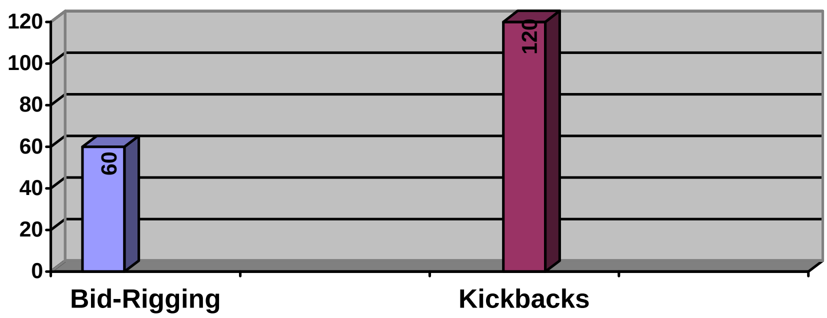
**Figure 17 Bribery - Comparison of Total Losses**




**Wells (1997:363)**

He stated that bid-rigging losses were the highest in money terms, despite the fact that there were twice as many kickbacks as bid-rigging incidents in numerical terms, as shown in Figure 18, in their study in the USA.

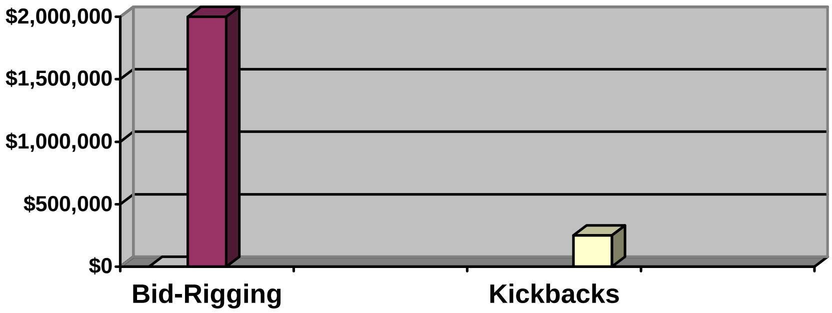
**Figure 18 Bribery - Comparison of Total Cases**




**Wells (1997:363)**

Wells (1997:363) stated that a review of the median losses shows that bid-rigging caused the highest losses to organisations. As indicated in Figure 19, the average loss of $2,000,000 was far higher than that of kickbacks, valued at approximately $250,000. Bid-rigging was the most costly in terms of average cash losses per annum.

**Figure 19** **Bribery – Comparison of Average Losses**




**Wells (1997:364)**

Thus, in bribery the intention is normally to offer anything of value to influence an official to act or to influence a decision. The offering of a payment can also constitute a bribe, even if the illicit payment is never actually made. A bribe is therefore a transaction where a vendor, for example, "buys" something with the bribes that are paid, which is referred to as the influence of the recipient of the bribe. Illegal gratuities are the third manifestation referred to under corruption and are described below.

### 2.3.3. Illegal gratuities

Illegal gratuities are similar to bribery, except there is not necessarily an intent to influence a decision. For example, if the Chief Executive Officer of a municipality is involved in the negotiation for land development with a vendor and, after the deal was approved, the official is then rewarded with a free international vacation. This might be regarded as an illegal gratuity, although it will be difficult to prove that the official expected such a holiday after the deal was awarded (Wells, 1997:383). However, the accepting of such a gift amounts to an illegal gratuity and this act is prohibited by the Code of Conduct of the public sector.

Thus, the retention of public confidence is a fundamental necessity, because without the public's trust, a local government would quickly become discredited. Therefore it is a requirement by legislation for local government to institute practices and procedures to detect corruption. The last manifestation referred to is economic extortion.

### 2.3.4. Economic extortion

Economic extortion is described as the opposite of bribery, because instead of a vendor offering a payment to an official to influence a decision, the official demands a payment from a vendor in order to make a decision in that vendor's favour. Thus, in any situation where an official might accept bribes to favour a particular vendor, the situation could be reversed to a point where the official extorts money from a potential vendor (Wells, 1997:382-383). Economic extortion holds a risk in that collusion between a vendor and an official from an organisation purchasing from that vendor can cause losses to an organisation. Organisations should therefore be aware of the risk of different manifestations of corruption in their organisation and should eliminate the causes of such corruption.

## 2.4. Causes of corruption

The objective of anti-corruption practices is to identify the causes of corruption and to ensure honesty. The traditional programmes and activities that have been adopted have tended to focus on preventing corrupt behaviour instead of addressing the causes of corruption. The aim should be to reappraise the way people think about corruption and anti-corruption practices with a view to formulating practices which emphasise transparent, accountable and effective action to mitigate the causes of corruption in a way that is in the public interest.

Painter (in Mavuso *et al*., 1999:73) lists several causes which motivate officials in the public sector to become involved in practices of corruption.

- Economic causes – Officials who are in financial difficulty will be more easily tempted by the financial gains of corruption, especially if they perceive the possibility of being caught as low. Salaries and wages tend to influence the extent of corruption and therefore public officials must be paid market-related salaries and wages to prevent the risk of them becoming involved in corrupt practices. The risk exists that if officials are paid much less than officials with similar training in other organisations, they might accept bribes to compensate for salary inequalities to the detriment of the public sector (Hood, 1995:197; Mafunisa, 2000:14; Rose-Ackerman, 1997:28, and Sykes *et al*, 1957:664-670). If public sector pay is low, the risk exists that corruption becomes a survival strategy. Incentive payments based on performance will be more likely to be successful if additional performance actually does produce substantial gains; if officials are not too risk averse; if performance and results can be measured, and if officials have sufficient discretion to respond to incentives. Corruptive practices such as collusion between employees, employers and third parties and poor internal controls are evidence that monetary payments can buy something valuable from officials and therefore incentive-based plans should begin with those systems permeated with corruption. A successful reform of incentives would both limit the risk of illegal pay-offs and improve performance.

  Thus structural changes in the operation of the public sector should be combined with more conventional proposals to raise pay and improve working conditions. The goal is not only to deter corruption which is the result of unacceptable pay structures among officials, but also to attract more qualified officials for public sector jobs to enhance service delivery (Haque *et al*., 1996:6; Mafunisa, 2000:13 and Reid *et al*., 1994:48).

- Political causes – Political causes refer to political decisions that can influence officials to become involved in corruptive practices. Causes such as monopoly discretion exercised by officials and politicians and lack of effective accountability mechanisms increase the risk of opportunities for corruption arising.

- Professional causes – It is often found that officials who have a strong professional and ethical background in the public sector experience a conflict between professional values and the values expected of a public official. By way of example, a medical doctor must work within certain budgetary constraints. But because it is prescribed that newborn babies must have a certain weight to qualify for expensive respiratory equipment, doctors are forced to let some babies die. This could happen, even though they might know that technically and professionally the child could have been saved, if it were not for the prescribed limits.

- Moral causes – Cultural and religious groups have different moral configurations, which implies that whatever common value system is being created within an organisation should be a contextual, negotiated and revisable agreement that results from dialogue. Although this is a costly exercise, it is still advisable, because the enforcement of a universalised ethical code that does not meet the requirements of the officials may be more costly in the long run as officials will not commit themselves to such value systems, which will in turn impede the realisation of an ethical culture (Pugh, 1991:17).

- Pressures at work – Work pressures, dangerous working environments and lack of job security serve as justifications for some officials to supplement their income in illicit ways as a type of "danger pay". Depending on the competitiveness between different industries management may decide to override controls to meet production targets to outperform competitors. Pressures at work could be a result of lack of control of managers, poor hiring practices or poor corporate ethics policy.

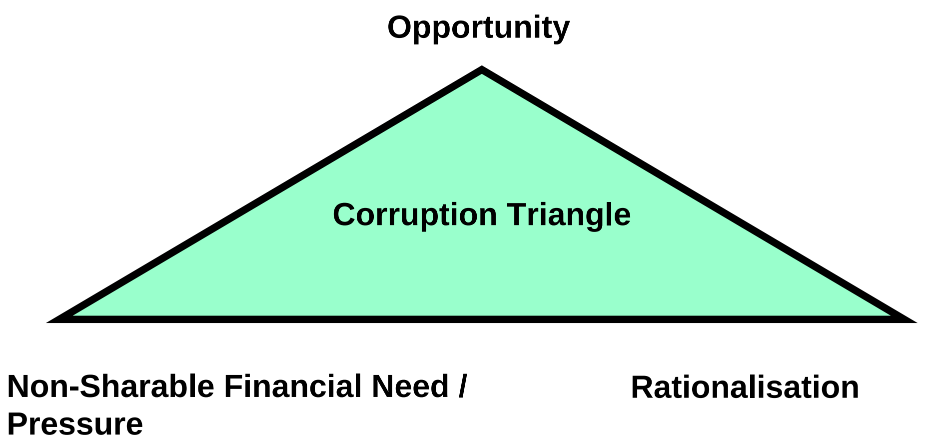
As stated above, corruption flourishes in the presence of organisational inefficiency, which promotes the causes of corruption. Such causes should be minimised by introducing measures to constrain unacceptable behaviour with regard to the misuse of monopoly decision-making powers and accountability (Abedian *et al*., in Mavuso *et al*, 1999:209-210).

The consequences of not braiding ethical behaviour into the policies of an organisation to foster cultural change may precipitate risks such as the possibility of loss of revenue, loss of stakeholder confidence and irreparable harm to an organisation's reputation. Therefore management should recognise internal and external causes that tend to foster corruption (Bologna *et al*., 1995:133, Halmagean, 1999:27-51 and McDonald, 2003:65-67).

Cressey (in Wells, 1997:10) undertook research to determine why officials are tempted to take assets from their organisations that they are not legally entitled to. He argued that officials become trust violators when they perceive themselves to have a financial problem which they could not share with other officials. By violation of their position of financial trust, these officials think that they could overcome their financial problems. Siegel (1989:193) states that if the official shared a financial problem with other officials who could have aided in the solution to the problem, the violation of the position of trust for personal gain could have been prevented.

Cressey's hypothesis (Wells, 1997:11), called the corruption triangle, is depicted in Figure 20.

**Figure 20** **Corruption triangle**




**Wells (1997:11)**

The corruption triangle represents the factors that facilitate corruption, namely (a) an opportunity, (b) non-sharable financial need/pressure, and (c) rationalisation. Three preconditions appear to be necessary for potential offenders to commit corruption: (a) they must have the opportunity to commit corruption; (b) they must have the motivation, for example, a financial problem that they do not want to share; and (c) they must excuse and justify their actions; for example, the official violates the rules by taking money from the organisation with the intention to pay it back at a later stage. Officials find it difficult to resist temptation if they are convinced that the chances of being caught or being connected with a corrupt act are low (Braithwaite, 1984:15; Geis, 1982:136; Ramoorti *et al*., 1998:3, Sawyer, 1981:742 and Warren, 2000:16).

Ngcuka (2001) indicated another factor that facilitates corruption, namely that the public accepts the existence of corruption, because it is not an act of violence. He referred to the following statistics regarding reported cases of corruption in South Africa:

| Year | Crimes | R-Value |
|---|---|---|
| 1994 | 13000 | 1.7 billion |
| 1998 | 55900 | 4.6 billion |
| 1999 | 65000 | 8 billion |

He argues that the following factors facilitate an increase in corruption levels:

- Corruption is not a spur of the moment incident, but is well thought through and offenders believe they won't be caught;
- Black people do not generally regard theft from white people as a crime.

Research can develop controls that minimise the risk of future occurrences. Care must be exercised to ensure that efficiency is not compromised and the cost of control must be evaluated against the scale of possible loss or damage to the organisation. Once controls are in place, follow-up tests must be performed to be sure that they are being applied, are working and are sufficient to prevent future corruptive activity.

To reduce the risk of losses that can have a detrimental impact on organisations, it is imperative to establish an ethical organisational culture to mitigate the risk that an ethical organisational culture will not be nurtured or sustained in an organisation.

## 2.5. Establishing an ethical organisational culture

Management needs to establish an ethical organisational culture to limit risks in an organisation. The Illustrated Oxford Dictionary (1998:202) describes "culture" as the "improvement by mental or physical training; the arts and other manifestations of human intellectual achievement regarded collectively". Culture may also be defined as a set of important understandings that stakeholders share as well as the amalgamation of beliefs, ideology, language, ritual and myth in an organisation. Management should therefore be aware of and understand the components that are needed to establish an ethical organisational culture as well as the importance of ethical approaches (Aaron, 1978:4; Barrier, 2003:41 and Rezaee, 2002:58). The following forms of conduct by management have been identified as key reasons for organisation failure:

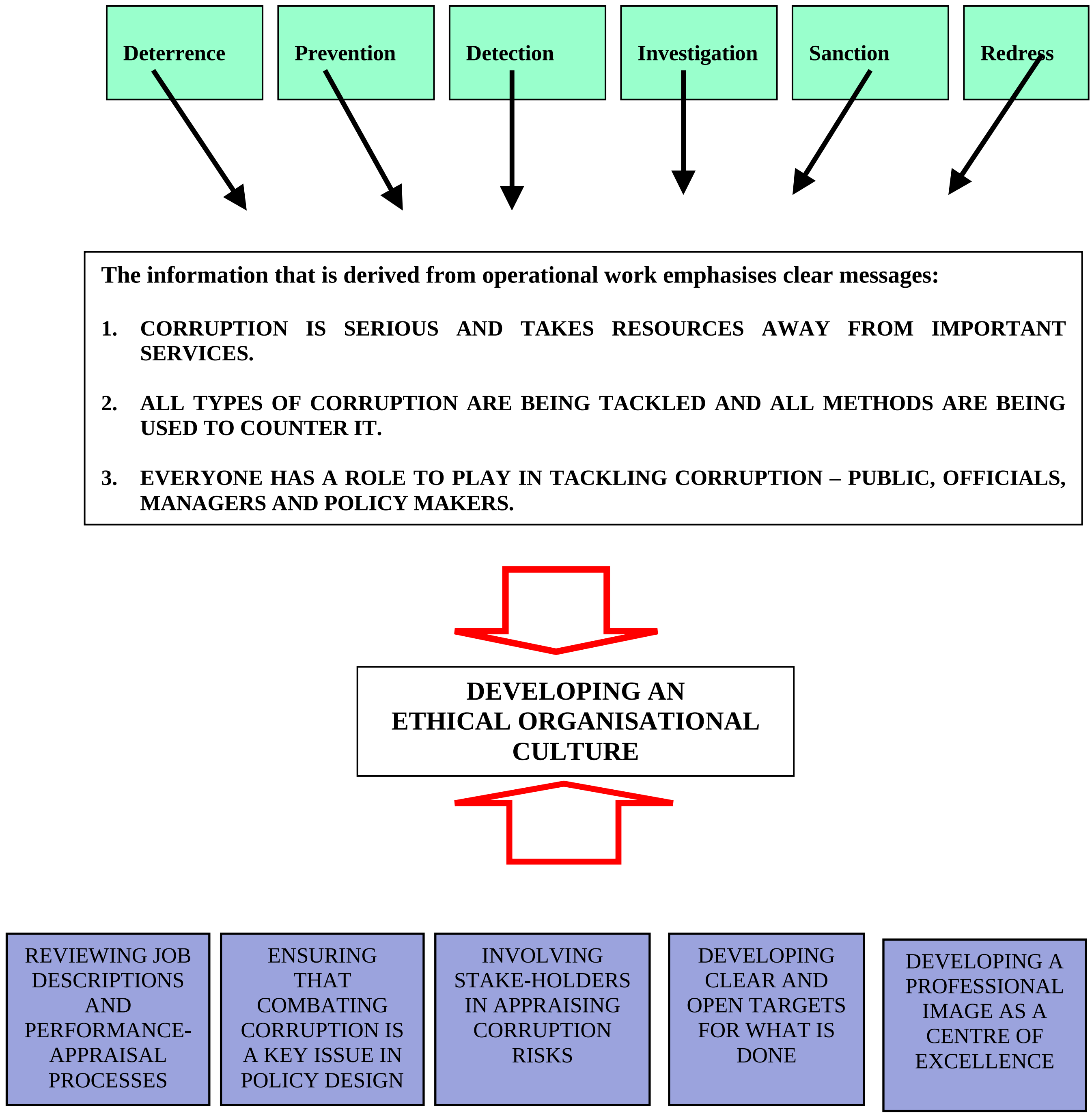
- Management sets a poor example by failing to uphold ethical standards;
- Management allows a culture of secrecy and rule-breaking;
- Dominant and charismatic officials are not challenged;
- A questioning and independent approach is not applied in cases of alleged corruption;
- Timeous action to mitigate risks is neglected; and
- Lack or collapse of controls (Alexander Forbes, 2004:6).

Stakeholders involve in corruptive practices should be informed that they are at risk of being detected and prosecuted. Therefore, stakeholders should be informed of the components of an ethical organisational culture to facilitate the establishment of an ethical organisational culture (Barrier, 2003:73 and Collins, 1993:325).

### 2.5.1. The components of an ethical organisational culture

Prevention of a decline in ethical behaviour should be managed and ensured by management. The components of an anti-corruption culture and its objectives are depicted in Figure 21. These components are indicative of what is needed to minimise the risk of corruption. Implementing deterrence measures such as a disciplinary system, video cameras and a corruption hotline could mitigate the risk of corruption (Minnaar-van Veijeren, 2005:19). Upgrading administrative and financial controls, which should enhance the detection of corruptive acts, can prevent corruption. The investigative, sanction and redress components should ensure that the root causes of corruption are identified and perpetrators should be aware that sanction measures would be enforced (Mafunisa, 2000:63). Management should ensure that the root causes of corruption are redressed to prevent recurrence. Implementing the components of an ethical organisational culture should assist organisations in achieving their objectives by giving clear notice that corruption will not be tolerated. To ensure that the objectives will be met, it is essential to conduct review and performance appraisals to make certain that corruption is addressed in policy design, to stimulate transparency by involving stakeholders in risk identification and to uplift the reputation of the organisation to such an extent that it is regarded as a centre of excellence (Salierno, 2005:39).

**Figure 21 Components of an ethical organisational culture**




**Elliott (2000:36)**

Developing an ethical organisational culture is important to minimise corruptive behaviour that appears to override normal standards of conduct (Doig, 1995:200). Codes of Conduct on their own to prevent corruption may be less effective and have less impact on managers, officials and stakeholders if they are not supported by strong sanctions and effective disciplinary procedures (Doig *et al*, 1998:148). The Report of The Auditor General of Canada (1995:9-10) proposed the following in an attempt to reduce the risk of self-enrichment:

- The appointment of an Ethics Counsellor to investigate allegations against officials in the public sector involving conflicts of interest; and
- Reporting to management on ethics in the organisation, the appointment of ethics advisors, periodic surveys to track attitudes and the establishment of confidential "hotlines" to report self-enrichment. In order to achieve the organisation's objectives, systems such as hotlines to report unethical conduct should be developed and put in place to minimise the occurrence of unethical conduct. In designing reporting systems, organisations focus a lot of attention on removing opportunities for officials to become involved in unethical conduct.

Values, beliefs and attitudes represent the culture of an organisation and they influence behaviour and decision-making activities in organisations. If a culture exists in the public sector where officials are committed to rendering quality and affordable services, the risk will diminish that officials will incur losses and waste resources, or become involved with corrupt practices to benefit themselves. An ethical culture entails internalising values and beliefs that will benefit the public sector's service delivery. It is also important to recognise, and differentiate, the differences between corporate and organisational cultures; corporate culture refers to and reflects management's values, interpretations and preferences, while organisational culture is much broader and embraces many subcultures (Barrier, 2003:73). Culture refers to the set of values that form the core identity of an organisation (Mafunisa, 2000:73; Pettigrew, 1979:572 and Sathe, 1983:3). Focusing on values presents potential benefits in that values could help to identify stakeholders and their interests as real and concrete. It could also assist in creating a strong culture of public service by implementing steps to establish an infrastructure to help officials to manage and deliver programmes without personal gain. When effective and continuous guidance is provided, the risk of exposure due to non-conformance to policies will diminish.

(Report of The Auditor General of Canada, 2000:14). Core values should be developed to guide officials.

There is a need to develop a set of core values that clarifies values for public officials. The following set of values could be customised for officials:

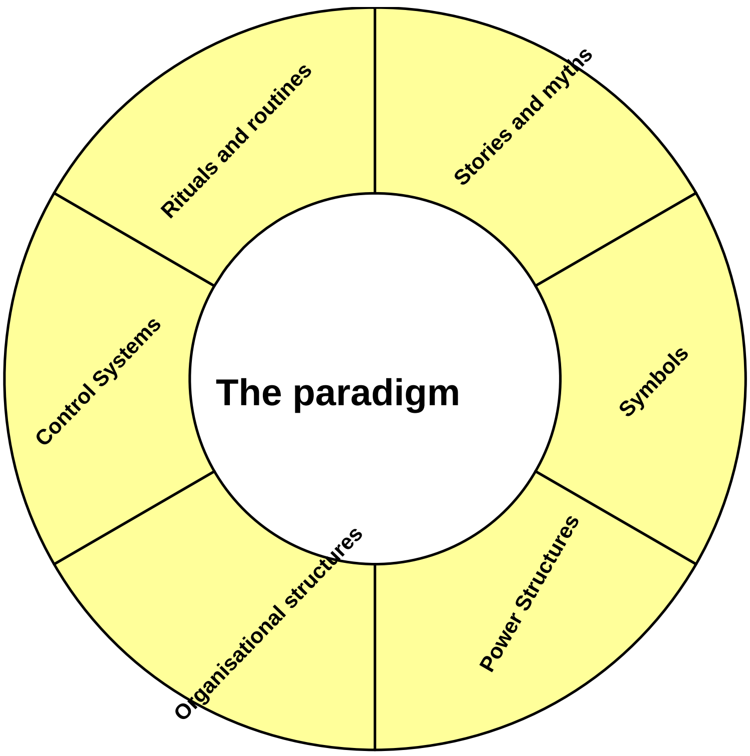
- Not to engage in activities that could be interpreted as conflicts of interest; and
- Maintain high performance standards such as:
  - exceptional quality of service;
  - continuous improvement in service delivery; and
  - procedures that ensure compliance with the law and codes.

Management within the public sector should exercise these values to mitigate the risk of an ethical organisational culture not being achieved. Values in the public sector could be enhanced by the identification of best practices and benchmarks for promoting values. These practices include commitment from management to establish an ethical culture in organisations, statements of values, policies, guidance and training, good-faith intervention, and assessment and reporting. These practices will encourage a sense of ownership through the motivation of officials to achieve objectives in such a way that an organisation can expand sustainable service delivery to stakeholders. The risk of enrichment through personal gain to the detriment of the organisation should decrease if officials and stakeholders buy into value practices (Ketz, 2003:3 and Pride *et al*., 1996:287). Stakeholders should realise that disciplinary action could be instituted if core values are not adhered to. However, disciplinary or legal action should be exercised in a fair manner without any prejudice to the rights of the alleged accused.

Thus, the concept of learning from incidents of unethical conduct should be emphasised by management. Management should focus on the important process by which the public sector ensures that policies, procedures and systems are responsive to newly discovered risks in their environments. Value practices have to be developed, implemented and monitored to enhance core values amongst officials and stakeholders in the public sector. The values of new officials entering the public sector may change the values prevalent in organisations. These officials need to be trained in the development of core values. The aim is to prevent the risk of values deteriorating to the detriment of the public sector. Values such as a commitment to ethical conduct and honesty need to be enhanced to prevent the risk of not establishing an ethical organisational culture successfully.

The factors which influence culture are indicated in Figure 22.

**Figure 22** **The cultural web**




**Johnson in Elliott (2000:31)**

The cultural factors indicated in Figure 22 refer to the key external factors that represent the risk areas affecting organisational performance. The cultural factors influence managers' and officials' perceptions of themselves, their internal organisation and their external environment. The risk exists that the organisational strategy can be influenced negatively if the managers and officials develop a negative perception of themselves as a result of cultural factors. Therefore organisational strategy is a product of social and political processes influenced by the beliefs and assumptions that officials hold. These beliefs and assumptions embody an organisation's view of itself, inclusive of its officials and its environment, and this is referred to as the organisational paradigm. The paradigm is a product of the components of the cultural factors and will be unique to each organisation (Johnson, 1992:28-36).

To achieve paradigm and cultural change, it is not only the hard elements (structure, systems, control) that must change, but also the soft elements (stories, rituals, symbols). Management should contribute towards establishing the paradigm and nurturing cultural change, and it is also their duty to resolve the discrepancy between what management hopes to achieve and what exists in the organisation (Nonaka, 1991:96-104).

To support the components of an ethical organisational culture and to facilitate the establishment of an ethical organisational culture, the necessity of commitment to an ethical conduct should be considered by management and embedded in the culture of the organisation. In this regard, organisations should reduce potentially detrimental dangers such as the risk of self-enrichment and promote honesty.

2.5.1.1. Commitment to ethical conduct

The cultivation of public sector ethics is one of the measures needed, because it is not ethical to deny legitimate rights of stakeholders. Mavuso (1999:65) states that knowledge of, and commitment to, public sector ethics should prevent the risk of officials behaving in an unacceptable manner to stakeholders. Such an approach should assist in highlighting:

- how public officials should conduct themselves;

- how public officials should contribute to making a good public services;
- what sort of persons public officials should strive to be; and
- respect for persons, truthfulness, loyalty and justice.

Ethical problems arise continuously in the public sector and moral reasoning is required to address them to prevent the risk of unethical conduct. The risk of unethical conduct can be mitigated by developing moral reasoning through:

- Ethics workshops aimed at developing dispositions, attitudes and virtues such as honesty, fairness, loyalty (Mafunisa, 2000:84);
- Improvement of public official's analytical skills in distinguishing between right and wrong, good or bad; and
- Development of their ethical imagination (Minnaar-van Veijeren, 2005:19).

Thus, ethical reasoning should assist in establishing a balance between theory (what should be done) and practice (what happens). A Code of Conduct should guide officials and complement the ethics system in an attempt to reduce the adverse affects of potential risks. Programmes should be put in place to encourage compliance and to identify officials who are not adhering to ethical requirements. The identification of the officials who do not comply should not be dependent on these programmes only, but also on the expectation that the vast majority of officials will comply with their obligations voluntarily and therefore honesty has to be promoted.

2.5.1.2. Promotion of honesty

Trokis (1990:3) believes that "a person and a society can be said to be operating with honesty when what they believe, what they think, what they say and what they do is consistent." He further stated that the increase in unethical conduct is a result of deterioration in peoples' concept of honesty. Deterioration in honesty will make it difficult for management to enhance a risk-management programme that is *inter alia* aimed at protecting the organisation.

The success of administrative functions depends primarily upon officials who comply with the applicable laws, regulations and delegations of an organisation. A factor that affects the likelihood of compliance is the way that stakeholders and organisations perceive the honesty of officials in the public sector, which could enhance administrative activities to achieve objectives and reduce risks such as non-compliance and self-enrichment. The honesty of officials in the public sector is thus an asset whose value lies in its influence on the perception of stakeholders. The enhancement of the concept of honesty is something that demands investment, safeguarding and maintenance, which could be achieved by implementing an integrated risk-management programme (Coderre, 1999:30 and Report of The Auditor General of Canada, 1998: Chapter 15:1).

To detect and prevent risks as well as to ensure that the public sector exercises due diligence in seeking to detect and prevent dishonesty by its officials and other stakeholders, it is necessary for the public sector to ensure that:

- compliance standards are followed by its officials and other stakeholders that are capable of reducing the possibility of dishonesty;
- officials are assigned the responsibility to oversee compliance with organisational standards;
- discretionary authority is not delegated to officials who have a propensity to engage in dishonest activities (Marshall, 1997:217);
- standards are communicated effectively to all officials and stakeholders by requiring participation in training programmes or by disseminating publications that explain in a practical manner what is required;
- standards are consistently enforced through disciplinary proceedings, including disciplining officials responsible for a failure to detect unethical conduct and;

- after an offence has been detected, all reasonable steps should be taken to respond appropriately to the risk and to prevent similar risks, including any necessary modification to its risk-management program to mitigate risks (Henderson, 1999:8-14 and Swemmer, 2001:8). Such action will assist management in its risk-management programmes in that stakeholders will realise that management is determined to reduce the likelihood and impact of risks.

It is imperative that management sets an example to provide viable solutions to the risk of declining honesty, which also mirrors its belief in fairness. The emphasis should not only be placed on the enhancement of services to stakeholders, but also on respect for the law and accountability. Management should focus on values to ensure that an ethical culture is established that will promote service delivery and minimise risks.

## 2.6. Summary

Ethical approaches are necessary to facilitate the manner in which the public sector is managed in that they minimise risks such as unethical conduct as well as creating guidelines on how to avoid risks. Ethical approaches should assist in creating and maintaining stakeholders' confidence and trust in the public sector. To prevent a decline in stakeholders' confidence, the public sector needs to address the risk that officials might enrich themselves to the detriment of the organisation; honesty needs to be promoted and values need to be established. Corruption needs to be detected and strategies implemented to reduce corruption. Integrated risk management is regarded as a mechanism to identify and remedy acts of unethical conduct to facilitate the realisation of an ethical organisational culture.

Management should be aware of manifestations of corruption that lead to unethical conduct such as conflicts of interest, bribery, illegal gratuities and economic extortion. The emergence of risks could have a negative effect on the establishment of an ethical organisational culture as well as on the effectiveness of a risk-management programme. Corruption can bring about losses for an organisation and therefore organisations should be aware of the risk of corruption and should eliminate the factors that facilitate corruptive actions against the organisation.

In order to establish an ethical organisational culture to limit risks, the causes of corruption need to be determined. Management should aim to reappraise the way officials think about corruption and formulate practices to reduce the causes of corruption in order to further the public interest. The causes of corruption should not be ignored and success in combating corruption will only be realised when corruption is regarded as socially immoral.

The elements that facilitate corruption are referred to as "the corruption triangle" and include an opportunity, non-sharable financial need/pressure and rationalisation. The implementation of internal controls assists in preventing corruptive action from occurring and also establishes an ethical organisational culture. Once controls are in place, follow-up tests must be performed to ensure that they are being applied, are working and are sufficient to prevent future corruptive activities.

An ethical organisational culture is a complex concept that has an influence on the administration and management of the public sector. It is defined as those ''soft issues'' such as, values, beliefs, assumptions, meanings and expectations that officials hold in common and that guide their behaviour and problem-solving behaviour. The ''hard'' issues include the investigative, sanction and redress components that should contribute to the identification or the root causes of corruption and making perpetrators aware that sanction measures would be enforced. Culture forms as groups of people come together and strive for goal attainment. When cultural factors are spread widely through the public sector's membership, an organisational culture is said to prevail and these factors will be at the core of public sector life. The absence of an ethical organisational culture may create the risk that officials become involved in corruption in various areas of service delivery such as the issuing of driver’s licences and allocation of houses.

Managers should work hard to make the culture of the public sector capable of adaptation and change. This is necessary to foster commitment amongst officials to organisational goals by combining their beliefs and values for the benefit of all. Cultural change is a type of bonding or emotional investment process, which will to a large extent mitigate the risks in an organisation. Establishing an ethical organisational culture is a long-term process that necessitates a reappraisal of the values that are central to the public sector. It will take the time and effort of dedicated officials to make these values central to all public sector structures and policies, and to everything public officials do.

Embedding the risk-management process will identify and minimise corruptive acts in an organisation. Risk management conducted on an integrated basis will set parameters and guide officials to focus their efforts and attitudes to enhance stakeholder value and efficient service delivery. In Chapter 3 various pieces of legislation that could be linked to risks management to serve as a guideline to officials have been identified. This legislation do not address legislation on integrated risk management *per se,* but it is regarded as essential for officials to be aware of current legislation to assist them in achieving the strategic objectives effectively and efficiently.

# CHAPTER 3

# LEGISLATION IN SOUTH AFRICA TO ENHANCE RISK MANAGEMENT

## 3.1. Introduction

One of the South African government's most important tasks is to build a public sector capable of meeting the challenge of improving the delivery of public services for all stakeholders. Access to public services is regarded as a rightful expectation of all stakeholders. However, there is a risk that the right of access to public services might not be realised in practice. Stakeholders and public officials know that the right to a service has a cost implication and therefore legislation is necessary to prevent the risk of distributing public services in an unequal and inefficient way.

Legislation is regarded as a guideline which has to be adhered to. The purpose of this Chapter is to determine the objectives of legislation applicable on risk management in South Africa which is selected to guide the public official in achieving the objectives of the legislation, optimum productivity and efficient service delivery. The risk of not achieving the objectives of the public sector will be largely eliminated or prevented should the public official be aware of applicable legislation and adhere to it. Knowledge of the legislation should prevent the risk of officials circumventing legislation because they feel they might escape detection.

This Chapter focuses on legislation that was promulgated to eliminate the risks of not rendering services in an effective, efficient and economical manner. The public official should be aware of this legislation and the objectives of the public sector to prevent the risk of sub-standard service delivery and consequent prosecution. There is no detailed legislation, except for brief references, to integrated risk management for local government in South Africa. Legislation where references can be made to integrated risk management will be described on a theme basis, for example, legislation to achieve the objectives of the public sector and current legislation to transform the public sector with the view to enhance service delivery.

## 3.2. Objectives of the public sector

The objective of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000), hereafter referred to as the Systems Act, is *inter alia* "To provide for the core principles, mechanisms and processes that are necessary to enable the public sector to move progressively towards the social and economic upliftment of stakeholders and ensure access to essential services that are affordable."

The Systems Act, section 50, refers to The Constitution of The Republic of South Africa, 1996 (Act No. 108 of 1996), section 195(1), (hereafter referred to as the Constitution) and states that public administration is governed by the democratic values and principles as embodied in the Constitution, section 195(1). The Constitution, section 195(1), states that public administration includes the following principles:

(a) professional ethics must be promoted and maintained;
(b) efficient, economic and effective use of resources must be promoted;
(c) public administration must be development-oriented, accountable and transparent; and
(d) services must be provided impartially and without bias.

The Constitution, section 195(2), states that the principles as laid down in section 195(1) of the Constitution apply to the administration in every organisation, for example, government, organs of state and public enterprises. Adherence to these sections in the Constitution should prevent the risk of sub-standard service delivery.

The Systems Act, section 50(2), states that a municipality must strive to achieve the objectives of local government as set out in the Constitution, section 50(2), in administering its affairs. The following objectives are referred to in the Constitution, section 152(1):

(a) provision for democratic and accountable government;
(b) provision of services in a sustainable manner;

(c) promotion of social and economic development and safe and healthy environment; and
(d) community involvement in matters of local government.

If these objectives are not achieved to the satisfaction of stakeholders, it could result in risks for local government.
The Systems Act, section 51, states that a municipality must, within its administrative and financial capacity, establish and organise its administration in a manner that would enable the municipality to:

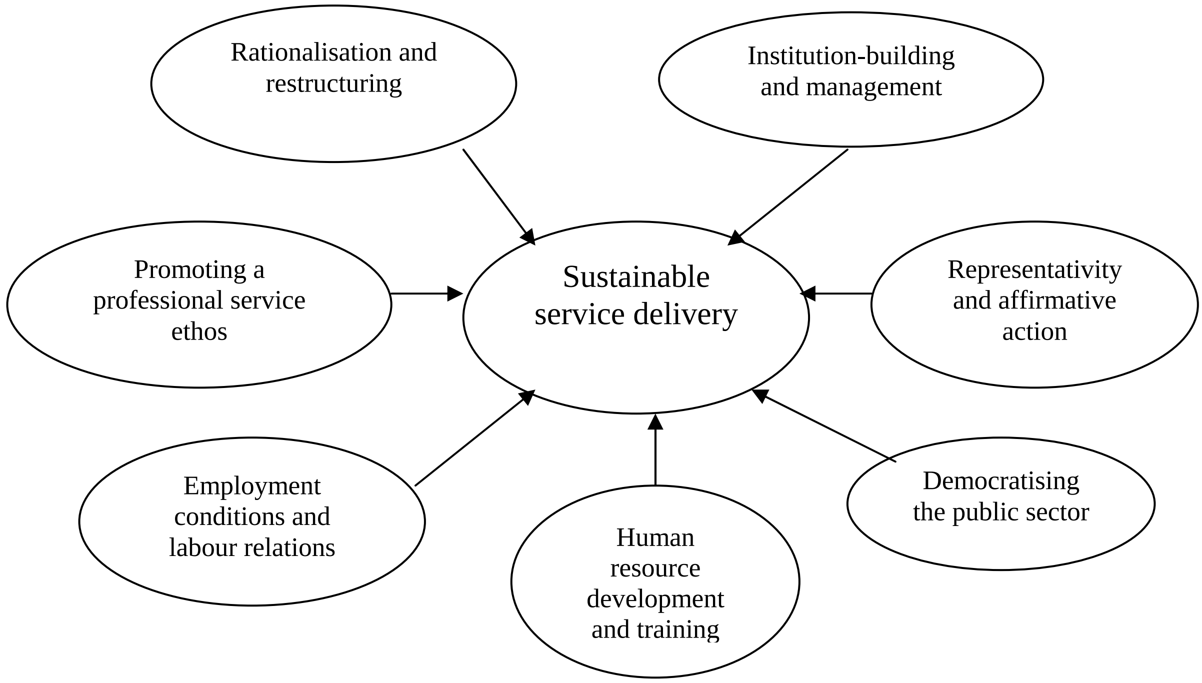
(a) be responsive to the needs of the local community;
(b) facilitate a culture of public service and accountability amongst its officials;
(c) be performance orientated;
(d) align roles and responsibilities with the priorities and objectives in the integrated development plan;
(e) establish clear relationships and facilitate cooperation, coordination and communication between officials and the stakeholders;
(f) assign clear responsibilities for the management and co-ordination of administrative units and mechanisms; and
(g) hold the municipal manager responsible for the overall performance of the administration.

Thus, the risk that the objectives of the public sector will not be achieved should be mitigated to ensure the realisation of sustainable service delivery as described in the Constitution as well as the Systems Act. Transforming the public sector is a key priority to enhance the effectiveness in delivering services, which should meet the basic needs of all stakeholders.

## 3.3. Transforming the public sector

Transformation the public sector is a key transformation priority, as depicted in Figure 23.

**Figure 23** **Transforming the public sector**




**Batho Pele White Paper (1997:9)**

The White Paper on Transforming Public Service Delivery, 1997 (Notice No. 1459 of 1997), also referred to as the Batho Pele White Paper, is primarily about the way that public services should be provided and how to mitigate the risk of inefficiency and ineffectiveness in delivering services. The Batho Pele White Paper states in section 1.2.12. that Batho Pele is a Sesotho adage meaning “People First” and to realise this adage in practice means that the public sector should be reoriented to optimise access to their services by all stakeholders within the context of fiscal constraints and the fulfilment of competing needs. To optimise access to services, certain service-delivery strategies should be implemented to overcome the risk that the basic needs of stakeholders won’t be satisfied.

### 3.3.1. Service delivery strategies

Service delivery strategies are needed to promote continuous improvements in the quantity, quality and equity of service provision. The Batho Pele White Paper (1997), section 1.2.3, requires public sector departments to *inter alia* identify the following:

a) a mission and vision statement for service delivery as well as the specific services to be provided and at affordable service charges;
b) service targets and performance indicators benchmarked against comparable international standards;
c) monitoring and evaluation mechanisms designed to measure progress and introduce corrective action, for example, the redirection of human and other resources from administrative tasks to service provision;
d) potential partnerships with the private sector, non-governmental organisations and community-based organisations to prevent the risk of sub-standard service delivery; and
e) the development of a culture of stakeholder care.

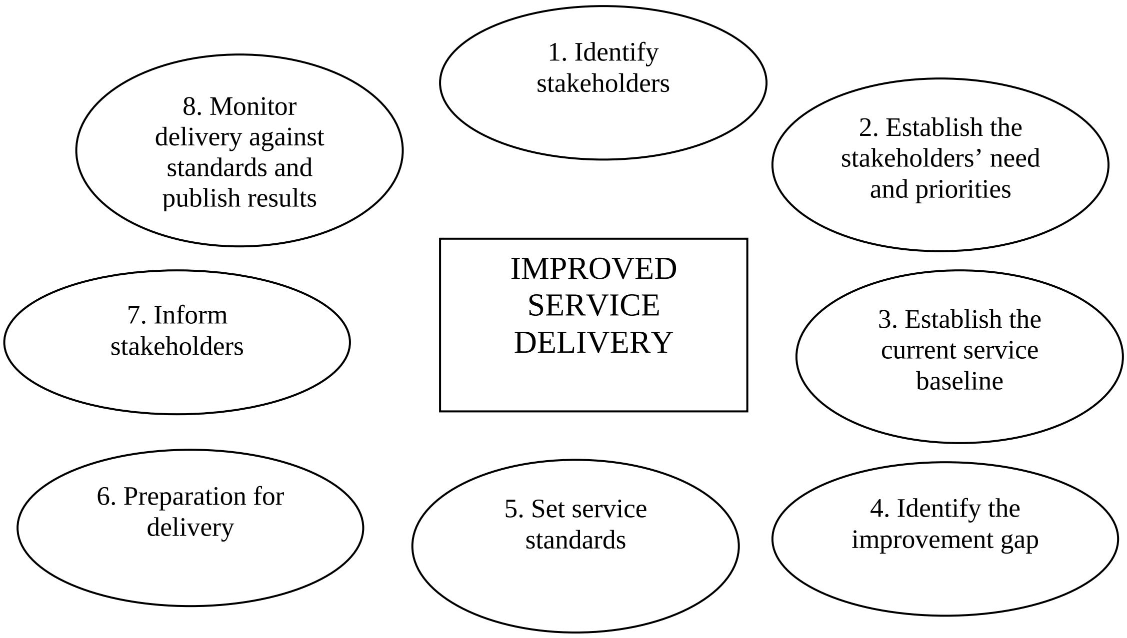
Thus, enhanced service delivery principles may improve decision-making, responsiveness and creativity. The delivering of services according to Batho Pele will support risk-management programmes implemented in organisations in that officials should know how to render public services according to pre-determined principles. This knowledge should obviate the risk that officials will render services in a biased way or for personal gain to the detriment of stakeholders.

In order to be effective, the public service delivery principles should be assessed and improved on a continuous basis to prevent the risk of non-adherence to legislative requirements.

### 3.3.2. Improving the public service delivery process

The Batho Pele White Paper (1997), section 7.2, states that the improvement of public service delivery is a continuous and progressive process, and not a once-and-for-all task. This means that, as standards are raised, the risk of higher targets not being met should be assessed through the implementation of service-delivery processes. The implementation of a process to improve service-delivery processes is illustrated in Figure 24 as an eight-step cycle.

**Figure 24** **Service-delivery improvement processes**




**The Batho Pele White Paper (1997)**

Step 1: Identify the stakeholders – The purpose is to identify all the recipients of services to mitigate the risk of inequity in service delivery.

Step 2: Establish the stakeholders' needs and priorities – The stakeholders' needs and priorities need to be established as this will serve as the starting point for the setting of standards. The delivering of services according to certain standards will involve decisions about resources and it is essential to accumulate accurate information about what stakeholders really want. Accurate information will prevent the risk of resources not being effectively used or services rendered that are not required.

Step 3: Establish the current service baseline – Accurate information about the current level and quality of service is essential in order to decide where and how to make improvements as well as to prevent the risk of sub-standard services being rendered. The time factor to make use of a service, the language in which the service is rendered and the resources needed for a service should be ascertained to bring about improvements. A thorough scrutiny of organisational arrangements, work processes and practices involved in delivering the services provided as well as the motivation and skills of officials will be required to mitigate the risk of not establishing the current service baseline effectively.

Step 4: Identify the improvement gap – The improvement gap is described as the risk that the gap between what stakeholders want and the level and quality of service currently provided is not closed. Therefore the prime aim of risk management is to close the gap with a service delivery improvement programme. The Batho Pele White Paper, section 7.2.6, states that accurate identification of stakeholders' needs and of the current service baseline will enable targets to be set for improvement in a systematic and prioritised way, taking into account the availability of resources.

Step 5: Set service standards – Once the improvement gap has been identified, standards can be set and progressively raised for closing the gap and eliminating the risk that service standards are not monitored and improved. Services standards are described as commitments to provide a specified level and quality of service to stakeholders at any given point in time. Service standards should accommodate stakeholders' main requirements to prevent the risk that aspects such as accessibility, response and turnaround times, accuracy, courtesy, provision of information and dealing with complaints are not properly addressed.

Step 6: Preparation for delivery – The management of information systems will be necessary to provide data on the unit costs of key services. Management will have to ensure that human and financial resources are shifted from inefficient and unnecessary activities, and used instead to ensure that delivery of services can be carried out at an affordable cost. Management at all levels should be held accountable for ensuring that these changes are made.

Step 7: Knowledge of level of services – The level and quality of services should be tailored to the needs of different stakeholders before they are launched. The key issue is that stakeholders and potential stakeholders must know and understand what level and quality of service they can expect to receive as well as what recourse they have if this is not achieved.

Step 8: Monitor delivery against standards and publish results – The purpose of monitoring is to overcome the risk that services have not achieved the standards that were set, to announce the results to stakeholders and to explain the reasons where the service has fallen short of the standard.  These results not only complete the accountability loop, but will provide valuable insights to guide further efforts to improve services in the future.

Thus, the Batho Pele White Paper has the potential to improve the way that public services are delivered and marks the start of a continuous process of improvement in service delivery.  During the period of transformation, when public officials face particular challenges, the Batho Pele principles remind officials that their most important task is service to the stakeholders and that they should commit themselves to set standards and strive to achieve higher standards.  For the Batho Pele White Paper to achieve its objectives, public officials should understand and support these objectives.  Public officials should be made aware that the risk of acts of corruption is that the success in transforming the public sector to achieve better service delivery could be delayed or achieved at a lower level than expected.  The risks associated with acts of corruption and maladministration should be addressed through the implementation of a national corruption-prevention strategy.

## 3.4. National corruption-prevention strategy

A national corruption-prevention strategy is necessary so that the public will not fear exercising their democratic rights.  A corruption-prevention strategy will contain the risk that stakeholders won’t report corruption because they may fear the consequences of doing so.  A national corruption-prevention strategy requires that government move beyond crisis management, but instead ensure that effective planning and sustainable success in reducing corruption will be achieved.  To facilitate a corruption-prevention strategy in an organisation, it will be necessary to commence with research and the facilitation of corruption-prevention programmes which should be inclusive of the prevention of maladministration.

### 3.4.1. Objectives of a national corruption-prevention strategy

The National Corruption Prevention Strategy of 1996 (1996:3) states the following objectives:

a) The establishment of a comprehensive policy framework, which will enable Government to address corruption in a coordinated and focused manner, which draws on the resources of all stakeholders.
b) The promotion of a common vision, which should stimulate initiatives at the various levels of Government, of how corruption will be addressed in public sector organisations in South Africa.
c) The development of a set of programmes, which should serve to focus the efforts of the public sector in delivering quality service, aimed at solving the risks leading to high levels of corruption.
d) The maximisation of stakeholders' participation in mobilising and sustaining corruption-prevention initiatives.
e) The creation of a dedicated and integrated corruption-prevention capacity, which can conduct ongoing research and evaluation of public campaigns to reduce corruption.

Thus, the objectives of the National Corruption Prevention Strategy is an approach to shift the emphasis from reactive risk control, which deploys most resources for responding after risks have already arisen, towards proactive risk prevention aimed at preventing corruption and maladministration from occurring at all.

In support of the proactive approach to identify risks as well as to investigate and determine the root causes for incidents, role players such as the Auditor-General and Special Investigating Units and Tribunals have been created. The purpose of these role players is to prevent risks from occurring or recurring. The Auditor-General Act, 1995 (Act No. 12 of 1995), section 3(4)(a)-(d) states that the Auditor-General shall to a reasonable extend provide satisfaction that precautions have been taken to safeguard the proper collection of money as well as with reference to the receipt, custody and issue assets; and that management measures have been taken to ensure that resources are procured economically and utilised efficiently and effectively.

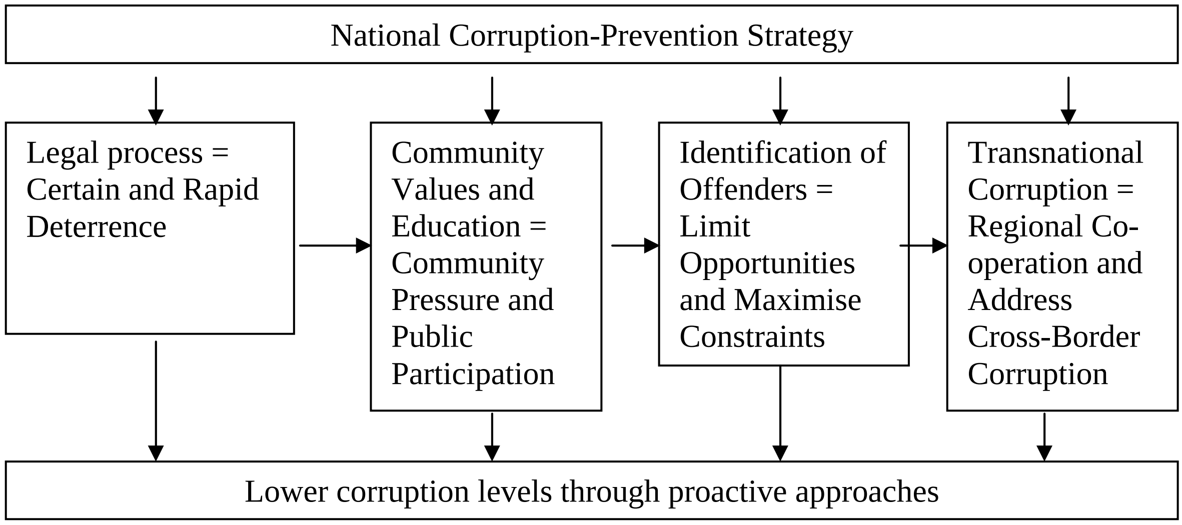
The powers of the Auditor-General are complemented with the Special Investigating Units and Special Tribunals Act, 1996, (Act No. 74 of 1996). The objective of this Act is to provide resources for the investigation of serious practices of corruption and maladministration in connection with the administration of State institutions as well as for the establishment of Special Tribunals to adjudicate upon matters emanating from investigations. The intention with the Special Investigating Units and Special Tribunals Act is to secure optimal service delivery by making it public that offenders, making them guilty of corruption and maladministration, will be duly investigated and prosecuted, which should eliminate or lower the risk of involvement in inefficient administrative practices.

Thus, if corruption and maladministration is not curtailed the risk exist that organisations may become totally ungovernable. Corruption and maladministration should be addressed through a multifaceted approach, which includes legislation to curb it, as well as with the co-operation of the various role players to identify the root causes of incidents. A four-pillar approach to prevent the risk of corruption and maladministration has been introduced by the South African Government in 1996 to deter stakeholders from becoming involved with inefficient activities to the detriment of organisations.

#### 3.4.1.1. The four-pillar approach

The Government has adopted the four- pillar approach with the intention to set out the different areas in which prevention should be developed. It is intended to provide a basis for the development of prevention initiatives at national, provincial and municipal levels as well as through civil society initiatives (National Corruption Prevention Strategy, 1996, (Chapter 6). The four-pillar approach is depicted in Figure 25.

**Figure 25 The four-pillar approach**




**National Corruption Prevention Strategy (1996)**

3.4.1.1.1. Pillar 1 – The legal process

The objectives are to make the criminal law process more efficient and effective in providing a clear deterrent to reduce the risks of re-offending. The key objectives of this process can be described as:

a) Increasing the efficiency and effectiveness of the process as a deterrent for corruption;
b) Focusing the resources on priority crimes;
c) Forcing inter-departmental integration of policy and management in the interest of coordinated planning, coherent action and the effective use of resources; and
d) Improving the service through increasing accessibility and responsiveness to the needs of the community.

3.4.1.1.2. Pillar 2 – Community values and education

Community values and education concern initiatives aimed at changing the way that communities react to corruption. This involves programmes which utilise public education and information in facilitating community participation in corruption prevention and devising strategies aimed at intervening in the way in which communities engage with and respond to corruption.

3.4.1.1.3. Pillar 3 – Identification of offenders

The identification of offenders focuses on designing systems to reduce the opportunity for corruption and increase the ease of identification of offenders. The rise in corruption is due to increased opportunities for corrupt acts to be committed, where the risks of detection and prosecution are minimised. The ultimate objective of this pillar is to ensure that corruption-prevention considerations are applied in the development of all structures and systems (National Corruption Prevention Strategy, 1996:12 and The White Paper on Safety and Security, 1998:14). The objectives of this pillar are mainly:

a) to encourage awareness of the possibilities of identification, thereby reducing and preventing the risk of corruption; and
b) to promote the use of new accounting systems in the design of service-delivery systems.

Thus, reducing corruption through the identification of offenders involves all activities which reduce, deter or prevent the risk of corruption by eliminating the risks that are thought to lead to corruption.

3.4.1.1.4. Pillar 4 – Counteracting transnational corruption

International corruption syndicates have a great influence in promoting corruption in South African organisations. Municipalities can assist in preventing transnational corruption through the establishment of local government corruption-prevention forums (White Paper on Safety and Security, 1998:34, (No. 1999-2004). The aim of transnational corruption prevention is to restrict, mobilise, improve and prioritise the deployment of intelligence capacity to prevent increased corruption in South Africa's public sector.

Thus, the objectives of the national corruption-prevention strategy are regarded as an approach is to enhance performance by shifting the emphasis from reactive corruption control towards proactive corruption prevention. To eliminate the risk that the objectives of a corruption-prevention strategy might not be fully achieved, it should be broadened to include maladministration. A performance-management system for local government needs to be adopted, because a risk-management programme will identify the non-realisation of predetermined performance measurements standards.

## 3.5. The establishment of a performance-management system

The Systems Act, section 38, states that a municipality must establish a performance-management system that is commensurate with its resources, best suited to its circumstances and in line with the priorities, objectives, indicators and targets contained in its integrated development plan. The performance-management system should promote a culture of risk management among its political structures and its administration by identification of risks that could prevent officials from performing efficiently and effectively. A municipality is expected to administer its affairs in an economical, effective, efficient and accountable manner to prevent the risk of stakeholders losing confidence in the assurances provided by management regarding, for example, sustainable service delivery. Lawrie *et al*. (2003:2) point out that legislative compliance and the implementation of a risk-management programme is a core process to facilitate the provision of assurances to stakeholders and, for example, to prevent rate payers from withholding their payments for rates and taxes as a result of poor service delivery.

The Local Government: Performance Management Guide For Municipalities, 2001 (No. 7146 of 2001), (hereafter referred to as the Performance Management Guide) states in Chapter 2 that the integrated development plan should at least identify the following aspects to complement the performance-management system:

a) the organisational framework, inclusive of an organogram required for the implementation of the integrated development plan as well as addressing the municipality’s internal transformation needs;

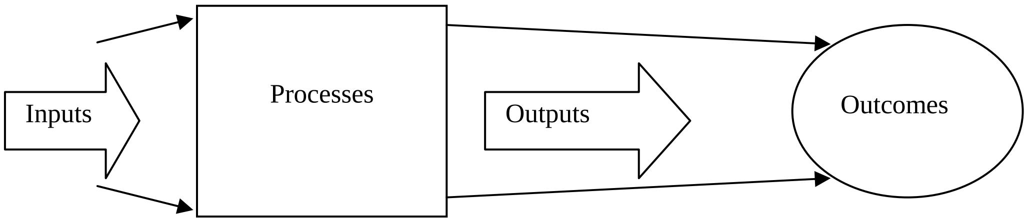
b) any investment and development initiatives to be implemented within the municipality;
c) key performance indicators need to be identified;
d) a financial plan and spatial development framework indicating all the strategies, patterns and programmes need to be identified as well.

The core components of performance indicators and targets are addressed in the Systems Act, sections 41, 43 and 44. Core components set appropriate performance indicators as a yardstick for measuring performance. They also determine the impact of performance standards that have not been met with regard to the priorities that have been determined as well as addressing the risk that the objectives as set out in the integrated development plan will not be achieved.

Measurable performance targets have to be set with regard to each objective and performance indicator. Steps have to be taken to improve performance, especially where the risk exists that development of priorities and targets may not be met. A process of regular reporting to stakeholders as part of the risk-management process has to be established as well.

The Performance Management Guide, sections 9 and 10, refer to the setting of key performance indicators and state that key performance indicators should include input, output and outcome indicators in respect of each objective. The different indicators can be described as follows: (1) input indicators refer to inputs that are going into the process; (2) costs refer to what the inputs cost; (3) processes refer to the set of activities involved in producing something; (4) output is regarded as the product or service generated; and (5) outcome refers to the impact or effect of the output being produced and the process undertaken. These indicators are depicted in Figure 26.

**Figure 26** **Key performance indicators**




**The Performance Management Guide (2001)**

The following are examples of key performance indicators:

a) the number of officials from employment equity target groups employed in the three highest levels of management in compliance with the approved employment equity plan;
b) the number of jobs created through local economic development initiatives including capital projects; and
c) the percentage of households with access to a basic level of water, sanitation, electricity and solid-waste removal.

Thus, to achieve the key performance indicators it is essential to monitor, measure and review the various key performance indicators at least once per year to identify any causes that could put achieving the organisational objectives at risk. To give effect to the integrated development plan, it should be used to prepare action plans for the implementation of the strategies identified by a municipality to accommodate the risk that officials may reject the implementation of a system to manage performance standards and to complement the performance-management system. The public sector should make officials aware of their responsibilities to avoid the officials from being accused of negligence for not performing their responsibilities with due diligence.

## <u>3.6. Responsibilities of municipal officials</u>

Officials on all levels in the public sector need to be aware of their responsibilities and that they could be at risk of being held responsible if they neglect their responsibilities. A distinction is made in legislation between the responsibilities of municipal managers, accounting authorities and other municipal officials.

### 3.6.1. Responsibilities of municipal managers and other officials

(a) Municipal managers – The Local Government: Municipal Finance Management Act, 2003, (Act No. 56 of 2003), (hereafter referred to as the Municipal Finance Management Act), section 93, defines the municipal manager as a person appointed in terms of the Systems Act, section 93J.

(b) Accounting authority – The Municipal Finance Management Act, (section 60), prescribes that every municipality must have an accounting authority, which must be accountable for the purposes of legislation. If a municipality has a municipal manager, that person is the accounting officer for that municipality, or if the municipality does not have a municipal manager, the council of the municipality is the accounting authority.

Zulu (2003:9) states that, if accounting officers are not aware of corruption and maladministration in their organisations, they fail in their duty of care and skill, and could be deemed negligent.

3.6.1.1. Responsibilities of municipal managers as accounting officials

The municipal manager must ensure that the municipality has and maintains an effective, efficient and transparent system of risk management. Cognisance should be taken of the fact that unauthorised and irregular expenditure must be reported promptly to the Auditor-General in writing, and effective and appropriate disciplinary steps must be instituted to mitigate the risk of officials undermining the internal control systems of the municipality (Barrier, 2003:73; The Municipal Finance Management Act, sections 32 and 62; The Municipal Finance Management Bill, (2000), section 35 and 29). The Act and Bill mentioned above refer to irregular and unauthorised expenditure and it is regarded as essential to determine the difference between the two concepts. Irregular expenditure refers to expenditure other than an unauthorised expenditure, incurred in contravention of, or that is not in accordance with, legislation (The Municipal Finance Management Act, 2003:16 and The Public Finance Management Act, (Act No. 29 of 1999), Chapter 1(1)). Unauthorised expenditure refers to an expenditure for which no provision is made in the budget of the municipality and includes overspending of the budget or vote, or an expenditure unrelated to the department or functional area covered by the vote (The Municipal Finance Management Act, 2003:20). Thus, any official who allows an irregular or unauthorised expenditure is liable to be disciplined, if higher-level approval and authorisation have not been obtained.

The Municipal Finance Management Act, 2003:20 and the Public Finance Management Act, Chapter 1(1)), refer to another type of expenditure, namely a fruitless expenditure, which is defined as an expenditure which was made in vain and would have been avoided had reasonable care been exercised. Thus, fruitless expenditure is not in the interest of stakeholders and service delivery. Any official who allows fruitless expenditure to continue must be disciplined to serve as a deterrent measure to prevent irregular, unauthorised and fruitless expenditure.

3.6.1.2. Responsibilities of other officials

These officials, other than the municipal manager, for example the Chief Risk Officer, must ensure that risk management is carried out within the area of responsibility of that official and that they are held responsible for the effective, efficient, economical and transparent use of financial and other resources within that official’s area of responsibility (No specific mention is made about risk officials in current legislation). These officials must comply with the provisions of the applicable legislation to the extent that it is applicable to that official and such an official is responsible for the management, including safeguarding, of the assets and the management of the liabilities within that official’s area of responsibility (The Municipal Finance Management Act, section 78, The Public Finance Management Act, section 57, The Municipal Finance Management Bill (2000), section 45 and section 61).

Thus, the responsibility of officials is to ensure that all revenue, expenditure, assets and liabilities of municipalities are managed economically, efficiently and effectively.

As in the case of municipal managers, other officials must be disciplined if their responsibilities are not executed in the interest of the public sector as a guideline to be consistent in mitigating risks. Officials should be aware of a Code of Conduct to guide them with the objective of executing their responsibilities to the best of their ability and in the interest of local governance.

## 3.7. Code of Conduct

The need exists to provide guidelines to officials with regard to their relationship with politicians, other officials and stakeholders from an ethics and risk-management perspective (Minnaar-Van Veijeren, 2005:17). Guidelines are also needed to indicate the spirit in which officials should perform their duties to obviate the risk of their performing unethically or beyond the parameters of their responsibilities. Management should ensure that officials are acquainted with the Code of Conduct and that the officials accept and abide by it to contribute towards greater honesty, integrity and efficiency in the public sector with the view to stamping out the risk of corruption.

### 3.7.1. Corpus of a Code of Conduct

The following aspects to guide officials and councillors to perform in a responsible and efficient manner and to prevent the risk of corruption are incorporated *inter alia* in The Code of Conduct for The Public Service, 1997, (No. 18065 of 1997), section M4.1 (hereafter referred to as the Code):

- An official should be faithful and honour the Constitution and put the public interest first in the execution of daily tasks. An official should execute the policies applicable to the municipality in a loyal manner and should also strive to be familiar with and abide by all statutory instructions applicable to the execution of duties.

- It is expected from the public official to serve stakeholders in an unbiased and impartial manner, and that the official should be polite, helpful, reasonably accessible and at all times treating stakeholders as being entitled to receive high standards of service (The Code, section M4.2. and The Systems Act, section 3).

- Officials should cooperate fully with other officials to advance the public interest and should execute all reasonable instructions by persons officially assigned to give them. Officials should refrain from risks such as favouring relatives and friends in work-related activities (The Code, section M4.3.).

- Officials should strive to achieve the objectives of the public sector cost effectively (The Code, section M4.4.). It should also be noted that other ‘’Codes’’, for example, Code and Procedure for Suspension of Suppliers are adopted by organisations to complement the official Code of Conduct.

- Officials should always behave in a manner that enhances the reputation of the public sector. Officials may not take a decision on behalf of the public sector concerning a matter in which that official, or that official’s spouse or partner, has a direct or indirect private interest. Such an official has to disclose to the council full particulars of any benefit received. It is stated in section 1(1) of The Corruption Act, 1992, (Act No. 94 of 1992) that “any person who corruptly gives or offers or agrees to give any benefit of whatever nature which is not legally due, to any person upon whom any power has been conferred with the intention to influence the person upon whom such power has been conferred to commit or omit to do any act in relation to such power or duty shall be guilty of an offence”. It will be regarded as corruption if it is proved that an official used public office for private gain.

- An official has a reporting duty if the Code has been breached. Whenever an official has reasonable grounds for believing that there has been a breach, the official must without delay report the matter to a superior officer or to the Speaker in the case of a municipality. Prompt reaction to all reports received will ensure that risks are promptly assessed and will ensure stakeholders that checks and balances are in place to address risks (The Systems Act, Schedule 2; Corruption Act, section 1(1)(a); The Constitution, Chapter 15; The Public Service Regulations, section M4.5).

- Councillors should be accountable to stakeholders and report back at least quarterly to constituencies on council matters, including the performance of the municipality in terms of established indicators.

- A councillor should not interfere in the management or administration of any department of the municipality unless mandated to do so by that council. Interference may create the risk of the reputation of the councillor and municipality being affected detrimentally. A councillor may also not give or purport to give any instruction to any official of the council, except when authorised to do so. A councillor may not obstruct or attempt to obstruct the implementation of any decision of the municipality. A councillor may not encourage or participate in any conduct which is not in the interest of a municipality (The Local Government: Municipal Structures Act, 1998, (Act No. 117 of 1998), Schedule 5).

Thus, in order to give effect to the relevant constitutional provisions relating to the public service, councillors and officials are expected to comply with the Code as prescribed in legislation. The Code should act as a guideline as to what is expected of them from an ethical point of view, both in their individual conduct and in their relationship with stakeholders. Compliance with the Code can be expected to enhance professionalism and help to ensure confidence in the public sector. Officials and councillors of a municipality should at all times loyally execute the policies of the municipality and perform the functions of office in good faith, diligently, honestly and in a transparent manner. Officials and councillors should act in such a manner as to obviate the risk that the credibility and integrity of the municipality are compromised as well as to treat all stakeholders equally without favour or prejudice; this should prevent officials and councillors from engaging in acts of misconduct. The ‘’Codes’’ should be broadened, for example, with reference to financial misconduct conducted by officials, to complement regulations and legislation. Proceeds of financial misconduct should be reported and protection should be provided to those reporting any proceeds received by officials and other stakeholders.

## 3.8. Financial misconduct

The act of financial misconduct is described in the Municipal Finance Management Act, sections 171-174, the Municipal Finance Management Bill, (2001), section 108 and 109, and the Public Finance Management Amendment Act, sections 81-85, with specific reference to the risk of misconduct by municipal managers, officials and accounting authorities. Wilful or negligent failure to comply with specific sections in the legislation or permitting an unauthorised or irregular expenditure is regarded as misconduct by these officials.

Proceeds received from an act of misconduct are referred to in the Proceeds of Crime Act, 1996 (Act No. 76 of 1996), hereafter referred to as the Proceeds of Crime Act, and the Prevention of Organised Crime Act, 1998 (Act No. 121 of 1998), section 4. The Proceeds of Crime Act, sections 2 and 3, state that an official has benefited from misconduct if that official has at any time received any payment or other reward in connection with any misconduct. Proceeds of misconduct are regarded as any payment or other reward received or held by an official over which the official has effective control in connection with any misconduct carried out by the official.

Officials should report acts of misconduct in an attempt to curb misconduct. Once misconduct has been reported, measures must be instituted in an attempt to recover the proceeds of misconduct from the officials who gained by obtaining the proceeds. If the proceeds of misconduct are concealed, the risk exists that officials may continue with misconduct and be personally enriched. The risk also exists that corrupt officials may influence other officials to become corrupt or threaten them with victimisation should misconduct be reported. Any person who hinders someone in the exercise, performance or carrying out of their powers shall be guilty of an offence. Effective communication should alert management to risks and therefore management should encourage officials and stakeholders to report acts of misconduct (Murdock, 2003:57-61).

The Protected Disclosures Act, 2000 (Act No. 26 of 2000) and the Protected Disclosures Bill, 2000, section 4(1-3) makes provision for procedures in terms of which officials may disclose information regarding irregular conduct by their employers or other officials as well as providing for the protection of officials who make disclosures.

Thus, every official has a responsibility to disclose misconduct in the workplace. Officials who disclose information are protected from any reprisals. The objects of the Protected Disclosures Act are threefold: (a) to protect the official from being subjected to an occupational detriment on account of having made a protected disclosure; (b) to provide for remedies in connection with any occupational detriment suffered; and (c) to provide for procedures in terms of which an official can disclose information regarding improprieties by the employer. Legislation to promote administrative action for internal and external stakeholders that is lawful, reasonable and procedurally fair is available to stakeholders whose rights have been adversely affected. Non-adherence by organisations to legislation providing for administrative action could cause a ‘’reverse’’ risk for an organisation.

### 3.9. Reasons for administrative action

The Promotion of Administrative Justice Act, (Act No. 3 of 2000), section 5, states that any person whose rights have been materially and adversely affected by an administrative action can request that written reasons be given for the administrative action; if the person has not been given reasons within 90 days after the date on which that person became aware of such action. This is to prevent the risk of departing from the requirement to furnish reasons for an administrative action that could affect a person’s rights adversely. The Promotion of Administrative Justice Act, section 5(4)(a), does make provision to depart from the requirement to furnish adequate reasons, if it is reasonable and justifiable in the circumstances, but the person making the request of such departure must forthwith be informed.

Thus, in determining whether a departure is reasonable and justifiable, all relevant factors must be taken into account, including:

- the objects, nature, purpose and likely effect of the administrative action;
- the extent of the departure and the relation between the departure and its purpose;
- the importance of the purpose of the departure; and
- the need to promote efficient administration and good governance.

Thus, if a risk of a person’s rights being adversely affected arises, such a person has a right to the judicial review of the alleged unjust administrative action.

### 3.9.1. Judicial review of administrative action

Any person may institute proceedings in a court for the judicial review of an administrative action. Officials should know that their administrative acts might be reviewed judicially. This knowledge and consequence should therefore mitigate the risk that officials practice inefficient administration, because they should realise that they are accountable for their administrative actions (The Open Democracy Bill, 1998, (No. B67 of 1998), (Chapter 6); The Promotion of Administrative Justice Act, 2000, (Act No. 3 of 2000), (section 6) and The Constitution, (section 33).

Thus, any person has the right to an administrative action that is lawful, reasonable and procedurally fair and, if the risk exists that one's rights have been adversely affected by an administrative action, such a person has the right to be given written reasons for the action. The right to provide for a review of the administrative action by a court also exists. The object of the legislation is to promote efficient administration and to create a culture of accountability. A number of "watchdog bodies" are active in the Public Sector of South Africa to assist and to complement the promotion of a culture of accountability.

## 3.10. Watchdog bodies for combating unethical behaviour

The role of watchdog bodies, such as constitutional, independent, *ad hoc*, and professional and staff bodies in South Africa will be described below to assist in combating the risk of unethical behaviour by the public official.

### 3.10.1. Constitutional bodies

3.10.1.1. Public Protector

The Constitution, section 182(1), authorise the Public Protector to investigate any alleged unethical conduct such as maladministration and corruption, which result in unlawful or improper prejudice to others. The Public Protector promotes the development of ethical behaviour and accountability through the investigation of unethical practices as well as making findings known to the public. The investigative mandate of the Public Protector contributes to the mitigation of the risk that officials may act in an irresponsible manner by instilling an awareness of accountability and acceptable behaviour in public officials (Mafunisa, 2000:41).

3.10.1.2. Auditor-General

The Constitution, section 188(1), makes provision for the post of the Auditor-General, whose function it is to investigate and audit the accounts of all the departments that are funded by public funds. Another function is to ensure that the public sector achieves the objectives for which the funds are made available in an economical and efficient manner within the ambit of the law. The post of the Auditor-General promotes ethical behaviour by mitigating the risk that officials may not act in an effective and efficient manner, because the officials know that their actions may be investigated (Mafunisa, 2000:43).

3.10.1.3. Public Service Commission

The Public Service Commission was established in terms of the Constitution, section 196, with the intent to provide for the promotion of effective public finance and administration as well as to encourage professionalism and ethical behaviour in the Public Sector. The Public Service Commission ensures that its objectives are achieved by observing the Public Sector, through, for example, monitoring by the Office of The Auditor-General, to follow sound principles of public administration for the efficient, effective and economical use of resources as well as to ensure that stakeholders' needs are responded to (Mafunisa, 2000:44).

### 3.10.2. Independent bodies

Allan (in Mafunisa, 2000:44) refers to independent bodies as impartial bodies and subject only to the Constitution and the law (the Constitution, sections 165 and 166). A function of independent bodies is to check on the risk of abuse of administrative power, and to make politicians and officials accountable for their actions by instituting disciplinary actions against politicians and officials, if unethical conduct has been committed (Rasheed *et al*. in Mafunisa, 200:45). The outcome of disciplinary actions – for example, the dismissal of an official – can be reviewed by an independent body to prevent the risk of an official being dismissed if it can be proved that the official was actually innocent.

### 3.10.3. *Ad hoc* bodies

*Ad hoc* bodies, such as a commission of inquiry, can be appointed to investigate matters of national interest, after which they cease to exist once this purpose has been attained. All matters concerning an *ad hoc* body are open to public scrutiny and inspection, unless the President provides for the confidentiality of the body's outcome (Cloete *et al.* in Mafunisa, 2000:45). *Ad hoc* bodies should ensure that equal penalties are applied to mitigate the risk that unethical conduct will be punished in an unequal manner. Public officials are aware that a commission of inquiry will be appointed if they do not apply effective management principles, which will reduce the risk of the ineffective and inefficient use of public resources, such as finances, human resources and tangible assets.

### 3.10.4. Professional and staff bodies

#### 3.10.4.1. Professional bodies

The objectives of professional bodies, such as the South African Local Government Association and Western Cape Local Government Organisation, are to promote the training and professional conduct of their members as well as to maintain a Code of Conduct that specifies the responsibility, interaction and accountability of their members (Cloete *et al*. in Mafunisa, 2000:47). A further objective is to mitigate the risk that officials may not have the required skills to conduct their functions and utilise their resources optimally, or may not behave in an acceptable manner.

#### 3.10.4.2. Staff bodies

O'Toole (in Mafunisa, 2000:48) argues that the main objective of staff bodies, such as the South African Municipal Workers Association, is to obtain improved conditions of service for their members. They serve as a vehicle to communicate morale, perceptions and attitudes of public officials, which sustain the ethical values of the public sector. In addition to improving conditions of service, they assist members in responding to charges of alleged misconduct. Staff bodies curb the risk of deteriorating ethics in the public sector in that they contribute towards instilling and maintaining ethical behaviour in public officials (Rasheed *et al*. in Mafunisa, 2000:49).

Thus, the behaviour of officials must be acceptable to stakeholders. In instances where unethical conduct is identified, officials should be held accountable and responsible. The role of watchdog bodies through internal control should limit the risk of a decline in the ethical behaviour of the public sector.

## 3.11. Internal control

Losses suffered by municipalities could be recovered through a system of internal control. Municipalities make use of systems of internal control by, for example, instituting internal audit as an independent appraisal function. The objective of a system of internal control is to mitigate the risk of uneconomical, ineffective and inefficient conducting of activities. The Municipal Finance Management Act, section 165, describes the control functions of an internal audit function. These functions include the preparation of a risk-based audit plan and to advise the accounting officer and audit committee on matters relating to internal audit; internal controls; risk and risk management and loss control. The problem is that all internal audit departments do not ensure that a risk based audit plan is prepared and audits conducted according to the Municipal Finance Management Act. A further problem is that smaller local authorities are not capacitated to prepare risk based audit plans.

Recoveries can be made from officials and third parties such as contractors and members of the public. Under certain circumstances, for example, when permission is granted, deductions can be made from the salaries of officials to recover losses (The Municipal Finance Management Act, section 32, and The Local Government Transition Act, Second Amendment Act, 1996 (Act No. 97 of 1996), section 10G(2)(f)).

Thus, if an official does not act in an effective, economical and efficient manner with a view to optimising the use of the resources available in the public sector, such official might be held responsible if damage or losses occur. Any damage or losses may be deducted from the remuneration of an official. Officials in the public sector need to be informed about the serious nature and implications of the various Acts that are applicable in the public sector. Officials must also be informed that any losses or damages that arise from a contractor who does not adhere to tender specifications must be recovered from such contractors and also that tenders can be cancelled under certain circumstances. The objective of internal control via audit, for example, verification that policy-decisions are executed, is to mitigate the risk of uneconomical, ineffective and inefficient conducting of activities.

## 3.12. Summary

Legislation is necessary to prevent the risk of unethical conduct in distributing equal and efficient public services. Sustainable service delivery should be ensured to achieve the objectives of the public sector as described in, for example, the Constitution and the Municipal Systems Act.

The White Paper on Transforming Public Service Delivery, referred to as the Batho Pele White Paper, requires public service departments to identify aspects such as a mission statement and guarantees of service delivery at affordable service charges; this will provide more effective services and the development of a culture of stakeholder care.

The improvement of public sector service delivery, as described in The Batho Pele White Paper, is a continuous, progressive process and not a once-and-for-all task, which means that as standards are raised, higher targets must be set. The process consists of the following steps: (a) identify the stakeholders; (b) establish the stakeholders' needs and priorities; (c) establish the current service baseline; (d) identify the improvement gap; (e) set service standards; (f) prepare for delivery; (g) inform stakeholders; and (h) monitor delivery against standards and publish results.

The National Crime Prevention Strategy requires that Government moves beyond a mode of crisis management and ensures that effective planning will be achieved. A four-pillar approach to corruption prevention was described with a view to enhancing a system of risk management. The intention is to provide a basis for the development of corruption-prevention initiatives. The following pillars are discussed: (a) process (b) community values and education (c) environmental design, and (d) addressing transnational corruption.

The responsibility of the municipal manager as the accounting official is to ensure that the municipality has and maintains effective, efficient and transparent systems of risk management and internal control; the municipal manager is also responsible for the effective, efficient, economical and transparent use of the resources. Officials other than the municipal manager, such as the Internal Auditor, should ensure that the system of internal control, for example, verification of documents is implemented within the area of responsibility of that official. These officials should take effective and appropriate steps within their area of responsibility to prevent any irregular, unauthorised, fruitless and wasteful expenditure and any under-collection of revenue due.

Guidelines, by means of a Code of Conduct, are needed to indicate the spirit in which officials should perform their duties, to prevent the risk of conflicts of interests and to indicate what is expected of them in terms of their personal conduct in the public sector. Management is responsible for the efficient management and administration of the organisation as well as for the maintenance of discipline and promoting a professional ethos amongst officials in order to contribute towards sustaining the integrity and efficiency of the public sector.

It is important that officials report acts of misconduct in an attempt to curb such misconduct, as this should deter officials from the risk of becoming involved in conduct to obtain personal gain to the detriment of municipalities. Once misconduct has been reported, measures must be instituted in an attempt to recover the proceeds of corruption from officials who gained by obtaining such proceeds. Unlawful or irregular conduct is detrimental to transparent governance in organisations. The principal objective of the Protected Disclosures Act is to make provision for procedures in terms of which officials may disclose information regarding unlawful or irregular conduct in the municipality without fear of reprisal. It is thus also the object of the Protected Disclosures Act to provide for the protection of officials who make disclosures.

The intention of the Promotion of Administrative Justice Act is to give effect to the constitutional right of access to any information held by a governmental body and to make available public information. It also provides for the protection of persons disclosing evidence of contraventions of the law and corruption, as well as ensuring their right to fair administrative action. The promotion of administrative justice and the accompanying protection will assist in eliminating the risk that unjust administrative procedures may prevail in the public sector.

The role of watchdog bodies, such as constitutional, independent, *ad hoc,* and professional and staff bodies is to assist in combating the risk of unethical behaviour in the Public Sector. Constitutional bodies include the Public Protector, the Auditor-General and the Public Service Commission. Watchdog bodies demand ethical behaviour from officials and politicians for which they can be held accountable and responsible. This should limit the risk of a decline in ethical behaviour in the public sector.

Legislation, such as the Municipal Finance Management Act, is in place that makes provision for the recovery of losses in that an official who is or was employed by a municipality could be held liable for losses, if it is proved that such an official was responsible for any loss or damage. Under certain conditions recoveries can also be made from contractors where, for example, a tender is withdrawn or where the contractor fails to execute a tender. Under such circumstances the contractor shall pay all additional expenses which a municipality may incur in inviting fresh tenders. Under certain circumstance deductions may also be made from the remuneration of officials in order to reimburse the employer, if it can be proved that an organisation suffered financial loss or damage because of the negligence, misconduct or any other form of irregularities by the official.

Management, officials and stakeholders should not only be aware of legislation that has an impact on municipalities, but they should also be aware of trends and emerging practices to obviate risks. Knowledge of trends and emerging practices can direct management to be proactive in managing risks, which is the focus of Chapter 4.

# CHAPTER 4

# INTEGRATED RISK MANAGEMENT: INTERNATIONAL TRENDS AND PRACTICES

## 4.1. Introduction

The objective of this Chapter is to describe the national and international trends to integrate risk management at all levels in organisations. Practices to facilitate the integration of risk management as well as to identify and evaluate risks will be described. Knowledge of trends and practices is essential to assist management in gaining knowledge and strategies on how to manage the organisation for the benefit of its stakeholders and to optimise service delivery. The identification of trends and practices should guide management in developing and implementing a culture of assurance that the organisation is providing optimal services as well as putting pro-active measures in place to prevent losses and to protect its reputation.

Integrated risk management serves to supply management with information rather than to drive corporate performance. Although a variety of aids are being used in integrated risk-management activities, comprehensive risk assessments are currently undertaken in only a few organisations. Integrated risk-management efforts are more successful when there is strong and visible support from management and dedicated cross-functional officials to drive integrated risk-management implementation and push it into operation. Integrated risk management should be introduced as an enhancement to already entrenched and well-accepted processes rather than as a new stand-alone procedure and then proceeding incrementally to avoid internal resistance.

The public sector should consider every aspect of implementation from choosing a method to how it will be rolled out within the organisation, from the aids that will be used to measure its success to how those results should be communicated to stakeholders. The potential obstacles and opportunities that can arise in the public sector in implementing integrated risk management to enhance service delivery will be addressed.

Management should identify international trends and emerging practices in risk management to mitigate the potential obstacles and to capitalise on opportunities facing the public sector in its task of enhancing service delivery.

## 4.2. Identification of trends and emerging practices

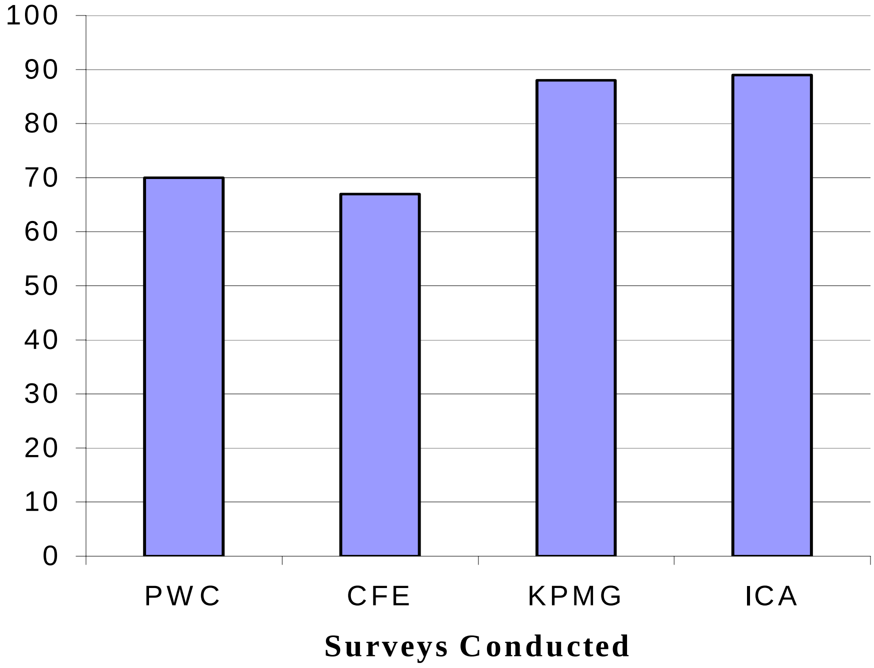
Researchers commented on the negative impact of corruption and maladministration worldwide and on the effective and efficient management of an organisation. The national and international aspects of unethical conduct need to be explored in order to ascertain which of them should be taken into account or be eliminated to ensure effective integrated risk management.

### 4.2.1. Status of corruption

Eigen (2001:1) stated that there is no end in sight to the misuse of power by officials in the public sector and that corruption levels are perceived to be as high as ever in both developed and developing worlds. He referred to the 2001 Corruption Perceptions Index (CPI), which shown that 55 out of 91 countries scored less than 5 out of 10, suggesting high levels of perceived corruption in the public sector. Countries such as Bolivia, Cameroon, Kenya, Indonesia and Bangladesh scored less than 2 out of 10.

The following statistics on integrated risk management were reported in the Corruption Perceptions Index. The research, as indicated in Graph 1 (developed by researcher), revealed that an increase in corruption is expected.

**Graph 1** **Increase in corruption**




With reference to Graph 1, PricewaterhouseCoopers (PWC) reported that 70% of major organisations in the United Kingdom and Germany stated that they had been subject to corruption in the previous two years. The Association of Certified Fraud Examiners (CFE) in Austin Texas (USA) indicated in their survey that 67% of 600 respondents declared that corruption is worse than five years ago. The Office of The Auditor-General referred to a KPMG survey on South African organisations in which it was stated that corruption increased to 88%, while the Forensic and Investigative Accounting Group attached to the Institute of Chartered Accountants (ICA) in South Africa stated that, based on their survey, 89% of organisations confessed that corruption is on the increase (PricewaterhouseCoopers, 2001:1; Association of Certified Fraud Examiners, 1998:28; Office of The Auditor-General, 1998:2 and Institute of Chartered Accountants, 1998:3).

### 4.2.2. Discovery of corruption

International surveys by the Institute of Chartered Accountants (1998:11) and the Office of The Auditor-General (1998:9) indicated that corruption has been discovered through methods such as:

(a) investigation by officials;

(b) internal audit review;

(c) by way of coincidence, e.g. fraudulent documents discovered while an official was on leave;

(d) notification by officials of their expectation that fellow colleagues are living beyond their means;

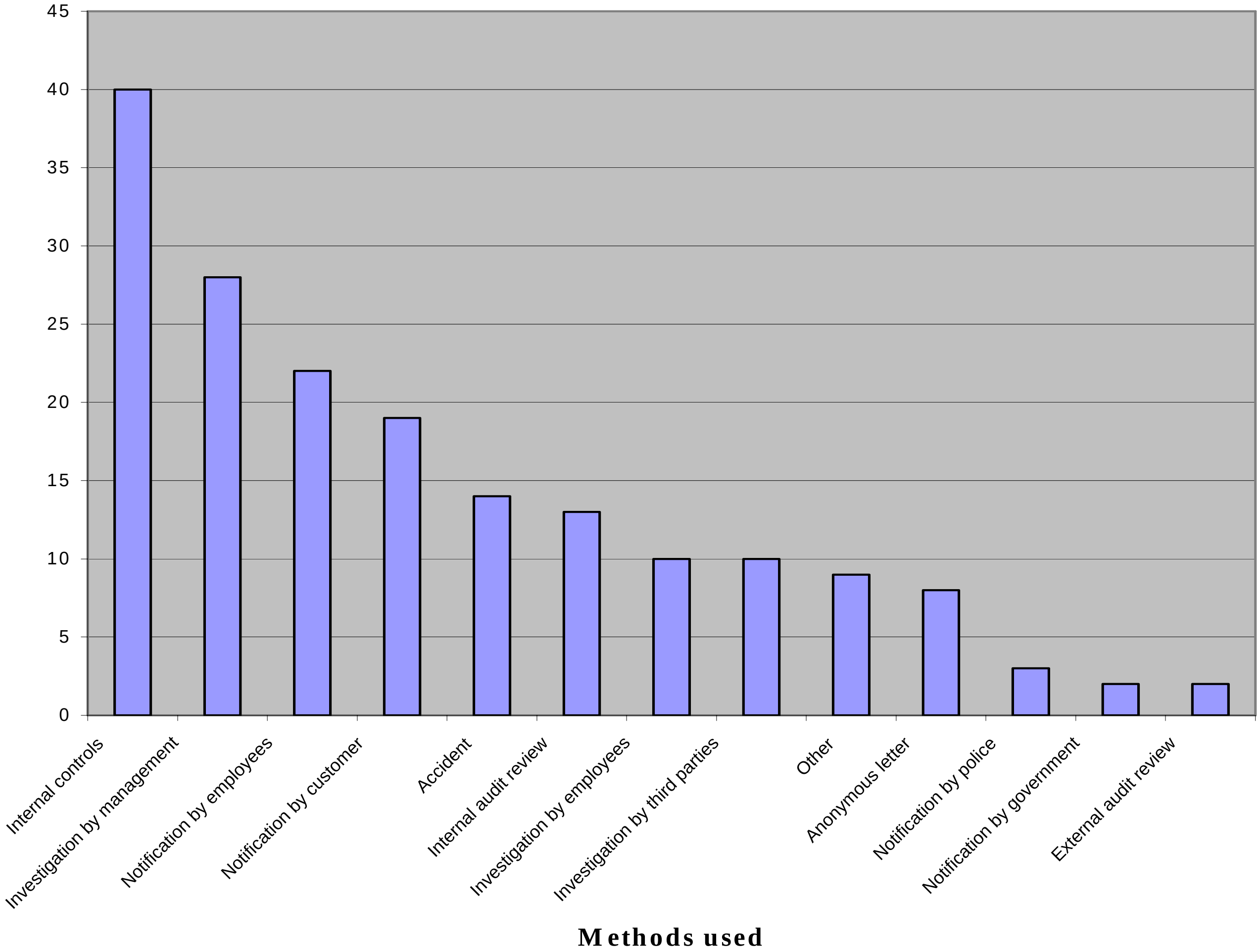
(e) notification by stakeholders through listening campaigns and letters to management;

(f) investigation by management; and

(g) internal controls such as the implementation of hotlines and verification checks.

Graph 2 depicts methods and percentages of how corruption has been discovered.

**Graph 2** **How corruption was discovered**

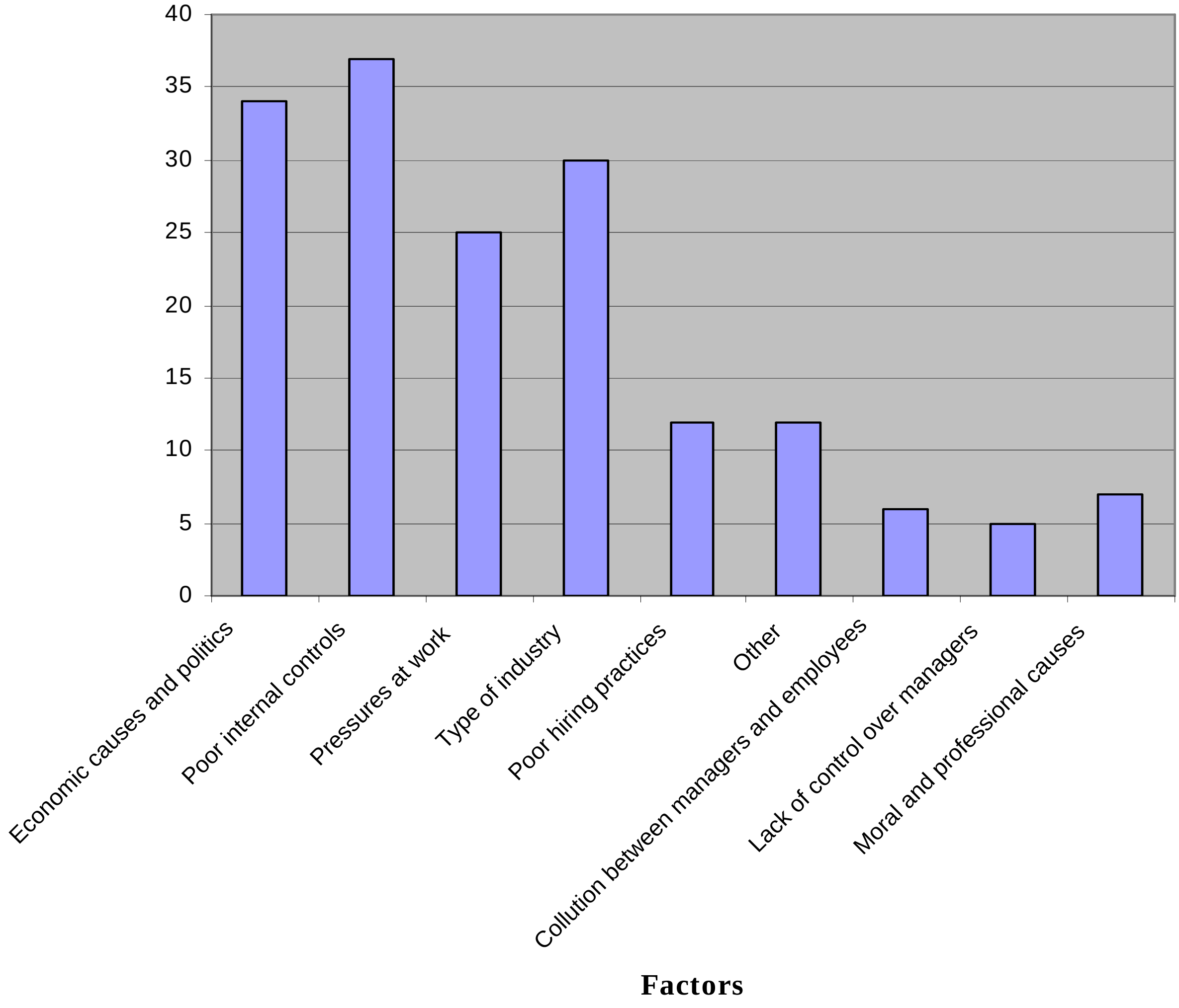



**Institute of Chartered Accountants (1998:11) and the Office of the Auditor-General (1998:9)**

### 4.2.3. Factors that caused corruption and maladministration to take place

The factors that caused corruption and maladministration to take place with percentages are depicted in Graph 3. Poor internal controls are the cause of the highest percentage of corruption and maladministration, which correlates with the methods through which corruption and maladministration has been discovered as depicted in Graph 2.

**Graph 3 Factors that caused corruption and maladministration to take place**



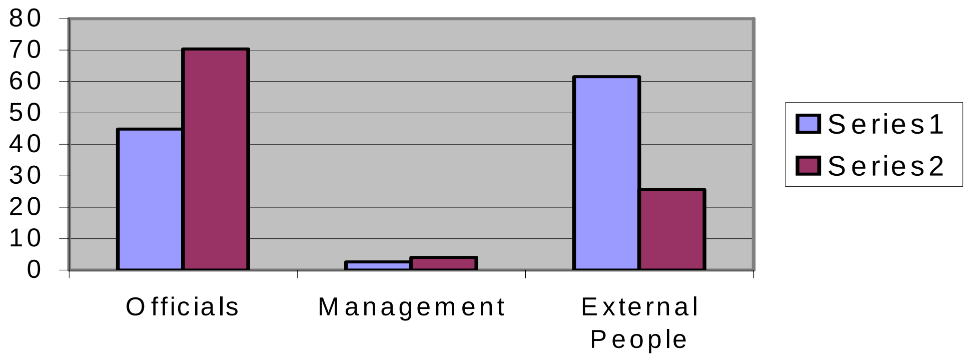

**Institute of Chartered Accountants (1998:10) and The Office of The Auditor-General (1998:10)**

The factors that caused corruption and maladministration to take place were researched by the Institute of Chartered Accountants (1998:10) of Canada and The Office of The Auditor-General (1998:10) in South Africa. The percentages represent an average of results as determined by the two organisations. The research by the Institute of Chartered Accountants and by the Auditor-General was done on public sector and private organisations.

### 4.2.4. Corruption committed by officials, management & external people

As established by the Office of The Auditor-General in South Africa, Graph 4 depicts the correlation of corruption committed by officials, management and external people with percentages. With reference to officials, it is indicated that fewer incidents of corruption took place in comparison with external people such as vendors, but the value of the losses to the public organisations were higher in the case of officials than in the case of external people. With reference to management, the ratio between the number of incidents of corruption and the value of the loss was almost equal. Series 1 in Graph 4 (developed by researcher) represents the number of occurrences of corruption by officials, management and external people, whilst series 2 refer to the value of the losses per category of officials, management or external people (Office of The Auditor-General in South Africa, 1998:8).

**Graph 4** **Officials, management & external people**




### 4.2.5. Prevention and detection of corruption

Eigen (2001:1) noted that managers should do more to establish transparency in the public sector, as a means to prevent and detect corruption and maladministration and to establish economic sustainability. He referred to countries such as Nigeria, Mexico and the Philippines, where it is much more difficult to prevent and detect corruption and maladministration. Managers are to seek assistance to implement anti-corruption programmes to reach the goal of transparency and to ensure a sustainable organisation.

PricewaterhouseCoopers, in their European Economic Crime Survey (2001:2), made a comparison between the rates in corruption between Western and Central Europe. Organisations in Western Europe have suffered higher incidences of corruption (29%) than organisations in Central Europe (26%). Varying levels of corruption awareness, differing standards and priorities in governance as well as diverse attitudes concerning the prevention of corruption caused these differences.

The European Economic Crime Survey (PricewaterhouseCoopers, 2001) conducted in Western and Central Europe referred to non-financial damage from corruption. Officials in Western and Central Europe (36%) felt that corruption had a negative impact on their morale and 16% of these officials believed that corruption impacts negatively on an organisation’s reputation.

Thus, although the direct relationship between corruption and service delivery is complex, the fact that corruption can impact negatively on factors such as the morale of officials and the relationships between organisations and their reputation that drive corporate performance highlights how corruption can affect organisational value from a non-financial perspective over the long term. The credibility of integrated risk management in international organisations should be indicative or used as a benchmark of the risk culture in organisations.

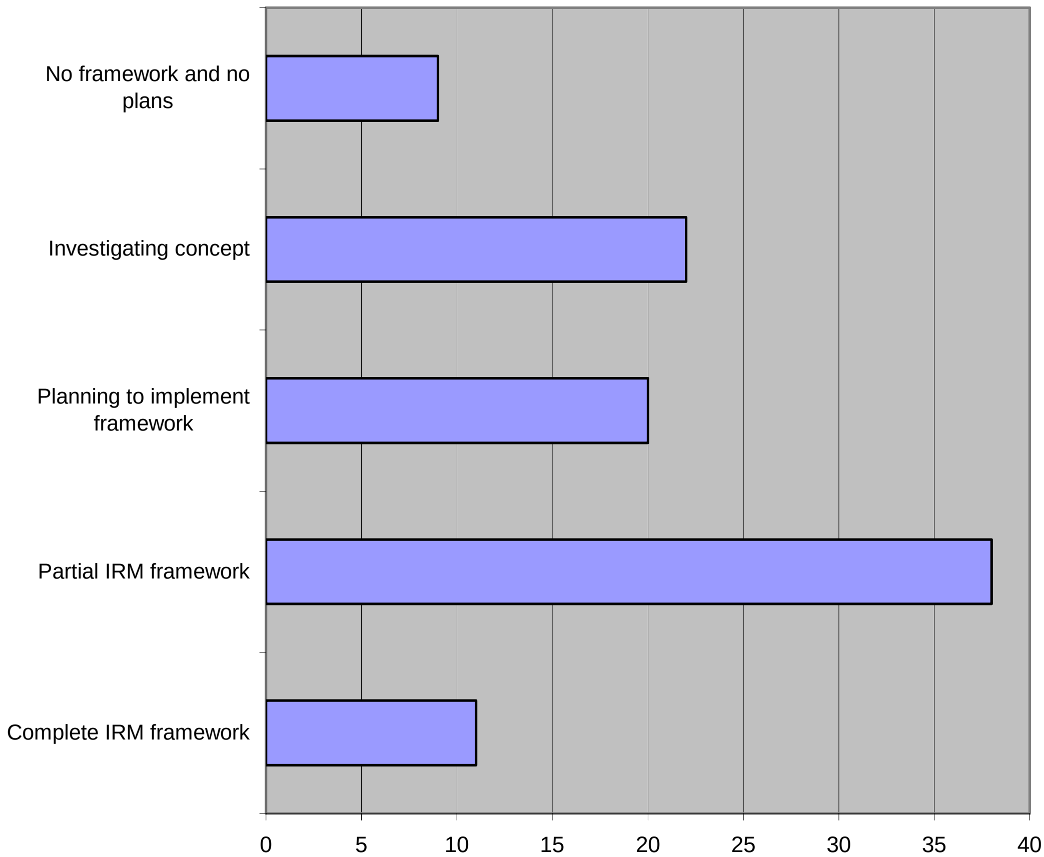
### 4.2.6. Credibility of integrated risk management internationally

Nickson (2002:9) stated that management is unhappy with the credibility of risk management. Nickson referred to a Chicago-based company, namely Aon, who surveyed 416 officers in charge of risk management, and conducted 11 follow-up interviews with Chief Financial Officers, treasurers and heads of risk management in Europe and North America. According to this study, European organisations are ahead of North America in integrating risk management, because of Europe's organisational governance rules and guidelines that call for more integrated monitoring and reporting of risk. However, according to Nickson (2002:9), only 5 percent of those surveyed in Europe and North America were satisfied with risk practices. More than half of the organisations surveyed were "less than satisfied" with their risk-management practices and only 12% had fully integrated risk-management functions, while 39% planned to implement an integrated risk-management system over the next 3 years. The development of an integrated risk-management system, as indicated by 38% of the organisations surveyed, was the prime motivation to respond better to an organisation's full range of risks.

- International state of integrated risk management framework

Miccolis *et al.* (2001:7) conducted research for the Institute of Internal Auditor's Research Foundation in the USA in 2001 (of which the findings are depicted in Graphs 5 to 10) and state that approximately 40% of respondents claimed to have at least a partial integrated risk-management framework in place, and just over 11% claimed to have a full integrated risk-management framework. The international state of integrated risk management with percentages is depicted in Graph 5.

**Graph 5** **International state of IRM framework**

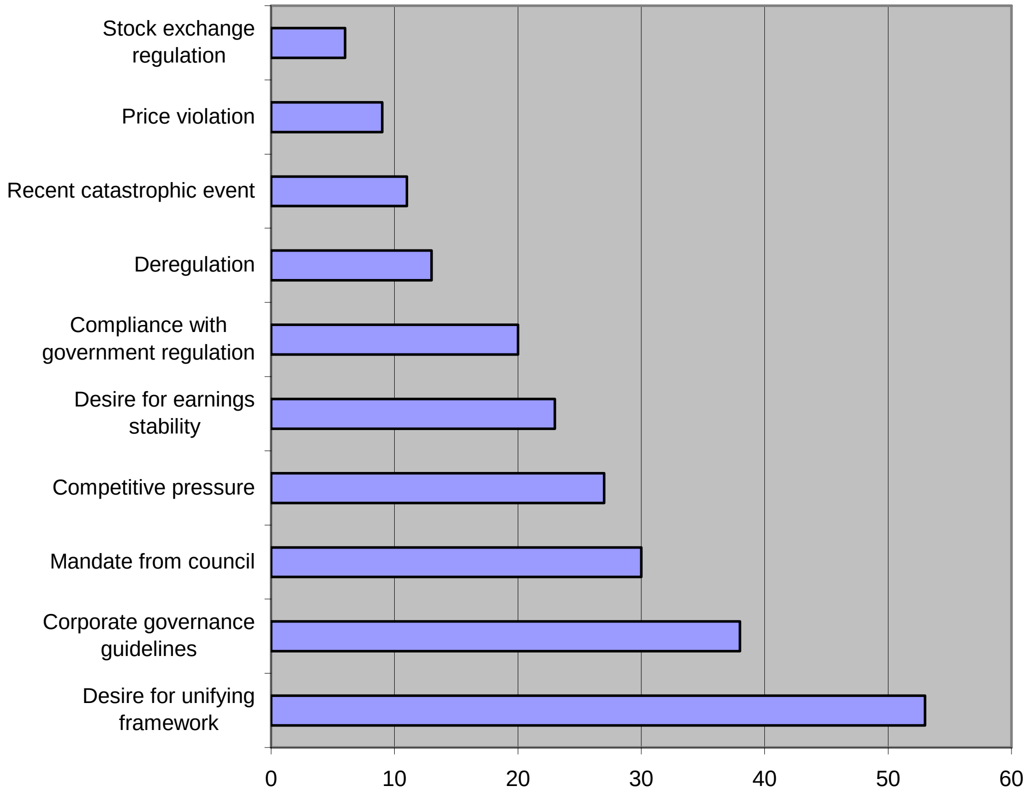



**Miccolis *et al*. (2001:8)**

- Factors driving integrated risk management implementation

Respondents were asked to identify the specific factors why organisations engage in integrated risk-management implementation. As indicated in Graph 6 with percentages, the desire or need for a unifying framework for managing risk is the most prominent reason for organisations to engage in an integrated risk-management activity, followed by the role of corporate governance guidelines to comply with legislation. The third driver for those organisations with integrated risk management was the role of a council (own interpretation) in mandating the need for implementing risk management in organisations.

**Graph 6** **Factors driving IRM implementation**

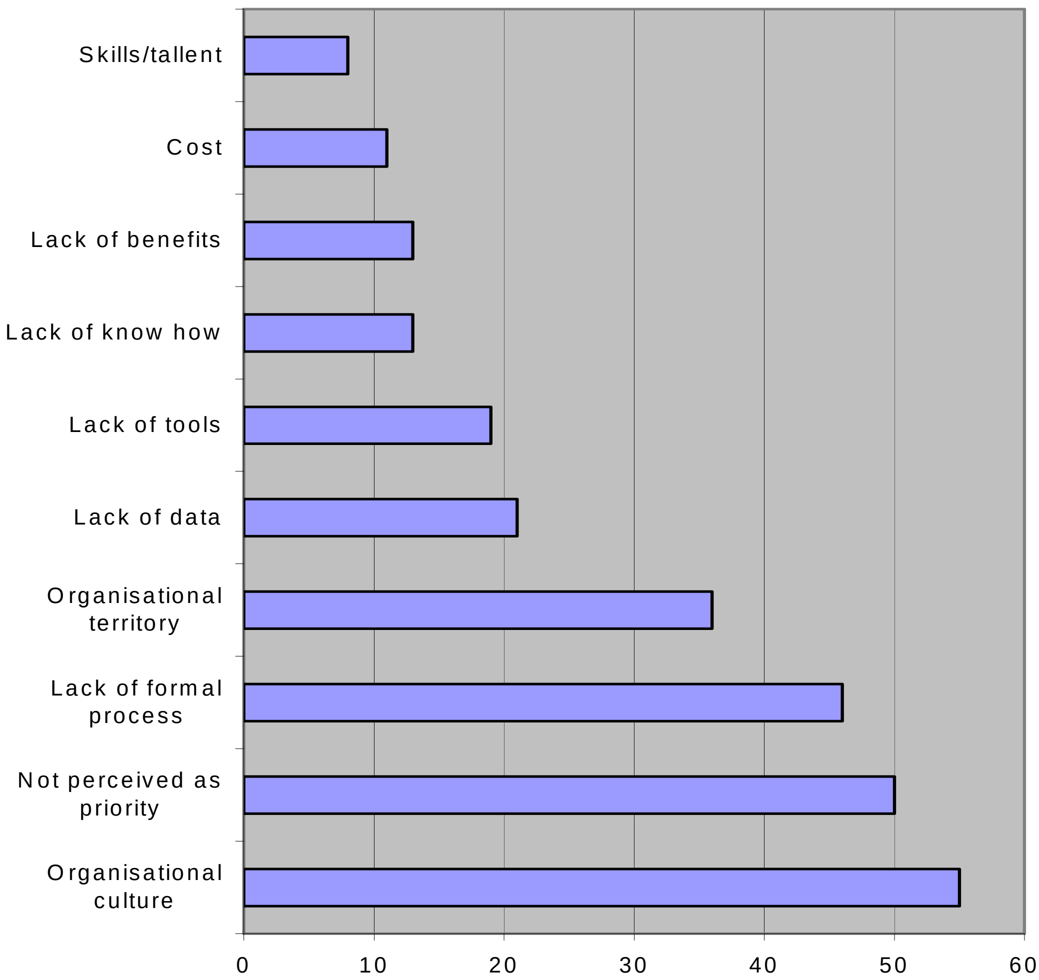



**Miccolis *et al*. (2001:16)**

- Top barriers to implementing integrated risk management

The analysis of the data regarding the top barriers with percentages (see Graph 7) to integrated risk-management implementation indicates that organisational factors such as organisational culture are ranked as the most important impediment to implementation. The issue ranked second from the top is "Not perceived as a priority among senior management". It was concluded that, of the respondents who picked "not perceived as a priority by senior management" as the primary impediment to implementing integrated risk management, 69% were organisations either planning or investigating integrated risk management. This same group of respondents found a lack of support from their political representatives in driving the movement toward integrated risk management in contrast to organisations with some form of integrated risk management. This result suggests that, while there are a number of internal and external factors influencing examination of integrated risk management, political support for committees driving the risk management programme may be the key to implementing the risk-management programme (Miccolis *et al*., 2002:10 and Kemshall *et al*., 1996:11).

**Graph 7** **Top barriers to implementing IRM**



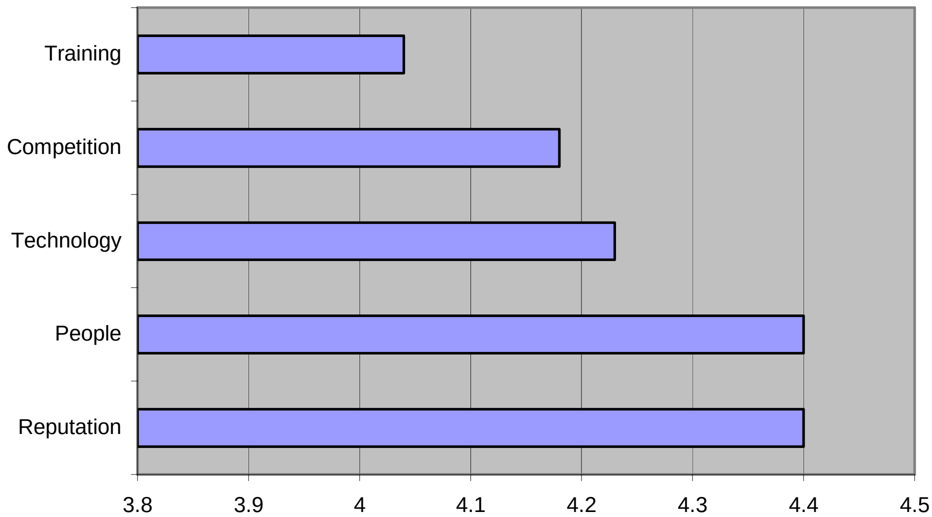

**Miccolis *et al*. (2001:17)**

Although it is does not appear in graph 7 Miccolis *et al* (2001:19) also stated that 82% of the respondents indicated that the most widely used committee to deal with risk management and compliance issues was the audit committee. The executive committee played a major role in 47% of the organisations and a risk-management committee was prevalent among 39% of respondents. Miccolis *et al*. (2001:20) state that these committees include senior management and have broad cross-functional membership. He draws a comparison between the top barriers to implementing integrated risk management (e.g. organisational culture; not perceived as priority and lack of formalised processes) and the fact that these committees are composed of members of management who clearly seem to be in a position to deal with these barriers, as indicated in Graph 7.

- Areas of risk influences

The rating of the five most important areas of risk influences revealed that “reputation” and “people/intellectual capital” rated the highest (4.4) on a five-point scale. Technology, competition and expenses on issues such as conducting workshops and training sessions rated 4.23, 4.18 and 4.04 respectively (see Graph 8).

**Graph 8** **Areas of risk influences**

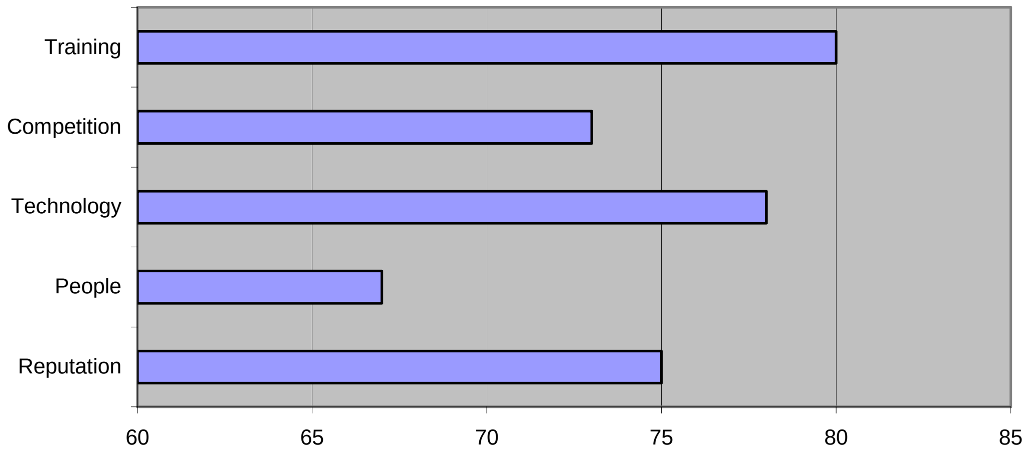



**Miccolis *et al*. (2001:23-25)**

- Management of risk influences

Miccolis *et al*. (2001:31) noted that 75% of respondents are actively managing reputation, 67% manage people/intellectual capital, 78% manage technology, 73% manage competition, while training expenses received the highest score, namely 80% (see Graph 9). It is noted that people/intellectual capital issues may require active management, because they are responsible to embed a risk culture in organisations as well as to enhance the risk management process.

**Graph 9** **Management of risk influences**

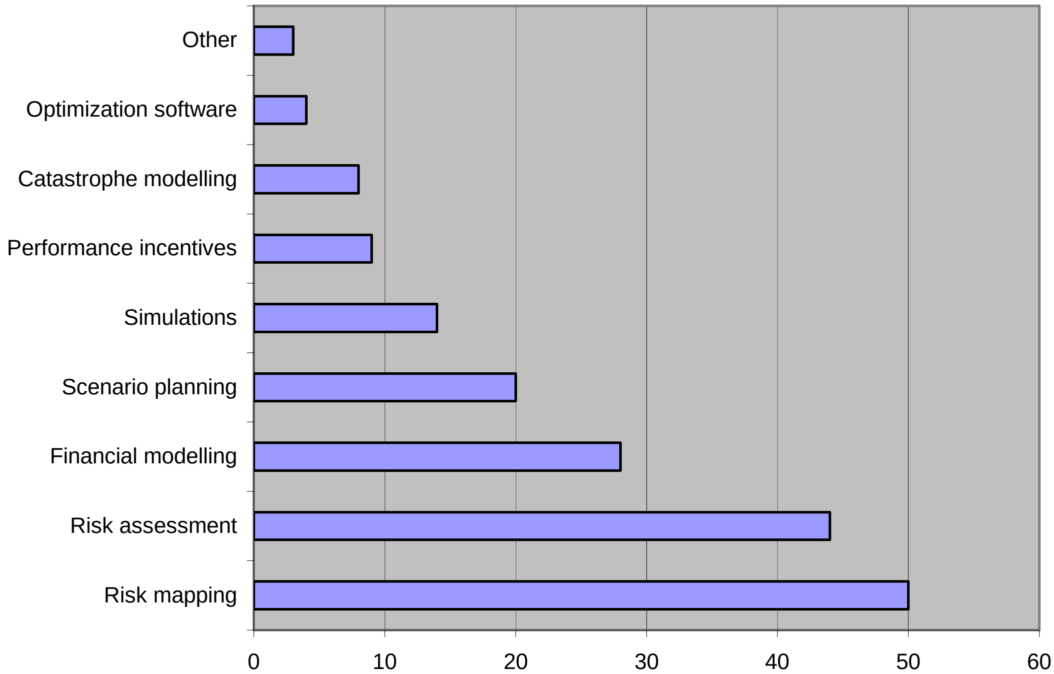



**Miccolis *et al*. (2001:31)**

- Types of tools used to implement risk-management processes

Miccolis *et al*. (2001:55) state in the research document for the Institute of Internal Audit's Research Foundation in the USA in 2001 that the use of sophisticated modelling tools is not much appreciated among the organisations surveyed. As depicted in Graph 10, modelling tools with percentages such as financial modelling are used as a primary tool among fewer than 30% of total respondents. Simulation tools as a primary technique are used in fewer than 15% of organisations. The risk-assessment process is more widely used to ascertain the root causes of risks as well as to assess the impact and likelihood of occurrence of a risk. The rating determined once the impact and likelihood have been determined is used to plot or map the risks visually. The mapping of the risks indicates the risk profile visually and it represent the most popular tool, because management can see by looking at the risk map how the risks cascades from high to low.

**Graph 10 Modelling tools used to implement risk management processes**



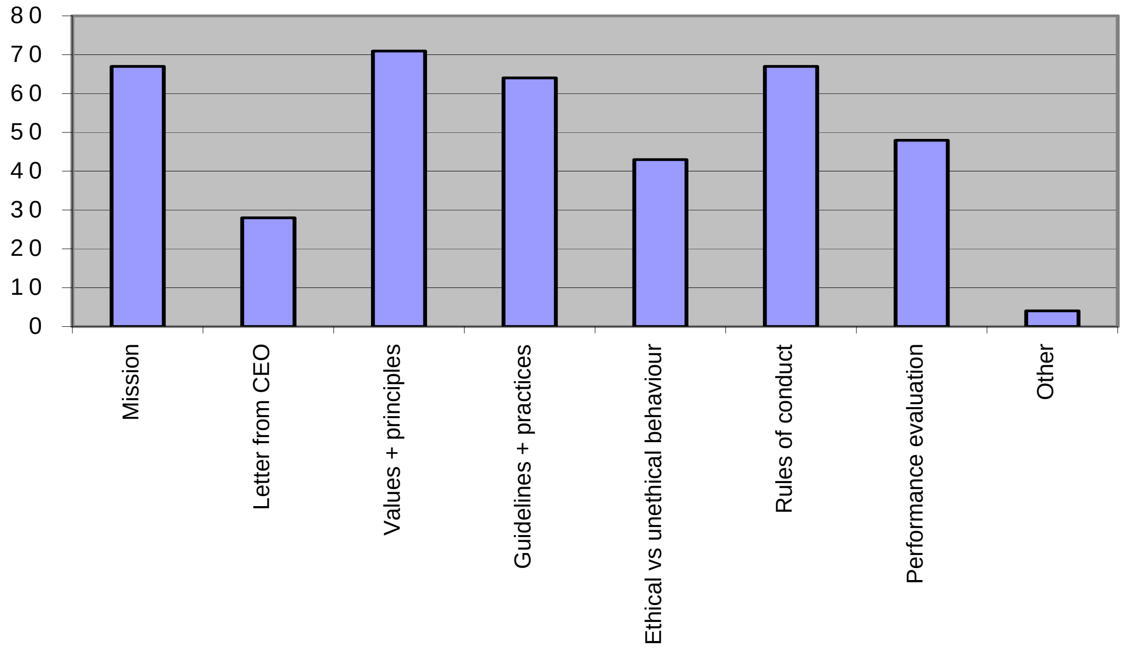

**Miccolis *et al*. (2001:55)**

- Establishment of a Code of Conduct in South African organisations

The object of the ethics practice survey was to measure the extent to which South African organisations succeeded in establishing certain basic ethics management practices. This survey was a combined effort between KPMG in South Africa, the Public Service Commission and Transparency South Africa (KPMG, 2001:1). This survey covered organisations in the public service (30 respondents, for example, government and education departments), private organisations (76 respondents, for example, chemical and pharmaceutical) and civil society organisations (60 respondents, for example, Salvation Army and Round Table).

The results indicate that the greater majority of organisations in South Africa only recently saw the need for such Codes and that Codes of Conduct are a relatively new management aid in South Africa. Grieve *et al.* (2001:6) state that this may explain the fact that Codes are not yet being distributed externally to all stakeholders and that the lack of external distribution is problematic, because raising awareness will enable pressure from external stakeholders of the organisation to encourage it to "walk the talk". Graph 11 depicts the contents in terms of percentage covered in the Code of Conducts surveyed.

**Graph 11** **Contents of Code of Conduct**



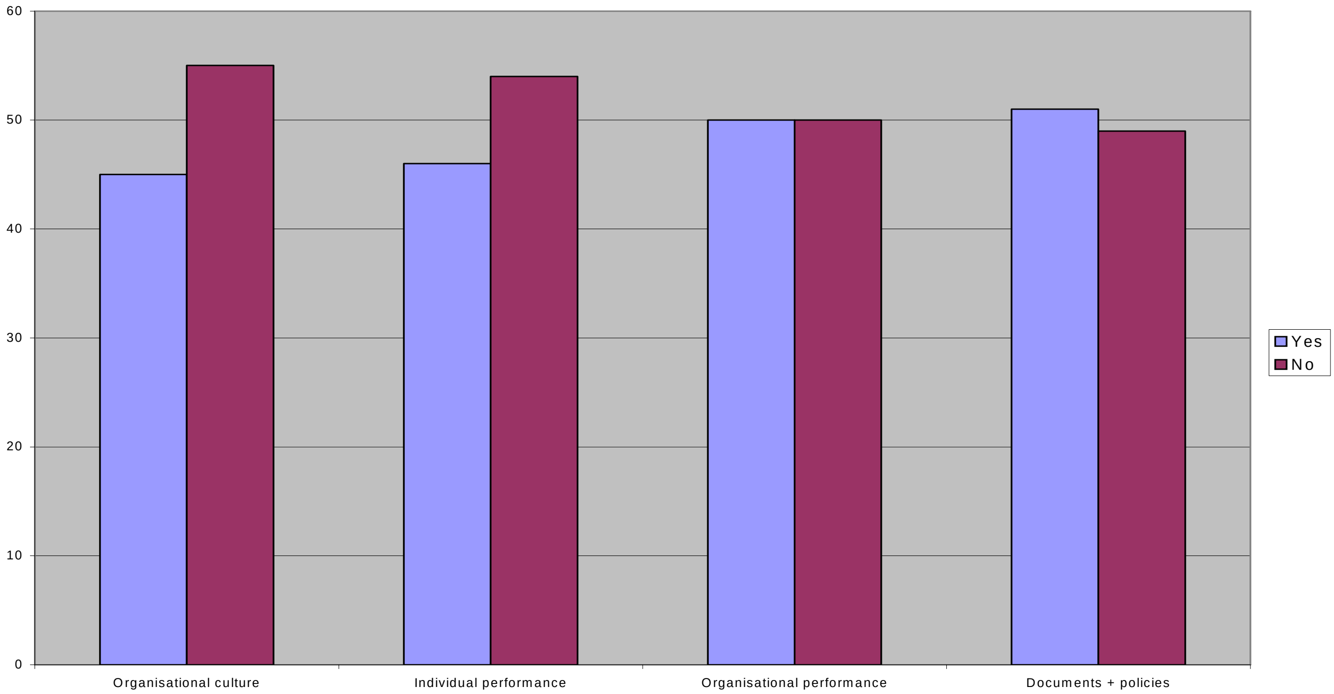

**Grieve *et al*. (2001:6)**

- Ethics related evaluations

The KPMG (2001) South African survey measured the extent to which South African public, private and civil organisations have succeeded in establishing basic ethics management practices. It was revealed that only 5% of the respondents reported that their personnel had a tertiary education in ethics and 52% received their ethics knowledge and skills through attendance of conferences, seminars or workshops. In answer to the question whether organisations undertake formal ethics-related evaluations with regard to the organisational culture (for example, number of corruption cases reported), individual and organisational performance (for example, performance management on an annual basis to determine if targets have been met) and other documents and policies (for example, integrated development policy), approximately

50% of the respondents confirmed that organisational culture, individual and organisational performance, ethics documents and policies are being evaluated (Graph 12).

**Graph 12 Ethics-related evaluations**

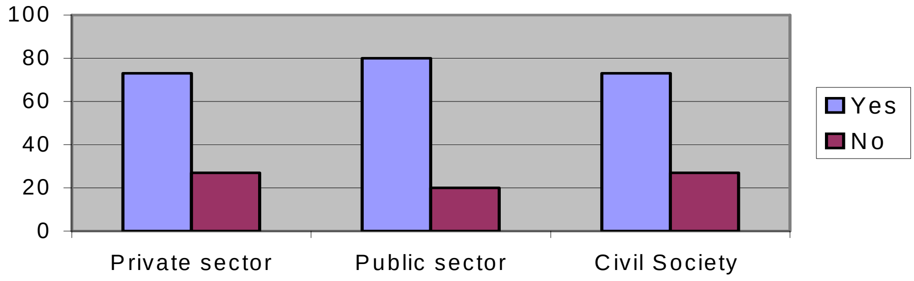



**Grieve *et al*, (2001:8)**

- Reporting mechanisms to protect personnel

With reference to the existence of reporting mechanisms, Grieve *et al*. (2001:8) state that 74% of respondents indicated that their organisations have a formal policy to protect personnel who report ethical or legal violations in South Africa. Comparative statistics between the private and public sector as well as civil society about the existence of a formal policy to protect personnel who report ethical or legal violations on a percentage basis are indicated in Graph 13.

**Graph 13 Reporting mechanisms to protect officials**



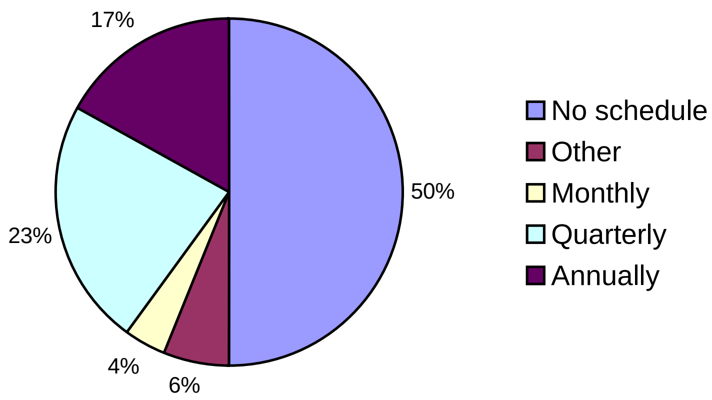

**Grieve *et al.* (2001:8)**

It is indicated in Graph 13 that 80% of public sector organisations have reporting mechanisms that protect officials. The private sector and civil society respondents reported that 73% of their organisations have reporting mechanisms that protect their officials.

In terms of confidential reporting mechanisms, South Africa (32%) compares well in terms of similar KPMG research in Canada, where it was reported that only 22% of respondents enjoy confidential reporting mechanisms. The Canadian respondents believed that their corporate cultures allowed for open communication without fear of reprisals and therefore their confidential reporting lines are not necessary. In the South African context 68% of organisations' respondents indicated that they were not informed of The Protected Disclosures Act, 2000 (Act No. 26 of 2000) and its implications. The publicising and marketing of the protection that South African officials have under The Protected Disclosures Act, 2000 (Act No. 26 of 2000) should reduce the risk of fear of victimisation.

Bodnar *et al.* (1999:298), in their 1998 survey concerning financial risk management by US non-financial organisations, asked questions about internal procedures for derivatives usage. The first question dealt with the number of organisations that had a policy in place to report on derivatives. To this question 79% of the respondents answered positively. The question regarding the frequency of reporting derivatives activity to management revealed the following results based on percentages, as depicted in Graph 14.

**Graph 14** **Frequency of reporting**



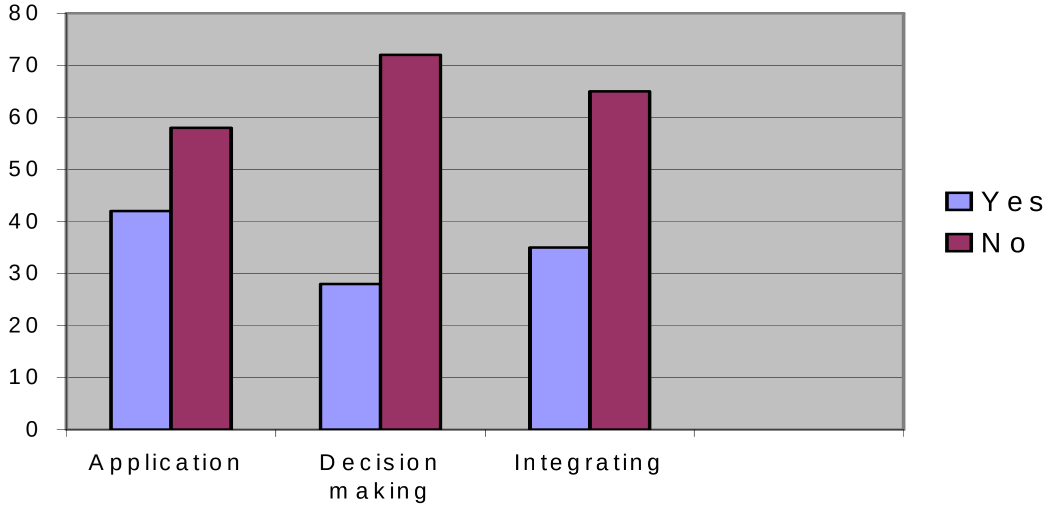

**Bodnar *et al* (1999:298)**

Graph 14 indicates that 50% of the organisations had no preset schedule to report on derivatives, while 27% reported to management either monthly or quarterly and another 17% annually. Bodnar *et al.* (1999:298), stated that this proportion is similar to the results of surveys undertaken by the Wharton School, University of Pennsylvania in 1998, on risk-management practice and derivatives used by non-financial organisations in the United States.

- Types of ethics training

Respondents were questioned on the type of ethics training with regard to (a) application of the Code of Ethics, (b) ethical decision making, (c) integrating ethics into everyday activities, and (d) other. The answers linked to percentages are indicated in Graph 15.

**Graph 15** **Types of ethics training**




**Grieve *et al.* (2001:9)**

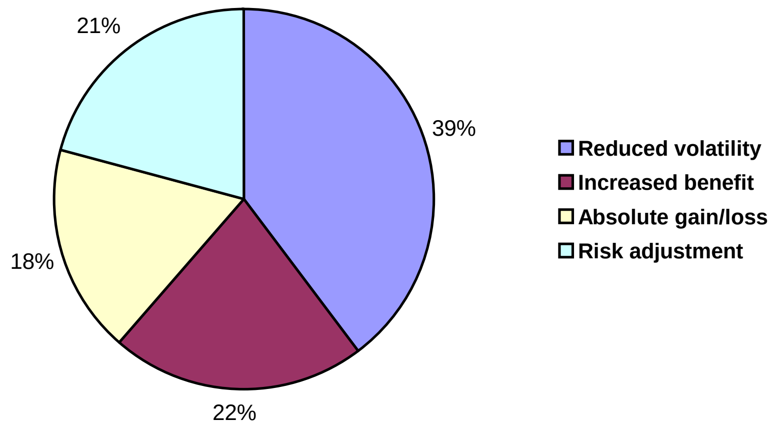
It is deduced from Graph 15 that 42% of the respondents indicated that their organisations do provide training on ethics codes and 58% of respondents indicated that their organisations do not provide training on the application of the ethic codes. 72% do not provide training on ethical decision-making and 65% provide no training on how to integrate ethics into everyday activities. From these percentages it can be seen that little is done to assist officials in developing ethical skills to enable officials to exercise discretion in their daily activities in a responsible manner.

Thus, the fact that only 42% of the South African respondents indicated that their organisations train their officials on the application of their ethics codes, restricts the positive value of the adoption of Codes in many organisations. The perception is created that a Code of Conduct is more of a reputation-management exercise and is not seen as part of the core business activities in which officials should be trained.

- Evaluation of the risk-management function

Evaluating the risk-management function within an organisation was also surveyed and the results are indicated in Graph 16.

**Graph 16 Evaluation of the risk management function**




**Bodnar *et al* (1999:300)**

The evaluation of the risk-management function in the organisations where it was implemented, indicated that “reduced volatility” was the most popular choice (39% of respondents) and 22% of the respondents indicated that they evaluate the risk-management function on the basis of its ability to identify and explore opportunities or increased benefit for the organisation, while 18% used an absolute gain/loss approach to risk-management evaluation. 21% percent of the organisations indicated that they preferred a risk-adjustment measure to evaluate the risk management function. The assumption is made that choices differ depending on aspects such as the nature of each organisation, its competitors, the environment that it is operating in as well as the culture of the organisation (for example, farming activities versus municipal activities). It was stated that the main purpose of risk management is to reduce risk rather than to increase benefits, because it could result in risk managers taking high risks that may increase the total risk-proneness of an organisation (Bodnar *et al*., 1999:300 and Young *et al*., 2001:377).

Thus, risks that are identified and evaluated should reduce volatility, in that the risks and opportunities can be managed proactively which will contribute to savings if risks are reduced. These benefits could be utilised to enhance service delivery as well as the reputation of the public sector. These benefits could also increase the confidence of stakeholders in the management of the public sector. Effective internal audit departments should also contribute to an increase in confidence in public sector management.

#### 4.2.7. Surveys on importance of internal audit for organisations

The results of the Auditor-General's survey in South Africa (2000:50) for the 1999-2000 financial year highlighted the following risks. These risks could be mitigated by increased performance although it is accepted that high risks are not necessarily an indication of poor performance:

- 46% of internal audit units had facilitated a risk assessment;
- 21% reliance could be placed on the work performed by internal audit;
- 44% of audit committees had made recommendations on how to mitigate risks;
- 42% reliance could be placed on the auditees' systems of internal control;
- 50% of the auditees had finalised a service-delivery-improvement programme; and
- 44% of the auditees had published an annual report for the stakeholders.

The Office of The Auditor-General in South Africa is further concerned about the number of instances where audit committees had not been instituted in the public sector or are not independent. Another factor of concern is that only 60% of respondents, representing all directors of Johannesburg Stock Exchange-listed companies in South Africa as per the KPMG (2002:7) survey, believed they have an effective internal audit function and only 19% of the respondents believed that increased emphasis should be given to internal audit. In contrast, 70% of respondents stated that their organisations have an effective risk-management process, with 62% believing that management receives sufficient feedback on the quality of risk management. Risk management, as per the KPMG 2002 survey, was rated as the 5$^{th}$ priority area out of a total of 17 priority areas for future corporate governance focus. The survey concluded that 80% of organisations surveyed expect to spend significant resources to establish effective risk management in their organisations in future.

Eckhart *et al.* (2001:52) referred to a survey conducted amongst 522 local authorities in the United States in 2000. This survey indicated that municipalities did not rely on either audit committees or the internal audit function and it is stated that in the mid-1990's audit committees and internal auditors were not prevalent in municipalities. According to Eckhart *et al*. (2001:52) the situation has improved since then and it is reported that, out of 299 respondents, 28% of the municipalities had an audit committee and 49% had an internal audit function. Based on these results, it is evident that there are opportunities for improvement. Reference is made to the assessments of activities that auditors perform in municipalities, which indicates an opportunity for auditors to show management that they can add value through expanding the scope of internal auditing. Eckhart *et al.* (2001:52-53) further stated that 51% of the municipalities surveyed do not have an internal audit function and the "absence of a legal requirement" in South Africa prior to 2001 is the most common explanation for why an internal audit function is not present. It is suggested that the lack of the enforcement as a legal requirement through legislation is the reason why municipalities in South Africa are not aware of the contribution that internal auditing can make, with the resultant risk that sound organisational governance might be non-existent or lacking.

The Association of Certified Fraud Examiners in Austin, Texas (1998:28), based on their survey from 1993-1995 amongst 600 American respondents, are of the opinion that internal auditors can be of assistance in combating corruption. The survey revealed that 70% of respondents believe that corruption detection and deterrence techniques have improved, which indicates that the growth of training and education in anti-corruption practices has affected practices against corruption positively. The majority of respondents (75%) hold an overall negative view about the state of efforts to curtail corruption, because they believe that law enforcement and the civil courts do not hand out adequate punishments to perpetrators of corruption. Another point of concern raised is that 75% of respondents believe that management does not allow adequate resources to detect and deter corruption. It is not surprising that the respondents believe they receive unsatisfactory support from management, as it is indicated that a non-revenue-generating function such as internal auditing is cut to the bone amid the current corporate trend in downsizing.

## 4.3. Summary

The majority of professionals internationally engaged in the field of prevention of risk are generally pessimistic about the status of efforts to control risk. The majority of respondents are of the opinion that:

- risk levels are on the rise;
- officials who commit corruption and maladministration are not punished adequately;
- management does not provide sufficient resources to combat risk; and
- management generally lacks the desire to prosecute unethical officials.

The costs of risk are high and it would seem that the potential for such material losses would prompt organisations to adopt an aggressive stance against risk, but the outcome of the surveys indicate that this does not generally happen. Accordingly, management should be encouraged to play a proactive role in the prevention of risk. If risk prevention is not a priority for management, it may become a priority for officials to become involved in, for example, corruptive practices. Every organisation should adopt an ethics policy that is strictly enforced.

The international surveys showed that there are some encouraging signs on the management of ethical practices, also in South Africa, but there are still challenges ahead. Another conclusion is that survey respondents realised that in some cases the reality experienced by officials or organisations might be different from some of the trends that were identified in the surveys. The quality and effectiveness of existing practices as well as the reasons for the absence of practices within some organisations needs to be examined. Attention should also be given to differences between organisations with reference to size and type of organisations. In this regard reference was made to the public sector, for instance, which needs to increase the number of confidential reporting lines of unethical conduct.

The low response rate in organisations that carry out ethical education is regarded as significant, because it is deduced that ethics-management strategies and management processes with reference to embedding an organisational culture in organisations are still new areas in South Africa. It was concluded that extensive ethics awareness-raising and training activities are still required within local government. In terms of the variability of organisational risks, a widespread internal clean-up of the ethics function within organisations is needed. The process should involve a range of activities that will demonstrate the organisation’s commitment to ethics and ethical behaviour. These processes should include:

- effective measurement of ethical performance and integration, and reporting;
- ensuring the effective design and implementation of ethics policies;
- developing appropriate ethics training programmes at all levels within the organisation;
- developing effective reporting mechanisms and ensuring that officials understand the need for, and consequences of such mechanisms; and
- appointing and supporting senior-level officials to co-ordinate and implement ethics programmes.

It is concluded that managers should consider the results as presented through surveys carefully in order to manage organisations optimally. Therefore, reasons for the practising of risk management should include the following:

- managing the risks to enhance stakeholder trust in the organisation;
- complying with requirements of regulators, financial institutions, vendors and others with enforceable interests in the organisation;
- managing or curbing any extraordinary costs to run and maintain operations;
- addressing moral and ethical concerns; and
- getting managers and officials to moderate the impact of risk and uncertainty on their day-to-day activities.

Stability and the reduction of uncertainty would be a risk-management objective in the sense that most managers value predictability in their environment. It should also be realised that stability is not necessarily the only criterion, because risk management can directly affect the seeking out of new risks, the decisions to take those risks and the measures that enhance the prospects of success. Therefore, arguing that competency-based risk-management goals are driven by stability considerations ignores the important upside potential that risk management provides. Thus, competency maximisation can also be a risk-management objective.

In order to implement risk management to enhance efficiency in the public sector, it is imperative to evaluate the findings in this dissertation. This evaluation will be conducted in Chapter 5 to realise the objective of minimising losses in local government by means of an integrated risk management programme.

## CHAPTER 5

## AN EVALUATION OF INTEGRATED RISK MANAGEMENT IN LOCAL GOVERNMENT IN SOUTH AFRICA

### 5.1. Introduction

Integrated risk management is a growing discipline and different views and descriptions exist of what integrated risk management involves. An integrated risk-management programme is not a one-size-fits-all product that can be bought off the shelf. This means, therefore, that an organisation has to reach agreement on aspects such as the terminology used, also referred to as organisational language, the process by which risk management can be carried out, the organisational structure and culture, and the objective of risk management.

The purpose of the evaluation is to identify the essentialities needed to make a success of the risk-management programme in local government. The benefits and opportunities of risk management must be capitalised on and enhanced. In order to prevent risks from becoming losses with adverse consequences, risks must be timeously identified. Mechanisms for stakeholders, such as training, policies and development of managerial skills, need to be established to contribute to the development of an efficient and effective risk management programme (Rucker, 2002:6).

The focus of this Chapter is to determine whether the risks that surround the organisation's past, present and future activities have been addressed and whether the risk-management process has been integrated into the culture of local government in South Africa. Aspects that will be described include policies, planning, management by example, organisation culture, control activities and monitoring to enhance the integrated risk-management process in local government. In this Chapter the problems prevalent in local government with regard to integrated risk management will be assessed. The positive aspects and recommendations to address the problems will be discussed in Chapter 6. To ensure sustainable risk management, management should focus stakeholders on the achievement of the objectives of integrated risk management.

## 5.2. Integrated risk management

Risk management in local government in South Africa is not completely integrated, which confirms Miccolis's view, based on an international survey, that there is a lack of formal integrated risk-management processes in organisations (see Chapter 4, Graph 7). The lack of integrated risk management may prevent local government from achieving its objectives.

### 5.2.1. Objective of risk management

Legislation, such as The Constitution, The Batho Pele White Paper (Notice No. 1459 of 1997), The Systems Act (Act No. 32 of 2000), and The Municipal Finance Management Act (Act No. 56 of 2003), stipulates that the objectives of an organisation have to be practical, achievable, clear and specific to serve as an instrument of motivation as well as an instrument of measuring the degree in which objectives are met (The Institute of Internal Auditors, 2003 – Practice Advisory 2110-1 and Sawyer, 1981:77, 101 and 103). The objectives of integrated risk management are to reduce the impact and likelihood of incidents and to secure stability of the cost of risk as well as to minimise recurrence of the risk so as to enhance efficiency in the operations of an organisation (Cafferty, 2003:25). Therefore, if the objectives are not achieved, officials will lose commitment to the integrated risk-management process, which could be regarded as a stumbling block in the attempt to achieve the objectives of the organisation (Denenberg *et al*., 1974:80; Greene *et al.*, 1983:4; Valsamakis, 1996:61; Van Niekerk, 2000:15 and Terry, 1978:15). The achievement of objectives can be facilitated by the implementation of a mission and vision statement, supported by an integrated risk-management programme. The mission and vision statement should provide proposals to stakeholders on how the objectives of an organisation can be achieved, whilst the integrated risk-management programme provides the details on processes to achieve the objectives in an economic, efficient and effective manner.

## 5.3. Integrated risk-management programme

Although risk-management programmes are to be found in certain local government organisations in South Africa, they are fragmented and implemented only in certain departments within local government. Fragmentation may result in the vision and mission not being fully understood and consequently not successfully achieved.

### 5.3.1. Mission and vision statement

Mission and vision statements are important mechanisms to focus the attention of officials on the objectives of risk management and the importance of controls, as well as on the conditions, corporate structure and service delivery in local government. Newsome (2003:12) states that the mission and vision statements provide purpose and focus the development of public sector organisations on specific risk-management goals and strategies. The lack of a mission and vision statement for local government organisations suggests that management is not publicly taking responsibility for the total programme of risk management or for the continuous evaluation of the effectiveness of the risk-management programme. Management has to accept that it is accountable to the council and public – for example, in the case of a local authority, for designing, implementing and monitoring risk management as well as integrating it into the culture and day-to-day activities of local government (Dunne *et al.*, 2002:26-31, Jackson, 2003:52 and Van der Westhuizen, 2003:7).

Considering the practicalities in local government in South Africa – for example the general waste and ineffective use of resources (Die Burger, 2005:1), unsustainability in the provision of basic requirements such as electricity (Die Burger, 2005:18) and the under-collection of municipal debt (Die Burger, 2005:5) it is evident that its objectives are not being achieved in the manner prescribed in legislation.

Thus, it is essential that the mission and vision are well communicated and understood by officials to keep them focused on objectives and strategies, and they may also assist in making officials aware of their responsibilities. Stakeholders have to have knowledge of the meaning of risk and risk management in order to focus on the relevant risks.

## 5.4. Definitions of risk and risk management

Risk refers to the probability that a hazard, such as lack of financial controls or unethical conduct, could lead to an incident of corruption or some form of loss to the organisation. The realisation of a risk could affect the output on organisation's performance over a period of time, which means that the greater the dispersion of possible outcomes, the higher the organisation's level of exposure to risks (Pfeffer, 1956:42; Denenberg, 1974:4; Greene *et al.*, 1983:24; 1984:4 and Deloach, 2000:48).

Risk management is defined as a function to identify, analyse and control the risks which threaten the assets of an organisation as well as to provide protection against the adverse consequences of risks to reduce the impact and likelihood of losses. The organisational ethical culture, processes and structures that are directed towards the effective management of potential opportunities and impact of risks, as well as the systematic application of management policies, procedures and practices, are also part of the risk-management function (De la Rosa, 2005:9-12; Dickson, 1998:18; Kloman, 1984:33; Valsamakis *et al*., 1996:14; Australian/New Zealand Standards for Risk Management, 1999:4). Risk management has to be integrated into the day-to-day activities of an organisation, such as decision-making.

Although risk and risk management are addressed by many writers and in standards such as the Australian/New Zealand Standards for Risk Management, the King 2 Report on corporate governance and in the COSO Framework, no mention to these definitions appears in what are generally accepted as important pieces of legislation for local government in South Africa, such as The Municipal Finance Management Act. The only statement referring to risk management that could be found is in section 62(c)(i) of the Municipal Finance Management Act, where it is stated that “a municipality should have and maintain an effective system of risk management and internal control”. The Structures Act and Systems Act also do not address risk or risk management by means of a definition; this can be regarded as a flaw, because a lack of direction for stakeholders results from the omission of important definitions.

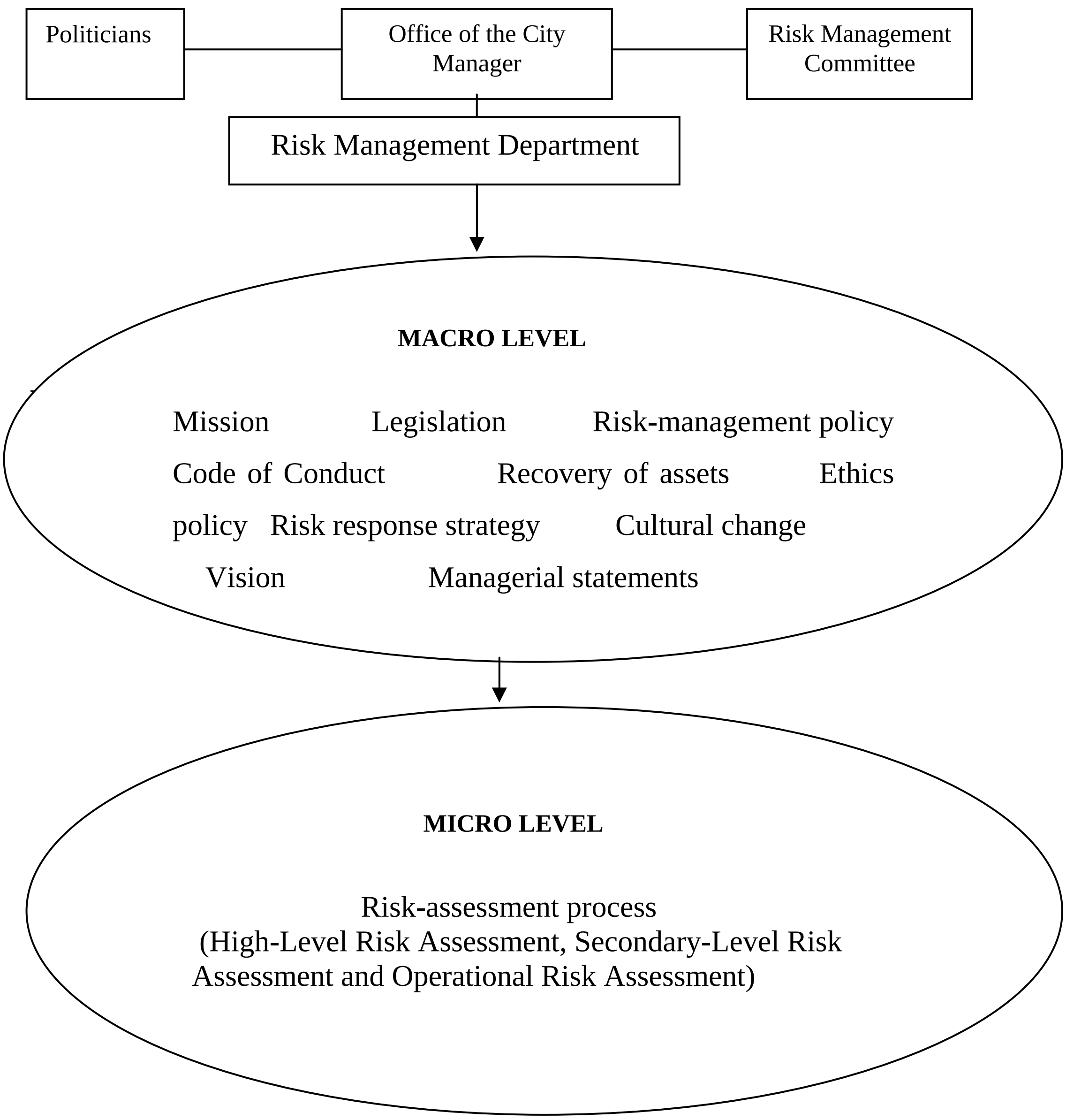
Thus, the contexts in which risk and risk management can be viewed are diverse and it is difficult to define these concepts in a universally accepted manner, but legislation that is applicable to local government has to provide the much-needed guidance in this regard. Risk management is a broader concept than risk, and the objective of risk management is to prevent or minimise the risks in the environment in which the organisation operates. To understand risks in a local government environment, it is necessary to have knowledge of the macro and micro levels that are needed to support the risk-management function.

## 5.5. Macro and micro risk-management support

Currently limited macro and micro risk management support exist nationally for an integrated risk management program in local government. This support on macro level as depicted in Figure 27 (developed by researcher) is needed. As indicated in Figure 27 the reference to “Politicians”, “Office of the City Manager” and “Risk Management Committee” is not part of the levels within the Risk Management Department, but represents those authorities to which the Risk Management Department has to report. The Risk Management Committee could consist of executive management and private representatives who are knowledgeable about integrated risk-management activities. The role of the Risk Management Committee is to inform politicians and the City Manager of the risks that might prevent a local authority from achieving its objectives as well as to guide the Chief Risk Officer, as head of the Risk Management Department, in achieving the objectives of the organisation.

The macro level addresses the aspects to be in place to enhance the efficiency of risk management in the public sector. The lack on macro level of the existence of, for example, proper legislation, the non-existence or non-enforcement of risk response strategies and Code of Conduct as well as the lack of, or inconsequent recovery of assets prevents the realisation of the full benefits of a risk-management programme in South Africa.

**Figure 27 Levels within the risk management department**



The micro level support which lack in local government in South Africa addresses the aspects that are needed to support the policies on macro level. The micro levels to be included in the risk assessments are necessary to avoid risks on the lower levels in local government not being identified and mitigated.

Thus, as depicted in Graph 5 in Chapter 4, it is clear that internationally few organisations (11%), inclusive of private and public sector organisations, have a complete integrated risk-management framework in place, which increases the possibility that organisations accept risks or suffer losses that they are not aware of. The following integrated risk-management processes therefore will be evaluated in terms of an efficient integrated risk management program implementation.

## 5.6. Integrated risk-management program

The success of an integrated risk-management program has to be measured against public management functions; this refers to policies, planning, management by example, organisational culture, control activities and monitoring, which are described below. The focus will mainly be on those aspects that are currently lacking in the South African situation, for example, there is no theoretical integrated risk management model for local government in South Africa which might be a reason for the lack of integrated legislation for risk management.

### 5.6.1. Policies

The implementation of policies is essential to achieve the objectives of an organisation effectively and this is in turn dependent on accurate information. The application and knowledge of policies is essential to avoid the risk that stakeholders are refused the right of access to public services. Such refusal may lead to disciplinary action against officials and legal suits against organisations (Marcella, 2003:67).

The following strategies have to be considered to support the policies.

5.6.1.1. Legislation

There exist a lack of complete encompassing legislation for integrated risk management on local government level in South Africa. Although certain deductions regarding risk management issues can be made as described in Chapter 3, consideration should be given to develop specific risk management legislation, because current legislation is not comprehensive. Current legislation mainly addresses corruption and disaster management, but reference to maladministration is lacking. Legislation providing guidance in terms of risk management structures, risk management processes to follow, personnel and posts requirements are also lacking. The lack of legislation contributes to problems such as no mission or vision statements and a lack of efficient and effective strategic objectives that are achievable, sustainable and cost effective.

5.6.1.2. Service-delivery strategies

Service-delivery strategies to enhance the quality and quantity of services, which are sustainable and affordable, must be implemented. Certain requirements, for example, developing service standards, are identified in The White Paper on Transforming Public Service Delivery, 1997 (Notice No. 1459 of 1997), Section 1.2.3, and can be measured against comparable international standards. Although service delivery standards which are applicable to local government do exist, they are merely lip service, because of managerial incompetence, loss of intellectual capital due to restructuring, political red tape, deteriorating or exhausted infrastructure (leading, for example, to disruptions in electricity supply), and lack of funds (for example, the exodus of knowledgeable officials resulted in debt control collapse). It has thus become almost impossible to render services in South African local government that are comparable with international best practices (Die Sake Burger, 2000:3; Die Burger, 2001:9, Die Burger, 2005:1 and Die Burger, 2005:5). Therefore, the performance of officials needs to be monitored and managed to mitigate the risk of service-delivery strategies deteriorating as a result of inadequate performance. The monies that are approved for budgeting purposes have to be spent on the identified projects to implement the service delivery strategies. The problem is that, based on the above articles in Die Burger, spending on approved projects (for example, upgrading of roads and water reticulation infrastructure) is not materialising in all instances. It must be acknowledged that the South African Government does endeavour to enhance the Country's infrastructure by approving R14,3 billion for infrastructure development in the 2005/2006 budget (Die Sake Burger, 2005:3 and Die Sake Burger, 2005:1).

5.6.1.3. Managing performance

It is necessary to implement and maintain a policy for managing performance to prevent the risk that key performance indicators and targets are not achieved (Prenzler, 2005:14-18). Criteria are determined in The Systems Act to clarify the roles and responsibilities of officials in implementing the performance-management system. Daily newspapers report examples of controversies over issues such as statistics on the number of houses approved and budgeted to be built for previously disadvantaged residents, but in reality the funds have not been spent on capital projects, or the targets for completion and delivery have not been met (Die Sake Burger, 2000:3).

Thus, officials have to be trained, for example, on an ongoing basis via internal courses, external short courses or professional courses to obtain a relevant degree or diploma in the management process with the view to developing an insight into public service delivery. Training will assist to improve the monitoring of the performance-management system to prevent the risk that projects such as approved capital for roads and housing projects are not executed during a specific time frame and within a planned budget.

### 5.6.1.4. Responsibilities of municipal officials

Cafferty (2003:45) states that municipal officials have responsibilities such as ensuring an efficient and effective policy for risk management. They are responsible for policies on internal audits and procurement, and for evaluating capital projects. Municipal officials are under an obligation to collect all money due and to minimise the risk of financial loss resulting from corruption.

Officials have to comply with legislation, which prescribes that steps must be implemented to ensure that irregular, fruitless and wasteful expenditure and under-collection of revenue are prevented (The Municipal Finance Management Bill, 2001, Sections 35 and 61, The Municipal Finance Management Bill, 2000, Sections 29 and 45 and The Public Finance Management Act, 1999 (Act No. 29 of 1999), Section 57).

Although certain officials regard their careers as providing a service to the communities and rendering services with dedication, instances occur from time to time where officials misuse their position of power and knowledge to benefit themselves. This happens because municipal managers and officials lack ability and capacity, for example, money and skilled officials (for example, risk officials), to effectively supervise and inspect the execution of policies and to monitor the trend deviations in income, expenditure and maintenance programmes (Die Burger, 2005:10).

### 5.6.1.5. Recovery of losses

The rendering of services and the conducting of financial affairs must take place in an accountable and transparent manner (Whitley, 2003:15). Clear policies have to be developed and regularly revised to assist in rendering services in an accountable and transparent manner. In practice not all officials are committed to the optimisation of resources in that certain officials make themselves guilty of, for example, failing to collect money; approving irregular payments; deficiency or damage to assets; or being responsible for claims because of an omission to carry out their specified duties (Die Burger, 2005:10). For example, the irregular inspection of fire hoses and extinguishers could result in public liability claims in case of losses of stakeholder's assets as a result of fire. The lack of optimisation of resources and consequent losses could be a result of an unacceptable organisational risk culture in local government in South Africa, as indicated in Graph 7, Chapter 4, as the top barrier that can impede the success of a risk-management programme.

Thus, management and officials need to fulfil their responsibilities in terms of policies in a cost-effective manner. The intention is to render services in a risk-free environment and for the benefit of stakeholders. The adherence to a Code of Conduct can facilitate the eradication of risks in service delivery.

5.6.1.6. Implementation of a Code of Conduct

A Code of Conduct is intended to enhance the professional ethos of officials, which will lead to the stamping out of the risk of unethical conduct and ensure confidence in the public sector. Stakeholders must be made aware of the value of accepting and abiding by a Code of Conduct, and hence any breach of a Code of Conduct must be reported without delay. Prompt reporting of any breach or potential breach may prevent the risk that, for example, the reputation of an organisation will be damaged. It will ensure that risks are assessed and it will also reassure stakeholders to know that checks and balances are in place to address potential risks (Cafferty, 2003:45 and the Systems Act). South African local governments do have a Code of Conduct, but the problem is that the benefits of a Code of Conduct are not always understood at the lower levels in local government. A Code of Conduct may be effective if officials are trained or reminded at regular intervals of its contents and meaning, but if the KPMG (2001) survey is any indication, it is doubtful if only the presence of a Code of Conduct will improve the ethical environment without thorough knowledge and insight in ethics, as only 5% of South African respondents indicated that officials have a tertiary education in ethics.

Thus, the effective enforcement of policies may assist management in their planning endeavours, especially if the policies are well known to all stakeholders.

## 5.7. Planning

Planning is necessary to inform management proactively of the identified risks that could disrupt the achievement of the objectives of an organisation. To mitigate losses and to prevent organisations from closing down, management has to ensure that an effective strategic, tactical, anti-risk and response plan is integrated into the organisation's objectives and strategy (Davis, 2002:8). These plans may enhance the detection of risks and can contribute towards protecting the reputation of the organisation.

The objectives of the strategic plan are to eliminate the probability of risks in an organisation as well as to minimise the losses when a control measure is circumvented. The tactical plan emphasises the completion of services within the agreed time frames and supports the achievement of the strategic anti-risk objectives. The anti-risk plans have to include all plans, policies, procedures, assessments and authorisation necessary to minimise the possibility of risks as an integral part of the organisation's asset-protection programme. Cafferty (2003:45) and PricewaterhouseCoopers (1999:31) state that, in order to close the gap between the identified risk profile and the level of risks that the organisation can accommodate, management needs to develop a risk response plan, for example, the risk of ageing of vehicles could increase maintenance cost or mechanical failure. This cost normally erodes capital budgets which prevents local government from rendering effective services.

The plans, if implemented successfully, may enhance the achievement of the objectives of an organisation. The plans needed to mitigate losses could include inspections at regular intervals, prompt pro-active responses to claims lodged and realistic financial due dates. It becomes clear from a history in the public sector of yearly applications to the Auditor-General to write off millions of rands due to losses such as unaccounted stock, time frames that are not met to render services, the close off of the financial records at year end and lack of control over sick leave, that the mentioned plans are almost non-existent or, if implemented, are not being managed properly (Die Burger, 2005:15 and Die Sake Burger, 2005:2). A sustainable risk-management process is dependent on the quality of management by example in the organisation. Competent management that can motivate officials to achieve the objectives of the organisation as well as to implement checks and balances to enhance controls is an equally important public management function.

## 5.8. Management by example

The tone that management sets has to be seen as the foundation for all other components of risk management to provide the necessary discipline and structure to the risk-management process (McNamin, 2005:39; Murray, 1997:50). Cafferty (2003:24) and Fazekas (2003:24) indicate that managers will have to lead a transformation process to the desired state, where each official sees risk management as part of the daily responsibilities.

It is doubtful whether an effective culture of control exists in local government in South Africa and whether management is creative in developing solutions to risk-management challenges. A lack of management by example is also prevalent, for instance, where politicians do not pay their bills for services received, or where government funds have been used by executive management to pay for a friend's bail (Die Burger, 2005:16 and Die Burger, 2005:5). Officials are expected to render services in an effective way and with the intention to optimise resources, and hence losses have to be recovered. Bodnar's 1995 and 1998 survey results (Bodnar *et al*., 1999:298), as depicted in Graph 14 (Chapter 4), confirm that 50% of US non-financial organisations surveyed have no preset schedule to report on derivatives, while 14% of organisations indicated that they do not have a documented policy for bringing derivative activities to management's attention. To prevent the risks of falling prey to losses, management need to ensure that the organisational culture is of such a nature that officials will refrain from unethical conduct.

## 5.9. Organisational culture

A paradigm shift has to take place in local government in South Africa whereby the identification of any risk that could cause organisational losses will be part of each stakeholder’s daily activity. Such a culture should enhance the reputation of local government, because stakeholders will realise that risks are well managed.

### 5.9.1. Embedding organisational culture

Embedding an organisational culture to encourage stakeholders to become risk averse is indispensable (Miscovich, 2005:43). President Bush, in Ernst & Young (2003:1), has stated that “In the long run there’s no capitalism without conscience… My administration will do everything in our power to end the days of cooking the books, shading the truth and breaking our laws.” The real cost of corruption goes beyond the pure financial loss to having an impact on reputation, morale and loss of trust amongst stakeholders (Deloitte & Touche, 2003:3 and McDonald, 2003:21-26). Johnson (in Elliott, 2000:31) referred to internal and external cultural factors that influence the officials in an organisation (see Chapter 2, Figure 22) and management has to ensure that negative influences are addressed to prevent the risk that organisational objectives might not be achieved.

Although it is difficult, if not impossible, to determine organisational culture precisely, the development of an anti-fraud culture in local government in South Africa is necessary. The four most predominant manifestations to commit corruption in organisations have been referred to as Conflict of Interests, Bribery, Illegal Gratuities and Economic Extortion (Chapter 2, Figure 13). Some organisations suffer catastrophic losses as a consequence of corruption and maladministration and therefore stakeholders must understand that corruption and maladministration could lead to a real and catastrophic loss for an organisation (Fazekas, 2003:1). The problem is that the main focus is on corruption, lacking integration with maladministration. The risk is that organisational decisions such as downsizing and restructuring, which are applied to numerous governmental and private organisations in South Africa, cause skilled and knowledgeable officials to leave their organisations. These officials are often responsible for prevention and detection controls, and a failure to administer these controls may create the risk of closing down as a consequence of corruption and maladministration due to insufficient training or experience (for example, the closure of Enron, Arthur Andersen, Parmalat and Leisurenet). The closure of an organisation or certain of its departments affects the reputation of such an organisation. Officials must preserve the reputation of their organisations and be made aware that a good reputation has to be embedded to enhance the risk-management process.

#### 5.9.1.1. Preserving reputation

Organisations need to preserve their reputation to succeed in rendering services in an efficient and effective manner (Aerts, 2001:54 and Messmer, 2001:40). Officials must be made aware that maintaining a good reputation should be an integral part of the risk-management process. During risk-assessment workshops conducted for the City of Cape Town local government during May 2005, the researcher customised a reputation risk-assessment tool used by Canadian local authorities to assess their organisational reputation in terms of 10 key indicators. Senior managers were requested to rate each question between 1 and 5 (1= “not at all” and 5= “very much”). The outcome revealed the standing of the City of Cape Town’s perception as lying between a 1 or 2 (average to below-average performance against the benchmark) for the majority (90%) of the questions (Faranani, 2005:21-22). Organisations cannot afford to put their image at risk, because stakeholders tend to look at the reputation before judging performance. Stakeholders expect organisations to become more socially responsible and regard topics such as risk management, the rights of less affluent stakeholders (such as stakeholders who cannot afford to pay for basic services) and corporate transparency as important reputation issues. To preserve reputation involves restructuring and planning to provide essential services, for example, water to stakeholders who cannot pay for such services.

Thus, organisational restructuring and planning to become socially acceptable is needed, because entrenched beliefs, practices and attitudes are challenged to provide sustainability of service delivery. Stakeholders are putting organisations under pressure by taking issues such as reputation, trust, price and quality of services into consideration when service delivery is evaluated (Binneman, 2002:13 and Du Plessis, 2002:42). Training in integrated risk management may assist in establishing a risk-awareness culture in local government which should enhance reputation and trust and therefore training courses have to be developed and implemented to further the importance and benefits of a risk-management programme.

5.9.1.2. Development of risk-management training material

- Formal training

Training is essential to promote and establish the risk-management process in local government in South Africa to maximise opportunities to enhance service delivery and to establish a commitment to anti-corruption programmes. Once officials and stakeholders understand that risks such as corruption and maladministration could ruin organisational reputation and deflect the objectives of the organisation, they might be keener to report and eliminate acts of corruption (Cafferty, 2003:45).

Co-ordination between education institutions in South Africa is lacking with regard to risk management training from a public and development perspective. Training institutions, for example UNISA and certain SETA's, do provide training in risk management, but from a financial/insurance perspective accommodating largely learners from the insurance industry. Although short courses in risk management are presented by institutions such as the Institute of Internal Auditors Internationally, knowledge gained is not necessarily tested by means of an examination, which may create the risks that officials attending these courses are not taking the training seriously.

The role that tertiary education institutions, such as the University of Stellenbosch in conjunction with other private sector organisations, play in assisting with the roll out of training material in integrated risk management for local government lacks co-ordination and should be explored. Local government to enhance corporate governance may appreciate support from education institutions in this regard which is currently seriously lacking.

- In-service training

The majority of local governments in South Africa do not have in-service training with specific focus on the enhancement of integrated risk management. This training is done in remote instances on an ad hoc basis by consultants.

Thus, training material to promote integrated risk management must be developed. Training material which deals with the implementation of the risk-management process has to address the problem of how to make people risk averse and may reduce the level of risks. Knowledge obtained through training may assist officials to become aware of risk-management principles as well as in the mitigation of risks and the identification of opportunities, because of the change in their mindset towards risks. Conducting training in integrated risk management should facilitate the embedding of an organisational culture where risks is controlled and this should in turn enhance the activities of an integrated risk-management function. To promote efficiency in local government, a formal process for establishing risk-management principles has to be developed and implemented. A risk-management function in local government needs to be established to support the principles.

### 5.9.2. Establishing a risk-management function

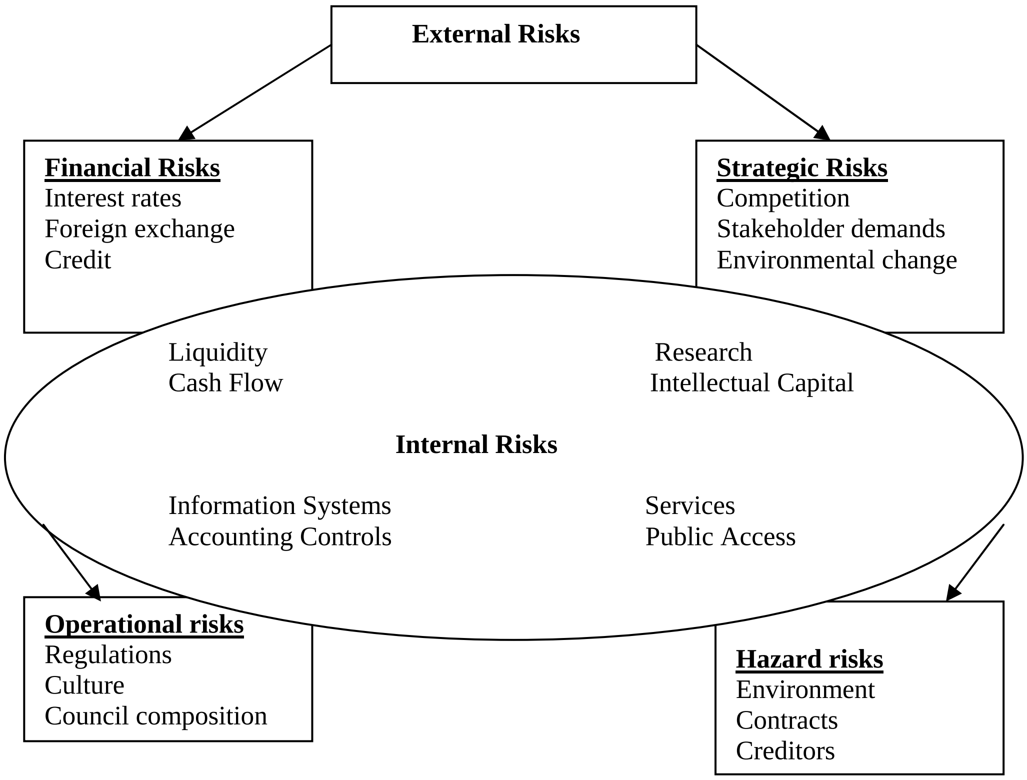
The placement of the office of the risk manager is referred to by Greene and Serbein (in Geldenhuys, 1993:23) as the position of the risk-management department in the organisation. The risk-management function must become integrated in all the departments of an organisation and become part of the decision-making process. The office of the risk manager has to be established in such a way that, if an incident occurs or a risk arises, the office of the risk manager should be informed without delay with the view to dealing with the issue as quickly as possible (Crockford, 1986:108, Marsh, 2004:16 and O'Rourke, 2002:9).

Management must not lose sight of the fact that the establishment of the risk-management function has a cost attached. The cost of risk management establishment varies between organisations and depends on the skills available and on the effort required to ensure that unacceptable risks are identified and managed before they cause losses. This finding correlates with the view of Miccolis *et al.* (2001:23-25) indicating that expenses of, for example, conducting workshops and training sessions, is regarded as one of the top five expenses for an organisation (see also Graph 8 in Chapter 4). Therefore, with reference to local government in South Africa there is a lack of risk management brochures, newsletters, centralised risk registers, workshops or relevant information and professional journals or risk management magazines. The following risks can impact on the cost of establishing a risk-management function and have to be considered by management:

- If the environment in which an organisation operates is exposed to rapid change, then it would be exposed to more risk than an organisation operating in a relatively stable environment;
- The size and complexity of the organisation will influence the cost of risk management;
- If the level of tolerance of the stakeholders tends towards the conservative and risk averse, then risk-management efforts will have to be rigorous and public interest in an organisation must be considered. The impact of the collapse of an organisation managing a pension fund, for example, is high, because it could wipe out the life savings of pensioners as well as affecting their qualify of living negatively. Risk management in these organisations must be given a high priority and the cost of implementation will consequently be high as well (Lee, 2002:13 and Kovacich, 2002:2).

The focus of a risk-management approach must be on the identification and treatment of external and internal risks, with the objective of adding maximum sustainable value to all the activities of the organisation (Attwater, 2001:57-59). The effectiveness of a risk-management process can be influenced by the fact that certain risks, such as financial risks, strategic risks and operational risks overlap in some areas, that is, where a risk has, for example, a financial impact on another risk (Airmic *et al*., 2002:2). The overlapping of external and internal risks is illustrated in Figure 28.

**Figure 28** **The overlapping of risks**




**Airmic *et al.*, (2002:3)**

Figure 28 shows, for example, that internal risks such as liquidity and the cash flow of organisations are influenced by external financial risks such as interest rates and the exchange rate. Management must be aware of the influence that external risks can have on internal risks to prevent the risk that an organisation will experience liquidity difficulties. The same applies to external strategic risks such as competition amongst organisations that can impact on intellectual capital; this can be addressed by recruiting officials in whom the organisation has invested time and money to enhance their skills and abilities.

Thus, the skills and abilities available in an organisation can influence the cost of risk-management establishment in cases where skills and abilities need to be developed from scratch. If effective training is not provided, it may increase the risk that risks are not proactively identified and managed. A lack of knowledge or ignorance regarding internal and external risks will cause overlapping, generating additional costs and/or wasting resources.

In the South African local government sector few examples could be found of the existence of an integrated risk-management function although ad hoc initiatives – for example, the management of fire risks, occupational health and safety and environmental risks – are evident. This statement correlates with Nickson (2002:9) (see Chapter 4, paragraph 4.2.6.), which states that only 5% of respondents surveyed in Europe and North America are satisfied with risk practices in their organisations. Currently structural and managerial changes are experienced in the public sector as well as the emerging of improved governance arrangements, which caused the out-sourcing of certain services with the consequential risk that the quality and/or cost of service delivery might be affected. This possibility enhances the need for the implementation of a risk-management function and relevant role players (for example, risk management committee) to enforce vigilance and care in rendering public services (Farrell, 2003:89 and Whitley, 2003:15) as well as to guide the risk-management function in achieving the objectives of local government.

#### 5.9.2.1. Risk-management committee

A risk management committee has a mandate to ensure that sound systems of risk management are set in place, which may enhance corporate governance in public organisations (Cafferty, 2003:46-47 and The Institute of Internal Auditors, 2003 – Practice Advisory 2110-1). The risk-management committee has to be empowered with the necessary authority to fulfil their mandate and responsibilities. The problem according to Miccolis *et al*. (2001:20) within local government in South Africa is that risk committees are not established in local government, with the result that officials who have to serve on risk-management committees, because of their abilities and experience, cannot give input holistically. This lack of input may affect the risk treatment plans negatively.

Thus, the risk-management committee has to consider the risk strategy and policy, and will have to monitor and report on the risk-management process. By executing their responsibilities, risk-management committees act as a catalyst to ensure that risks are continually revised and assessed, which in turn facilitates the control activities needed to effect organisational culture change.

## 5.10. Control activities

Controls assist officials to identify deviations and problems. The risk-management process makes provision for the evaluation of the effectiveness of controls as well as for developing action plans to enhance controls, where necessary. Graph 3 in Chapter 4 shows that poor internal controls such as collusion, overriding of controls and poor ethics policy (based on surveys conducted by the Institute of Chartered Accountants and the Auditor-General in South Africa during 1998) are the factors responsible for most of the corruption in organisations. The following formal and additional informal controls have been identified as essential for an effective and efficient risk-management process.

### 5.10.1. Formal controls

Formal controls represent controls necessitated by, for example, existing legislation such as the MFMA, referred to in the King 2 Report or as prescribed in standards applicable to local government.

5.10.1.1. Whistle-blowing

Whistle-blowing mechanisms, for example, reporting misuse of assets, do exist in the public sector in South Africa. The problem is that they have to be repeatedly and widely marketed so that all stakeholders are aware of the mechanism and the procedure to follow in order to report risks. As referred to in the description regarding Graph 13, Chapter 4, only 22% of officials in South African organisations have access to confidential reporting lines, but 68% of the respondents indicated that they were not informed that they are protected from disclosures. The protection of potential informers under the Protected Disclosures Act, 2000, (Act No. 26 of 2000), is not always guaranteed, which creates a fear of being victimised once an incident has been reported (Die Burger, 2000:2). The benefit of whistle-blowing mechanisms is to give management an opportunity to remedy a risk or unethical conduct before it is reported to the media. Figure 21, Chapter 2, has indicated that the implementation of deterrence measures such as a hotline to report incidents could mitigate the risk of corruption (Minnaar-van Veijeren, 2005:19).

Thus, the ongoing marketing of whistle-blowing mechanisms in local government in South Africa and the assurance that reporters will be protected may curb the risk of corruption and preserve the reputation of an organisation.

5.10.1.2. Contingency plan

Contingency plans with regard to, for example, emergency preparedness (National Environmental Management Act, 1998, Act No. 107 of 1998) in cases of disaster, do function with varying degrees of effectiveness within the public sector, but holistic integrated contingency plans setting out action against perpetrators as well as the methods for recovery of losses (Chartered Management Institute, 2004:7 and Oz, 2004:6) are lacking. For example, local government has to ensure that vendors act ethically and with integrity when rendering services to public sector organisations (Cafferty, 2003:45). A contingency plan to address the risk of vendors not rendering services in an ethical manner has to include suspension procedures for vendors of public sector organisations. Such contingency plans should mitigate the risk of corruption and provide assurance to stakeholders that management will not tolerate unethical conduct.

Thus, the purpose of the contingency plan is to be ready to act immediately in an organised and efficient manner when an incident is reported. The contingency plan has to be authorised by the risk management department and internal audit have to assist in providing assurance about the effectiveness of the contingency plan to enhance the performance of local government.

#### 5.10.1.3. Internal audit

The internal auditor can assist in evaluating controls, which involves verification that measurement mechanisms are accurate to ensure that procedures are proper and duly followed (Naidoo, 2002:1-2), but a statement made by the Auditor-General (see paragraph 4.2.7.) indicates that only 46% of internal audit activities facilitated a risk assessment. Naidoo (2002:3) describes risk management as a strategic approach that can be used by internal auditors to inform and equip management with techniques to regularly plan, continuously monitor, and periodically measure and review the performance of an organisation in terms of objectives for efficiency, effectiveness and impact within the organisation. The problem is that certain internal audit functions get involve with risk management activities that represent roles/activities that should not be undertaken by internal audit functions. The roles/activities that should not be undertaken include – setting the risk appetite; management assurance on risks; taking decisions on risk responses and implementing risk responses on behalf of management and accepting accountability for risk management. The reason why internal audit may not become involve with these roles/activities is that their independence may be negatively affected.

Thus, internal audit officials in local government in South Africa have to focus on their core function with regard to integrated risk management which is to provide assurance on the effectiveness of the risk management process. Internal audit, as an independent function, has to be re-engineered to fulfil their role effectively and to add value in achieving the objectives of local government.

5.10.1.4. Risk management processes

Risk management processes are either lacking or not consistently performed within local government in South Africa (Nickson, 2002:9). Five processes (determining of internal environment and objectives, identification and assessment of risks, development of a risk response plan as well as the implementation of the plan and the monitoring of the integrated risk management process) are required as a minimum to implement an effective risk-management process within an organisation. Depending on the organisation's overall risk-management philosophy, culture and structure, it may be possible to combine or omit certain processes, but all the steps in the process should receive attention (Australian/New Zealand Standards for Risk Management 4360, 1999:25-27). The risk-management process has to be applicable to all levels in local government. The problem with not attending to all the steps in the process is that, for example, an action plan is developed to prevent a loss from recurring, but neither the cause nor impact of an incident on local government services is assessed. Should this be done, the effect on other departments in local government could also be determined. The problem is that the lack of consistent application of integrated risk management in local government in South Africa may lead to some organisational objectives not being achieved in an integrated and effective manner. Thus, it is imperative for the success of the risk-assessment process that all levels participating in the process have to buy into the process and agree on the steps to be followed.

### 5.10.2. Additional informal controls

Informal controls supplement formal controls as additional controls to enhance the identification and assessment of risks within local government in South Africa. The application of informal controls may enhance the risk management process. Several examples of informal controls are described below.

5.10.2.1. Knowledge sharing, co-sourcing and intellectual capital

Knowledge sharing and co-sourcing do exists in the public sector, for example there are initiatives such as Project Consolidate initiated by the Department: Provincial and Local Government (1996), for example, tenders with accounting and auditing firms to assist municipalities where managerial skills are lacking. The risk is that the management level might revert back to a situation where projects are not effectively managed once the specific project is concluded and the organisations that were driving the projects withdraw from the municipality that assistance was given to. Co-sourcing with other organisations, for example, professional accounting and auditing companies, is a manner of obtaining knowledge that officials cannot achieve on their own in their organisations, but the risk exist that officials may not apply the knowledge gained effectively (Ho, 2003; Skosana, 2003; Larkin, 2003 and Van Heerden, 2003). Intellectual capital refers to knowledge that is in the possession of an official which can cause a risk to the organisation if the official reveals the information to, for example, other stakeholders (Stofberg, 2002:10), or should such officials leave the organisation.

Price (2000:24) states that different types of officials have access to different sets of assets and of information. For example, reference was made in Chapter 2 (on Ethics) to the need to address conflicts of interest, where the risk exists that officials may unduly favour organisations in which they have self-interest because of a lack of proper procedures, for example, confidentiality agreements. Officials can pose a threat to local government, with specific reference to officials with greater that average access to assets and sensitive information. Confidentiality agreements amongst officials in local government in South Africa is not common and should be introduced to protect the security of information and to bind an official during employment as well as for a specified time after employment not to divulge privileged information to the employer’s disadvantage (Price, 2000:24).

Thus, knowledge sharing and co-sourcing must be controlled by including clauses in pre-employment contracts in such a way that local government benefits from the investment made in officials. Intellectual capital drainage may cause pressure on other resources, for example, the remaining officials, and must be well controlled to prevent the loss of officials in whom investments were made. Informal controls have to provide assurance to stakeholders that information, for example, the identification of prime land for residential or industrial development is not misused by officials by buying the land themselves for less than market value and selling it at unrealistically high profit margins.

5.10.2.2. Categorising risks

Risks such as asset misappropriation and corruption contribute to approximately 6 percent loss in revenue of US organisations (Scott, 2002:13) which necessitates risk-management strategies. It appears that risks are not categorised in local government; for example, the City of Cape Town embarked on strategic and operational risk assessment only during May 2004 and no risk register or risk categories were available to use as a platform for risk assessments. Enquiries at various other municipalities, for example, Tshwane, City of Johannesburg, Overberg, Breede Valley as well as several other Southern Cape municipalities, revealed that none of them categorises risks. By using a set of risk categories, organisations can expand their capability to control risks. The two main purposes of risk categories are to assist in grouping the organisation's risks and controls per group as well as to assist officials to monitor the identified risks. Although it is not possible to develop a set of risk categories that would fit all local governments in South Africa, one should realise that major losses often result from a risk that never occurred before. The key is to develop a manageable number of risk categories that generate meaningful information for effective control (Roth *et al.*, 2002:57-58).

Thus, a set of risk categories will focus the attention of management on major risks that would most probably not be revealed without risk categorisation. The process has to be complemented with an integrated risk-management approach with the view to integrate risk-management into the local government governance approach.

5.10.2.3. Integrated risk-management approach

The objective of the integrated risk-management approach is to enhance governance in local government by adopting integrated risk-management. Cassiem (2003) shares this view that management must not focus, for example, on the financial aspects of an organisation only, but rather to integrate risk management in all the activities of local government which is lacking in the majority of local governments in South Africa.

The integrated risk management approach is necessary, because risk management is not integrated in local government in South Africa, but dispersed across departments and conducted on an ad hoc basis. Integrated risk management legislation to enhance the achievement of, for example, strategic and operational objectives, compliance to rules and regulations and implementing a risk management process by all local governments in South Africa is lacking. Other legislation concentrates on, for example, disaster management and corruption, but not maladministration which causes risks to be managed in silo's and not holistically. An integrated risk management approach could enhance the control of risks.

Thus, an integrated risk management approach may assist in achieving sustainable service delivery, which will not be achieved if risk management is applied in certain departments only without an integrated approach. Although all the steps in the risk management process is important the risk identification step is of particular importance to identify and assess all possible key risks, especially those that could have a catastrophic effect if ignored or not identified.

5.10.2.4. Integrated risk assessments

A holistic integrated instrument to identify immediate and basic causes for incidents as well as providing specific and general recommendations to assist in risk assessments is lacking. If a risk that could be catastrophic is overlooked, this could have major implications for an organisation, and even lead to the closure of the organisation (Marsh, 2004:11-12). The problem is that the steps in the risk-management process are not consequently applied or not integrated in local government in South Africa, which makes the assessment of risks difficult. For the purpose of integrated risk assessments in local government, risk assessments should be classified and implemented in three levels: high-level risk assessments; secondary-level risk assessments; and operational risk assessments. These levels are necessary to obtain optimum results with reference to the identification of all possible key risks during the risk assessments in local government instead of what happens in the traditional approach, where mainly high-level risk assessments are conducted. The problem with the traditional approach in local government is that lower-level or operational risks could be overlooked and therefore not be managed.

Thus, the purpose of the proposed three levels of risk assessments is to ensure that a holistic approach can be achieved into the process. This process endeavours to ensure that all the relevant risks are identified and evaluated, and that proper controls are put in place to manage these different levels of risks. Management has to enhance organisational governance by assuring stakeholders of its acceptance of its responsibility and accountability by bringing about certain certifications.

5.10.2.5. Managerial certifications

It seems that managerial certifications (where management certify that they are aware of the contents of project reports and that the correct disclosures are made, and by signing such certification management cannot claim ignorance if it becomes apparent that material false disclosures were made) are not addressed in, for example, legislation that is applicable to local government and the King 2 Report. The certification of disclosures made from time to time will enhance the risk-management process, because it will be an obligation for management to take responsibility for mitigating risks (Fazekas, 2003:5, Tierney, 2003:41 and Thompson, 2003:75).

Thus, ignorance of risks that could cause losses on local government level can be no excuse for management. Those on the management team who are responsible for certifying reports must be disciplined and face civil and criminal prosecution if they are found guilty of false certification. An objective of the risk-management programme is to address risks proactively, but also to deal with risks with the view to mitigating the causes of risks as soon as possible and to stabilise the organisation once an incident has occurred.

#### 5.10.2.6. Treatment of risks

During the assessment workshops conducted by Faranani (2005:23) for the City of Cape Town, senior management were requested to indicate their own levels of risk tolerance/risk taking with regard to their respective roles and activities. Faranani (2005:23) declared: “It was revealed that the majority of managers are risk averse and are not inclined to be risk-takers in order to achieve their objectives. Their approach towards risk taking leans towards being more conservative”. The effect of the ‘’conservative’’ approach is that there is a tendency amongst management in local government in South Africa to rather transfer or terminate a risk in stead of accepting a risk by managing it properly. Fergusson (2003:8) and Marsh (2000:34) stated that risk is a measure between impact and likelihood, and that risks have to be treated by considering the options to transfer, terminate, tolerate and mitigate. To ensure that the treatment of risks is effectively executed, sentencing guidelines need to be in place to discipline officials who are not co-operating.

#### 5.10.2.7. Organisational sentencing guidelines

The organisational sentencing guidelines outline penalty practices that local government have to follow to show that they would like to prevent or mitigate losses. The organisational sentencing guidelines can punish a local authority if it is guilty of perpetrating risks. For example, if the loss amounts to R10 million due to corruption, then the fine that should be imposed should be R10 million (Reeves, 2001:24).

The Municipal Finance Management Act (Act No. 56 of 2003) addresses financial problems, such as preparation of financial recovery plans and provincial interventions and criteria for determining serious financial problems, applicable to municipalities in Chapter 13. Although mention is made of financial recovery plans to continue to provide basic services (see, for example, sections 137, 139, 141 and 142 of the Municipal Finance Management Act), no reference is made to penalties that equal the amount of the loss or scale of the corruption. Chapter 15 of the Municipal Finance Management Act addresses disciplinary action against officials, while sections 173 and 174 state that in case of a criminal proceeding where an official is convicted, an appropriate fine or a maximum of 5 years imprisonment can be imposed, but again no mention is made of a fine that equals the amount of the loss or scale of the corruption.

Thus, the sentencing guidelines may encourage local government officials to take care in preventing losses. Risk is not static, but rather dynamic and therefore proactive planning by management to manage risks properly is necessary to embrace the needs of stakeholders through effective service delivery. Management must set the example and implement procedures, such as verification of records, to ensure that transactions are done in a transparent manner.

5.10.2.8. Verification of records

Management in local government in South Africa does not generally verify vendors' records, but because of changing times and complex price and contract stipulations, purchasing departments now realise the need to verify vendor data through vendor verification checks. This procedure will eliminate the problem that certain officials provide preferential treatment to certain vendors.

The possibility always exists for officials to be corrupted by third parties such as vendors through kickback schemes as identified in Figure 18, Chapter 2

(Klintgaard, 1997:19 and Reid *et al*., 1994:45). Such collusion between officials of local government and vendors is difficult to prove, unless the organisation obtains the permission of a vendor to peruse the vendor's records to confirm or reject allegations of corruption. Vendor verification clauses in agreements between local government and vendor which is negotiated up-front can assist in controlling corruption by affording a discovery device in executing a verification check (Lanza, 2003:13). The right to verify is necessary to act on alleged violations of the local government's ethics policy in circumstances such as the rendering of faulty or inferior-quality services (Die Burger, 2005:9); short deliveries of services or services not delivered in local government in South Africa (Becker, 1986:169; Hollinger, 1983:6 and Lui, 1986:21-22).

Thus, officials from all the departments in local government will have to become involve to identify instances where vendors are receiving preferential treatment or not acting in accordance with the contract. The involvement of officials may contribute to the information and knowledge needed to act against officials and vendors who receive personal benefits (Banks, 2002:32-33). Management has to ensure that segregation of duties is established as a control to discourage attempts at corrupt actions.

5.10.2.9. Segregation of duties

The lack of adequate segregation of duties can put all the activities and functions within local government at risk. In instances where the segregation of duties is not applied, the risk exists that one official accepts responsibility for all the activities in a process; for example, one official requests material, authorises the ordering thereof, signs the delivery note and authorises payment (Sawyer, 1981:94). The lack of segregation of duties creates the risk of facilitating corruption and maladministration, because no other official(s) co-supervises the specific activity. Management has to ensure that the lack of segregation of duties can be rectified by the involvement of an independent official such as a supervisor to enforce due diligence in processes. The perceived opportunity to commit corruption can be overcome by identifying opportunities to implement the segregation of duties in processes (Dervaes, 2001:49).

Thus, because inadequate segregation of duties is a cause of risks, local government must operate with the full knowledge that detecting this risk should be the primary focus and objective of everyone in the organisation. The lack of segregation of duties may be seen as an opportunity for ‘’risky’’ officials to collude with vendors to the detriment of the organisation they are employed with. Although it is difficult to prevent corruption and maladministration by internal officials when they are pressurised to collude with vendors, local government have to ensure that confidentiality agreements are in place to prevent and detect unethical conduct.

## 5.11. Summary

The lack of an integrated risk management program for local government in South Africa creates the risk that key risks are not identified timeoulsy. The result is that risks are not prevented from becoming losses, some of which could have adverse affects. A further consequence is that opportunities are not identified and capitalised on. The lack of an integrated approach in identifying and assessing risks causes management to be unaware of the key risks in the internal and external environment of local government which can impact negatively on the achievement of strategic and operational objectives.

Objectives that are not practical, achievable, clear and specific, cannot serve as an instrument of measurement to determine the degree to which the objectives were met. A lack of an integrated mission and vision statement for local government prevents stakeholders to focus on the objectives of risk management and the importance of control, which will assist in achieving the objectives of local government. The lack of a mission and vision statement suggests that management is not publicly taking responsibility for the total process of risk management or the continuous evaluation of the effectiveness of the risk-management process. The identification of macro and micro levels (macro levels address those aspects that need to be in place to enhance the efficiency of risk management, while the micro levels address the aspects needed to support the macro level) within the risk-management function are lacking. A lack of macro and micro levels prevents the realisation of the full benefits of the risk-management process in local government.

The public management functions address policies; planning; management by example; organisation and control activities. The aim with the development and implementation of policies is to ensure that the objectives are achieved effectively. A lack of risk policies in local government in South Africa impedes the realisation of objectives which may lead to disciplinary action against officials and legal suits against local government. The lack of knowledge regarding policies can cause that stakeholders are being denied access to services or receive sub-standard services with reference to the quality and quantity of services and the improvement of the sustainability of service delivery. Policies are not efficiently addressing the recovery of losses from officials as well as the rendering of services in an accountable and transparent manner. The current Code of Conduct for local government officials and politicians are not effectively and consistently enforced which prevents local government from instilling a professional ethos amongst stakeholders and contributing towards the rendering of services in an accountable and transparent manner.

Improper planning prevents the proactive identification of risks which lead to disruption of activities. There is a lack of effective strategic, tactical and anti-risk response plans being developed and implemented to mitigate losses. The problem in local government is that management lacks the competencies to develop, implement and sustain checks and balances to enhance controls, with the result that risks which could be catastrophic are not assessed.

The inability to manage by example and lack of discipline structure to the risk-management process, management is not proactive to implement procedures and systems to ensure that transactions are done in a transparent manner. The problem is that it is considered doubtful whether an effective culture of control exists in local government in South Africa and whether management is creative in developing solutions to the risk-management challenges.

The local government culture is not preserving its reputation which is essential to ensure that officials will refrain from corruption. The embedding of an anti-corruption culture is necessary, because it is lacking in local government in South Africa. Training is essential to promote and establish the risk-management programme and to change the culture of local government. Such training material is not regularly available for local government in South Africa. Knowledge obtained through training may assist officials to become aware of risk-management principles as well as ways to mitigate risks. Training may enhance the identification of opportunities, for example enhanced training to render effective services, because of the change in the mindset towards risks. The absence of the effective structuring of the risk-management department and incorporating risk management in an integrated manner in the decision-making process is concerning. The general absence of risk-management committees in local government in South Africa negates the importance of the implementation and effectiveness of an integrated risk management program, because the mandate that a risk management committee has to ensure sound risk-management programmes cannot be executed. The problem is further that due to the absence of risk-management committees it cannot act as a catalyst to ensure that risks are continually revised and assessed, which facilitates the control activities needed to effect organisational culture change.

Formal and additional informal control activities which can be improved, have been identified as being essential for an effective and efficient risk-management process. Whistle-blowing does exist in the public sector, but it is not a control that is trusted by stakeholders because of the lack of protection if disclosures are made. Contingency plans in local government lack strategy and procedure to be followed against perpetrators of corruption or for the recovery of losses. The risk of vendors not rendering services in an ethical manner, which should mean that such vendors have to be suspended, needs to be improved. Internal audits in the local government have to be re-engineered to gain credibility and to add value in achieving the objectives of the public sector. The application of risk-management approaches is lacking or not consistently performed at all levels within the local government environment. It is imperative for the success of an integrated risk-management programme that all stakeholders have to be committed to the integrated risk-management programme.

Knowledge sharing and co-sourcing to assist local government do exist, but the risk remains that management might revert back to a situation where projects are not effectively managed once assistance has been provided and the institutions that was providing the assistance, withdraws. The risk of intellectual capital drainage must be prevented, because it leads to pressure on the remaining officials in local government and also represents losses on investments made in officials over the years. The problem is that knowledge sharing and co-sourcing are not controlled in such a way that local government benefits from the investment made in officials, and intellectual capital drainage may motivate other officials to leave the organisation as well. The lack of confidentiality agreements creates the risk that officials may unduly favour organisations in which they have a self-interest because of improper procedures. The problem is that confidentiality agreements are not common in local government, even though they may protect the security of information and bind officials not to divulge privileged information to the employer's disadvantage should they be introduced.

The lack of risk categories in local government prevents them from managing their risks properly, because management lacks information that profiles the risks and therefore it is not possible to develop action plans to mitigate and monitor the unknown risks. Risk-management policy statements are lacking, with the consequence that risk management is not integrated into all the activities of local government. The risk-assessment process has to be conducted on high, secondary and operational levels within the public sector to obtain buy-in from all stakeholders and to prevent the risk of certain categories of risks being overlooked. A lack of risk assessments on all levels may result in catastrophic risks not being identified.

Managerial certification to prevent local government officials from claiming that they were unaware of corruption and maladministration is lacking. The enforcement of managerial certifications by management in local government will enhance the risk-management process, because managers will have to certify that the local government's risks are under control. The treatment of risks is dependent on the measure between the impact and likelihood of a risk materialising. The problem is that management in local government is risk averse and therefore conservative about risk taking, which could lead to lost opportunities for local government. The problem with treatment plans after implementation is that monitoring is not done consistently, which could lead to further lost opportunities. Monitoring is essential to ensure that the treatment plans remain cost effective and achievable.

The implementation of organisational sentencing guidelines may mitigate the risk of damages or losses caused by local government officials, but the problem is that existing legislation that is applicable to local government in South Africa does not refer to penalties that equal the amount of a loss. The transgression of organisational sentencing guidelines could result in serious fines in an attempt to restrain local government from engaging in corrupt activities and this may encourage them to take greater care to prevent losses.

Management in local government in South Africa does not verify vendor's records, but to prevent officials from enjoying personal gain in official transactions, management has to ensure that vendor's records may be verified to confirm or deny allegations of corruption. The lack of adequate segregation of duties in local government can put all the activities and functions at risk. Management has to ensure that the lack of segregation of duties is rectified by the involvement of an independent official such as a supervisor to enforce due diligence in the processes.

As a result of the shortcomings or total lack of an integrated risk management program for local government in South Africa, the normative aspects of achieving effective and efficient integrated risk management in local government will be described in Chapter 6.

# CHAPTER 6

# INTEGRATED RISK MANAGEMENT: A NORMATIVE APPROACH TO ESTABLISH AN INTEGRATED RISK-MANAGEMENT PROGRAMME IN LOCAL GOVERNMENT

## 6.1 Introduction

The objective of the research that has been undertaken is to make proposals to reduce losses and corruption in the service delivery provided by local government through the implementation of an integrated risk-management programme. A further objective is to effect and maintain risk management in local government at an affordable cost within the boundaries of relevant legislation as well as to make stakeholders aware of the importance of integrated risk management in achieving the objectives of local government. Although the contents of each chapter cannot be regarded as an exhaustive list of aspects addressed for an effective and efficient integrated risk-management programme, they should provide enough information to deduce aspects that have to be included in a normative proposal for an integrated risk-management programme in local government in South Africa.

It is important to understand the objectives of integrated risk management and to adopt a mission and vision statement in support of these objectives, which should contribute towards reducing losses in local government. It is of equal importance to ensure that all levels within local government will implement a risk-management programme to prevent key risks being overlooked.

The processes with reference to policies, planning, management by example, organisational culture, control and monitoring will be described, which will include aspects such as the need for risk-management legislation, specifically for central, provincial and local government; embedding risk management in the organisational culture; structuring of a risk-management department and control activities to facilitate an integrated risk-management programme.

The development of training material and the training of officials is important to embed a risk culture.  Knowledge gained through training should assist officials in conducting investigations to determine the causes of incidents or to prevent risks proactively.  Techniques will be proposed to further assist officials in the identification and evaluation of controls to ensure that losses are kept to a minimum. A questionnaire will be introduced to assist management to ascertain the risk culture and to take the necessary remedial action to mitigate potential losses or to prevent a recurrence of losses.

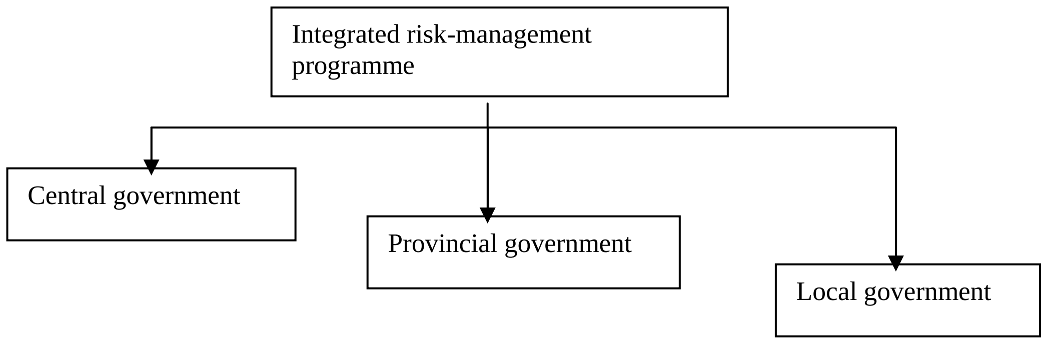
Integrated risk management is an evolving discipline and therefore risk identification and assessment workshops should be presented at least annually for the whole organisation to enable stakeholders to become aware of new risks, if any, and to evaluate the existing controls to determine their efficiency and effectiveness.

The aspects considered most appropriate for an efficient and effective integrated risk-management programme will be described below.

## 6.2 Integrated risk-management programme

An integrated risk-management program should be implemented in all spheres of government.  This research has focused on local government, but central and provincial government are not regarded as less important.  Because of the different functions performed by each sphere of government, it should not be best practice to enforce a uniform integrated risk-management programme in all three spheres of government.  Figure 29 (developed by researcher) illustrates the three spheres of government.

**Figure 29 Spheres of government**



The lack of – or in some instances the incomplete – implementation of an integrated risk-management programme in local government in South Africa needs to be rectified with an integrated approach supported by politicians, executive management and other stakeholders. This integrated approach is necessary to enhance the attainment of the objectives set by South African local authorities.

### 6.2.1 Objective of integrated risk management

The focus of officials in local government will be influenced negatively if the objectives of integrated risk management are not understood. It is essential to plan resources to obtain financial stability and operational effectiveness before, or as soon as, a risk has arisen. This could be achieved through managing risks efficiently and effectively by means of loss-prevention activities, which will reduce the cost of financing risks.

The objectives of risk management should prompt officials to provide reasonable assurance that the following general requirements have been met:

- The identification and distinction between core and non-core risks prevalent in organisational functions;
- Reliability and integrity of information;
- Economical and efficient use of resources; and
- Safeguarding of assets and resources (O'Reagan in Salierno, 2003:34).

Thus, the objectives of integrated risk management should be clear and achievable. Reasonable assurance that the objectives of risk management are being achieved should be provided to facilitate the realisation of efficient and effective local government. Reasonable assurance should obviate the risk that aspects such as compliance with policies and safeguarding of assets are not being addressed. The main objectives are to achieve short-term stability of the cost of an incident and to put measures in place to prevent a recurrence of similar risks over the long term. A mission and vision statement is an important mechanism to focus officials on the objectives of risk management.

### 6.2.2. Mission and vision statement

- Mission

The contents of a mission statement should assist in enhancing the degree of efficiency and effectiveness in local government. The following mission statement is proposed :

Ensure that losses are minimised to improve organisational performance and to provide reasonable assurance to stakeholders that risks are being managed within the local government environment.

- Vision

The mission statement should be supported and complemented by agreeing on a vision for local government that states, for example, that management should take the responsibility for embedding integrated risk management in the daily activities of everyone in local government in South Africa. The vision should state that risk management anticipates and avoids threats and losses as well as identifying opportunities (Institute of Internal Auditors, 2003:13; KPMG, 2002:3 and Deloach, 2000:93). Newsome (2003:12) states that an effective integrated risk-management programme is the foundation for a well-governed and controlled organisation and therefore responsibility and accountability for risk management must be kept at the highest level within the organisation. Local government should be clear on what they want to accomplish through risk management and management should:

- ensure that officials are committed to risk-management practices;
- build a reputation amongst all stakeholders of being a safe, caring and transparent employer as well as to promote an ethical culture in local government;
- have a fully protected balance sheet. This will ensure that an integrated risk-management process is implemented and supported by everyone in local government;
- develop an anti-fraud culture in local government;

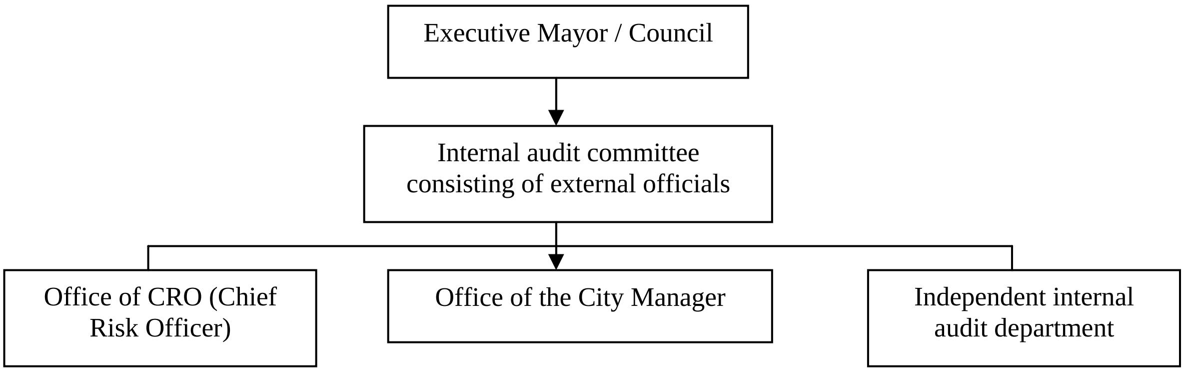
- implement of a risk-management committee to oversee and provide guidance to ensure an efficient and effective risk-management programme;
  develop controls and action plans to improve responsiveness in mitigating risks
- ensure that internal controls are built into and not onto organisational processes; and
- realise that internal control provides reasonable, but not absolute, assurance that the objectives of local government will be achieved (Institute of Internal Auditors, 2003:19).

Thus, it is essential that the mission and vision statement should be well communicated to, and understood by, officials if they are to be kept focused on objectives and it should assist in making officials aware of their responsibilities.

## 6.3. Definition and locus of risk management

Although the various definitions of risk and risk management as referred to in Chapter 1:1 and 7 provide a comprehensive description of the risk-management function, an applicable definition of risk management in a local government environment should be put into effect. A combination of the definitions proposed by COSO (2003:3) and King (2002:77) should suffice for local government, namely "Integrated risk management is a process to identify and assess actual and potential risks, effected by the council, senior management and officials at all levels, to provide reasonable assurance that the objectives are being met, opportunities capitalised and to determine whether risks will be terminated, transferred, tolerated or treated depending on the risk tolerance or appetite". Therefore, to effect the definition of risk management the locus of the integrated risk-management department in the organisational hierarchy should be on executive level to provide authority to the office of the Chief Risk Officer in executing the functions mentioned in the definition (see Figure 30 – developed by researcher).

**Figure 30 Macro Structuring of an Integrated Risk-Management Department**




The structuring of an integrated risk management department will be described in detail in paragraph 6.7.3. of this Chapter.

Thus, the development of a risk-management definition for local government should provide guidance to stakeholders and act as a stimulus to integrate risk management in the daily activities of everyone in a local authority environment. It must be understood that risk management is an interactive process that enhances decision-making by contributing a greater insight into risks, their impacts and likelihood of occurrence. Proper assessment of potential risks should contribute towards assessing the integrated risk-management process against the generic public management functions.

A normative approach on how to enhance the generic public management functions with reference to policies, planning, management by example, organisation culture, control activities and monitoring will be described to ensure that the risk-management process is successfully undertaken in local government.

## 6.4. Policies

The implementation and execution of policies is important i) to ensure that services are rendered that will meet international standards, ii) to manage performance and the responsibilities of officials, iii) to recover losses where applicable, and iv) to adopt a Code of Conduct to guide officials in rendering optimal services. The policies are described below.

### 6.4.1. Legislation for integrated risk management

Legislation specifically for integrated risk management on local government level is critically needed to guide officials in decision-making. The MFMA and other legislation as described in Chapter 3 should be used as a foundation to formulate integrated risk-management legislation. Other non-legislative documents such as the COSO framework, King 2 Report and the IRMSA Code of Practice should also be taken cognisance of in developing integrated risk-management legislation.

The following aspects, which should not be interpreted as a final or complete index of legislative aspects, should be incorporated into legislation: purpose of legislation; definitions; responsibility for the risk-management programme; responsibilities for determining tolerance and appetite levels; methodology to embed integrated risk management, for example, training, policies, regular workshops and reporting; providing assurance to stakeholders; responsibilities of risk-management committee and internal audit committee; responsibilities of risk-management department, line managers and internal audit; monitoring intervals for risk identification and assessment, and penalties for non-adherence to legislation.

The implementation of a code of conduct should assist in the optimisation of resources, because it provides guidelines to stakeholders on how to act in the interests of local government in South Africa.

#### 6.4.1.1. Code of Conduct

A Code of Conduct is needed to direct officials to avoid conflict of interests and to prevent the risk that officials might, for example, use inside knowledge to benefit themselves to the detriment of the organisation. The Municipal Systems Act (Schedules 1 & 2) does prescribe a Code of Conduct for local government politicians and officials, which should be enforced on local government stakeholders. Training should be provided to make officials aware of the contents of the Code and such training should be repeated at regular intervals to ensure that new officials are also informed of the Code. Non-adherence to the Code should be punished through disciplinary procedures and attendees at training courses should sign a document after the training to ensure that officials cannot claim at a later stage that they were not informed about the contents and meaning of the Code. The implementation of organisational sentencing guidelines should enforce the execution of the Code of Conduct.

Local government has a public commitment to deliver services to stakeholders in an honest and fair manner and not for private gain. The following principles *inter alia* should be addressed in the Code of Conduct to promote the public interest:

- Officials should demonstrate the highest standards of personal integrity in public activities to inspire confidence in local government;

- Officials should accept the responsibility for securing and protecting assets against risks threatening such assets as well as to prevent such a risk from gaining capacity;

- Officials should serve stakeholders with respect, concern and responsiveness, recognising that services to the public are beyond services to themselves;

- Officials should strive for personal professional excellence to promote sound and effective integrated risk management in local government;

- Officials should not realise any personal gain or engage in any interests that are in conflict with the performance of their official duties and responsibilities;

- Officials should not further their private interest by using non-public information that they obtain in the course of their employment or use their public office and organisational assets for private gain;

- Officials should not engage in any interest or activity without authority that is in conflict with official duties and responsibilities;

- Officials should refrain from engaging in nepotism and favouritism or from making unauthorised commitments that purport to be those of local government;

- Officials should not commit sexual harassment or discrimination against any official; and

- Officials should be informed that failure to comply with the terms and spirit of the ethics policy might expose them to internal disciplinary action and possible sanctions.

Thus, officials should promptly report corruption and adhere to all laws, regulations and policies. Officials should therefore endeavour to avoid any actions that would create the impression that they are violating the law or the ethical standards applicable to local government (Deloitte & Touche, 2000:1; Fazekas, 2003(b):4; Lione, 1999:76 and Local Government: Municipal Systems Act, 2000 (No. 32 of 2000), Schedule 2). Politicians and officials have a duty to ensure that the credibility and integrity of local government are not compromised. Stakeholders should be treated equally without favour and officials should not enjoy personal gain to the detriment of the stakeholders. High levels of service-delivery standards should be maintained.

6.4.1.2. Service-delivery standards

The objective should be to implement service-delivery standards to enhance the quality and quantity of services, which are sustainable and affordable. One of the requirements is to develop service standards that can be measured against comparable international standards. Service standards should be evaluated continuously and measures should be implemented to monitor progress in achieving the objectives of local government. Officials’ tasks should be re-engineered to mitigate the risk that prescribed standards might not be met. Management should ensure that a culture of customer care is developed and instilled amongst officials through, for example, management by example and training.

The White Paper on Transforming Public Service Delivery, 1997 (No. 1459 of 1997), section 1.2.7. describes principles that public sector officials should apply in creating an effective and efficient public sector. These principles may be summarised as follows and should be implemented to prevent the risk of legislative requirements not being met:

> Stakeholders should be regularly consulted to determine the degree of satisfaction regarding the quality of services rendered and they should be informed of the level and type of service that could be expected to be rendered. Stakeholders should be treated with courtesy and they should be entitled to access to equal services.

Thus, to enhance value-for-money in service delivery, officials are obliged to inform the stakeholders of the financial aspects of rendering a service and in instances where the desired service level is not achieved or maintained, the responsible officials need to redress the situation effectively and timeously. Therefore, the performance of officials needs to be managed.

6.4.1.3. Managing performance

The performance-management system should promote a culture of performance management amongst officials as well as be commensurate with the organisation's resources to meet the targets contained in the integrated development plan. Managing the performance of officials should be enhanced to ensure sustainable service delivery.

Thus, officials and the public should be trained in the management of the public participation process with a view to improving the performance-management system. Both officials and the public should be involved in capacity building, such as participation in determining and implementing key performance indicators in organisations. Such actions should ensure that proper services are rendered and they will mitigate the risk of legal action against officials.

#### 6.4.1.5. Responsibilities of municipal officials

Municipal officials need to fulfil their responsibilities in a cost-effective manner without the risk of misusing their position of trust for personal gain. To execute their responsibilities effectively, officials have to build ability and capacity to enhance their skills. The intention should be to render services in a corruption-free environment for the benefit of stakeholders and to optimise resources. Officials who are not executing their responsibilities in a responsible manner and who therefore cause losses, should be penalised by having such losses recovered from these officials themselves.

#### 6.4.1.6. Recovery of losses

It is expected that the public sector should render services in an effective way and with the intention of optimising its resources. If losses occur it is the duty of the Office of the City Manager, in the case of a local authority, to quantify the amount and impact of the loss and to institute appropriate disciplinary action. The City Manager should also take action to recover the losses through an internal disciplinary process and/or external criminal and civil actions. If a loss has occurred as a result of corruption, then the incident must be reported to the South African Police Services and the Auditor-General, depending on the amount of the loss (Local Government Transition Act, 1996 (No. 97 of 1996) Section 10G(2)(f) and (g) and Financial Regulations for Regional Services Councils, 1991 (No. 1330 of 1991, GN R1524, Section 24(1)).

Thus, to prevent the risk of losses occurring, systems of control (for example, regular inspections) should be implemented, maintained and tested by management. The Chief Risk Officer should appraise these systems of control independently and on a regular basis to provide assurance that the risk of losses will not arise or that they will be identified in good time. Officials who do not act in the interests of local government and who do not optimise the resources available to render services might be held accountable for any damage or losses suffered.

#### 6.4.1.7. Organisational sentencing guidelines

Current legislation that is applicable on local government, for example The Municipal Finance Management Act is not strict enough to curb the spate of corruption within the local government environment. The legislation has to be revisited and attention devoted to the incorporation of sentencing guidelines that should at a minimum equal the amount of a loss due to gross negligence or corruption. Such strict penalties should encourage local government officials to prevent, or refrain from, causing losses or committing corrupt actions. Official should not be allowed to pay back the amount of losses or damages, as often happens, but if they are found guilty of an offence, they should be dismissed. Organisational sentencing guidelines, which could vary from department to department, should be enforced by ensuring and inscribing in contracts that vendors' records can be scrutinised to prevent the collusion of organisation officials with vendors.

#### 6.4.1.8. Verification of records

Verification of vendor's records is a method to inform both the vendor and corrupt officials that verification checks can be conducted. In order to permit local government to execute such checks on an unconditional basis, the council of a local authority should develop policy to enact such verification and it should be incorporated as a standard in each contract or any form of agreement with vendors. Thus, such policy should enhance the controls and effectiveness of an integrated risk-management process as well as other role players responsible for assessing the effectiveness of controls, for example, internal and external auditors. Management, through the principle of segregation of duties, should further reinforce the verification of records as a control to discourage corruption.

#### 6.4.1.9. Confidentiality agreements

Management should implement confidentiality agreements in employment contracts to prevent officials from divulging privileged information to third parties. Legal action and the imposing of penalties should be enforced when officials do not adhere to confidentiality agreements. The confidentiality agreements should be reviewed and signed annually to remind officials not to divulge privileged information. Schedule 2, section 6(1) & (2) of the Systems Act (2000:116) could be reformulated to serve as a confidentiality agreement between local government and officials. The following content is proposed: "Officials may not without permission disclose any privileged or confidential information, inclusive but not limited to (a) information determined by council, structure or official of local government to be privileged or confidential (b) discussions in closed session by the council or committee of the council (c) violations to a person's right to privacy, or (d) information described to be privileged, confidential or secret in terms of any law, to an unauthorised person."

Adherence to legislation should enhance the credibility of the risk-management department. This will ensure that the risk-management department is built on the correct foundation to obtain the commitment of stakeholders to the interests of local government and those who are dependent on the services rendered by local government. The development of a departmental risk-management policy can facilitate the optimisation of services and the use of resources. The departmental risk-management policies should be distributed and adopted by all the departments within local government.

### 6.4.2. Departmental risk-management policy

In developing an organisational risk-management policy, the Chief Risk Officer should initiate the development of a corporate policy and framework for managing risks. Consideration should be given to incorporating the following information in an organisational risk policy:

- local government should decide up front what the level of risk that it is willing to take will be (risk appetite) and to maximise opportunities, for example, to be in a position to act pro-actively to mitigate risks that flow from taking risks;
- management should disclose that they are accountable and responsible for the risk-management process as well as for the system of internal control. Management should give reasonable assurance to stakeholders that the systems of internal control will identify risks (Deloach, 2000:93-96 and Monash, 2000). Annexure A represents an example of a risk-management policy statement.

- the objectives and rationale for managing risk;
- making it clear that stakeholders should be considered risk owners and should therefore be committed to, and responsible and accountable for risk management;
- introducing mechanisms available to assist stakeholders in their effort to manage risks;
- training stakeholders to assist in driving the risk-management programme;
- informing stakeholders that performance in relation to the policy will be measured; and
- ensuring appropriate levels of rewards and sanctions via performance-management processes for adherence or non-adherence to the policy.

6.4.2.1. Segregation of duties

Segregation of duties should make it difficult for corrupt officials to collude with third parties such as vendors, especially if management makes supervisors aware of this risk and reminds supervisors on a regular basis that they should be alert to shortcomings, for example, in the supply chain, and to take remedial action to prevent losses through segregation of duties. Wells (1997:149) stated that the primary method of prevention of corruption is the segregation of duties. Corruption normally occurs when one official has control over the entire accounting transaction, for example, authorisation, recording and custody. The solution is to segregate the duties by making more than one official responsible for a specific task in the accounting process, which should deter or curb corruption.

Thus, the effective enforcement of the policies may assist management in planning their risk responses and contingency plans, especially if they are well understood by all stakeholders.

## 6.5 Planning

The implementation of a risk-response plan should enhance the potential to reveal risks. No risk-management programme can provide total protection against corruption, but making all stakeholders aware of what is expected can reduce risks and therefore management needs to develop a risk-response plan. A risk-response plan should ensure a disciplined approach in the management of risks, which can be outlined as follows:

- The risk response plan should address the organisation’s attitude towards risk and the objectives of the risk-response plan;
- The plan should prescribe individual responsibility for the management of risks and the designated officials should have the technical knowledge and authority to manage the risks that the official is responsible for;
- The current processes as well as processes envisaged for the future to reduce the risks to an acceptable level should be included in the plan (IIA, 2003:14);
- Performance measures to measure proactively and reactively need to be implemented to enable management to assess and monitor the effectiveness of the risk-response plan;
- Independent internal or external experts should assess the adequacy of the response to a risk; the frequency of such reviews will depend upon the nature of the risk;
- The risk-response plan should also make provision for a contingency plan to mitigate losses after an incident.

The contingency plan should also serve as a deterrent if it is known that the organisation has procedures in place to act swiftly on its own or in conjunction with other authorities to address risks (Chartered Management Institute, 2004:7 and Oz, 2004:6). Stakeholders should be informed that the organisation would take action against perpetrators as well as ensure the recovery of losses; for example, officials will be dismissed and suppliers suspended if corruption is proved in the procurement process. To ensure fairness and transparency, a code and procedure need to be adopted to provide a process for suppliers who are in danger of being suspended from the supplier’s list to present proof of their innocence or mitigating factors, which should be considered before a suspension is imposed. An example of a “Supply Chain Management: Code and Procedure for Suspension of Suppliers” is attached as Annexure B. The researcher developed this Code and Procedure for Suspension of Suppliers for the City of Cape Town. Attached to this Code is the “Code of Conduct applicable to the procurement of goods, services and engineering and construction works by public bodies’’ as well as the procedure for ‘’Deregistration of contractors to public bodies who supply goods, services and engineering and construction works’’ who breach the Code of Conduct applicable to them. The researcher further developed a document which is also attached to Annexure B referring to ‘’Acts of misconduct other than breach of contract’’ under which a supplier should be suspended. The documentation that was developed by the researcher was not implemented by management which may be the cause of loosing money, for example, through suppliers who continue to render inferior services knowing that the Codes as developed won't be exercised.

Local government should approve a contingency plan and update it annually. The following aspects may be included in a contingency plan (Barnett, 2000:10; Davis, 2002:8-11 and Ernst &Young, 2002:15):

- Scope of the contingency plan – The scope should address the role and commitment of management and council in the detection of risks. The procedure to be followed with regard to disciplinary action and recovery of assets should also be described.

- Initiating the incident – Once an incident has been reported the assets need to be secured and suspects need to be closely supervised or suspended. The organisational strategies need to be revisited to ensure that objectives will still be met and a cost analysis needs to be undertaken to determine the best course of remedial action. Insurers need to be informed and support services, such as the South African Police Services, need to be informed of the incident.

- Responsibility of officials – The contingency plan should outline the team and skills needed to investigate the incident. Depending on the impact of an incident, the team could include lawyers, auditors, engineers, medical doctors and forensic accountants.

- Suspect officials – The contingency plan should be fair and suspect officials should be given the opportunity to respond to allegations.

Suspect officials should be informed that they have a right to consult with their union or legal representative and they must be informed that, if they are suspended, they have no right to enter any premises of the organisation that they have been working for. The *audi alteram partem* rule should also be applied whereby the suspect should get an opportunity to explain his/her version of an incident.

- Collecting documentary evidence – It is necessary to ensure that all original documents are secured and handled cautiously. The risk exists that documentary evidence might be destroyed, which could lead to a lack of evidence and consequent scrapping of the case from the court roll. In cases where computers are confiscated, the experts in this field need to be called in for assistance to prevent evidence from being declared not admissible.

- Communication with the press – Officials should be reminded not to release any information to the press, except through the correct channels as prescribed in the contingency plan.

- Contact details – The contingency plan should distribute and update the contact names and numbers of officials who should respond to complaints.

Thus, the implementation of a risk-response plan should assist management to meet the increased expectations by identifying risks with a potentially high impact and likelihood, or to identify restraints that need to be removed to capitalise on opportunities. The purpose of the contingency plan is to be ready to act immediately in an organised and efficient manner should an incident be reported. It should also indicate who should be contacted and what procedure to follow in order to report any risk. The contingency plan should spell out clearly that only authorised officials might divulge information to the press; the intention here is to ensure that the reputation of the organisation is not damaged. To prevent that risks materialise in losses, organisations need to ensure that the organisational culture is of such a nature that officials will refrain from unethical conduct. A paradigm shift should be effected whereby the identification of any risk that could cause organisational losses will become part of each stakeholder's daily activity; in this regard management should lead by example.

## 6.6 Management by example

Management by example is urgently needed on local government level to prevent the deterioration in leadership that is currently experienced (Die Burger, 2005:7 and Die Burger, 2005:15). Management needs to be creative in developing solutions to challenges and it is therefore proposed that management should not shy away from involving experts nationally and internationally to assist them in addressing these challenges. There is no ethical example stronger than the leadership provided by the head of an organisation and by that modelling of behaviour which occurs under strong influences such as management that is supposed to set the tone at the top. Management should realise the importance of their personal example, because setting this example is the real ethical connection to ensure an efficient integrated risk-management process (Murray, 1997:50). The example set by management should be so contagious that other employees in the organisation will adopt an organisational culture that refrains from unethical conduct.

## 6.7 Organisational culture

An organisational culture that is focused on risk identification and mitigation should provide the assurance to stakeholders that risks are well managed.

### 6.7.1. Embedding organisational culture

The Institute of Chartered Accountants in England and Wales revealed in their 2001 annual Fraud Advisory's Panel Report (Ernst & Young, 2003:10) that "The development of a corporate anti-fraud culture requires serious and sustaining training. Yet little progress in the marketplace can be reported since the Panel's 1999 survey which revealed serious deficiencies in the programme run by business, educational institutions and the professions." The reality is that if corruption is given the opportunity to occur, the risk exists that this can happen on a huge scale. Officials at all levels in the organisation should assist in effecting a paradigm shift to enhance openness, honesty and transparency. Officials should regularly be made aware of the warning signs of corruption and they should not hesitate to report unethical conduct.

6.7.1.1. Risk-Prevention Survey: A Questionnaire

A questionnaire has been developed by the researcher that could be used for survey purposes with the objective to determine the knowledge and attitude of officials in the public sector towards risk management (Annexure C for CD and example document). Van Blerk (Personal interview, 2003) supported the objective with the questionnaire in correspondence with the researcher. The questionnaire has six options to indicate each respondent's level of agreement with a statement made. By way of example, each question can be answered as follows:

- (1) agree strongly;
- (2) agree;
- (3) agree slightly;
- (4) disagree slightly;
- (5) disagree; or
- (6) disagree strongly.

It is proposed that the number of officials participating in the survey should not be more than 30. The ideal should be to include officials from all levels in the organisation and they should be representative of all the directorates. Such a composition of participants will eliminate the risk of possible biases of the interpretation of the results by certain officials. Once every participant's answer has been captured, a graph will automatically be prepared to represent the result of a group visually, see Annexure D for an example of graph. This graph is interpreted as follows: With reference to question 5 on the questionnaire (see annexure C) "I would be more confident in reporting possible corruption than 6 months ago", four participants "agreed slightly" (3); one participant "disagreed slightly" (4) and one participant "disagreed" (5). Officials, knowledgeable in the risk-management discipline, should then evaluate each graph to inform management of the outcome; for example, according to the outcome of this graph, it could be deduced that officials are not more confident now than six months ago about reporting possibilities of corruption. Although it is accepted that the outcome may vary between different departments in local government, such an outcome, as per the example, should direct the attention of management towards what should be done to prevent losses and to enhance risk management in local government. Another benefit of the questionnaire is that it protects whistle-blowers, because it is completed on an anonymous basis.

Thus, the results of the survey should assist in determining the knowledge and attitudes of officials towards risk management. The evaluation of the questions should give a holistic indication of issues for the organisation as a whole that need to be addressed to enhance the organisational culture. For example, the outcome of the questionnaire should direct management to conduct training in, for example ethics, risk response plans or procedures to follow in reporting incidents of corruption. It should also be deducted from the questionnaire which issues represent top barriers in the risk management system and such issues should then be subjected to a risk identification and assessment workshop. Such issues represent risks that, if left unattended, could prevent local government from achieving its objectives. The survey puts in place a foundation to gauge and change the organisational culture as well as to identify the risk factors that need to be addressed to mitigate risks such as corruption. The evaluation and communication of the survey results should help to raise the awareness and importance of risk management and of an anti-corruption culture in local government.

Efforts to encourage the embedding of a risk culture should be supported through words and deeds, and officials should be convinced that failure to act against corruption could worsen the consequences for the organisation and its stakeholders as well as the reputation of local government.

### 6.7.2. Preserving reputation

The reputation of local government is normally judged on the quality and quantity of services rendered, as well as their affordability and sustainability. Management needs to evaluate these aspects continually and make adjustments in advance to prevent deterioration in the services delivered. A deterioration in service delivery could lead to prolonged mass action and demonstrations, which could impact negatively on the reputation of local government, for example, limitations on its credit rating, which could in turn lead to a stagnation of capital works because of lack of funds. The reputation of local government should be enhanced if less affluent residents could be accommodated by means of, for example, free essential services such as water or services at a reduced rate. The functioning of a risk-management department could enhance the level of service delivery and consequently the reputation of local government.

### 6.7.3. Structuring of a risk-management department

The structuring of the risk-management department should contribute and enhance the conducting of the activities that should be undertaken by the risk-management department. The following activities should be included (Institute of Internal Auditors – UK and Ireland (2004:1):

- Communicating the strategic objectives of the organisation;
- Determining the risk appetite of the organisation;
- Communicating information on risks and risk training material in a consistent manner at all levels in the organisation;
- Continuous assessment of risks that may have an impact on officials and stakeholders; cause damage or loss; lead to interruption of service delivery; influence insurance arrangements or result in the contravention of laws;
- Continuous evaluation of identified risks to determine their impact, causal circumstances and likelihood of occurring;
- Design and implementation of risk-management plans to deal with identified risks;
- Investigate incidents to develop and/or enhance controls;
- Consider and respond to reports, new risks identified and their evaluation;
- Continuous evaluation of risk incidents and reports to determine trends and to implement corrective actions;

- Constant evaluation of risk-management activities to ensure correct focus and cost effectiveness of programmes; and

- Monitoring and coordinating the integrated risk management processes and the outcomes.

The problem is that certain internal audit functions due to the lack of a risk-management department undertake the above-mentioned activities on behalf of a risk-management department. To prevent the internal audit function from the risk of waiving its independence a risk-management department should be structured.

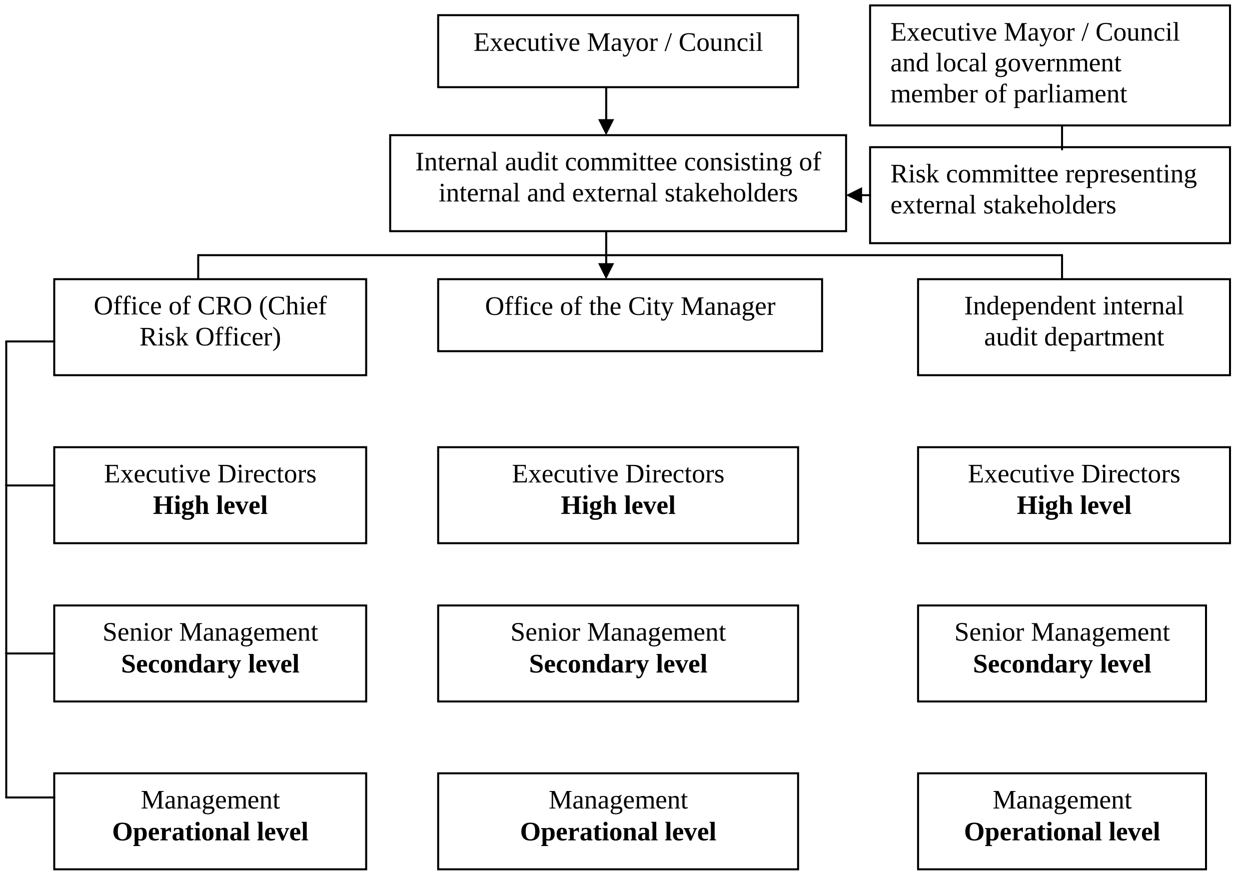
In structuring the risk-management department the following aspects should be taken into consideration to enhance the activities of the risk management department:

- the position of the risk management department in the organisational hierarchy;
- the level of responsibility and accountability that is expected from risk managers; and
- the number of officials assigned to the department, which will be influenced by the size of the organisation and the complexity of services rendered.

The risk-management department should consist of external stakeholders to enhance objectivity and to prevent subjectivity or biases and should report top risks (high impact and high likelihood) to the audit committee due to the absence of applicable legislation. The ideal situation should be where the risk committee report directly to the Executive Mayor / Council and to the local government member of parliament.

A proposed structure for the functioning of an integrated risk-management department in a local government environment is depicted in Figure 31 (developed by researcher).

**Figure 31 Functioning of an Integrated Risk-Management Department**




The CRO should be on the same salary level as the Executive Directors, with a communication and reporting line to the Office of the City Manager to ensure that the necessary authority is established to embed and integrate risk management in all the activities of local government and at all levels. The Office of the CRO should render services to the three levels indicated, namely the high, secondary and operational levels.

The breadth of risk management's involvement with organisational operations has expanded over the years and this expansion is still gaining momentum. It has created a situation in which the department of the CRO should be established on the executive management level. The office of the internal auditor should be closely linked to that of the CRO in an effort to keep the risk-management department focused on the risks facing the organisation (COSO, 2003:97; Hancock, 2003:9; Institute of Internal Auditors, 2003:89 and King, 2002:89).

- Internal audit department

The internal audit department has to provide an independent and objective assurance that the risk-management programme is effective in executing risk-management matters. To achieve this the internal audit department has to monitor and evaluate checks and balances in the functions and processes, which is an important function in ensuring and exercising good governance in local government. By improving the effectiveness of risk management, the internal audit department helps an organisation to accomplish its objectives through a systematic and disciplined approach. This approach includes the interviewing of officials to obtain clarity about, for example, how certain systems function and responsible officials for specific tasks; conducting inspections and verifying the contents of documents, which is supported by working papers to provide the assurance that risks are properly controlled. This approach contributes towards providing the assurance that the organisational objectives will be achieved. The internal audit department should adopt a best practice approach to establish an audit presence that has standing in the organisation and commands respect and credibility at all levels (King, 2002:86; Bredell, 2002:15 and Hickey, 2002:31).

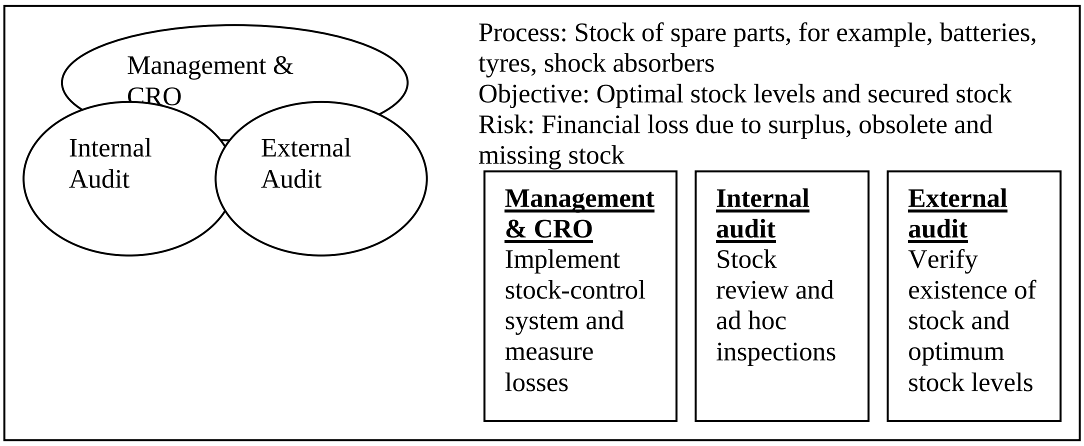
The role of internal audit in risk management is described by the Institute of Internal Auditors – UK and Ireland (2004:1-3) to provide objective assurance to management (council in case of local government) on the effectiveness of risk management; that top risks are being managed appropriately and that the risk management and internal control framework is operating effectively. To fulfil this role effectively the Institute of Internal Auditors – UK and Ireland (2004:2) indicates the core internal audit roles in regard to integrated risk management that have to be performed. These roles are:

- Giving assurance on the integrated risk management process;
- Giving assurance that risks are correctly evaluated;
- Evaluating integrated risk management processes;
- Evaluating the reporting of top risks; and

- Reviewing the management of top risks.

Although it is expected from the internal audit department to provide independent confirmation of management's statements about the effectiveness of the risk-management process, the internal audit department should not take on the functions, systems and processes of the risk-management department, but should assist them in monitoring the risk-management process. In this regard the risk-management process facilitates a combined approach in that management and the council obtain assurance that identified risks are effectively managed through the three main assurance providers, namely management themselves in conjunction with the risk-management department, external audit with reference to audit consultants, and the Office of the Auditor General and internal audit (KPMG, 2002:25 and King, 2002:75-76). This combined approach to provide reassurance is depicted in Figure 32 with reference to the management of spare parts for vehicles in an organisation. The combined reassurance approach entails that the three main assurance providers independently ensure that the risk of, for example, financial loss, or obsolete or missing stock is mitigated through, for example, stock inspections and verification checks.

**Figure 32 Combined Assurance Approach**




**KPMG (2002:25)**

Assurances given for risk management depend on the nature of the risks and the credibility of the assurance provider in terms of skills, experience and judgement to provide assurance that the risks are being managed adequately.

### 6.7.3.1. Classification of managerial hierarchy

For the purpose of risk assessments in local government, the managerial hierarchy should be classified into three levels. This classification should contribute to integrating risks, because the risk-management department should be in a position to have holistic knowledge of all the identified risks in the organisation. The risk-management department should also be positioned to determine sustainable and cost effective solutions to the identified risks and implement such solutions throughout the organisation in conjunction with management. Internal audit's assurance task should also be enhanced, because the classification approach should put internal audit in a position to provide objective assurance that the risk management process included assessments on all the levels within local government.

The three levels are:

- High-level risk assessments;
- Secondary-level risk assessments; and
- Operational risk assessments.

These levels are proposed to provide reasonable assurance that potential risks are identified during the risk-assessment process, instead of adopting the traditional approach where mainly high-level risk assessments (on executive level) are conducted, because overlooking a risk that could be catastrophic could have major implications for an organisation, such as the closure of that organisation (Marsh, 2004:11-12). The risk with the traditional approach is that lower-down or operational risks could be overlooked and therefore not be identified in good time.

#### 6.7.3.1.1. High-level risk assessments

High-level risk assessments should focus on key stakeholders such as members of the Office of the City Manager, Executive Directors and political representatives. The following methodology should be implemented at the high-level risk assessment:

- gather background information on, for example, key functions;
- review and understand the objectives;
- conduct risk-assessment awareness training to sensitise or focus representatives' attention on risks; and
- conduct one-on-one interviews with the selected key stakeholders with the intention to identify preliminary risks as well as related controls in place to bring the risks down to acceptable levels.

Based on information gathered on the methodology as described above, workshop material should then be prepared by the risk-assessment facilitators. All the preliminary risks identified should be collated to serve as the basis for the actual high-level risk assessment. The purpose of the high-level risk assessment should be to evaluate the preliminary identified risks, for example, by the members of the Office of the City Manager, in order to identify and document the risks with a potential major impact that could prevent the public sector from achieving its objectives.

Aspects such as the following should be considered and discussed:

- identification of, and agreement on, what the major risks are;
- evaluation of the identified risks in terms of their impact and likelihood;
- the prioritisation of the risks by means of risk-rating criteria;
- identification of the key controls which management relies on to bring the risks down to an acceptable level;
- the evaluation of the current key controls as well as the development of improved controls for risks where controls are non-existent or not effective; and
- the assignment of responsibility and accountability for management of the risks.

6.7.3.1.2. Secondary-level risk assessments

Secondary-level risk assessments should be facilitated with key stakeholders such as the executive manager – for example, the executive director of the Directorate: Trading Services – and the process owners (directors) of all the sub-directorates under the control of the Executive Director: Trading Services. The risk-assessment facilitators of the risk-management department should adopt the following methodology in conducting the secondary-level risk assessment:

- gather background information on the key responsibilities of the executive director and each process owner;
- review and understand the directorate's service-delivery plans and objectives;
- conduct risk-management and risk-assessment process awareness training; and
- conduct one-on-one interviews with process owners with the view to identifying preliminary risks as well as the related controls that are in place to bring the risks down to acceptable levels.

As with the high-level risk assessments, the risk-assessment facilitators should prepare the material for the secondary-level risk assessment based on the information as gathered during the preliminary identification of risks. All the preliminary risks identified should be collated to serve as the basis for the actual secondary-level risk assessment. The purpose of the secondary-level risk assessment should be to evaluate the preliminary identified risks jointly in order to identify and document the major risks that could prevent the directorate from achieving its objectives.

The same issues that need to be discussed and considered at the high-level risk assessment, for example, the identification, evaluation and prioritisation of risks, identification and evaluation of controls as well as the assignment of the responsibilities and accountability to manage the risks, should also be discussed at the secondary-level risk assessment.

6.7.3.1.3. Operational risk assessments

Operational risk assessments should be conducted with officials within each directorate, for example, managers and supervisors who are responsible for all the functions in the various departments and sections within each directorate. The risk-assessment facilitators should consider the risks identified at the high-level risk assessment as well as the secondary-level risk assessment. The purpose of the operational risk assessment, according to The Institute of Internal Auditors, 2003 – Practice Advisory 2600-1 and National Treasury, 2002:52 is to:

- identify the specific risks that are prevalent in each operation;
- measure and prioritise each operational risk;
- identify and confirm the controls that are currently relied upon to bring the specific risks down to acceptable levels;
- determine the effectiveness of the controls relating to each of the specific risks; and
- identify and determine specific officials responsible for improving the management of the specific risks.

Risk-identification documentation has been developed to assist risk-management facilitators to identify and assess risks prevalent on the three levels within an organisation.

6.7.3.2. Risk-identification documentation

Documentation as referred to in Annexure G was developed for the purposes of this research to inform the reader of the basic aspects involved when high-level, secondary-level and operational risk assessments are conducted. This document can be used to obtain information to populate best practice equipment such as CURA (an electronic technique to capture and manage risks holistically). The document in Annexure G is intended to give a better practical understanding of risks identified during assessments and it may be described as follows:

Annexure G (1/2) - The upper-left-hand block contains information about the directorate, department and branch to which the risk assessment is applicable as well as its main operation/function. The upper-right-hand block describes particulars of the official by whom the document was completed. This official is responsible for the correctness of the information on the document, but not necessarily for the management of the specific risks.

The bottom half of the document is used to prompt the risk-assessment attendee to first identify and list all risks. Each risk identified should be described in such a way that everyone attending the risk-assessment workshop easily understands it.

A clear description of the risks should assist in determining the impact on the organisation should the risk occur. The consequence, should a risk occur, indicates the impact on service delivery, resources and assets. The consequences should be assessed on a scale of 1-10 indicating whether they could be insignificant, minor, moderate, major or catastrophic.

The risk-assessment official should give an indication of the probability or likelihood of the risk occurring on a scale from 1-10. Indicators such as rare, unlikely, possible, likely or almost certain could be used. The official should give an indication of the residual risk decision that is best for local government. The residual risk is obtained by the equation "Inherent Risk Minus Control". A decision should be taken by management representing the department in which the risk was identified in conjunction with the Chief Risk Officer, to ensure uniformity in the risk management process, to mitigate the risk; to change the nature of the activity at risk, for example, a decision to insure or transfer the risk; or to terminate the risk through the elimination of the cause of the risk by inventing better or alternative controls. A risk could also be tolerated. Should a decision be taken to accept or control the risk, then the risks should be prioritised to determine which risks should be managed best. A response plan should be developed to manage the prioritised risks.

Annexure G (2/2) – This section deals with the controls in place and actions to be taken to enhance existing controls or to develop new controls where controls are lacking. Each risk is further scrutinised by detailing what method(s) is used to control a specific risk. The opportunity exists to indicate what should be done additionally to control a risk more effectively and efficiently. An indication must be given of whether a control measure is in place as well as the effectiveness of a specific control. The official who is responsible for controlling a specific risk should be identified. The cost of existing controls should be indicated. If a control is not in place, or if an existing control is ineffective, action should be identified to improve the lack of control. An official should be assigned to take responsibility for each action. A due date to effect action should also be recorded to ensure that an identified official takes responsibility for a risk within a reasonable time.

Thus, the risk-identification document facilitates the process of identifying risks as well as prioritising risks. On completion of the document, it can be used as documentary evidence to prove that local government is taking action to manage risks as well as to assign officials to take responsibility for the effective management of risks. The functions of the internal audit and risk-management department are not the same, but they are complementary in nature. Risk management provides combined assurance to management, the council and the audit committee that risks are being properly addressed. The purpose of the proposed three levels of risk assessments is to obtain the buy-in of every one in local government. This process should ensure that all the relevant risks are identified and evaluated, and that proper controls are put in place to manage these risks. Using best practice methodology and equipment in this process is an expensive process, but should be regarded as a proactive approach in the interest of local government and its stakeholders. This approach should reassure all the stakeholders, but this should be further demonstrated by the implementation of various pro-active control activities.

## 6.8. Control activities

The CRO, with agreement of management, should attend to the following control activities to facilitate an effective and efficient risk-management process within local government. The control activities consist of various role players, such as the CRO and risk-management department, risk-management committee, line management, internal auditor and other control activities such as whistle-blowing mechanisms, managerial certifications, treatment and monitoring of risks, incident investigations and the retaining of skills in the organisation.

- **Risk-management department –** The risk-management department needs to assume the functions and processes applicable to embed a risk culture in local government, for example, analyse and adapt to current best risk-management practices; ensure compliance with legislation; advise management on an integrated risk-management strategy setting; develop and implement practices, systems and procedures to identify risks on high, secondary and operational levels; facilitate risk-assessment workshops and conduct training in risk management.

- **Risk-management committee** - Once a risk-management department has been structured, a risk-management committee has to be established to enforce efficient and effective service delivery. The establishment of a risk-management committee could assist in the evaluation the risk-management programme and enhance the level of good governance in an organisation.

Currently structural and managerial changes are being experienced in local government as well as the emergence of improved governance arrangements. Improved governance arrangements resulted in the out-sourcing of certain government services, with the consequent risk that the quality and/or cost of service delivery might be affected. This possibility heightens the need for a risk-management committee to enforce vigilance and care in rendering public services (Farrell, 2003:89 and Whitley, 2003:15). A risk-management committee should have a mandate to ensure that sound systems of risk management are set in place, which should enhance sound corporate governance in local government (Cafferty, 2003:46-47 and The Institute of Internal Auditors, 2003 – Practice Advisory 2110-1).

Botha (in Geldenhuys, 1993:126) and Lawrie *et al.* (2003:8) state that the establishment of a risk-management committee is an important prerequisite for a successful risk-management process. Legislation prescribes that management is responsible for a system of effective risk management in local government. The risk-management process has the benefit that it holds officials responsible and accountable for specified activities. The implementation of a risk-management committee should facilitate management's endeavours to implement an effective risk-management process, because in executing its responsibilities, further assessments may be identified to reduce risks to an acceptable level. The risk management committee should include officials such as management, CRO, internal and external auditors as well as other stakeholders with the necessary interest and knowledge of risk management to execute the mandate successfully. The mandate should include the evaluation of the identified risks that threaten local government and ensuring that the organisational assurance providers, such as management, CRO, internal and external audit, adequately address these risk areas. The primary mandate of the risk-management committee should be to:

- establish, maintain and communicate a common understanding of all the risks to be addressed in order to achieve organisational objectives;
- identify and obtain the commitment of the risk profile of local government;
- co-ordinate risk-management and assurance efforts to avoid duplication as well as to ensure adequate coverage of risks.;
- execution of the process of risk management to achieve objectives and implement strategies;
- ensure the implementation of measuring systems to gauge performance with risk programmes, to benchmark best practices and to assess progress toward the desired standards;
- communication and awareness training sessions to educate stakeholders with a view to reducing exposure to risk; and
- development of reports to be considered by the audit committee (King, 2002:76, Marsh and KPMG, 2002:24-25).

Thus, the risk-management committee should report to the audit committee, which consists of external persons appointed on a contract basis with a knowledge of integrated risk management. They should consider the results with a view to deciding the nature and extent of assurance required from the assurance providers such as management, and internal and external audit. The risk-management committee should be empowered by the Council, in the local government context, with the necessary authority to fulfil their mandate and responsibilities, especially when risks are identified that had not been responded to appropriately in the past; this should facilitate the control activities needed to effect organisational change.

- **Line management –** Line managers need to be aware that risks are prevalent in all their daily activities and that they are the first officials to take responsibility for risk identification and to take steps to mitigate risks. Line managers should call on the risk-management department for assistance should they encounter risks beyond the scope of their management and knowledge.

- **Internal audit –** Provide assurance on the risk-management process and that top risks are being identified and properly assessed. It is the purpose of the internal audit activity to independently evaluate and to contribute to the improvement of risk-management systems to enhance assurance to stakeholders through consultation. The scope of internal auditing work entails an approach to evaluate and improve the adequacy and effectiveness risk management in carrying out assigned responsibilities. The purpose of evaluating the adequacy of local government's existing risk-management processes is to provide reasonable assurance that these processes are functioning as intended and that they will enable the achievement of local government's objectives and goals, and to provide recommendations for improving local government's operations in terms of both efficient and effective performance (Institute of Internal Auditors, International, 2001 (The Standards for the Professional Practice of Internal Auditing (Standard 2100).

- **Whistle-blowing mechanisms -** The existence of whistle-blowing mechanisms should be widely marketed to prevent local government from receiving negative publicity, which could harm its reputation. To ensure that whistle-blowing mechanisms are effective to prevent corruption and minimise risks, the following aspects need to be considered by management:

  - ensure that stakeholders are informed that the prime function of a whistle-blowing mechanism is to detect and prevent risks from occurring;
  - ensure that the mechanism to report an incident, for example, a hotline number, is properly marketed and not assume that all the officials will read and understand correspondence in this regard. The marketing of the whistle-blowing mechanism should include live presentations so that stakeholders can ask questions that concern them. Management should stress the fact that the reporter of an incident will be protected;
  - assure officials that it is not necessary only to report alleged corruption based on factual evidence, but that suspicions of possible risks or corruption are reported as well. Officials should understand that it is better to report suspicious incidents and discover that they were without

substance than to find out at a later stage that an incident with a high impact did take place to the detriment of the organisation;

- officials should understand that risks affects everyone in the organisation and therefore officials need to secure their own as well as the organisation's interest;
- ensure that officials on all levels are treated the same to prevent a situation in which officials might argue that the hotline is used by management as a tool to be used against lower-level officials only;
- give regular feedback to stakeholders to convince them that their complaints have been attended to, otherwise stakeholders could feel that their input was ignored with the consequence that they might not report incidents in future;
- make available a corruption and response policy on whistle blowing on the intranet so that stakeholders can familiarise themselves with its contents; and
- require all officials to sign an annual declaration of compliance to remind them of the mechanism and to obviate their not reporting incidents of risks and corruption (Fazekas, 2002:11, Hollyman, 2002:16 and Sherwin, 2002:10).

When incidents of corruption are reported, whistle-blowers normally prefer to remain anonymous, because of their fear of being victimised. Whistle-blowers experience stress during the process of investigation that follows after the information has been forwarded to investigators. Whistle-blowers incur costs for travelling and telephone calls, for example, to keep the investigators informed of, among other things, the movement of suspects and incidents that are planned to commit corruption; sometimes whistle-blowers have to visit their medical practitioners to obtain medication and treatment to cope with the stress of the investigation, which generates medical expenses.

Organisations should show an appreciation of a whistle-blower's commitment to report incidents of corruption with a view to preventing risks that could escalate. Whistle-blowers who reported incidents in good faith should be rewarded according to an approved policy. The following factors should be considered in determining whether a reward will be paid to a whistle-blower:

- any possibility of personal gain that the whistle-blower may enjoy by reporting an incident;
- the accuracy and completeness of the details provided; and
- the possibility of a successful disciplinary, civil and/or criminal prosecution (Deloitte & Touche, 2000:21).

Thus, the organisation is dependent on stakeholders to blow the whistle in cases where the organisation is at risk of suffering a loss. Whistle-blowers may be victimised and therefore they should be rewarded to compensate for such suffering as well as to cover their expenses. Once a report has been received, a contingency plan needs to be in place to address the risk. Prompt and professional attendance should eliminate or curb the risk of increased loss that the incident might raise.

- **Managerial certifications -** Management should make the following certifications:

  - certify that managers have reviewed reports and that to the best of their knowledge the report does not contain untrue material facts and does not omit a material fact that would make the statements in a report misleading;
  - financial statements and information in reports fairly present material facts, financial conditions and results of the operations of local government;
  - acknowledge their responsibility for establishing and maintaining internal controls, and also that the controls have been communicated throughout the organisation;
  - before a report is issued managers should certify that they have evaluated the effectiveness of controls and they should report the conclusions of their findings regarding the controls;

- if significant deficiencies are found during the evaluation of controls, this should be brought to the attention of the audit committee and risk-management committee; and
- management should also disclose whether they have found any corruption, material or not, perpetrated by officials who have a significant role in the organisation's controls (Fazekas, 2003:5 and Tierney, 2003:41).

Thus, ignorance should be no excuse for management. Managers who are responsible for certifying reports and other material documents should be disciplined and face civil and criminal prosecution if they are found guilty of false certification. An objective of the risk-management processes is to address risks proactively, but also to deal with and monitor risks with a view to mitigating risks as soon as possible and to stabilise the organisation once an incident has occurred.

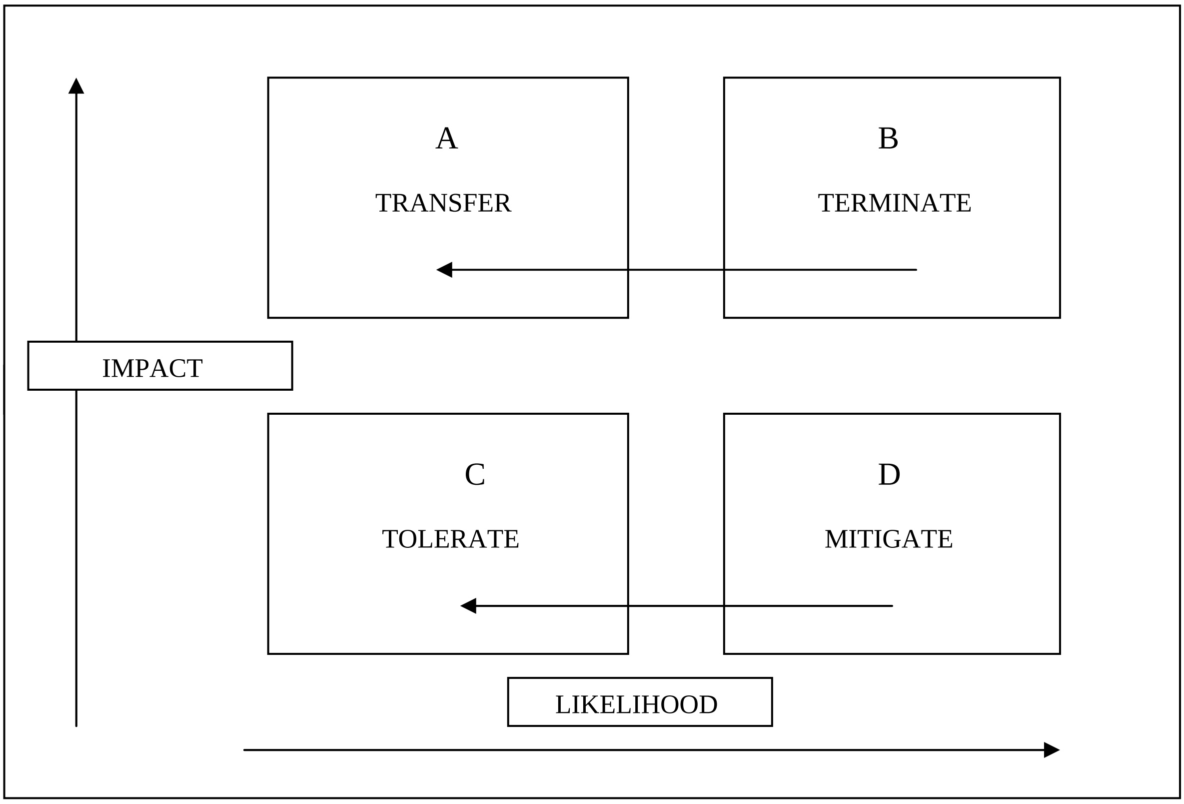
- **Treatment and monitoring of risks**

The treatment of risks should aim to control the adverse effects of identified risks by eliminating risks where possible as well as to minimise any loss after an incident has taken place. In an effort to eliminate or reduce the frequency and impact of risks the treatment should be cost effective and achievable (Marsh, 2000:34). The treatment of risks aims to do away with identified risks and, where risks cannot be eliminated, to put controls in place to reduce the impact of a risk or the likelihood of occurrence. Risk treatment should be cost effective and achievable, and it should be monitored regularly.

The categorisation of risks is important to control risks more effectively; this should assist officials in understanding and monitoring risks more efficiently. The benefit of risk categorisation is that one solution could be applied to many risks in a risk category, which in turn enhances the effectiveness of the risk-management process. See Figure 35 and Annexure E for an example of risk categorisation.

Monitoring risks is necessary to determine the effectiveness of the treatment of risks, to ensure that controls are adapted to changing risks, and to evaluate the risk-management process on a continuous basis (at least once a year). This process will reassure stakeholders in that they will have the know that the impact and likelihood of potential risks are well controlled. Fergusson (2003:8) stated that a risk is a rating between impact and likelihood, and that management should rate risks to determine whether a risk should be transferred, terminated, tolerated or mitigated. This rating is depicted in Figure 33.

**Figure 33** **Rating of risks**




**Fergusson (2003:8)**

Fergusson (2003:9) states that a decision should be taken in respect of risks with a high impact and high likelihood, for example, to terminate a risk (B Terminate quadrant) and/or risks with low impact but a high likelihood (D Mitigate quadrant). He further states that risks with a high impact but low likelihood (A Transfer quadrant) are typically outsourced or transferred through insurance practices, while risks with low impact and likelihood (C Tolerate quadrant) are generally tolerated or accepted. The risks identified in the Tolerate quadrant must not be ignored, as exposures to risk initially perceived as insignificant can develop into material losses

(Doherty, 2000:5, 36-38). The result of risk monitoring should be effectively communicated to stakeholders, so that they can understand the basis on which decisions are made and why actions are required to control risks properly (Australian/New Zealand Standard 4360, 1999:20).

A risk-rating mechanism as depicted in Figure 34 (developed by researcher) can be used to determine a rating for a risk. A risk rating could be subjective and therefore it is best practice to obtain a group decision on a consensus basis and to revisit ratings after a period of six months to one year. Although an ordinary EXEL spreadsheet can be used to facilitate a risk assessment workshop, it is recommended that a formal risk assessment software such as CURA be used to develop a databank for future reference and to act as a guide to enforce a common language in a local government environment.

**Figure 34** **Risk-rating mechanism**

**Impact**

Critical/Catastrophic (9-10) **A**

Significant/Major (7-8)

Marginal/Moderate (5-6) **B**

Immaterial/ Minor (3-4)

Negligible/Insignificant (1-2) **C**

**Likelihood**

| (1-2) | (3-4) | (5-6) | (7-8) | (9-10) |
|---|---|---|---|---|
| Rare/Remote | Unlikely/ Occasional/ Unusual | Possible/ Potential/ Occasional | Likely/ Expected/ Frequent | Almost Certain/ Continuous |

From Figure 34 is can be seen that a risk with a "catastrophic" impact and an "almost certain" likelihood (for example, power failures on a continuous basis in the Western Cape) is indicated as "A" – 81%-100% chance of materialising. A risk with a "marginal" impact and a "possible" likelihood (for example, the completion of a clinic one month later than planned) is indicated as "B" –

25%-36% chance of materialising, and a risk with a “negligible” impact and a “rare” likelihood (for example, the Western Cape region becoming a desert within 5 years) is indicated as “C” – 1%-4% chance of materialising. It can be deduced that risk A should receive immediate managerial attention to terminate the risk. Annexure F (developed by Alexander Forbes Risk Services and the researcher) represents a risk-rating sheet that should be used by the CRO to assess risks, because it provides a more detailed grid to assess risks accurately.

- **Incident investigation -** Incident investigation is an important step in the development of the risk-management process which should also be undertaken by the risk department. The objective of the incident investigation is to understand the real values that can be achieved and to arrive at effective and affordable controls to risks. To achieve the objective, the investigators should be skilled and experienced in eliminating conflicting evidence and information in order to present an accurate reflection of the real causes of an incident (Thompson, 2003:75). However, management should evaluate reports discreetly before they are investigated to prevent innocent officials from being embarrassed based on false accusations. Investigators should be informed that there is seldom a single cause for an incident and should therefore be aware that multiple causes for an incident should be sought and investigated.

Thus, the result of a thorough investigation should provide management with the necessary information to determine the likelihood of recurrence of the incident and the potential for a major loss. The implementation and development of effective controls is dependent on the quality of the investigation, otherwise the same risks could surface at a later stage. Investigations should enhance the reliance on emerging trends and assist in implementing controls based on info derived from the trends.

- **Retain risk skills in organisation**

  Politicians and management need to ensure that officials retain the necessary skills obtained through knowledge sharing, co-sourcing and investment in intellectual capital to manage local government effectively. Such skills should result in local government benefiting from the investment made in officials. The working environment of officials and the organisational culture should be made attractive to curb the risk of officials leaving local government, with the result that additional work pressure could motive other officials also to leave in search of better job opportunities.

Risk-management training material should be developed and continuously upgraded to enhance the control activities. Training is also an essential method to raise risk awareness and to embed a risk culture in local government.

## 6.9. Risk-management training material

Training in risk management may enhance understanding the importance of integrated risk management amongst all stakeholders which in turn may enhance the reputation of local government.

### 6.9.1. Development of risk-management training material

Training is essential to promote and establish the risk-management process in local government. Relevant risk-management training material should mitigate the risk that organisations fail to render services that meet the predetermined standards of service delivery as well as the expectations of stakeholders (Cafferty, 2003:45).

Officials should be examined after training courses have been conducted to ensure that they understand the contents of training courses. The researcher has designed training courses with examination for training of local government officials. The training material include:

- Introduction to integrated risk management
- Risk assessment and measurement
- Risk assurance
- Root cause analysis and incident investigation
- Business continuity management; and
- Facilitating integrated risk management workshops

The development of the course content of training material should be undertaken as a separate study. This research suggests certain related risk-management concepts or topics that should be considered in assembling risk-management training material for periods such as one to three days, ten days' modular courses or three-/four-year diploma or degree courses. The objective of the short courses should be to accommodate officials who cannot afford to be out of office for longer than, say, three consecutive days at a time. Distance training in integrated risk management should be considered. Long-term full-time training (three years) should be considered to accommodate students who would like to start off their career in risk management. The feasibility of presenting long-term full-time training after hours over a four-year period for those interested officials who are full time employed, should be considered. The training courses should prepare the student to become knowledgeable in all the facets of risk management in local government. It is suggested that a work group should be established to research and evaluate the contents of each course. The concepts/topics that should *inter alia* be considered in the development of integrated risk-management training courses are listed below:

6.9.1.1. Theory of integrated risk management

- public management – ethics and anti-corruption strategies and the establishment of a risk-management culture in the public sector;
- policy making on risks;
- information management;
- macro and micro economics;
- human resource/personnel management in risks;
- management of organisations; and

- studies on buyer behaviour and how to achieve competitive advantage.

6.9.1.2. Legislation on integrated risk management

- develop relevant legislation on integrated risk management;
- Constitution of South Africa; PFMA; MFMA; Systems Act;
- Code of Conduct, policies, IRMSA Code of Practice;
- corporate governance as per the King 2 report and COSO Framework;
- commercial/mercantile law; ordinances and bylaws;
- occupational, health and safety legislation; and
  legislation applicable to environmental management.

6.9.1.3. Financial management

- local government finances and accounting principles;
- tax law;
- statistics;
- analysis of data; and
- marketing theory and practices.

6.9.1.4. Management of risks

- understanding the rationale behind determining organisational objectives;
- integration of risk management into organisational strategy and planning;
- risk-management process in accordance with international standards (Farrell, 2003:88);
- global risk-management perspectives and principles;
- development of a methodology and strategy to conduct high-level, secondary-level and operational-level risk assessments;
- scientific cause analysis of key risks;
- risk-treatment options;
- monitoring of the risk-management process; and
- reporting on risk issues.

6.9.1.5. Corruption

- introduction into global practices of corruption, according to the Association of Certified Fraud Examiners;
- introduction into asset misappropriation schemes; and
- anti-corruption legislation.

6.9.1.6. Technological

- implementation of anonymous reporting devices such as a hotline;
- implementation of a technique/questionnaire to determine the organisational culture in local government; and
- technology to detect corruption, for example Analyst Notebook.

6.9.1.7. Skills development

- research methodology to assist in ongoing research because the environments in which organisations operate change from time to time;
- presentation skills development;
- professional interrogations techniques;
- conducting investigations;
- how to analyse statements and affidavits; and
- testifying at enquiries, disciplinary hearings, criminal and civil cases.

6.9.1.8. Assignment

- case studies; and
- practical assignment on a risk-related incident.

(Horwood, 2003:1-10; Elliott, 2000:63; Jarret, 2003:12; Geldenhuys, 2000:2; Association of Certified Fraud Examiners, 2003:19; Drennan, 2002:4-5 and Vincent, 2002:9-15)

Thus, the proposed training material should provide a broad spectrum of relevant topics to officials in local government as well as to other stakeholders. The training material should create the foundation for changing mindsets about the way local government renders services compared to the situation in the past. Knowledge obtained through the proposed training should assist in officials to become aware of risk-management principles as well as in the mitigation of risks and the identification of opportunities. Officials should be equipped to achieve organisational objectives. Proactive risk-management support mechanisms, such as the Integrated Risk Monitoring Technique (IRMT), should be implemented by management to assist in mitigating risks; this should contribute to the effective and efficient realisation of organisational objectives.

## 6.10. Integrated Risk Monitoring Technique

The Integrated Risk Monitoring Technique is a corporate risk-management technique designed to assist officials in the identification and evaluation of the cause of an incident. A simplistic technique was designed by International Risk Control Africa (IRCA) prior to 1998 to reduce the incidence of physical accidents in the workplace, specifically from an Occupational Health and Safety technical perspective. This technique was expanded and improved by the researcher to the extent of approximately 70% to include causes such as corruption and legislation that is not adhered to, as well as an additional level to address specific recommendations to remedy the lack of controls. These recommendations include inadequate mental or physical capability; lack of knowledge; lack of skill; stress – physical or mental; improper motivation; abuse or misuse; general personal factors; inadequate leadership and supervision; inadequate equipment and resources; inadequate or lack of standards/procedures/legislation; and legislation not adhered to. This technique is depicted in Figure 35 as well as in CD format (Annexure E). For the purposes of this research, the various levels of the Integrated Risk Monitoring Technique will be described to better understand the methodology to be used to identify and evaluate an incident. The technique assists officials who encounter incidents that could cause losses in the workplace to identify remedies to mitigate the impact of the loss as well as to prevent or reduce the risk of future losses. The comprehensiveness of the technique is intended to assist officials in identifying key risks and not to overlook risks that could cause losses to an organisation. The application of this technique is intended to assist officials in their daily tasks, should they encounter a risk incident, to identify the root causes of the risk. The main levels of the Integrated Risk Monitoring Technique is described below to provide a holistic perspective on the various levels applicable (Cafferty, 2003:47 and IRCA, 1998:8).

### 6.10.1. Determining the type of incident to report the loss (Step One)

In step one seven types of incidents have been identified to determine the type of loss, namely incidents involving (1) people, (2) equipment, (3) revenue, (4) liability, (5) environment, (6) property or (7) reputation. The technique allows the official to evaluate the risk potential, which is indicative of the high, medium or low level of the risk with reference to (1) the probability of recurrence, (2) the frequency of the incident; and (3) the potential impact of the incident. In determining the type of the loss, cognisance should be taken of the sources of evidence available at the scene of the incident for future reference, such as people present at the scene, the position of items damaged or people injured, documentary evidence on the scene, parts or equipment that could be used as evidence as well as the re-engineering/simulation of the scene or incident.

### 6.10.2. Identification of the incident (Step Two)

The event that precedes the loss is described as an incident. The Integrated Risk Monitoring Technique prompts the official to identify several incidents that could be responsible for a loss, including (1) misappropriation of the organisation's assets, (2) theft, (3) corruption such as fraud, (4) lack of segregation of duties, (5) negligence, (6) collusion between officials and third parties such as vendors, and (7) lack of verification. The circumstances that immediately precede the incident are referred to as the immediate cause of the loss.

### 6.10.3. Immediate cause of loss (Step Three)

An immediate cause of loss could be the result of a sub-standard act or a sub-standard condition. Sub-standard acts refer to acts such as the deviation from a standard practice, policies or procedures, standards and delegations or adherence to prescribed legislation, which could be the root cause of corruption. Sub-standard conditions refer to instances where no or inadequate policies, procedures or standards are in place and also to instances where delegations and legislation are non-existent or inadequate, which could contribute to the root causes of corruption as well. The basic causes of an incident represent those real causes that prompt the immediate causes to materialise.

### 6.10.4. Basic causes (Step Four)

Basic causes represent the origins of the substandard acts and conditions. In identifying the underlying basic causes, personal and job factors need to be identified and evaluated. For the purposes of this research seven personal factors and five job factors that could be viewed as a basic cause have been identified.

### 6.10.5. Specific recommendations to remedy lack of controls (Step Five)

Specific recommendations, based on the experience and knowledge of the researcher, have been developed for each personal and job factor to remedy the lack of controls as identified and evaluated as basic causes. In the absence of control, the loss sequence begins and it prompts the basic and immediate causal factors to materialise, with the effect that an incident occurs which generates a consequent loss.

### 6.10.6. Lack of controls – General recommendations (Step Six)

General recommendations to overcome the lack of controls – such as lack of leadership and administration; lack of or improperly planned inspections and maintenance, and lack of critical task analysis – have been made to assist in minimising the risk of losses.

The Integrated Risk Monitoring Technique could be used in a proactive manner. The proactive approach will assist officials to identify remedies to prevent a risk from re-ccurring to minimise the impact and likelihood of an incident (Sawyer, 1981:219). The Integrated Risk Monitoring Technique can be consulted by officials to identify the most practical solution to mitigate an incident. A hypothetical case study is described below to assist officials in the effective use of the Integrated Risk Monitoring Technique.

**Utilisation of the Integrated Risk Monitoring Technique: a case study**

In instances where, for example, corruption for personal gain has been committed by officials through the forgery of official documents to obtain tar and sub-base purchased by local government, the Integrated Risk Monitoring Technique could be used in the following manner to determine remedies for the prevention of a re-currence of the incident.

Loss (Step One) – The loss suffered by local government, according to the example, includes revenue, property and the reputation of the local authority. The probability, frequency/likelihood and impact of this type of incident are classified as high. The reason for this classification is that up to 25 tons of tar were misappropriated at regular intervals using official transport, labour and funds for personal gain. This act was committed by forging official documentation and colluding with other officials and vendors. The incident evidence in this instance refers to paper evidence in the form of an audit trail as well as the position of the sites where the work was supposed to be done, according to the official documentation.

Incident (Step Two) – This refer to corruption through the act of fraud. Due to the lack of verification by supervisors to ensure that the work was done according to the information on official documents an opportunity for corruption was created which resulted in fruitless expenses. The incident cannot be described as having occurred in the interest of the stakeholders and it resulted in an action where no value-for-money was achieved for local government.

Immediate cause (Step Three) – The immediate cause of the incident that caused the loss was sub-standard acts. In this instance a deviation from standard practices, policies and procedures took place. The immediate cause of the incident is not due to a sub-standard condition, because adequate practices, policies and procedures are in place, but management did not verify it.

Basic causes (Step Four) – The basic causes could involve personal and job factors. The following personal factors could have facilitated the basic causes that led to the incident (the numbers in brackets refer to the numbers in Figure 35 or annexure E in CD format for easy reference):

- Inadequate performance feedback to officials (5.4);
- Lack of incentives (5.7);
- Misuse of official assets (6.10);
- Misuse of inside knowledge (7.8).

The following job factors could have facilitated the basic causes that led to the incident:

- Inadequate supervision/leadership to prevent incidents (8.6);
- Conditions that led to incident previously ignored (8.9);
- Lack of commitment and/or involvement in work function (8.10);
- Absence of zero tolerance towards misuse of resources (8.16);
- Irregular inspections (9.5);
- Non-adherence to maintenance programme (9.6);
- Lack of corporate governance, culture and values (11.1);
- Non-adherence to ethics policy (12.7).

Specific recommendations (Step Five)

- Regular performance appraisal (5.4);
- Implement reward policy (5.7);
- Training in corporate ethics policy and enforce procedure; supervisors should be held responsible and accountable (6.10);
- Adherence to basic conditions of service, education and ethics (7.8);
- Train/upgrade quality of supervision (8.6);
- Analyse databank of incidents (8.9);
- Training and communication to enhance commitment (8.10);
- Make officials aware of legislation regarding wasteful and fruitless expenditure (8.16);

- Development of inspection programme and enforcement thereof (9.5);
- Develop maintenance programme and enforcement thereof (9.6);
- Awareness campaign in corporate governance, change culture and promote positive mindset to share corporate values (11.1);
- Regular training or awareness of applicable legislation (12.7).

Lack of control (general recommendations) – (Step Six)

To prevent the incident from recurring, the following general recommendations could be applied to upgrade controls with reference to:

- Leadership and administration – Obtain commitment and participation of senior and middle management (A3), establish risk-control performance standards (A4) and assign responsibilities to control risks (A9);
- Leadership training - Update risk-control training for senior and middle management (B6);
- Planned inspections and maintenance – Perform planned inspections of operation (C1) and develop a system for officials to report sub-standard acts and conditions in writing (C7);
- Critical task analyses and procedures – Develop objectives for critical task analysis and procedures (D3);
- Incident investigation – Develop system for reporting and investigation of incidents (E5);
- Task supervision – Ensure the analysis of task supervision reports (F4);
- Legislation – Ensure regular education and review of applicable legislation (G2);
- Incident analysis – Analyse the cause of the incident and effectiveness of controls to reduce possibility of recurrence (H2);
- Personal communication – Plan personal contacts with officials who are doing the job to gain knowledge of progress and quality of work (L4);
- Group communications – Implement regular group meetings with officials to discuss proposals for the control of risk (M1);
- General promotion – Communicate with the stakeholders to report incidents of lack of control of risks (N8);

- Reporting mechanisms – Implement mechanisms whereby stakeholders can revert to whistle blowing to report incidents and reward stakeholders for information that could prevent losses (Q1).

Thus, the Integrated Risk Monitoring Technique assists officials either to determine the real causes of an incident or to be proactive in preventing incidents that could cause losses. Documentation should be utilised to assist management to determine risks as well as to assess risks specifically to identify new risks or opportunities that could be capitalised on.

## 6.11 Summary

The intention with the implementation of an integrated risk-management programme is to enhance the efficiency and effectiveness of service delivery in local government at an affordable cost. Integrated risk management refers to the organisational culture, processes and structures that are directed towards the management of potential opportunities and adverse effects of an incident as well as to the policies, procedures and practices in place to achieve this objective.

The objective of integrated risk management is to urge officials to provide reasonable assurance that compliance with policies and procedures is achieved as well as the accomplishment of established objectives for operational programmes. Officials should ensure that information is reliable, and that resources are used in an economical manner to safeguard the organisation's assets and resources. Management should ensure that the objectives of risk management are clearly understood and achievable. A proper understanding of risk-management objectives should ensure that stability is secured soon after a risk has materialised as well as to develop and implement measures that will prevent a recurrence of similar incidents.

The purpose of a risk-management mission statement is to enhance the degree of efficiency and effectiveness in local government by improving organisational performance. The mission statement's objective is to focus the attention of officials on the importance of their commitment to risk-management practices. The mission and vision statements are complementary to each other in that the vision statement provides a sense of purpose and focuses the development of risk-management objectives and strategies. The vision statement should be communicated to officials to keep them focused and to make them aware of their responsibilities and legislative requirements.

To ensure that the risk-management programme is successfully undertaken in local government, the generic public management functions with reference to policies, planning, management by example, organisational culture, control activities and monitoring have been described. The implementation and execution of policies are important to ensure, for example, that services are rendered which are sustainable and affordable, and to manage performance and the responsibilities of officials, to recover losses where applicable, and to adopt a code of conduct to guide officials in rendering optimal services. Legislation for integrated risk management on local government level is critically needed to guide officials in their decision-making process. Various pieces of legislation and other non-legislative documents such as the IRMSA Code of Practice, COSO Framework and King 2 should be consulted as a foundation to develop legislation specifically applicable to integrated risk management. Other aspects addressed under policies included the development of a risk-management policy; organisational sentencing guidelines; verification of records; segregation of duties and confidentiality agreements.

To ensure a disciplined approach in the management of risks, a risk-response plan should be adopted. The plan should describe individual responsibility for the management of risks so as to succeed in reducing the risks to an acceptable level. The implementation of a risk-response plan will assist management to meet the increased expectations by identifying risks with potentially high impact and the likelihood of occurring, and to identify the constraints that need to be removed to capitalise on opportunities. The implementation of a risk-response plan should enhance the potential to discover risks. A risk-management programme cannot provide total protection against managerial failure, but a response plan makes all stakeholders aware of what is expected from them, which should reduce risks. A contingency plan should serve as a deterrent, if it is known that the local government has procedures in place to act swiftly to mitigate risks. The scope of the contingency plan should address the role and commitment of management and the council in the detection of risks.

Management by example is urgently needed on local government level to prevent the deterioration in leadership that is currently being experienced. Management should not hesitate to involve national and international experts to assist them in the challenge to be creative in developing solutions to the challenges. An organisational culture has to be embedded that is focused on risk identification and mitigation, which should provide assurance to stakeholders that risks are well managed, with the consequent enhancement of the reputation of local government. The establishment of a risk-management department should be linked to the internal audit function in an organisation. The Office of the Risk Manager should be structured in such a way that every incident that might have a substantial impact on the organisation will be reported to the risk manager for swift action. The Office of the Internal Auditor should be linked to the risk manager's office, which will assist the risk manager to remain focused on risks facing the organisation. It is a function of the Internal Audit Department to provide independent assurance that management's statements about the effectiveness of the risk-management process are correct. The Internal Audit Department should assist the council and management in the monitoring of the risk-management process, but should not assume the functions, systems and processes of risk management. The development and implementation of a risk-management programme is dependent on the support of the executive management team and councillors, and the risk-management programme should be driven by a policy, which should be well communicated to the organisation's stakeholders. The policy should assist in managing the risks and ensure that the process for managing risks is integrated with other planning and management services.

Time spent during risk assessments should be optimised by focusing on the risks and the evaluation of controls. The managerial hierarchy in local government that should be considered for risk assessments should be classified into three levels, namely high-level risk assessments, secondary-level risk assessments and operational risk assessments. These levels are proposed to obtain optimum results during the risk-assessment process instead of using the traditional approach, where mainly high-level risk assessments are conducted.

The organisational culture needs to be secured by politicians and management to ensure that officials are retained to capitalise on the skills obtained through knowledge sharing, co-sourcing and investment in intellectual capital to manage local government effectively. A questionnaire has been developed to determine the culture of local government in a proactive way. The evaluation of the questions and answers should give an indication of issues that need to be addressed to enhance the organisational culture. The questionnaire puts in place a foundation to gauge and change the organisational culture as well as to identify the risk factors that need to be addressed to mitigate risks such as corruption.

Management should attend to internal and external controls to facilitate an effective and efficient risk-management process within local government. The control activities consist of various role players, such as the internal auditor, line management, CRO, risk department and risk-management committee. The objective of the implementation of a risk-management committee is to enhance the level of corporate governance in an organisation as well as to enforce vigilance and care in rendering public services. The mandate for a risk-management committee should include the evaluation the risks that might impact on the organisation as well as to ensure that the organisational assurance providers are well equipped to address the identified risk areas. The risk-management committee acts as a catalyst to ensure that risks are responded to promptly and to revise and assess risks on a continuous basis. Risk-management support mechanisms such as whistle-blowing, contingency plans to address risks, the role of internal audit, knowledge sharing, categorisation of risks, managerial certifications, treatment and monitoring of risks need to be implemented to assist in identifying risks. These mechanisms will guide officials to render services to stakeholders in an honest manner and not for private gain. Officials will realise that services should be rendered to further the public interest and not their own. Effective mechanisms to report malpractices and corruption should enhance corporate governance and the integration of risk-management principles in corporate governance.

Training needs to be undertaken to promote and establish the risk management-process in local government. The objective of training is to enhance service delivery and to establish an anti-corruption commitment. Training in risk management should mitigate the risk that organisations might not be able to render services that meet the predetermined standards for service delivery as well as the expectations of stakeholders. Training should change fixed mindsets and assist in making officials aware of risk-management principles as well as the mitigation of risks and the identification of opportunities. The application and knowledge of legislation should guide officials in acting effectively and efficiently, thereby reducing the risk of rendering services of inferior standards. The objectives of an organisation will also be achieved in a legal manner. Criteria set in legislation for the managing of performance should be followed to prevent the risk that objectives are not achieved. According to legislation, officials are responsible for ensuring that financial management and internal control are conducted effectively and efficiently within their area of jurisdiction. Officials must ensure that steps are implemented to ensure that irregular, fruitless and wasteful expenditure and under-collection of revenue are prevented. Officials should conduct their responsibilities in a cost-effective manner.

Each incident of corruption or loss should be investigated to prosecute officials or third parties as well as to determine the root causes of incidents and to determine mitigation strategies to prevent any recurrence of such incidents. The objective of incident investigation is to understand the real values that can be achieved and to develop effective and affordable solutions to risks. A technique to determine the causes of incidents, namely the scientific cause analysis technique, as well as a process to investigate incidents should be implemented to mitigate risks. The scientific cause analysis technique is a corporate integrated risk-management technique designed to assist officials in the identification and evaluation of the root cause of an incident. The application of this technique could assist officials in their daily tasks, should they encounter a risk incident, to identify the root cause of the risk.

A document to identify risks has been designed to assist officials. The layout of the document prompts officials to ask specific questions in determining and describing risks with a view to obtaining consensus on the real risk. A clear description of the risk assists in determining the cause and impact of a risk, should it materialise. The effectiveness or existence of controls to mitigate a risk is evaluated to determine a risk rating with reference to the impact and likelihood of the risk materialising. The rating is dependent on the score of each risk, which should assist management in determining what mitigation strategy – for example, tolerate, transfer, terminate or treat a risk – will be used. On completion of the document, it can be used as documentary evidence to prove that local government is taking action to manage risks as well as to assign officials who take responsibility for the effective management of risks.

Local government has a public commitment to deliver services to stakeholders in a transparent and fair manner, and not for private gain. Principles have been proposed to further the public interest. Officials should therefore endeavour to avoid any actions that would create the impression that they are violating the law and ethical standards applicable to local government. The researcher is convinced that the implementation of the contents of this thesis will prevent losses, because a risk culture will be become embedded over time in local government in South Africa.

## GENERAL OVERVIEW

### Background

As far back as 1700 BC the Babylonians had established "bottomry" (type of loan issued by grantee) as a risk financing control to manage the risks associated with the international transport trade (Valsamakis *et al*., 1996:2). In approximately 700 BC the Greeks introduced the first risk-control measures by extending the bottomry principle and developed bonds with special provisions, which were aimed at reducing the risk of losses to the grantee of the bond.

The discipline of risk management was generally unknown in South African organisations before the 1970s. In 1975 B. Edmundson formed the South African Risk Management Association, but it never really gained momentum and was dissolved in 1979. The failure of the Association was attributed to the focus on loss control and insurance (and not on integrating risk management in achieving the strategic objectives of organisations), the lack of education and the lack of a sound theoretical base on which risk management principles could be developed. Multinational insurance companies who were aware of the discipline considered it counter-productive, because the real strengths of risk management were not known or had not been proven yet. Valsamakis *et al.* (1996:v) state that this perception has changed and especially insurance companies realise the merits of risk management, because of competition in the market place. This realisation has led to organisations over a broad spectrum now becoming aware of the economic benefits that risk management can offer and also that risk management is a legitimate mechanism to enhance the identification and management of risk itself, which minimises or prevents foreseeable losses.

Management in some organisations has developed processes to identify and manage risks, whilst others have begun developments and still others are considering doing so. A common risk-management terminology is lacking and there are few widely accepted principles that can be used by management as a guide in developing and implementing an effective risk-management programme and to benchmark the integrated risk-management process (COSO, 2003:1).

Integrated risk management is a mechanism to identify risks such as corruption, waste of resources and abuse of organisational assets, but also to indicate opportunities to achieve objectives effectively and efficiently. Managerial input is required to mitigate the risks that face an organisation. The challenge that local government faces is preferably to mitigate risks proactively to succeed in the challenge to render affordable and equitable services with diminishing resources. This challenge needs to be addressed in order to meet the objectives of local government in an efficient and effective manner. Integrated risk management can be applied to assist management in identifying and evaluating potential risks to prevent or diminish their impact on the organisation. The objective of this research is also to assist and to inform management about techniques to manage risk proactively.

**Objective**

The objective of the research is to develop theoretical and practical aids to assist officials in local government to identify risks proactively in order to minimise losses. The results of this research should help to ensure that management in local government is adhering to the requirements of the King 2 Code of Conduct as well as legislation such as The Local Government: Municipal System Act, 2000 (Act No. 32 of 2000) and The Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003).

Another objective of the research is to design an approach that will minimise risks in local government. Stakeholders need to be aware of the importance of risk management in achieving the objectives of local government. If stakeholders in local government develop an attitude whereby everyone regards risk management as in integral part of the daily activities, as well as developing an attitude of zero tolerance against potential risks, losses should diminish, which should in turn improve the reputation of local government in South Africa. The objective should be achieved if stakeholders are made aware of risk-management principles; if stakeholders accept responsibility for their activities and actions; if management and officials are made aware of applicable legislation; and that business plans should be drawn up in such a manner that risk action plans and the performance of officials can be monitored and measured over time. The principle of “working smarter and not harder”, which should be facilitated by the implementation of an integrated risk-management process should curb corruption and losses, which should in turn generate substantial savings and increase the credibility of local government.

The underlying objective of integrated risk management is to provide value for stakeholders by recalibrating the activities of local government to enable management to operate more effectively in environments filled with risks. Integrated risk management provides enhanced capacity to do the following: align risk appetite and strategy; link growth, risk and return; enhance risk-response decisions; minimise or prevent operational losses; identify and manage cross-organisational risks; seize opportunities and rationalise capital (COSO, 2003:3).

A further objective of the research is to propose integrated risk management as a mechanism to enhance efficiency and effectiveness in local government as well as to develop techniques that can be used by management which are practical, user friendly and feasible to enhance integrated risk management. To attain this goal it is imperative for each stakeholder, including officials, recipients of services, management and politicians, to be committed to achieving the benefits that can be realised by applying integrated risk management. The application of an integrated risk-management process should enhance the optimisation of service delivery and the minimising the cost and expenses attached to service delivery. According to legislative requirements, with particular reference to The Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003), the “Board” or, for example, the Mayoral Committee or Council in the case of local government, and the management are responsible for the risk-management function.

**Problem statement**

A lack of research to identify and assess risks indicates that integrated risk management in South Africa is generally neglected on local government level, which could be ascribed to a lack of knowledge of the benefits and opportunities that could be gained via an integrated risk-management programme. The researcher argues that the decision makers on local government level could increase their interest in the risk-management process if the dissertation demonstrates that the theoretical information can be utilised to formulate practical solutions in ways that are easy to understand and to implement.

The process of managing risks in an integrated manner in local government in South Africa needs to provide reasonable assurance to stakeholders that the most significant risks are identified, assessed and mitigated. The following prominent problems in local government in South Africa are being highlighted: (1) lack of application of risk management in an integrated manner that becomes part of the strategic decision-making process; (2) lack of legislation to enforce the application of integrated risk management in local government in South Africa; (3) lack of training in aspects such as risk management, ethics and risk response plans; (4) lack of practical aids or techniques, for example, corruption surveys and standard guidelines to assist officials to manage risks proactively or to assist them in taking remedial action to prevent recurrence of an incident; (5) absence of an organisational culture where everyone in local government regards risk management as an integral part of daily activities, yet not be totally risk averse but able to identify and capitalise on opportunities; and (6) lack of commitment and leadership by example from politicians and management.

Thus, integrated risk management is a mechanism to minimise or curb corruption; the implementation of this mechanism has the potential to enhance ethical behaviour in local government as well as to establish a risk-aware culture. The establishment of an ethical culture and a commitment from stakeholders to abide by the principles of risk management should enhance the standards of equitable and sustainable service delivery.

## Methodology

The methodology adopted to ensure that the objectives of the dissertation are achieved includes a qualitative and descriptive approach of aspects such as risk-management processes, corruption, ethics, legislation, and international trends and practices. A critical evaluation approach was used to determine the shortcomings in current risk-management practices such as the lack of an integrated risk-management process and the consequences of this. A problem-solution approach was also followed to propose alternatives and recommendations that would enhance the integrated risk-management process. A deductive approach from theory to practical solutions was followed to ensure that a practical and feasible solution to enhance integrated risk management could be implemented, which should be sustainable and measurable. A quantitative study based on the researcher's own surveys and questionnaires was not undertaken, although national and international surveys and questionnaires conducted by, for example, auditing companies were proposed to enhance risk management and to obtain information.

From the analysis of the theory regarding integrated risk management (Chapter 1) and ethical conduct (Chapter 2); current legislation applicable on South Africa (Chapter 3); and international trends and practices (Chapter 4) an action research approach was followed, which was substantiated by outcome based proposals. These practical outcome based proposals represent practical actions to mitigate the problems identified in the dissertation.

Thus, this action research is based on a combination of the above criteria as well as the participation, observation and practical proposals applied.

The researcher, who has in excess of twenty years' experience in local government in South Africa, also conducted interviews, searched the internet, studied various literature sources such as magazines, books, journals and legislation, and used his own experience to determine the root causes of risks and solutions to remedy risks. The experience of the researcher includes:

- Admission to professional associations – Associate and graduate membership of the Institute of Town Clerks; full membership of the Association of Certified Fraud Examiners (Austin, Texas); fellow membership of the Society of Risk Managers (SA); ordinary membership of the National Association of Local Government Auditors; *ex officio* membership of the Board of Municipal Accountants; and GIA accreditation of the Institute of Internal Auditors (SA).
- Continuous education with certification – SAMTRAC "Flagship" course presented by NOSA; Scientific Cause Analysis Technique, Fundamentals

of Risk Assessment and Crime Risk Management presented by International Risk Control (Africa).

- Development of policies and training manuals – Policy documents such as a Code of Ethics, Fraud and Response Policy; Reward Policy; Risk Management Programme; Fraud Hotline and Audit Charter. The following training material has been developed – A holistic approach to integrated risk management; Primary and advanced risk-management training; Ethics training and a SETA-aligned risk-management training course for SA municipalities.
- Forensic experience – Managed forensic division of the Cape Metropolitan Council as well as the fraud hotline for the City of Cape Town; involved with forensic investigations, incident and trend analysis, and testifying at disciplinary hearings; Council for Consolidation, Mediation and Arbitration; and regional and magistrate's courts.
- Risk-management experience – Involved in the implementation of a risk-management programme for the Cape Metropolitan Council and City of Cape Town. Assisted smaller local authorities in risk identification and conducted approximately 30 high-level risk assessments with leading risk-management organisations such as Alexander Forbes Risk Services, Faranani Risk Solutions and Ngubani.

**Additional research**

This dissertation can enhance the culture of risk management as well as the reputation of local government in South Africa. Because of the dynamic nature of risk management, the material proposed in this dissertation should be revised regularly and research should be done to enhance the proposed training material over time. Local government should take note of the increase in national and international risks, which occurred due to the lack of integrated risk-management processes and the consequential disregard of so-called "red flags", for example, the collapse of Enron, Parmalat and the attack on the World Trade Centre.

**Structure of dissertation**

The research approach range from a theoretical description to practical solutions and techniques to further integrated risk management. The contents of the Chapters are outlined briefly below.

Chapter One is entitled "A macro approach to risk management", which indicates that integrated risk management is an interactive process, which consists of well-defined steps that should be executed in the correct sequence. The outcome of conducting risk assessments is that they should support the decision-making process, because management will have a holistic insight into the risks that local government faces as well as the potential impact should a risk materialise. Aspects such as the definition of risk management, the objective of risk management, attitudes toward risk, evolution of the integrated risk-management process, the cost of risk, the strengths and weaknesses of the risk management process, and evaluation of controls such as the COSO and COCO models are discussed. The intention is to provide the reader with an overall perception of integrated risk management from a macro theoretical perspective.

Chapter Two describes "An ethical organisational culture to mitigate risks" and focuses on ethics and morality in organisations. It is believed that organisations with an ethical culture have a better change to be successful in implementing an integrated risk-management programme than organisations with less ethics. A high standard of ethics improves the level of corporate governance, which is dependent on an effective and reliable integrated risk-management process to provide assurances to stakeholders that risks are being managed properly. Aspects such as corruption, maladministration, fraud, conflicts of interest, causes of corruption, the components of an ethical organisational culture and the factors that influence the organisational culture are explained.

The topic "Practice of legislation in South Africa to enhance risk management" is described in Chapter Three. Reference to legislation is seen as an important guideline to stakeholders to ensure that one of the South African government's most important objectives, namely the building of a government sector that is capable of meeting the challenge of improving service delivery, is met. There is a risk that the right to a service might not materialise or that services are being provided in an unequal way. The purpose of Chapter Three is to describe the contents and purpose of applicable legislation on local government level and to assist them in achieving the objectives of legislation, optimum productivity and service delivery. Knowledge of legislation should minimise the risk that officials circumvent legislation for personal gain, because they will realise that there is a possibility of being detected and prosecuted. The attention of officials is also drawn to the fact that losses can be recovered under certain circumstances, which should prevent the risk of sub-standard service delivery for motives of personal gain. Specific legislation on integrated risk management for local government in South Africa is lacking and the development and implementation of relevant legislation addressing specific integrated risk-management aspects should assist in embedding integrated risk management and the enhancement of the reputation of local government in South Africa.

Knowledge of international trends and practices is essential to assist politicians and management in managing local government for the benefit of the stakeholders. Chapter Four is entitled "Integrated risk management: International trends and practices" and the objective of this Chapter is to explore the aspects relating to corruption to ascertain what should be done to eliminate risks that would prevent the achievement of an effective integrated risk-management process. Chapter Four addresses aspects with an international focus, such as methods to uncover corruption, factors that cause corruption, the role of stakeholders in committing corruption, the current state of risk management in organisations, barriers preventing the implementation of integrated risk management, reporting mechanisms and ethics training.

Chapter Five is entitled "An evaluation of integrated risk management" and describes the aspects that should be implemented or improved on local government level, as described in Chapters One to Four. For purposes of this dissertation the aspects of greatest concern that could jeopardise the effectiveness of an integrated risk-management programme have been identified. It should not be deduced, in instances where a risk-management programme has been implemented but not in an integrated manner, that the specific risk-management programme is operating effectively and efficiently. Various aspects of a problematic nature are described with reference to aspects such as the objective, mission and vision of risk management and the processes that should receive attention. The processes include the managerial processes such as policies, planning, management by example, organisational culture, control activities and monitoring. The evaluation of risk management should focus the reader's attention on the importance of the normative aspects that need to be implemented or revised to ensure that the objective of risk management is achieved.

Chapter Six represents normative aspects that should be put in place to enhance the mitigation or prevention of risks in service delivery on local government level and is entitled "Integrated risk management: A normative approach to establish an integrated risk-management programme in local government". This normative Chapter proposes solutions to all the problems as identified and evaluated in Chapter Five as well as the following additional aspects: training material in integrated risk management; organisational sentencing guidelines; verification of records; incident investigation; the integrated risk monitoring technique and hypothetical case study; a risk-prevention questionnaire; segregation of duties, confidentiality agreements and an ethics policy. The achievement of the proposals in Chapter Six can lead to a situation where integrated risk management, in South African local government, is part of everyone's activities and part of management's decision-making process. The benefits of integrated risk management and the capitalisation on identified opportunities should enhance the reputation of local government in South Africa by providing reasonable assurance to stakeholders that risks are being managed proactively, which should in turn ensure that integrated risk management is an effective and efficient mechanism to enhance affordable, equitable and sustainable service delivery. Chapter Seven addresses an appraisement of integrated risk management in local government in South Africa.

## Conclusion - Integrated Risk Management: A Mechanism to Prevent Risks for Local Government: A Critical Perspective

There is no legislated, integrated risk-management programme for local government in South Africa. The development and implementation of relevant legislation on integrated risk management should assist in embedding an organisational culture where everyone is obliged to adhere to legislative requirements and to conduct their day-to-day activities accordingly. Legislation would direct the mindset of stakeholders to be conscious of the existence of risks in the environment in which they function and therefore of the need for these risks to be identified timeously. The proactive identification and mitigation of risks should prevent them from developing into adverse consequences. Integrated risk management is not only essential to identify and manage risks, but also to identify opportunities to contribute to the realization of the objectives of local government.

The objectives of local government should be well communicated to stakeholders as being practical and achievable, and their achievement should be assessed to ensure that objectives are being met. A vision statement needs to be developed (and acted upon) to focus stakeholders' attention on what local government should strive to achieve. The vision statement needs to be complemented with a mission statement to provide guidance to stakeholders on how the vision for local government should be achieved. The lack of a vision and mission statement could result in politicians and management not taking responsibility for the risk management programme. For the purposes of this thesis the integrated risk-management process is divided into macro and micro levels, because a lack of activities within the two levels could prevent the realization of the full benefits of an integrated risk-management programme. If there is no structure for an integrated risk-management department on the correct level, this could impact negatively on the functions that should be undertaken by the Office of the Chief Risk Officer.

The evaluation identified that the risk-management processes that should be measured against generic public management functions are generally lacking or incomplete. The processes referred to are: formulation of policies; planning; management by example; organisation and control activities. The lack of policies based on relevant legislation impedes the realization of objectives and it may lead to disciplinary action against officials and legal suits against local government. Legislation for integrated risk management on local government level is lacking, which impacts on decision-making in the absence of proper legal guidelines that officials can follow.

Management needs to effect proper planning with regard to strategic, tactical and anti-risk response plans, but the problem is that management generally lacks the skills to effect proper planning, with the effect that catastrophic risks might not be identified and their potential impact mitigated. It is doubtful whether management on local government level possesses the necessary skills to manage by example in order to provide the necessary discipline and structure for the risk-management process.

An anti-corruption culture is lacking and therefore the embedding of an anti-corruption culture is necessary to prevent officials from engaging in corrupt activities, such as conflict of interests; bribery; illegal gratuities and economic extortion. A paradigm shift to enhance openness, honesty and transparency has not occurred, nor are officials made aware on a regular basis of the warning signs of corruption and the duty to report unethical conduct. Training material with a specific focus on integrated risk management for local government is lacking in South Africa. Training material is necessary to assist in embedding an anti-corruption culture as well as to be risk averse, but also to identify opportunities. Formal risk-management departments, which are guided and supported by an integrated risk-management committee are lacking, resulting in the decision makers in local government not being properly informed about risks facing local government.

Various control mechanisms are either lacking or not effective; for example, whistle-blowing mechanisms do exist in some local authorities, but potential whistle-blowers do not trust the guarantee of privacy or anonymity when making statements. Other controls that need attention include: contingency plans for a strategy and procedure to be followed against perpetrators; knowledge gained by means of knowledge sharing and co-sourcing is not sustainable over a period of time due to officials leaving local government; mechanisms to halt intellectual capital drainage; risk registers and the categorization of risks; risk policy statements and managerial certifications stating that risks are under control.

Management tends to be conservative or risk averse, which could impede the treatment of risks as well as the realization of opportunities. This risk-averse attitude could impact on the cost effectiveness and relevance of risk-treatment plans. Monitoring of risk-treatment plans is not conducted on a continuous basis or at all; this could impact negatively on the assurance that the treatment plans remain cost effective and achievable. Organisational sentencing guidelines, which could assist in mitigating losses, are not available. If officials are aware of these issues, and especially if legislation prescribes that fines equal at least to the extent of the loss suffered can be imposed, officials would take greater care to prevent losses.

The lack of verification of vendor's records as well as the lack of segregation of duties could put the activities and functions within local government at risk. This lack could increase losses as a result of corruption as well as harm the reputation of local government. The lack of confidentiality agreements to prevent confidential information from becoming known to competitors could cause officials to engage in corrupt activities for personal gain. Legislation should make officials aware that they must not divulge privileged information, because of penalties that could be imposed.

## **Recommendations**

The implementation of the recommendations should assist in achieving the objectives stated in this thesis. Such realization should *inter alia* improve the decision-making process in local government, which should consequently enhance the delivery of services in a cost-effective and sustainable manner as well as enhance the reputation of local government in South Africa.

Realisation of the objectives of integrated risk management is necessary to ensure that stability is secured soon after a risk has materialised as well as to develop and implement measures that will prevent a recurrence of an incident. An objective for integrated risk management as well as a mission and vision statement has been developed with the intention to focus stakeholders' attention on the objectives of risk management and to sensitise them on how the objective could be achieved through the mission and vision statement. The structure of an integrated risk management department should be created on a level equivalent to that of executive directors, with a direct reporting line to the Office of the City Manager. The Chief Risk Officer should report on a regular basis (for example, quarterly) to the audit committee and at least on a six-month basis or at shorter intervals, as may be necessary, to the Executive Mayor/Council. Three levels for risk assessments, namely high-level, secondary-level and operational–level assessments, have been proposed to provide reasonable assurance that risks on all levels in local government have been identified.

Local government should undertake the generic public management functions to ensure that the risk-management processes are successfully implemented. In this regard, the execution of policies is important to ensure that sustainable and affordable services are rendered; to manage the performance and responsibilities of officials; to recover losses where possible; and to adopt a code of conduct to guide officials in rendering optimal services. Management should be seen as taking the lead by putting service delivery first by implementing controls. Management by example should assist in embedding an organisational culture that is focused on risk identification and mitigation. Such a culture should provide the assurance to stakeholders that risks are well managed, with the consequent enhancement of the reputation of local government.

The risk-management function should include an office of the risk manager, which should be positioned in such a way that every incident will be reported to the risk department for further action. The risk-management function should facilitate the execution of the risk-management programme and processes. The purpose of the implementation of a risk-management committee is to enhance the level of corporate governance of local government level and to supervise the evaluation of risks that might have an impact on the organisational objectives as well as to ensure that all identified risks are addressed for mitigation purposes.

Management should evaluate internal and external controls to facilitate the risk-management programme, and effective mechanisms such as whistle-blowing and fraud hotlines should be put in place to report corruption. Management should promote training in integrated risk management to change fixed mindsets with the intention to make stakeholders aware of risk-management principles, to mitigate risks and to identify opportunities to ensure that objectives are being met. The following aspects should be incorporated into risk management training material: financial management; theory and legislation on integrated risk management; management of an integrated risk-management programme; corruption and the role of technology to assist in the management of a risk programme; and skills development. Legislation should be developed for integrated risk management on local government level and proposals based on the experience of the researcher and the King 2 Code have been made in an effort to effect relevant legislation. Legislation should address aspects such as sustainable and affordable service-delivery standards; management of performance; responsibilities of officials and recovery of losses should officials be corrupt or negligent; a code of conduct and a risk management policy addressed in legislation; organisational sentencing guidelines; verification of records; segregation of duties; and confidentiality agreements.

It is essential to determine the root causes of every incident and therefore each incident needs to be investigated to determine these causes. Mitigation strategies should be developed to prevent recurrence of incidents, and officials and third parties should be prosecuted and losses recovered should they be found guilty of causing a loss. To assist stakeholders in determining the root causes of incidents as well as to identify remedies, a scientific cause analysis technique has been developed, which should be provided in CD format or as a hard copy handout to stakeholders to manage risks.

Other processes to support the risk-management programme include the obtaining of managerial support for the implementation of the risk-management programme; the development of a risk-management policy and the communication thereof to stakeholders; promoting integrated risk management in local government; and monitoring and reviewing of the programme to ensure that the integrated risk-management policy remains relevant. A questionnaire has been designed to determine the culture of local government in a proactive way. The purpose of the questionnaire is to serve as a foundation to gauge and change the organisational culture as well as to identify the risk factors that need to be addressed to mitigate risks such as corruption.

These recommendations should provide a basis for management familiarise itself with the most pertinent risks, which should in turn enhance decision making and the reputation of local government.

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