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# Financial Risks Management in Public Sector Organisations

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**Abstract**

Effectiveness of financial risk management predicts the successful implementation of different government projects and programmes. Empirical facts, however, indicate the existing financial risk management framework is not that effective for enhancing effective identification and mitigation of financial risks in the contemporary complex South African public sector organisations. Using a qualitative research method, this study provides a meta-synthesis of theories and empirical studies on financial risk management in the South African public sector. The motive was to identify the major inhibitors and appropriate financial risk management framework that can be suggested. Despite highlighting the existence of essential regulatory frameworks, findings revealed the effectiveness of financial risk management in the contemporary South African public sector is still constrained by poor culture of financial risk avoidance, poor commitment of managers and political leaders, limited integration of financial risk management measures at municipal levels, weak internal audit systems, and technical loopholes in the existing regulatory frameworks. In addition to relying on the existing regulatory frameworks, it is suggested that public sector risk managers must adopt a comprehensive financial risk management framework coherently integrating essential key success factors encompassing a culture of risk avoidance, risk management structures, training and development, good governance and ethics. Other postulated strategies included the allocation of sufficient resources, integration of risk management in outsourcing, monitoring and evaluation, and the establishment of the financial risk information system. With appropriate environment created after the integration of these key success factors, it is posited that it becomes possible for public sector financial risk managers to successfully apply a six steps' (step 1: identification of risks, step 2: analysis of the causing factors, step 3: analysis of the likelihood of occurrence, step 4: prioritisation of the identified risks, step 5: formulation and implementation of risk response, and step 6: continuous evaluation of the effectiveness of risk response undertaken) approach for risk identification and management.

**Keywords:** financial risk management; public sector organisations; performance; risk management

## 1. Introduction

Effective financial risk management edifies identification and elimination of slacks in the process of project implementation (Jeppesen, 2010:27). The end results are often reflected in the inducement of the required momentum in the pace of project implementation (Jeppesen, 2010:27). Such slacks can include theft of funds or corruption by managers and employees that lead to the misdirection of funds allocated for project implementation (Tcankova, 2002:290: Jeppesen, 2010:27). The elimination of slacks and risks that lead to project failures can influence avoidance of unnecessary costs and the associated wasteful expenditures (Henriksen & Uhlenfeldt, 2006:107). These resulting cost savings can influence resource optimisation and the extent to which optimal output can be produced from the limited governmental resources to meet the constantly increasing needs and wants of the population (Hommen & Rolfstam, 2009:17). While deriving from Section 196 of the South African Constitution, roles and responsibilities for the implementation of a risk management strategy in all the contemporary South African public sector organisations are contained in the Public Finance Management Act (PFMA), 1999, as amended by the National Treasury's (2009) Framework for Risk Management in Public Sector organisations.

Unfortunately, evidence indicates that despite the existence of this regulatory framework, effectiveness of financial risk management in the contemporary South African public sector organisations is still undermined by the increasing prevalence of uncontrolled fraud and corruption among public officials, poor compliance with legislations and poor internal audit systems (the National Treasury, 2014:5; Pricewaterhouse Coopers, 2014:3). There also seems to be significant reliance on the National Treasury's (2014:5) Six Steps' Framework Approach that requires risk identification, analysis of the causing factors and the likelihood of occurrence, prioritisation of the identified risks, formulation and implementation, and continuous evaluation of the effects of risk response.

Yet, theories indicate that the effectiveness of financial risk management is not only influenced by such procedural steps, but also other factors encompassing a culture of good governance, top management's support and commitment towards risk management initiatives, and a culture of total organisational risk management (Buttimer, 2011:66;Charette, 2009:71). Such shortfalls seem to affect the effectiveness of the overall process for the identification and management of financial risks in the contemporary South African public sector organisations. It is therefore against that backdrop that this research was conducted so as to determine an integrated strategic framework that can be suggested.

## 2. Literature Review

It is evident in the views of authors such as Beasley, Clune and Hermanson (2005:521) that financial risk management is a concept derived from the larger body of the discipline of risk management. The notion of risk management was largely drawn from the concept of insurable risks that organisations used for decades prior to the emergence of the notion of financial risk management (Beasley et al. 2005:521). Although the modern concept of risk management takes an integrative approach in the identification and management of risks, in the days of insurable risks, the process of risk identification and management was largely done in silos (Beasley et al. 2005:521). Silo-based approach undermined the overall level of synchronisation to ensure that all probable risks are covered (Ranong & Phuenngam, 2009:6). It was such limitations that caused the abandoning of the notion of insurable risks in favour of the emergence of the modern concept of risk management (Ranong & Phuenngam, 2009:6). In contrast to the notion of financial risk management that may take a narrower perspective, Beasley et al. (2005:521) posit that although different authors define the concept of risk management differently, its core concept is latent in the fact that it entails a larger and wider approach undertaken by managers to plan, organise, lead and control activities to ensure that all the probable events that may emerge and disrupt the achievement of enormous benefits associated with accomplishment of different organisational activities are identified and prevented or mitigated.

In contrast to Beasley et al.'s (2005:521) interpretation, Cendrowski and Mair (2009:13) argue that for financial risk management to be effective, it is imperative that managers and executives treat the two concepts as intertwined. They attribute their arguments to the fact that risk management influences effectiveness of financial risk management just to the same extent that financial risk management does to the general process of risk management. It is the fundamental argument of Cendrowski and Mair (2009:13) that no matter the overall commitment of the managers, it is not reasonably practicable to expect financial risk management to be effectively accomplished without ensuring the overall effectiveness of risk management. In that regard, they reason that although financial risk management is just a subset of the notion of risk management, it forms the main part of the risk management process. In a view that echoes such assertion, Daud, Zald and Hussein (2010:133) highlight specifically that financial risk management refers to the process through which the executives and board of directors conduct appropriate analysis to ensure that destabilising factors are identified and mitigated or prevented to maximise the organisation's overall potential of being successful in the achievement of its outlined strategic objectives and goals.

Deloitte (2008:4) notes that although it is apparent that financial risk management forms part of strategy formulation and implementation, in a number of instances, the process of strategy formulation has been accomplished in lieu of the exercise or integration of the necessary measures for enhancing risk identification and mitigation. In such instances, they caution that it is has often been evident that the process of strategy implementation tend to get exposed to enormous risks that can turn costly for the executives to mitigate. Despite different interpretations by Cendrowski and Mair (2009:13), Daud et al. (2010:133) and Beasley et al. (2005:521), the fundamental arguments among these authors seem to imply that financial risk management is critical not only for the successful strategy implementation, but also for the realisation of effective organisation's performance. In all these instances, they perceive that financial risk management influences thorough analysis and identification of all the most probable and less probable events whose occurrence could cause significant negative ramifications on the performance of an organisation.

In that regard, financial risk management is singled by authors such as Daud et al. (2010:133) and Beasley et al. (2005:521) to be a measure for enhancing cost minimisation and the overall extent of the sustenance of an organisation. Due to the uniqueness of each organisation, Desender (2007:39) reveals that there is no general consensus on the factors that influence the overall effectiveness of financial risk management. Mehr and Hedges (2013:118) outline up to about eight steps for enterprise risk management. However, in all their views, it is apparent that most of the steps that they outlined are in line with the six key steps that authors encompassing Daud and Yazid 2009:222), Gates (2006:13) and Liebenberg and Hoyt (2013:28) articulate to include: step 1: the outline of key management roles and responsibilities, step 2: establishing the context of risk assessment, step 3: identification and prioritisation of risks, step 4: design and implementation of risk treatment plan, and step 5: monitoring and review of risk management process. When financial risk management is effective, the views of authors such as Nocco and Stulz (2006:8), and Razali, Yazid and Tahir (2011:202) indicated that its overall positive effects are often linked to sustainable growth and improvement of operational efficiency. Although it is not questionable that the effectiveness of financial risk management is linked to such variables, it is apparent from theories of authors such as Ranong and Phuenngam (2009:23), and Petit and Pourquery (2005:19) that the overall ability to achieve such values can be undermined by lack of top management's support and commitment, a culture of financial risk management, communication and consultation on risk management initiatives, and information technology. As it is highlighted in the next section, empirical facts indicate that as much as appropriate legislations and regulations exist, enfostering a culture of effective financial risk management seems to be yet a challenge in the South African public sector organisations.

## 3. Overview: Financial Risks in the South African Public Sector

The argument that effectiveness of financial risk management is a challenge is accentuated by the fact that it is evident in empirical facts that from the financial year 2008/2009, financial misconduct increased from a sum of R100 million (346%) to R346 million in 2009/2010 million (the Public Service Commission-PSC, 2012/2013). Studies imply that it further soared in 2010/2011 by another 269% to reach R932 million (the Public Service Commission-PSC, 2012/2013). In the year 2012/2013, the PSC highlights that the total funds lost to unmitigated financial risks associated with corruption hit over R1 billion. The implications of these financial losses that are certainly linked to unmitigated financial risks are causing significant tolls on the successful implementation of government programmes and projects (Wilkinson, 2014:6). As a result of the housing backlogs, the survey conducted by the National Census in 2011 revealed that the number of shacks had risen to over 1.9 million, representing 13% of the households in South Africa, and a decrease of 3 percentage points since 1996 (Wilkinson, 2014:6).

Evidence also implies that poor financial risk management is affecting the provision of healthcare and education services (Equal Education, 2012:2). Out of the 24 793 public schools in South Africa, 14% are indicated by Equal Education (2012:2) not to have electricity, as 93% has no libraries (Equal Education, 2012:2). Although in the 2013/2014 annual budget allocation, education received R233 billion, which was an increase of 15% from the previous year, strong evidence has emerged that a significant amount of R233 billion has not gone towards the improvement of the country's education system (Equal Education, 2012:4). In other words, trends of financial risks in the public education system indicate that school principals, the school governing bodies and financial officers are involved in about 40% of the corruption in schools (Corruption Watch, 2012:9; Equal Education, 2012:4). Further, 16.2% of corruption were found to be related to the irregularities in the school procurement processes (Equal Education, 2012:4).While, in the Gauteng Department of Health, Corruption Watch (2012:3) indicates that an investigation by the SIU is ongoing over the loss of R1 billion arising from the irregular award of tenders. The Public Service Commission (2012/2013) on the other hand states that so far the Department of Roads and Transport has the highest cases of tender frauds totalling about 493 cases. These increasing trends of financial risks demonstrate the weaknesses of the existing financial risk management systems. Attributable to this view is the fact that if the existing National Treasury's (2014:5) Framework was effective, the cases of financial misconduct would have not grown to the extent it has so far done. This view echoes the PSC's (2011) revelation that since the existing framework remains ineffective for operationalising financial risk management, a more comprehensive framework is required to support the implementation of financial risk management within the broader public management and strategic planning spheres. It is in line with such a view that this research is being undertaken.

## 4. Problem Statement

Lack of appropriate framework for financial risk management undermines effective financial management and optimisation to ensure that all the socio-economic programmes are effectively implemented to achieve the intended social and economic objectives and goals.

## 5. Purpose of the Research

The purpose of this research is to evaluate challenges affecting the effectiveness of financial risk management in the contemporary South African public sector organisations so as to determine the mitigating measures that can be suggested.

## 6. Methodology

Conceptual analysis as a qualitative research technique was used to enhance critical in-depth analysis and exploring of the complexity and different facets of the challenges inherent in the financial risk management framework used in the South African public sector organisations (Glesne (2010:144;Schilling, 2006:28). The use of this technique involved unfolding, exploring and understanding of different concepts from core financial risk management literature, government documents, newspapers, journal articles and website information on financial risk management in the South African public sector organisations (Elo & Kyngas, 2008:107; Fereday & Muir-Cochrane, 2006:5). This process of analysis was guided by the two fundamental research questions that involved probing:

- What are the challenges marring effectiveness of financial risk management in the contemporary South African public sector organisations?
- What are the key success factors that can be used in conjunction with the existing regulatory framework to spawn effectiveness of financial risk management and mitigation in the contemporary South African public sector organisations?

The purpose of such evaluation was to facilitate the comparison and triangulation of the ongoing process of financial risk management in the contemporary South African local government with core financial risk management literature (Elo & Kyngas, 2008:107; Fereday & Muir-Cochrane, 2006:5). Such approach influenced the identification of major inhibitors, and the clarification, refinement and validation of the ideas conceptualised as the probable concept for enhancing effectiveness of financial risk management in the contemporary South African public sector organisations. The details of the results are as set out in the next discussion.

## 7. Results

In line with the illustration in the methodology and the two indicated research questions, the results of the theoretical analysis are presented according to the key headings that include:

- Regulatory Frameworks: Financial Risk Management in the South African Public Sector Organisations
- Limitations: Financial Risk Management in the South African Public Sector Organisations

The details are as follows.

### 7.1 Regulatory Frameworks Financial Risk Management in the South African Public Sector Organisations

Core theories on financial risk management indicate effectiveness of financial risk management to transcend the mere establishment of essential policies and regulatory frameworks (Beasley, Branson, & Hancock, 2009:28; Borgelt & Falk, 2007:122). In addition to the commonly used cyclical approach for financial risk identification and management, the other essential factors include top management's support and commitment towards risk management initiatives, a culture of total organisational risk management, and communication and consultation of the stakeholders on financial risk management initiatives (Beasley et al. 2009:28; Borgelt & Falk, 2007:122). As much as the overall understanding and application of risk assessment measures at the lower governmental structures is important, the overall buy-in of the top management is also essential.

The commitment and support of the senior managers influence the integration of the concept of financial risk management during the strategic planning process and the overall process associated with project conceptualisation (Liebowitz, 2007:44; Marx, 2008:16). This enhances the cascading of the expected financial risk management approach down to the lower echelons of the organisational structures (Ambe & Badenhorst, 2012:242). The notion of a culture of total organisational risk management connotes the situation under which every manager, supervisor and employee willingly embraces the notion of risk management in all the processes of activities' accomplishments (Ambe & Badenhorst, 2012:242). With every employee aware of the total organisational risk management initiative and the notion of risk management integrated in the process of strategy formulation and implementation, it becomes easier for a government department to tackle risks from all angles.

However, the approach used in the South African public sector seems to fall short of most of the essential constructs for effective financial risk management. The financial risk management approach used in the South African public sector organisations seems to be hinged only the regulatory and policy frameworks (Public Service Commission, 2011). The 1996 Constitution of the Republic of South Africa does not expressly provide for the need of risk management. However, the need for the initiatives which are necessary for mitigating and managing financial risks during the implementation of public sector projects are inherent in Section 195 of the Constitution of the Republic of South Africa, 1996 (The Public Service Commission, 2011:66). In Section 196, the Constitution sets out the normative principles for achieving an effective public administration. Among which is the initiative for ensuring the successful implementation of government projects and programmes so as to enhance the ability of the government to meet its obligations of meeting the needs of the citizens more effectively (The Public Service Commission, 2011:66).

The Constitution impliedly bestows on the directors and managers in public departments the mandate to exercise the necessary due diligence to ensure that all the implemented government projects and programmes achieve the desired strategic objectives and goals (The Public Service Commission, 2011:66). In a bid to achieve this, the General Procurement Guidelines (2013:16) acknowledges that risk management is one of the tools and techniques which can be used for ensuring effective planning and accountability by the directors and managers in government departments.

In line with Section 196 of the Constitution, the roles and responsibilities for the implementation of a risk management strategy in all the public sector organisations is now contained in the regulations published in terms of the Public Finance Management Act (PFMA), 1999, as amended by the National Treasury's (2009) Framework for Risk Management in public sector organisations. The National Treasury's (2009) framework for risk management agitates for the creation of an enabling environment for risk management by adopting appropriate risk management strategy, improving human resource capacity, and emphasising the use of an effective enterprise risk management framework.

It also emphasises the need for risk identification, risk assessment, risk response, communication and reporting, monitoring, and the key roles and responsibilities of the risk management committees and audit committees. In terms of risk identification, it emphasises that risk identification must comprise of a deliberate and systematic effort to identify and document the institution's key risks. Its motive is to enhance the understanding of what is at risk within the context of the institution's explicit and implicit objectives and to generate a comprehensive inventory of risks based on the threats and events that might prevent, degrade, delay or enhance the achievement of the objectives.

Although these legislative frameworks provide clear processes of how financial risks can be identified and mitigated in public sector organisations, over-reliance on such regulatory frameworks deprives managers in the public sector of the essential constructs such as a culture of good governance and ethical practice that lubricate the process for financial risk identification and management. This argument is echoed in the fact that theories indicate that the effective application of risk management strategies does not necessarily imply that the public sector managers must be risk averse. Instead, it just provides managers with the measures for ensuring that risks are confidently managed to an acceptable level (Faure & De Villers, 2014:61). Attributable to this view is the fact that an organisational culture that strives for risk averseness can precipitate inflexibility that inhibits the ability of the organisation to operate more effectively and influence the successful delivery of all government programmes.

With stronger reliance on regulations and the narrow concept of risk management in the National Treasury's (2009) Framework for Risk Management, it is unlikely that such a culture has been inculcated in the South African public sector. The National Treasury's (2009) Framework for Risk Management highlights the six main steps that influence effectiveness of risk management to include step 1: identification of risks, step 2: analysis of causing factors, step 3: analysis of the likelihood of occurrence, step 4: prioritisation of the identified risks, step 5: formulation and implementation of risk response, and step 6: continuous evaluation of the effectiveness of risk response. Despite the clarity of these regulations and legislations, there seems to be major limitations marring the effectiveness of financial risk identification and mitigation in the contemporary South African public sector organisations.

### 7.2 Limitations: Financial Risk Management in the South African Public Sector Organisations

A critical evaluation and interpretation of different empirical studies imply that the existing financial risk management framework is unable to effectively control the increasing financial misconducts and the associated spiralling losses due to limitations linked to; poor culture of financial risk avoidance, poor commitment of managers and political leaders, limited integration of risk management measures at municipal levels, a weak internal audit systems, and technical loopholes in the existing regulatory framework (Van Niekerk & Visser, 2010:14; Ngoepe, 2014:6; Corruption Watch , 2012:3; the Chartered Institute of Internal Auditors, 2013:4).

- *Lack of a Culture of Financial Risk Avoidance*

Fostering a culture of risk avoidance among employees and managers is one of the means through which financial risks can be mitigated and managed (Ngoepe, 2014:6). As much as analysis indicates that there is concern by certain employees and managers to ensure a culture of risk avoidance, evidence implies that there is almost lack of a culture of risk avoidance among the employees (Ngoepe, 2014:6). This is reflected in the fact that instead of the employees and managers avoiding engaging in activities that lead to the increment of financial risk, trends indicate that most of the activities such as fraud and corruption that lead to financial losses are usually perpetrated by the employees and managers (Arrowsmith, 2010:18).

Yet, even in the event that the financial losses are discovered, it is highly apparent that in certain instances, only limited efforts have been undertaken to ensure that the funds lost are recovered (Allwright, 2013:3). Allwright (2013:3) sums all these in his assertion that: "Financial misconduct is generally open to interpretation because of the dynamic nature of cases that are investigated, and the PSC has also found that there is a lack of understanding of the legislation that covers misconduct. As a result, incidents of misconduct do not get the attention that they require, and an environment is created that opens up departments to corruption." In other words, there seems to be an entrenchment of a culture of poor risk management to indirectly encourage the benefiting of certain individuals in powerful positions.

Even if some of the employees, managers and political leaders were willing to take effective measures to address the ongoing poor management of financial risks, the entrenchment of such a culture would certainly undermine the undertaking of the necessary mitigating measures (Van Niekerk & Visser, 2010:14). In other words, a strong culture of lack of financial risk avoidance seems to have emerged out of the overall poor commitment and support of the public sector managers and political leaders.

- *Poor Commitment of Managers and Political Leaders*

The overall poor commitment and support of public sector managers and political leaders is one of the factors influencing the poor management of financial risks in the modern public sector organisations (Corruption Watch, 2012:3). Had there been effective commitment and support of the managers and political leaders, appropriate review and remedial measures would have been undertaken to ensure that all financial risks are identified and managed. Instead, trends indicate that it is the same managers who engage in activities that lead to the increment of financial risks (Corruption Watch, 2012:3).

Empirical facts show that in the Eastern Cape Province, most of the managers and councilors are often the ones commonly involved in fraud and corrupt activities that cause financial risks and losses (De Lange, 2011:17). Yet, as Barclay (2013:6) reveals, it has also been confirmed not only that some of the municipal tenders are being offered in response to bribes, but also that some of the officials have also been influencing the allocation of tenders to the firms that in certain cases they solely own. Barclay (2013:6) also highlights that some of these individuals make double mistakes that include, one allocating tenders to themselves in a manner that flout the prescribed policy and legislative prescriptions of the state, and secondly getting payments and not delivering.

The overall poor commitment and support of managers and political leaders seem to have also affected the creation of effective structures for risk management in most of the municipalities in the country. As much as the Treasury Regulations (2009) advocate for the establishment of risk management committees, most of the local government units, especially at the municipal levels still do not have effective risk assessment and management units. Such lack of relevant structures undermines effective identification and management of risks during the process of the implementation of different government programmes (Acevedo, Rivera, Lima & Hwang, 2010: 80).

Instead, there is a tendency for most of the municipalities to rely only on risk analysis and reports provided by the internal auditors who are usually nevertheless also less skilled and competent. Risk identification, assessment and mitigation is a complex activity that requires an enormous amount of in-depth technical project management, finance, accounting and scientific knowledge for it to be effectively accomplished (Acevedo et al. 2010:80). Although the personnel with such skills could be available at the national and provincial structures of local government, they are often rare at the municipal levels.

Part of the explanation is attributable to the fact that the country in general has not been producing enough graduates in these areas (Acevedo et al. 2010:80). This creates scarcity and lack of competent personnel in the areas of risk management at the municipal levels. The negative implications are usually manifested in poor outcome of risk analysis, identification and management. The analysis of empirical evidence also indicates that poor commitment and support of the managers and political leaders affected the integration of risk management measures in the entire modern South African public sector organisations.

- *Limited Integration of Risk Management Measures*

The Chartered Institute of Internal Auditors (IIA) (2013:4) indicates that awareness levels regarding the application of risk management as a day-to-day management tool are relatively low at the middle management levels. The IIA (2013:4) reveals that there are problems related to work ethics and nepotism as important obstacles in the way of effective administration due to the fact that the code of conduct has not been successfully institutionalised in most of the government departments.

Although extensive work has been done in the province with the assistance of donor organisations to identify transversal risk areas in departments, the overall internal capacity to ensure the effective roll out of the learning experience on risk identification, assessment and management to all supervisory staff is limited (Ambe & Badenhorst, 2011:100 ; Public Sector Audit Committee, 2014:6). The IIA (2013:4) also notes that perceived instances of nepotism were also highlighted in the appointment processes as service delivery barriers in the administration process. These findings echo the views of Naude and Ambe (2013:55) and Peterson (2013:119) whose studies revealed that there is a need for an inclusive process in the development of a risk strategy or fraud prevention plan.

Peterson (2013:119) argues that without a clear understanding of the rationale for specific control measures, officials view such arrangements as merely obstructive. Despite noting that information technology in most of the government departments is not adequately utilised by departments as an early warning system due to capacity problems, these authors also indicate that there is limited knowledge regarding the obligation of departments to develop a fraud prevention plan and the statutory requirement of an appropriate certificate to be issued to the provincial treasury. Peterson (2013:119) further states that there is an extensive need to cascade the principles and management tools offered by risk management down to the lower supervisory levels in all departments.

In other words, the view that the overall entrenchment of the concept of risk management in the operations of most of the modern public sector organisations still remains quite limited is accentuated by the fact that the results of the study conducted by the Chartered Institute of Internal Auditors (IIA) (2013) suggest that over a third of public sector organisations still do not have effective mechanisms in place to manage risk. It elaborated that of the 42% of the central government departments, 37% of local government organisations rated their own organisation's awareness of risks and the effectiveness of its processes to manage them as 'in the early stages', 'in development' or even 'non-existent'. With poor commitment of managers and less integration of financial risk mitigating measures in the process of activities’ accomplishments in most of the departments of the modern public sector organisations, the overall effectiveness of the internal audit system also seems to have been affected.

- *Weaknesses of the Internal Audit Systems*

The overall weakness of the existing internal audit system has emerged to mar the effectiveness of the process for managing financial risk in the modern public sector organisations (Barclay, 2013:19). This is either because the staffs in the internal audit departments are overwhelmed by workload, or because they are not skilful enough to deal with all aspects of financial risks (Barclay, 2013:19). Barclay (2013:19) points out that effective internal audit can play a key role in supporting public sector boards and management in reducing the recurrence of major public sector scandals such as the problems in organisational culture that jeopardized patient care at the Mid Staffordshire NHS Trust, or the poor governance that resulted in a flawed bidding process for the West Coast Mainline franchise. However, Barclay (2013:19) notes that the overall capacity and efficiency of the internal auditors are still quite poor and below standards to help organisations to manage a wide range of risks facing them, including financial and fraud risks, data security risks, and health and safety risks.

Since then, Barclay (2013:19) reveals that the public sector has launched the first ever unified nationwide Public Sector Internal Audit Standards, introduced in April 2013. However, the IIA's research highlights that these standards are not yet being fully adhered to in some areas of local government. The IIA (2013) says that this could create a conflict of interest to potentially limit internal audit's ability to be completely objective in fulfilling its scrutiny of financial controls, which also fall into the remit of the CFO. Cuts to some public sector internal audit budgets are also an issue.

Barclay (2013:19) also highlights that public sector heads of internal audits are allocating less time to supplier risk than those in the private sector, despite the increased levels of outsourcing of public sector activity. He added that just 12 per cent of public sector organisations' heads of internal audit perceive that outsourcing is one of the top risks that they devote time to, as compared to 37% in the private sector. The IIA points out that the outsourcing of public sector projects to private sector contractors has recently resulted in some high profile problems, such as the controversy over the administration of 'fit to work' benefit assessments by Atos Healthcare, and the failure of G4S to provide adequate security staff for the Olympics forcing the organisers to call on the army.

The effects of these are latent in the fact that the outcome of the process of supplier selection may not lead to the selection of the suppliers with the requisite competencies, skills and business acumens and commitment to ensure that the implementation of allocated government programme is successfully accomplished. Such interference renders the overall process less transparent and open to competition. Subsequently, it undermines the five main pillars for supplier selection which are outlined in Section 217 (1) of the Constitution of the Republic of South Africa (Act No. 108 of 1996) and by the Government General Procurement Guidelines (SAGGPG) (2013:3) to include value for money, open and effective communication, ethics and fair dealings, accountability and reporting, and equity.

- *Loopholes in the Financial Risk Management Legislations*

The tendency for the risk management system to over-rely on legislations and regulatory frameworks is one of the limitations of financial risk management in the contemporary public sector organisations. Over-reliance on the regulatory framework affects the integration of financial risk management measures in the strategic plans of most of the government departments. At the same time, it also implies that all their major loopholes are most likely to come into play to undermine the effectiveness of the financial risk management. One of these loopholes is often latent in the required high standard of "beyond reasonable doubt" for proving fraud and corruption cases.

The use of legislations and regulations signifies that they provide not only the preventive measures, but also the remedial measures through which financial risks can be mitigated. However, with such high standards required for proving fraud cases, it means most of the investigations of fraud cases usually go on for a long period of time without substantial evidence being obtained. The resultant effects are usually manifested in the undermining of the effectiveness of the legal measures for recovering the lost funds.

Such a view, perhaps explains why Allwright (2013:3) noted that in the financial year 2009/2010, the Public Service Commission indicates that no criminal actions were taken in the 57% of the cases of corruption and fraud in the public sector, as in 2010/2011, the PSC's reports also indicated that no legal actions were taken on the 76% of the reported corruption and fraud cases. All these point to either lack of commitment and unwillingness of the authorities, or the loopholes in the legislations and regulations for mitigating financial risks.

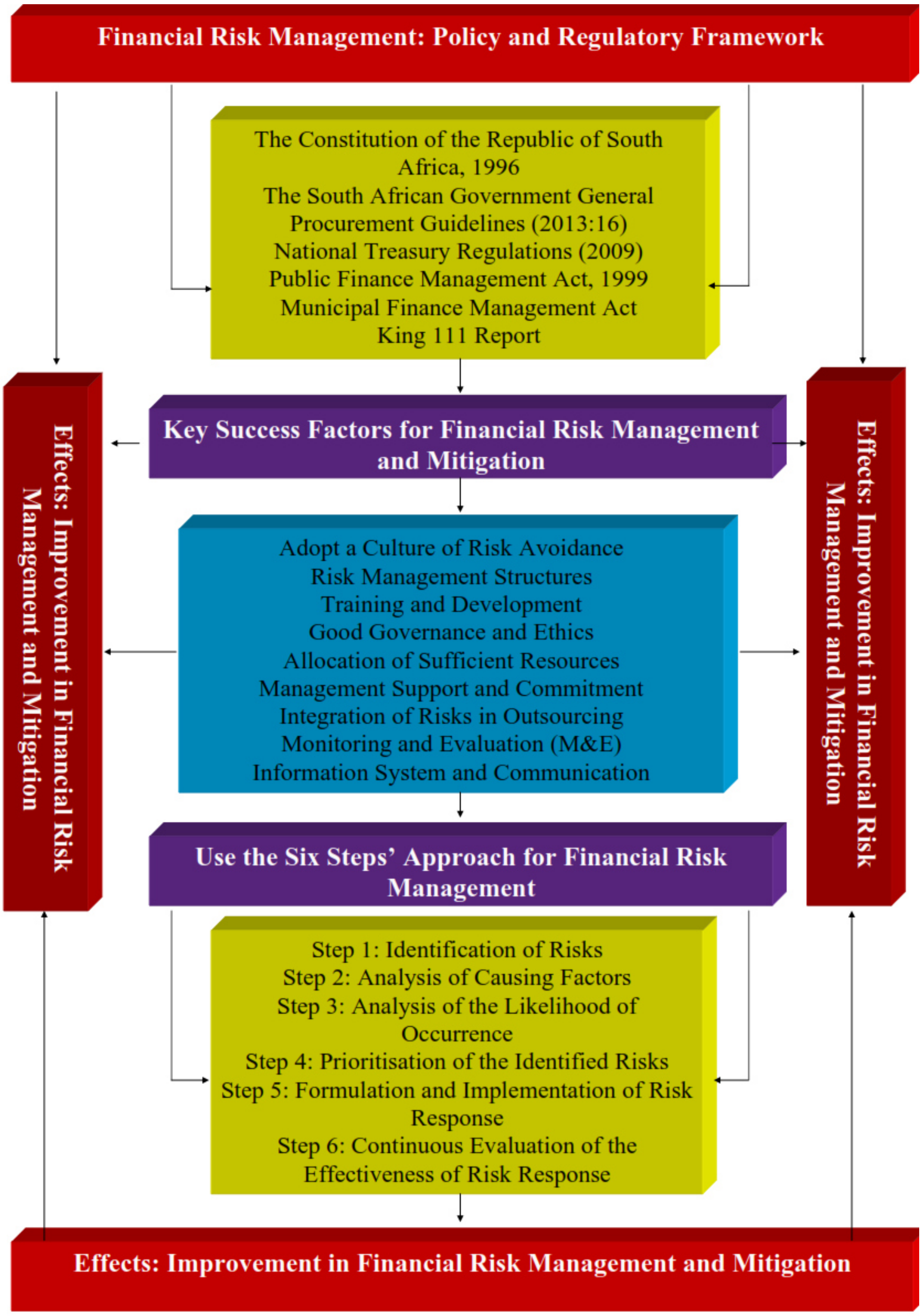
The aggregate negative implications of all these on the effectiveness of the regulatory framework is reflected in Allwright's (2013) revelation that although the final cases of financial losses attributable to fraud and corruption totalled R 346 million, only 13% (R 44 million) was recovered, as a total of 87% (R302 million) remained lost. Besides the limitations associated with the technicalities of the legal measures for financial risk management, the Public Service Commission (2011) indicates that the other challenges are linked to the inconsistency in the application of the law. The PSC (2011) highlights that these limitations are reflected in the fact that although the Exchequer Acts are supposed to be repealed by all the provinces, five provinces have not yet done so to thereby undermine the compatibility of its provisions with the prescriptions of the Public Finance Management Act, 1999 (PMFA). In other words, these inconsistencies raise a lot of uncertainties about compliance issues and the overall effectiveness of the roles of the provincial treasuries.

## 8. Managerial Implications

In a nutshell, the study highlights the South African public sector to have all essential regulatory frameworks. However, significant parts of the findings herald effectiveness of financial risk management to be fraught with poor culture of financial risk avoidance, poor commitment of managers and political leaders, limited integration of risk management measures at municipal levels, weak internal audit systems, and technical loopholes in the existing regulatory frameworks. As much as some of the municipal projects have been successfully implemented, some of the drawbacks of poor financial risk management are more likely to be latent in the decline in the quality and quantity of the delivered services, cost implications and delay of the process of project implementation. If the South African public sector organisations are to effectively manage and mitigate the effects of the increasing financial risks, then, in addition to the existing regulatory framework, it is argued in Figure 1 that managers must adopt a comprehensive financial risk management framework to facilitate the integration of certain key success factors.

**Figure 1:** A conceptual framework of key constructs for effective financial risk management and mitigation in the contemporary South African public sector organisations




**Source:** Researcher's own construct as derived from the interpretation of different theories and literature on financial risk management in the modern public sector organisations.

As it is illustrated in Figure 1, these key success factors include; fostering of a culture of risk avoidance, and the establishment of risk management structures that effectively cascade to the local municipalities. In line with the illustration in Figure 1, the other factors encompass training and development of the capacity and competencies of risk management staff at all levels of the governmental structures. Investment in the training and development of risk management specialists shall contribute towards improving the overall capacity of municipalities to deal more effectively with all the issues concerning financial risk identification, assessment and mitigation. This view is derived from the fact that the findings revealed that as much as in the national and provincial structures of local government, the personnel with such skills could be available, at the municipal levels, they are scarced.

This can be reversed if the management hires consultants to develop course contents for the internal training programmes in conjunction to the partnerships with the public universities.

Such approach will solve problems associated with the current situation under which most of the municipalities tend to rely on accountants, and financial and auditing experts. In addition to training, there must also be the emphasis of good governance and ethics. The view that the management must foster and entrench the culture of good governance, ethics and integrity is derived from the findings that indicate that the effectiveness of the framework for risk management is not the problem, but the overall attitudes and approach of the senior managers and project directors towards good governance, ethics and integrity. Such governance and ethics approach seems to undermine effective use of the framework for financial risk management.

In order to reverse such a trend, the management should foster, entrench and integrate the concepts of good governance and ethics not only in risk management, but throughout the entire process of project implementation. During the process of project conceptualisation and outsourcing of relevant contracts, senior directors and managers must ensure all risks are identified and mitigated. It is also critical that managers take cognisance that the overall governance, ethics and integrity are accomplished in the manner that enhances the effectiveness of risk management and the successful implementation of all government projects and programmes. Despite the need for the allocation of sufficient resources, the political leaders, directors and management in the South African public sector should demonstrate genuine support and commitment by acting in the way that leads to the minimisation of financial risks. At the same time the risk management technocrats must also ensure the effective integration of risk management in outsourcing, encourage constant monitoring and evaluation, and establish effective financial risk information system.

The establishment of independent structures to monitor and evaluate risk management will provide the management with the requisite expertise for risk identification, assessment and mitigation. In other words, through a specialist risk monitoring and evaluation department, the management will be able to constantly identify and correct deviations undermining effectiveness of risk management during the process for the implementation of different government projects and programmes. With appropriate environment created after the integration of these key success factors, figure 1 indicates that it becomes possible for public sector financial risk managers to successfully apply a six steps' approach for risk identification and management that involves; step 1: identification of risks, step 2: analysis of causing factors, step 3: analysis of the likelihood of occurrence, step 4: prioritisation of the identified risks, step 5: formulation and implementation of risk response, and step 6: continuous evaluation of the effectiveness of the risk response.

**9. Suggestion for Further Research**

The paper examines all the factors that influence effectiveness of financial risk management. However, this wider approach limited the detail evaluation of the influence of certain critical factors. One of such critical factors is the notion of good governance and ethics among the political leaders, directors, managers and employees in the South African public sector. Future studies must therefore be directed towards exploring how good governance and ethics would influence the effectiveness of financial risk management in the contemporary South African public sector organisations.

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