

**THE POTENTIAL OF INTERNAL AUDIT TO ENHANCE PUBLIC
SUPPLY CHAIN MANAGEMENT OUTCOMES**

BY

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**Thesis presented in partial fulfilment of the requirements for the
degree of**

Master of Public Administration



at the

University of Stellenbosch

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April 2005

DECLARATION

I, the undersigned, hereby declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

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ABSTRACT

Public sector reform in South Africa became a reality with the change in political dispensations in 1994. In South Africa the transformation of the public sector became critical in order to provide for a better life for all. This required regulatory frameworks that could establish good governance and a holistic transformation of the public sector. Similar, to other countries financial management reform became critical to establish high performance public sector institutions, but specific to South Africa, to support equity in society.

In this study the assumption is made that Internal Audit has a critical role toward the supply chain management framework, especially in relation to the two broad underlying motivations for procurement reform in South Africa. These are good governance and preferential procurement toward socio-economic empowerment. Both Internal Audit and supply chain management are private sector management methodology that forms part of the financial management reform of the public sector.

The study of literature revealed that modern day Internal Auditing plays a vital role in ensuring that an organisation is efficiently run, morally sound, technologically advanced, cognisant of the environment and other areas of concern, and safe from unnecessary risk. It plays a crucial role toward improving organisational governance. Supply chain management is a mechanism used to create maximum benefit from resource acquisition and application amongst key stakeholders and organisational functions. The focus of supply chain management in the South African public sector is efficiency, effectiveness and economic use of resources in a context of development and equity. Internal Audit and the supply chain management concept, as applied in the South Africa, are contextual and should therefore be interpreted in terms of this context apart from the universal understanding of methods of reforms to meet multiple ends.

The case study of the Learner Transport Services (LTS) was applied to explore the research questions. The LTS is a procurement initiative by the Western Cape Education Department to transport learners in poor communities who live more than five kilometres from their nearest school and, through preferential procurement, empower emerging contractors. As such, the LTS provides an ideal case for exploring Governance and supply chain management for empowerment dynamics at the operational level, but investigations and performance audits completed by the office of the Auditor General and the WCED indicated irregularities in the LTS initiative.

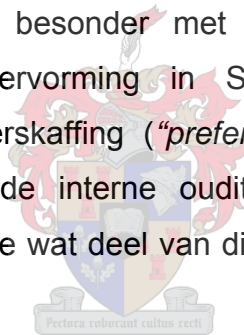
The question therefore explored, was to what extent Internal Audit could have contributed to good governance and supply chain management for empowerment. LTS reports and other primary sources of data were consulted, and expert interviews were conducted to answer this question. It was found that Internal Audit can be a value adding service by becoming pro-active in assessing the exposure to risk in procurement initiatives to achieve the strategic objectives of the broader supply chain management concept.

The recommendations for this research study revolves around the important role that Internal Audit can assume in becoming a proactive role player in the evaluation of preferential procurement initiatives in particular and supply chain management for empowerment in general in assessing the risk exposure and the controls available to meet the required objectives of an initiative such as the LTS and the broader objectives of the organisation.

OPSOMMING

Openbare sektor hervorming in Suid Afrika het 'n werklikheid geword met die verandering in die politieke bedeling in 1994. Die transformasie van die openbare sektor het kritiek geword om 'n beter lewe vir almal te voorsien. Dit het regulerende raamwerke wat goeie regeerkunde ("*governance*") en 'n holistiese transformasie van die openbare sektor vereis. Soos in ander lande, het finansiële bestuurshervorming kritiek geword om hoë-prestasie openbare sektor instellings te vestig, maar spesifiek vir Suid Afrika, om billikheid in die samelewing te ondersteun.

In hierdie studie word die veronderstelling gemaak dat 'n interne oudit 'n kritieke rol het teenoor die voorraadketting bestuursraamwerk ("*supply chain management framework*"), in besonder met betrekking tot die twee breë motiverings vir verskaffingshervorming in Suid Africa. Hierdie is goeie regeerkunde en preferente verskaffing ("*preferential procurement*") tot sosio-ekonomiese bemagtiging. Beide interne oudit en voorraadkettingbestuur is privaatsektor bestuursmetodieke wat deel van die finansiële bestuurshervorming van die openbare sektor vorm.



Die studie van die literatuur het aan die lig gebring dat hedendaagse interne oudit 'n sleutelrol speel om te verseker dat 'n organisasie doeltreffend en moreel bestuur word, tegnologies gevorderd en bewus van die omgewing en ander areas van besorgdheid is, en veilig van onnodige risiko is. Dit speel 'n beslissende rol tot die verbetering van organisatoriese regeerkunde. Voorraadkettingbestuur is 'n meganisme wat gebruik word om maksimum voordeel van hulpmiddelaanskaffing en aanwending tussen sleutelrolspelers en organisatoriese funksies te skep. Die fokus van voorraadkettingbestuur in die Suid Afrikaanse openbare sektor is doeltreffendheid, doelmatigheid en die ekonomiese gebruik van hulpmiddels in die konteks van ontwikkeling en billikheid. Interne oudit en voorraadkettingbestuur, soos dit in Suid Afrika toegepas word, is kontekstueel en moet dus in terme van hierdie konteks

geïnterpreteer word, afgesien van die universele begrip van metodes van hervorming om veelvoudige doelwitte te bevredig.

Die gevallestudie van die “Learner Transport Services (LTS)” is gebruik om die navorsingsvrae te ondersoek. Die LTS is ’n verskaffings inisiatief van die Wes Kaap Onderwysdepartement (WKOD) om vervoer te verkry vir leerders in arm gemeenskappe wie meer as vyf kilometres van hulle skole bly, en om deur preferente verskaffing opkommende kontrakteurs te bemagtig. As sulks, die verskaf die LTS ’n ideale geval om regeerkunde en voorraadkettingbestuur vir bemagtigingsdinamieka op operasionele vlak te bestudeer, maar ondersoeke en prestasieoudits wat deur die Ouditeur Generaal en die WKOD uitgevoer is, het onreëlmatighede in die LTS inisiatief aangedui.

Die vraag wat dus nagevors is is tot watter mate interne oudit tot goeie regeerkunde en voorraadkettingbestuur vir bemagtiging kon bygedra het. LTS verslae en ander primêre ander bronne van data is geraadpleeg, en deskundige onderhoude is gevoer om hierdie vraag te beantwoord. Dit is gevind dat interne oudit kan ’n waarde-toevoegende diens wees deurdat dit proaktief kan word om die blootstelling vir risiko in verskaffingsinisiatiewe te skat om die strategiese doelwitte van die breë voorraadkettingbestuur konsep te bereik.

Die aanbevelings van hierdie navorsingstudie draai rondom die belangrike rol wat interne oudit kan aanneem om ’n belangrike rolspeler te word in die evaluering van ,spesiefiek, preferente verskaffingsinisiatiewe en voorraadkettingbestuurs vir bemagtiging, in die raming van die blootstelling tot risiko en die beheermaatreels wat beskikbaar is om die vereiste doelwitte van ’n inisiatief soos die LTS en die breër doelwitte van die organisasie.

ACKNOWLEDGEMENTS

I hereby wish to thank my family and friends, and in particular my parents for their understanding and support they afforded me to complete the thesis. To Professor Johan Burger I wish to extend my gratitude for supervising this project.



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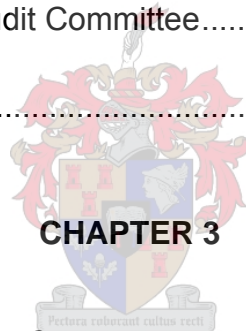
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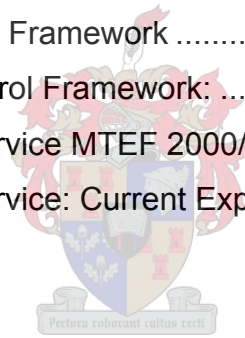
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LIST OF ABBREVIATIONS

- ANC:** African National Congress
- BEE:** Black Economic Empowerment
- BEEcom:** Black Economic Empowerment Commission
- BBBEEA:** Broad-Based Black Economic Empowerment Act (BBBEEA), 2003
(Act 53 of 2003)
- COSO:** The Committee of Sponsoring Organisations of the Treadway
Commission
- EC:** European Commission
- ERM:** Enterprise-wide Risk Management
- HDI:** Historically Disadvantaged Individuals
- IIA:** The Institute of Internal Auditing
- IMF:** International Monetary Foundation
- IOG:** Institute on Governance
- LTS:** Learner Transport Services
- NPM:** New Public Management
- OECD:** Organisation for Economic Co-operation and Development
- PFMA:** Public Finance Management Act, 1999 (Act 1 of 1999 as amended by
Act 29 of 1999)
- PPPFA:** Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000)
- PRC:** Presidential Review Commission
- SCM:** Supply Chain Management
- SCMF:** Supply Chain Management Framework
- UNDP:** United Nations Development Fund
- WB:** World Bank
- WCED:** Western Cape Education Department

CHAPTER 1

INTRODUCTION AND RESEARCH PROBLEM

1.1. Introduction

Reform in the public sector globally, is aimed at introducing better performance and entrepreneurial management. This was driven by the New Public Management approach. Reform based on this type of an approach includes budgetary and financial reforms, structural reforms, procedural or technical reforms and relational reforms. The objective would be to achieve high performance management with the focus on how to allocate and use financial resources in a manner that would enhance performance of government spending agencies and service delivery. According to Pollitt and Bouckaert (2000: 64) budget reforms, which include accounting systems and auditing have been driven by two external pressures, namely the restraint of public expenditure for macro-economic reasons and the pressure for performance improvement within the public sector.

South Africa as an emerging democracy in 1994 required political, constitutional and administrative changes. The role of the public sector required change from an antagonistic relationship with civil society to that of a partnership with civil society. South Africa was faced with same problems of transforming the public sector as countries across the world. The main areas of concern were based on the trajectories of financial reform namely, budgeting, accounting systems and auditing.

According to the Presidential Review Commission (PRC) (1998: 1-2) the South African public sector reform was mandated by the terms of reference found in the White Paper on the Transformation of the Public Service (WPTPS), 1995, the Interim Constitution, 1993 and section 195 (1) of present Constitution, 1996. These legislative frameworks lead to the establishment of the Presidential Review Commission (PRC) in March of 1996. This commission was mandated to

recommend strategies for a new culture of governance in public institutions, which were fundamentally flawed. The PRC recommended an establishment of good governance and a holistic transformation of the public sector. A fundamental requirement was to establish a more flexible financial management system and shift away from the rules bound Exchequer Act of 1975. The White Paper on Financial Management Reform 1996, section 216 and 217 of the Constitution of the Republic of South Africa 1996, (Act 108 of 1996) and Presidential Review Commission, 1998 promoted the promulgation of the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999). The PFMA was promulgated to regulate financial management at both national and provincial spheres of government. It acts as an overarching policy framework to guide practices in effective and efficient utilisation of financial resources.

The PFMA in terms of section 38 1(a) (1) and (2) read with sections 76 and 77, requires the accounting officer to have systems of financial, risk management and an Internal Audit function in place. The approach adopted for Internal Auditing is based on the prescribed standards of the Institute of Internal Auditing (IIA). This approach requires the assessment of adequacy and effectiveness of systems of internal control, risk management and governance processes which ensure that the objectives of the organisation is met. Internal Auditing's relevance is non-negotiable in light of the demands for financial reforms and an emphasis on the devolvement of authority and increases accountability for outputs and outcomes. Potentially, Internal Auditing has the ability to be one of the most influential and value added services available to an accounting officer.

1.2. Background

In this study the assumption is made that Internal Audit function is a prerequisite for governance and that it has direct bearing on the supply chain management (SCM) system of the Western Cape Education Department (WCED). The SCM system of the WCED is transversal in its application as prescribed by the National Treasury's Supply Chain Management Framework (SCMF). The SCMF

has two broad focus areas, namely good governance and preferential procurement for socio-economic empowerment.

The Internal Audit function was established in 1999 as a centralised function with the Provincial Administration of the Western Cape as per Cabinet Minute No. 355/1999 on 19 September 1999. It functioned in a shared capacity within the Province. According to the Western Cape Financial Governance Review (2003:23) Internal Audit as a result of inadequate human resources focused mainly on the Departments of Education, Health and Social Services and Poverty Alleviation. It was reasoned that these departments constitute 80% of the Provincial budget and therefore pose the highest risk according to the financial risk assessment which was completed for the financial year 2002/2003.

Internal Audit service is a co-sourced service commitment to assist individual departments in achieving its strategic objectives by building a culture of good corporate governance values, ethics and risk management in line with global practices and Internal Audit methodologies. The Internal Audit service is managed centrally by the Provincial Treasury since August 2003. Internal Audit reports directly to and is accountable to the relevant Accounting Officers in terms of tri-party Service Level Agreement. The complete roll-out of Internal Audit to all provincial departments will only be achievable by 2006 once a provincial risk profile has been developed by January 2005, a consideration regarding the organisational fit of the Internal Audit would be considered, i.e. centralised, decentralised shared, detached or a combination of such (Western Cape Medium Term Budget Policy Statement 2005-2008: 117).

Lynne Brown the MEC for Finance, Economic Development and Tourism in the Western Cape on the 20th May 2004 authorised and approved a charter for Internal Audit and risk management which would be co-sourced to a multi-disciplinary and multi-firm consortium as a service provider. The Sihluma Sonke Consortium provides a service of risk assessment and Internal Audit for the Provincial Government Western Cape Departments inclusive of the Provincial

Parliament (Sihulma Sonke Newsletter, 2004: 1). The charter was approved by (MEC) for Finance, Economic Development and Tourism.

The system of apartheid instituted separate education for all race groups and meant that learners were often bussed to school from their homes, walked long distances, or had to live in hostels. Over time this pattern has become entrenched and is both inequitable and expensive. The Learner Transport Service (LTS) is still operative and the numbers of learners and the budgeted amounts have increased substantially. The expenditure amount has increased from R53 million to R110 million over an eight year period. Historically, the LTS was contracted out to individuals currently classified as historically disadvantaged individuals (HDI) as the scheme was employed within the previous Administration of Coloured Affairs: House of Representatives. With the amalgamation of the education departments in the Western Cape in 1995, the LTS was integrated into the services provided by the WCED.

The study proposes to question the extent of the level of functionality of Internal Auditing in the WCED, and how this contributes to the effectiveness, efficiency and economic use of resources for the LTS. This is based on the yearly Auditor General's Reports on the WCED and a Performance Audit Report (PR 188/2003) by Auditor General on the LTS (2003) which exposed deficiency in the administration of the LTS. LTS is a procurement initiative and it involves economic empowerment of the previously disadvantaged.

A further question for this research study is the effect of this deliberate policy expression by government to ensure economic opportunities. Has it necessarily improved service delivery and the outcomes for LTS and to what extent has empowerment been effected? How was its performance measured in respect of actual outcomes? According to the Western Cape Medium Term Budget Policy Statement (WCMTBPS) 2004-2007 (2003: 44) the concept of supply chain management will come into effect as of 1 January 2004. Supply Chain Management (SCM) is a collaborative strategy, which aims to integrate

procurement and provisioning processes, which eliminate non-value added cost, time and activities to competitively serve end customers better.

How will it influence enabling legislation such as the Preferential Procurement Policy Framework Act (PPPFA), 2000 (Act 5 of 2000) in building the required capacity of contractors who are awarded contracts based on their status as HDI's? How is senior management given the assurance that a SCMF that is decentralised to institutional level can improve the service and empower those HDI's with out an evaluation by Internal Audit given the problems highlighted in the Auditor-General's annual reports and the performance audit which commenced the 8th April 2002 and the final report being published in October 2003?

1.3. Research Problem

In this study the assumption is made that Internal Audit has a critical role to play toward the supply chain management framework, especially in relation to the two broad underlying motivations for procurement reform in South Africa. These are good governance and preferential procurement toward socio-economic empowerment. The research problem for this study has two questions:

- What is the level of functionality of Internal Auditing in the Western Cape Education Department?
- Does the level of functionality of Internal Audit affect the SCM initiatives?

The researcher intends using the case study of the LTS as one of the explorative tools in researching the potential of Internal Audit in the WCED toward enhancing SCM.

1.4. Research Objectives

The researcher aims to analyse LTS in order to provide senior management of the WCED with an example of how a well-implemented and functional Internal Audit function could provide management with an ongoing, credible and

structured measure of effectively achieving its objectives. Furthermore, as both the independent and dependant variables are new methodological management approaches in the public sector, the research intends to provide information that can stimulate debate on the applicability of these approaches to the public sector.

1.5. Research Design and Methodology

The study is an empirical design based on a case study. This research study is both qualitative and quantitative. This includes extensive reading and gathering of information from literature from both the international and local practices of Internal Auditing in the private sector and public sector. Obtaining financial and existing data in order to validate and compare it to the findings of other methodology used in the study. This information would be gathered within the WCED from the directorate's budget administration logistical services, research and physical resource planning.

According to Welman and Kruger (2001: 63-64) the advantage of non-probability sampling is that it is economical and less complicated. In using purposive sampling the intention of the researcher is to concentrate on Audit Committee (AC), senior management in the WCED and role players at Provincial Treasury and the individual private sector companies involved in the provision of an Internal Audit function. The function of Internal Audit was co-sourced to a consortium of established chartered accounting firms of which 40% are historically disadvantaged. Furthermore, the Office of the Auditor General will be interviewed to test their understanding of the role of Internal Audit in relation to the Performance Report (PR 188/2003) of October 2003. Semi-structured interview questions will be compiled to gain opinions of different parties involved in Internal Auditing and the LTS. The following aspects will be covered by the interviews:

- Value adding service;
- Internal Audit as a change agent;

- Internal Control processes;
- Risk Management ;
- Governance processes;
- Supply chain management;
- Preferential procurement

1.6. Preliminary Literature Review

An approach was followed to source literature based on legislative factors that resulted in civil service reform initiatives in South Africa. This influenced the decision to source literature on international civil service reform and more specifically New Public Management (NPM). Furthermore, literature in respect of the Internal Audit function and governance was gathered. The nature of the case study directed the researcher to source information concerning procurement and SCM.

1.6.1. Public Governance

According to Pollitt and Bouckaert (as cited in Burger 2005: 2) reforms in the public service connote dynamic theory and context specific practices that cannot have universal meaning as reform reasons, reform forces, particular features and consequently the reform trajectories vary from case to case and evolve in a particular case as the reforms itself and the forces around the case causes change.

Public sector reform has its origins within the theoretical paradigms and management philosophies of Traditional Bureaucracies, NPM and Public Governance. According to the Organisation for Economic Co-operation and Development (OECD) Observer (2003: 2) the first generation pioneers of public sector reform not only faced the challenge of adjusting to a rapidly changing world economy, but also the rhetoric of the day that government itself was a problem. Therefore, the generic cause of bureaucracies was addressed by the reform solution of NPM to arrive at the desired result of efficiency. NPM could

best be described as bringing competitiveness to the public service; by introducing management methodology that has its origins within the private sector and is applied to the public sector with its primary goal of economic efficiency. In this manner public expenditure could be reduced, public sector labour market could be freed-up and more market-type mechanisms can be introduced to government. Burger (2005: 3) explains that within the paradigm of NPM professional managers are in control of business units where they deliver on that which counts and not necessarily what works best for society over the long run. Their focus is on output and this fragmentises services due to a lack of an integrated vision to which each service must contribute. Therefore, there is this corresponding tension between the conception of people as consumers, from the state versus market scenario, the concept of people as citizens from the context of state and society.

Reforms in the public sector were not wrong, as keeping governments efficient and affordable was a critical problem then and it remains so today. However, according to the OECD Observer (2003:2) reforms were insufficient. Firstly, there was an assumption that by transposing management ideas whole sale into the public service with a strong emphasis on formal systems of specification and measurement would not have adverse effects. The public service is a highly complex environment in which such an approach needs to be contextual. Secondly, government remains a single enterprise and they operate within a unified constitutional setting and in a coherent body of administrative law. As such, government's performance is determined by the interaction of a number of levers such as the policy process, the budget process, the civil service management process and the accountability process, within the ambit of a political/administrative culture. Therefore, the various levers in government would inevitably involve each other at various stages. Thirdly, there was a failure to understand that the public management arrangements not only deliver service, but enshrine deeper governance values and become inseparable from the constitutional arrangements in which they are embedded.

According to Burger (2005: 5) public governance does not discard the idea of traditional bureaucracies and NPM, but places it on a tactical, operational and support level where they belong and provides the strategic integrity to use them appropriately. It is about how to ensure that public services are delivered and society is developed in a context sensitive manner which sustainable over a long term by providing real investment in society, the environment and the economy. Similarly, Minogue *et al* (1999: 17) explains that modern public administration is not just about efficiency, it also involves the ideas of democratic participation, accountability and empowerment.

The constructs of Internal Audit and SCM have their origins within the private sector. Their implementation in the South African public sector requires not only that they are structured, executed and supported effectively, but that they are aligned with and measured against a particular and widely shared strategic vision for our society. In the South African context it is the Constitution, 1996.

1.6.2. Establishing High Performance Financial Management

Wind and Main (1998) identified 13 characteristics associated with high performance systems, which relate directly to the NPM approaches. Popovich (1998: 11) suggests that a high performance organisation is a group of employees who produce desired goods and services at higher quality with the same or fewer resources. A critical element of any high performance organisation is that its activities are long-term vision and outcome directed, rather than only short-term output directed objectives. In the context of the thesis, it means that high performance indicators should measure the desired societal outcomes in addition to service related outputs. Therefore, a performance related support function such as Internal Audit should also support these higher outcomes.

In terms of financial management supporting high performance, Wind and Main (1998) explain that there is not necessarily a direct correlation between price and value. In a price orientated environment in the public sector the evaluation of performance is about adhering to approved input orientated budgets and

tendering procedures. Value orientation evaluates value for money and performance. In addition, speed is essential to enhance performance as an indicator to what extent a system or process has succeeded to eliminate waste and fine tune processes. Finally, information based services are cheaper and faster and more accurate than machine-based systems. It allows for a sharper focus on the elimination of unnecessary activities.

Finance acts as one of the main components of any reform agenda. The other three components are personnel, organisation and performance measurement. Pollitt and Bouckaert (2000: 129) explain that a key element in performance management modernisation is the development of an adjusted and modernized financial set of tools, which include a budget system, accounting and auditing system. Both the constructs of Internal Audit and SCM are directed toward creating an environment of high performing financial management environments with an emphasis of improving public management of resources in public institutions.

1.7. Legislative and Regulatory Framework

In developing societies across the globe the regulatory reform has become an essential part of the discourse on local economic development and anti-poverty programs. It is recognised that the regulatory framework is established by both central and local governments and is designed to apply nationally and provincially. The South African reform process has taken a similar path in which the regulatory framework expresses pro-poor service delivery and empowerment. This chapter discusses the regulatory frameworks within which the independent and dependant variables operate in the South African context. As the case study is operational within a Western Cape provincial department both the national and provincial regulatory framework applicable to the case study is discussed.

The Interim Constitution of the Republic of South Africa, 1993 (Act 200 of 1993) and the existing Constitution of the Republic of South Africa ,1996 (Act 108 of 1996) forms the legislative background for financial management reform in South

Africa. Sections 216 and 217 of the Constitution (1996) have specific relevance to the establishment of a financial management and procurement system. The Presidential Review Commission (PRC) (1998) received its terms of reference and was mandated to recommend strategies for public sector reform within the framework of the aforementioned legislation. Together, with the PRC recommendations and the White Paper on Financial Management Reform (1996) a policy framework would be established in order to give guidance in introducing and implementing various strategies aimed at reforming the approach to the financial management and expenditure budgeting in South Africa. The PFMA was promulgated as the financial management framework for government, thereby replacing the rules-based Exchequer Act of 1975.

Internal Audit derives its mission from the government's overall vision and principle of accountability and improved governance. Government seeks to ensure that the taxpayer's money is used effectively, efficiently and economically. Furthermore, these monies need to be accounted for. As a government ruled by law, it is common cause that all financial management actions taken by public sector institutions relate to the relevant legislative provisions. According to Devenish (1998:309) the effective and transparent control of public finance is of crucial importance as the prudent management of the economy is of national interest and influences the success or failure of government policies.

1.7.1. The Constitution of the Republic of South Africa, 1996 (Act 108 of 1996)

Section 216 (1) of Chapter 13 of the Constitution which provides the basis for national treasury to prescribe measures to ensure transparency and expenditure control in each sphere of government by introducing the following criteria:

- i. Generally recognised accounting practices;
- ii. Uniform expenditure classifications; and
- iii. Uniform treasury norms and standards.

The establishment of Internal Auditing and audit committees in government is seen as integral to the aforementioned criteria as prescribed by section 216 (1) of the Constitution in enhancing transparency and improved financial management of which procurement plays a fundamental role.

Section 217 (1) of the Constitution provides the basis for procurement and determines that:

“When an organ of state in the national, provincial or local sphere of government, or any other institution identified in national legislation, contracts for goods or services, it must do so in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.”

Van der Waldt *et al* (2000: 35) explains that all procurement should be compliant and consistent with the constitutional requirements as set out in Section 217. The Constitution has a dualistic impact in that good governance must be applied in the procurement of goods and services and this must be read in conjunction with Section 195 (1) Chapter 10 of the Constitution which states *“that public management must be governed by democratic values and principles as set out in the Constitution”* which includes the efficient, effective and economic use of resources. Furthermore, section 217(1) to 217(3) of the Constitution provides for public procurement that is fair, equitable, transparent, competitive and cost effective. Section 217(3) of the Constitution further confers an obligation on national legislation to prescribe a framework providing for preferential procurement in order to address the social and economic imbalances of the past.

1.7.2. Public Finance Management Act, 1999 (Act 1 of 1999 as amended by Act 29 of 1999)

The changes brought by the PFMA were not just a technical response to the restrictive Exchequer Act of 1975. The PFMA was promulgated to modernise

budgeting and financial management, by shifting the focus from inputs towards results, and hence onto improved accountability, in the context of a medium-term planning framework. Similarly, Du Preez (2000: 27) argues that it is clear from the provisions on accountability in the PFMA, that the drafters and Parliament were of the opinion that the provisions of the Exchequer Act, 1975 fell considerably short of adequately addressing the duties, responsibilities and sanctions required to enforce statutory and managerial accountability.

According to Van der Waldt *et al* (2002: 30) the success of the PFMA is dependant on the development of new leadership skills in order to drive a process of financial management reform in the public sector. It requires a change in mind set in which both financial and non-financial professionals must be suitably equipped to implement the reforms as envisaged by the Act and the Constitution. The PFMA objectives are to allow managers to manage in the public sector but to hold them accountable for the use of resources made available to them. The objectives of the PFMA was to regulate financial management in the national and provincial governments, to ensure that all revenue, expenditure, assets and liabilities of government is managed effectively and efficiently and to provide for the responsibilities of persons entrusted with financial management in government .

1.7.3. Internal Audit and the Audit Committee

Chapter 5, Section 38 of the PFMA lists the general responsibilities of accounting officers, while Section 38 (a) (1) and (2) requires the accounting officer to ensure that the department has an effective, efficient and transparent systems of financial and risk management and internal control. Furthermore, an accounting officer must maintain a system of Internal Audit under the control and direction of an audit committee complying with, and operating in accordance with regulations and instructions prescribed in Sections 76 (4) (e) and 77 of the PFMA. Section 77 makes specific provision for the establishment of an audit committee in departments, which must consist of at least three persons meeting twice a year.

1.7.3.1 Internal Audit

The Internal Audit function, which includes both the Audit Committee and the Internal Audit component, also has an important role to play in the implementation of the PFMA.

According to Du Preez (2000: 27) the responsibilities of the Internal Audit function in terms of the PFMA are the following:

- The evaluation of all systems of financial and risk management and internal control;
- Acting as an early warning system to detect things that go wrong;
- Assistance to managers to identify risks and the development of effective and efficient systems in the organisation;
- Monitoring the implementation of the PFMA;
- Implementing the provisions of the PFMA.

Du Preez (2000: 27) argues that in order to effectively implement the accountability provisions of the PFMA it must be assumed that sections 38 to 43 were formulated to achieve a specific goal, i.e. that each section and subsection requires some form of action. The use of resources in an effective, efficient and economic fashion should be complimented by the equitable distribution of those resources to have an impact on the society that it serves toward sustainable empowerment. According to the Western Cape Financial Governance Review (2003: 17) the Internal Audit function is charged with assisting management in the effective discharge of responsibilities, promoting the establishment of cost effective controls, assessing risks and recommending measures to mitigate those risks.

1.7.3.2 Audit Committee

Section 76(4) of the PFMA states that the National Treasury may make regulations or issue instructions applicable to all institutions to which the Act applies concerning: audit committees, their appointment and functioning and Internal Audit components and their functions. Furthermore, section 77 of the PFMA prescribes the establishment of an audit committee:

- (a) must consist of at least three persons of whom in the case of a department
 - i. One person from outside the public service;
 - ii. The majority of members may not be in the employ of the department except with the approval of the relevant treasury;
 - iii. The chairperson may not be in the employ of the department.
- (b) must meet twice a year;
- (c) may establish a shared audit committee if the relevant treasury considers it economical.



The establishment of an audit committee enhances the independence and effectiveness as it is responsible in ensuring that the Internal Audit function operates in an enabling environment. The audit committee acts as an extension of top management and remains responsible to the Accounting Officer appointed by the executive authority. The Internal Audit function should report functionally to the audit committee and administratively to the Accounting Officer.

1.7.4. Public Sector Procurement Reform Legislation

The regulatory framework of public sector procurement is dualistic. Firstly it is aimed at enabling government to use its purchasing power to accomplish specific socio-economic objectives as set out in the Reconstruction and Development Programme (RDP) in 1994 and the Growth, Employment and Redistribution

Strategy (GEAR) in 1996. Secondly, the aim is to ensure that public sector institutions adhere to international best practices and good governance in the procurement of goods and services for public consumption.

SCM is a collaborative strategy, which aims to integrate procurement and provisioning processes, which eliminate non-value added cost, time and activities to competitively serve end customers better. It gives effect toward public sector reform in two broad focus areas, namely good governance and preferential procurement for socio-economic empowerment. The Supply Chain Management Framework (SCMF) gives effect to procurement reform that is uniformed and complies with international best practice.

1.7.4.1. Preferential Procurement Policy Framework Act, 2000 (Act 5 of 2000)

The Preferential Procurement Policy Framework Act (PPPFA), 2000 (Act 5 of 2000) and its accompanying regulations were promulgated to prescribe a framework for a preferential procurement system. It gave effect to section 217(3) of the Constitution of 1996 by providing a framework for the implementation of the procurement policy contemplated in sections 217(2) of the Constitution of 1996. The specific goals and objectives of the preferential procurement policy according to the PPPFA include provisions for encouraging and supporting contracting with persons, or categories of persons, historically disadvantaged individuals (HDI's) by unfair discrimination on the basis of race, gender or disability.

According to Van der Waldt *et al* (2002: 38) Section 2(1) of the Act, stipulates that an organ of state must determine its own preferential procurement policy and implement it within the framework of the Act. This gives effect to a preference point system in which HDI's receive preferential treatment in the adjudication of tenders. Furthermore, this can ensure the programmes of the Reconstruction Development Programme (RDP) are implemented.

1.7.4.2 Broad Based Black Economic Empowerment Act, 2003 (Act 53 of 2003)

The Broad-Based Black Economic Empowerment Act (BBBEEA), 2003 (Act.53 of 2003) expands the framework provided in the PPPFA to take into account and to apply codes of good practice for Black Economic Empowerment (BEE). Furthermore, it provides for the use of qualification criteria for the issuing of licenses, the sale of state owned assets and the entering into of public - private partnerships. The Act and Strategy for Broad Based Black Economic Empowerment envisage the strengthening of government's legislative and other policy instruments towards achieving its BEE objectives. This includes the PPPFA and its associated regulations. The PPPFA provides for public sector institutions to implement a preference system in the allocation of contracts for categories of service providers to advance the interest of persons disadvantaged by unfair discrimination. BBBEEA uses a balance scorecard to gauge the success, guidelines and codes including the financial support mechanism for proposed BEE initiatives. Government's strategy for broad based black economic empowerment looks beyond the redress of past imbalances to using BEE as a powerful tool to broaden the country's economic base and accelerate growth, job creation and poverty eradication (Department of Trade and Industries Strategy for Black Economic Empowerment, 2003).

1.7.4.3. Supply Chain Management Regulations

On the 10 September 2003, Cabinet approved the adoption of a Policy Document titled "Policy To Guide Uniformity In Procurement Reform Processes In Government". This document points out the direction that government is moving towards in the implementation of the SCM within Government. This policy strategy was intended to guide the uniform implementation of Governments procurement reform initiatives and the issuing of Regulations in terms of Section 76 (4) (c) of the PFMA.

Section 76(4) (c) of the PFMA determines that:

“The National Treasury may make regulations or issue instructions applicable to all institutions to which this Act applies concerning the determination of a framework for an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective”

In terms thereof, the National Treasury issued a Regulation determining a framework for SCM, accompanied by a Policy Strategy guiding uniformity in this process. Section 38 of the PFMA, confers general responsibilities on the Accounting Officer. In section 38 1(a) (iii) it states the accounting officer for a department, trading entity or constitutional institution:

- a) *“must ensure that the department, trading entity or constitutional institution has and maintains;*
- iii) *an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost-effective ...”*

Both Section 76(4) (c) and 38 (1) (a) (iii) imposes an obligation on the National Treasury and the Accounting Officers to realize a procurement and provisioning system that would comply with the requirements of the Act.

1.7.4.4. Devolvement of the Supply Chain Management Function to the WCED

According to the Western Cape Provincial Treasury Circular No.37/2002 the first phase of procurement reform was the introduction of the Western Cape Preferential Procurement Policy that took effect on 01 January 2002 (issued per Treasury Circular 37 of 2001 dated 13 December 2001). This subsequently led to the Departmental Preferential Procurement Plan for the Western Cape Education Department (WCED).

In the second phase, greater powers were devolved to the WCED in preparation of transferring the entire responsibility and accountability for procurement to the Accounting Officer, thus giving effect to the spirit and purpose of the PFMA and in particular to the abovementioned Section 38 of the PFMA.

The third phase of the reform process entailed the full-blown introduction of the concept of SCM, the regulating framework and guiding principles underpinning this concept that was issued by the National Treasury in terms of its Section 76(4) (c) obligation of the PFMA. The WCED was informed by Circular 36/2003 that the full-blown implementation of the SCM will commence from the 1 January 2004. The Accounting Officers Supply Chain Management (AOSCM) System was compiled for the WCED and will be executed through the Accounting Officer's delegations. This final phase set out the obligations of Departments in the Western Cape in anticipation of accepting complete accountability for SCM.

1.8. Summary

An historical background to financial management reform setting was given by way of introduction for this research study. Furthermore, a contextual setting related to the case study and its relationship with the independent and dependant variable, namely Internal Audit and SCM was discussed. Chapters 2 and 3 expand on the literature related to the Internal Audit function and SCM. The research questions, objectives and the proposed methodology were discussed. Finally, this chapter introduced the legislative environment for both the independent and dependant variable. The financial management reform process is part of a modernisation process of public management that has direct impact on public financial management and procurement. The procurement reform process which started in 1995 was directed at two broad based focus areas, that of good governance and preferential procurement to address socio-economic objectives. This procurement reform process was supported by the introduction of a number of enabling legislation which included the PFMA, the PPPFA and the BBBEEA which expands the PPPFA to include policies of good practice for BEE.

CHAPTER 2

GOVERNANCE AND INTERNAL AUDIT

2.1. Introduction

This chapter will discuss the constructs related to the main variables of this thesis which are discussed in Chapter 3. The chapter will analyse the literature related to the independent variable and its role within governance of public sector institutions. However, the concept of governance will be discussed first as it acts as the environmental context in which Internal Audit functions both in the private and public sector. Similarly, Percy (2001: 351) explained that the private sector has become synonymous with financial reporting, whereas in the public sector it goes beyond the financial world and reports on probity, regulatory and arrangements for economy, efficiency and effectiveness and the delivery of public services. The assumption made by Percy indicates the contextual difference between the public and private sector auditing. This chapter will discuss governance, the role of Internal Audit, internal controls and risk management and the oversight role of the audit committee within these arrangements.

2.2. Governance

The analysis of governance is important to this study as it is assumed that Internal Audit is a mechanism that improves governance within organisations. Governance becomes the context in which Internal Audit functions. This is important as the public sector environment has changed from an administrative culture to a management culture in which management and citizens expect better value from the same but reducing financial resources. Furthermore, the literature review on the dependant variable in this study will highlight the importance of good governance not only globally, but in the South African context.

Esterhuysen (2000: 61) explained that governance can be described as a multi-dimensional concept which requires unpacking as it covers the obligation of supervising and monitoring management performance through a process of holding management accountable to stakeholders in an organisational sense. Governance essentially deals with issues of performance and conformance within a context of co-production between society and the state toward empowerment and sustainability of that society.

2.2.1. Defining Governance

Governance is clearly distinguishable from government. However, it seems common for society to associate the concept of governance with that of government. This blurred conception is cause of confusion as the concept of governance is difficult to capture in a simple definition. Similarly, Pierre and Peters (2000: 14) argue that it has become a confusing concept as a result of it becoming a umbrella concept for a wide variety of phenomena which include policy networks, public management, co-ordination of sectors in the economy, public private partnerships, corporate governance and good governance as a reform objective of the World Bank (WB) and the International Monetary Fund (IMF). The discussion on governance definitions have been sourced from literature on governance by international organisations.

According to the ¹Institute On Governance (IOG), governance in a simplistic definition is the “*art of steering societies and organisations*”. One of the central components of governance is decision making. However, the IOG argues that critics of this definition assert that governance is not simplistic, but by its nature it is messy, tentative and unpredictable. It is complicated as it involves multiple role-players who expect that their input is considered in the process of decision-making. The IOG expands on the aforementioned definition of governance. According to the IOG governance “*is the interface with stakeholders, the source*

¹ The Institute On Governance (IOG), a Canadian non-profit organisation, was founded in 1990. Its mission is to explore, share and promote good governance in Canada and overseas by helping governments,

of the strategic decision that shapes the organisations and its work, and ultimately accountability for the work and the actions of the organisation". From this definition the element of accountability is crucial as the roles of performing a task, governance and management are intertwined to improving societal goals.

The World Bank (WB) defines governance as the traditions and institutions by which authority in a country is exercised for the common good. This includes the process by which those in authority are selected, monitored and replaced, the capacity of the government to effectively manage its resources and implement sound policies, and the respect of citizens and the state for the institutions that govern economic and social interactions among them.

The European Commission (EC) explains that the term governance is a very versatile one. It is used in connection with several contemporary social sciences, especially economics and political science. According to EC governance originates from the need of economics (as regards corporate governance) and political science (as regards State governance) for an all-embracing concept capable of conveying diverse meanings not covered by the traditional term of government. Referring to the exercise of power overall, the term governance, in both corporate and State contexts, embraces action by executive bodies, national assemblies and judicial bodies. The term governance corresponds to the so-called post-modern form of economic and political organisations.

The United Nations Development Programme (UNDP) explains that governance is a neutral concept comprising the complex mechanisms, processes, relationships and institutions through which citizens and groups articulate their interests, exercise their rights and obligations and mediate their differences. According to the political scientist Roderick Rhodes as cited in www.europa.eu, the concept of governance that is used in contemporary social sciences has at least six different meanings, the minimal State, corporate governance, new public

voluntary organizations, private and public sectors and communities put it into practice for the well being of citizens and society.

management, good governance, social-cybernetic systems and self-organised networks.

2.2.2. Good Governance

Good governance has been a response to the public sector reform era between the 1980's to 1990's lead by the various versions of the NPM approach. The focus and attention of NPM was given to the measurement of results at both the individual and organisational level in respect of outputs. Public governance differs from NPM in that attention is given to level of interaction by public institutions in order to generate desired results to the end customer or citizen. It emphasizes a stakeholder focus with accountability and transparency as key factors in service delivery. This is emphasized in the UNDP (1997) definition of good governance which addresses the allocation and management of resources to respond to collective problems in societies based on the principles of participation, transparency, accountability, rule of law, effectiveness and equity.

According to Cloete (1999: 12) good governance is the achievement of a democratic government to develop policies to achieve its objectives in developing a sustainable society, by mobilising, applying and coordinating all available resources in the public, private and voluntary sectors both domestically and internationally in the most effective , efficient and democratic way. The definition by Cloete relates to the governance mode of social-cybernetic systems and networks. An essential prerequisite for good governance is democracy. Similarly, it is argued in the epilogue as cited in Onimode *et al* (2003: 244) that democracy is critical for both political and economic governance. Democracy needs to be internalised in all social institutions if it is to grow and become ingrained within all human relations. Democracy is critical in politics, economic development and management, just as governance is important for politics and economic prosperity and sustainability.

According to Boviard and Löffler (2003:10) governance is a positivistic concept and good governance is a normative concept that needs to be treated as a

contextual-dependant concept. Good governance cannot be transplanted into an operational blue print, it must be negotiated and agreed on by all stakeholders and these stakeholders must evaluate those principles agreed upon. Pierre and Peters (2000) argue that governance is a process with a contextual approach to political behaviour and is less concerned with institutional outcomes. Therefore, it is civil society and government that co-produce in order to ensure the delivery of services and sustainability of those goods and services. Similarly, IOG views that good governance is shaped by cultural norms and values and that there can be no universal template for good governance. Good governance is about achieving the desired results within the context of values and is culture specific to an organisation.

Good governance can also be conceptualised as part of a development process in which the proper management of the public service as a state instrument acts as a facilitator in the development process. According to Agere (2000: 6) the improvement of the management system in the public service contributes to the development process. This means that managing of the public service becomes more complex as policy becomes more internationalised and involves broader stakeholders. The boundaries between management and policy formulation become more blurred due to the fact that more responsibilities are delegated to management which encourages risk taking and accountability. More emphasis is placed on public sector managers within a performance orientated environment than the traditional control systems. They are required to have management capabilities, competencies and attain set goals with limited resources. Furthermore, global pressures to co-operate and compete, rising expectations of citizens, the need to reduce public deficits are forcing countries towards good governance.

Three major actors exist in promoting good governance, namely the state, a mobilized civil society and a productive civil society (Agere: 2000:10). The successful interaction amongst these actors results in sustainable human development. Governance is achieved by effective states that create enabling

political and legal environments for economic growth. A prerequisite for governance is a vibrant civil society, a government that plays a key role in providing public goods through revenue collection and market regulation and efficient public sector management of these resources based on a legal framework of accountability and transparency. A key focus for good governance is the development of human resources in these delivery institutions with an emphasis on accountability, institutional and legal frameworks for development, information and transparency. This creates an enabling environment for growth in society.

Löffler (as cited in Bovaird and Löffler 2003: 164-165) argue that governance and good governance have common elements but are different in that in a multiple stakeholder focus collective societal problems are not solved by public authorities but solved through a network of individuals and groupings. Formal and informal rules are used in the process of stakeholders determining the importance of these rules through a negotiated process. Good governance differentiates from the NPM paradigm towards a co-operative system of networking in order to facilitate between bureaucracies and societal organizations. Good governance does not reason only in terms of outputs and inputs as with NPM, but recognises key inputs from societal interaction. It is inherently political as there is a constant interplay of stakeholders who exercise power in order to further their own interest.

2.2.3. Key Principles of Good Governance

The United Nations Development Program (UNDP) in 1997 enunciated key principles that can be found in most literature on governance. These principles according to Graham et al. (2003: 3) have universal recognition and they overlap or are in conflict at some point. The UNDP principles are the following:

- Legitimacy and voice
- Direction
- Performance

- Accountability; and
- Fairness

The UNDP principles are discussed in depth in the in the following sub-sections.

2.2.3.1. Accountability

Accountability is a key requirement to good governance as it relates to holding governments responsible for their actions. Accountability cannot be enforced without transparency and the rule of law. According to the UNDP (1997) government, the private sector and civil society organisations are accountable to the public and the institutional stakeholders.

Similarly, Agere (2000: 7) views the role of accountability as holding the responsible elected or appointed individuals and organisations charged with a public mandate to account for specific actions, activities or decisions to the public from whom they derive authority. Kuzi (2004: 2) furthers this argument in relating accountability to the non-fulfillment of public institutions with normal prescriptions in accordance with public resource management. This suggests that accountability relates to the ability to account for allocation use and control of public expenditure and in it is concerned with establishing the enforcement of rules and regulations of corporate governance. Van der Westhuizen (2003: 4) similarly argues that an organisation has an obligation towards providing certain information to its stakeholders as a result of legislation. True accountability stems from the wish of an organisation to provide information beyond legislative requirements if such an organisation proactively thinks through its own degree of accountability.

2.2.3.2. Transparency

The UNDP views transparency and the availability of information to citizens as pervading good governance and reinforcing accountability. Transparency is built on the free flow of information in which institutional processes and information are directly accessible to concerned with them and enough and relevant

information is provided to understand and monitor. Transparency can be defined as public knowledge of policies of government and confidence in its intentions. According to Fuhr (2000: 67) transparency is a prerequisite for successful beneficiary participation in program design and implementation and support in the states overall expenditure policy. Similarly, Agere (2000: 7) argues that transparency requires making public accounts verifiable, providing public participation in government policy-making and implementation and allowing for choices to be made by citizens regarding choices impacting on their lives.

2.2.3.3. Participation

This is intrinsic to governance as public involvement improves information flow, accountability, due process and voice and thereby improves public sector management. The UNDP (1997) relates participation to having a voice in the decision-making process directly or the legitimate intermediate institution that represents their intention. Participation is built on having the freedom of speech and the relevant capacities to participate constructively. Good governance mediates differing interest groups to reaching a consensus on issues.

Similarly, Agere (2000: 9) argued that public participation acts as a check on the power of government in process in which stakeholders exercise influence over public policy and share control over resources and institutions that affects their lives. Therefore, public participation is focused on the empowerment of citizens, the interplay between various role players in society and creates an enabling regulatory framework and economic environment which generates legitimate demands and monitors government policies and actions.

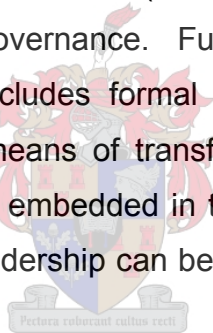
2.2.3.4. Legal Framework

According to the UNDP (1997) the principle of fairness and equity refers to the right of society to have opportunities, to improve and maintain their well-being, within a legal framework that is fair and impartial, especially in relation to human rights. Governance can be ensured in a legal and judicial system that is pro-

government and pro-governance must be applied objectively by an independent judiciary. This implies a state where there is rule of law and sanctions applied against those who transgress these laws. It promotes human rights and inflow of private capital. According to Agere (2000: 9) in the absence or in a society where the rule of law is weak, foreign direct investment is discouraged, transaction costs can be distorted and rent seeking activities become rampant. Enforcement requires firm action against all corrupt behaviour at all levels in society.

2.2.3.5. Leadership

The UNDP views leadership as being intrinsically linked to giving direction and strategic vision for the public to have a long term perspectives of good governance and human development, including what is needed for such development. According to the OECD (2001: 12) leadership is a critical component of good public governance. Furthermore, governance is the underlying value of a nation includes formal aspects such as separation of powers, checks and balances means of transferring power, transparency and accountability. These have to be embedded in the public sector culture in order for these values to actualise. Leadership can be interpreted as the heart of good governance.



2.2.3.6. Performance

According to the UNDP (1997) performance relates to institutional responsiveness that serves all stakeholders equitably. Therefore, effective and efficient institutions must have processes that produce results in an economic manner. These can be based on needs assessments, policy guidelines to be discussed with the public before decisions are made, and the timely delivery of economic and social services and goods.

2.2.4. Modes of Governance

Governance has emerged as a dominant idea of the later reform era of the public sector. Governance in a traditional approach was related to direction through a

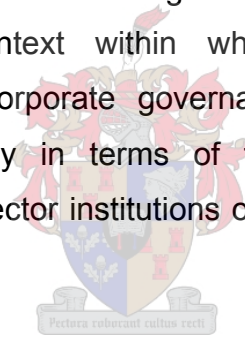
hierarchy. This approach has been eclipsed with new models of governance which changed government to becoming more flexible, deregulated, participatory and competitive. According to Pierre and Peters (2000) the concept of governance derived popularity from a shift of formal government structures to a broader process and from its utility function to encompassing the range of institutions and relationships engaged in the governance process. Contemporary governance has a multi-level character where international, national and sub-national processes of governance are interlinked in a negotiated fashion. Pierre and Peters (2000) sketch the modes of governance as three scenarios, namely towards the reassertion of control, letting other regimes rule and towards communitarism, deliberation and direct democracy. Similarly, Milward and Provan as cited in Hill and Hupe (2002: 180) argue that the actual governance paradigm is not a singular concept but consists of several modes of governance each with equal analytical relevance. This can be identified in the work of Ahn *et al* (2002:4) identified four modes of governance, namely:

- Political management: This covers both the public service and steering of enterprises in reform in which the relationship is defined according to the type of government institution, specific decisions to change the organisation or to relinquish direct control over them. This is the traditional approach to governance which has been replaced by new models of governance.
- Steering and management agents and networks: Governance is centred on principals and agents with relationships conducted through contracts. The concepts of marketisation and managerialism are found in the governance model of New Public Management. States that implemented this model attempted to reverse the growth of government in order for the market to play a leading role in society.
- Regulators: This addresses the conduct of relationships between organisations and institutions, in which state intervention in the market economy is to achieve public objectives.

- **Corporate Governance System:** This is a form of governance where there is a framework of principles and a micro focus on the individual organisation. This mode of governance is applied at the company level and public agency level in which they are directed and controlled by such a framework. Typical features of such frameworks include accountability, transparency and integrity.

2.2.4.1 Corporate Governance

Public concern over public service institutions stems from the widespread structural reforms of the public sector during the 1980's and 1990's in both the developed and developing countries. Furthermore, Ootobo as cited in Onimode *et al* (2003: 101) argues that while an inappropriate political environment was a major impediment to economic reform and growth, another reason is that political governance defines the context within which economic and corporate governance are practiced. Corporate governance is important not only its economic sectors but broadly in terms of the country's entire economy. Furthermore, how the public sector institutions of a country are managed matter for national development.



2.2.4.2 Defining Corporate Governance

Corporate governance is defined in a number of ways and it is helpful to distinguish between the various definitions. According to Ootobo as cited in Onimode *et al* (2003: 104) the concept of corporate governance can be defined in terms of relationships, supervision, control and leadership. Solomon and Solomon (2004: 14) defines "corporate governance as a system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all stakeholders and act in a socially responsible way in all areas of their business." This definition explores the relationship between stakeholders, management and the board of directors.

The Organisation for Economic Cooperation and Development (OECD) (1999) defines corporate governance as “a system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance.” This definition of the OECD associates governance with decision making but also the structure through which organisational objectives are set and attained in relation to a performance standard. It introduces the concepts of goal congruence, incentives, monitoring and control.

The Institute of Internal Auditors (IIA) according to Hermason and Rittenberg as cited in the Research Report on Internal Audit (2003: 27) defines organisational or corporate governance as “dealing with the procedures utilized by the representative of the organisations stakeholders to provide oversight of risk and control process administered by management....The monitoring of organisational risks and the assurance that controls adequately mitigate those risks both contribute directly to the achievement of organisational goals and the preservation of organisational value.....Those performing governance activities are accountable to the organisations stakeholders for effective stewardship”. This definition differs from that of the OECD above in that the IIA recognises that effective governance approaches are contextual and that different approaches are required in different cultures.

2.2.4.3. Linkage Between Governance and Corporate Governance

Corporate governance has a linkage to public governance within any economy. According to the World Bank (2000: 14) corporate governance is linked to public governance in the following ways. Firstly, minority shareholders in companies would have difficulty asserting their rights in a weak legal system, and can lead to

corporate ownership structures that are highly concentrated. Secondly, unaccountable and non-transparent public governance can lead to blurring of lines between the two types of governance modes. This can lead to a dysfunctional corporate governance where there is state intervention, utility or capital market corruption and crony capitalism.

The National Treasury Draft Guidelines (2003) on Internal Audit similarly argue that corporate governance in the public sector encompasses a wide range of areas in which the accounting officer is accountable. Public sector institutions have to satisfy a complex range of political, economic and social objectives. Public sector institutions operate in accordance with legislation which acts as a check's and balances mechanism that drives a value system with an emphasis on values, accountability and transparency.

Political governance sets the orientation of an economy and regardless of which type of political-economy a country has, an effective corporate governance framework is vital. However, economic governance provides the context for corporate governance. According to Otobo as cited in Onimode *et al* (2003: 102) corporate governance stands at the intersection of law, public policy and business practices as it provides the laws within which corporations are established, the regulatory framework for conduct and the macro-economic framework. Corporate governance frameworks are influenced by two types of influences, namely internal and external stakeholders. Internal stakeholders include shareholders, company's board and management. The external stakeholders include suppliers, employees, customers, communities where organisations operate and the larger public and state. There are a number of current trends and developments that influence corporate governance from the external stakeholder environment. These are, according to Otobo as cited in Onimode *et al* (2003: 104), globalisation, liberalisation, privatisation, regional co-operation and integration, and civil society activism.

2.2.4.4. King 2 Report On Corporate Governance

The aim of the King 2 Report was to promote the highest standards of corporate governance in South Africa as an on going process toward corporate governance reform. According to Ehlers and Lazenby (2004: 41) its purpose was to review and clarify the proposal for an inclusive approach adopted in the King Report 1994, to recognise the increasing importance placed on reporting on social, ethical, environmental, health and safety matters and to recommend a new code of corporate governance for South Africa that is measurable and based on outcomes. The distinguishing factor about the King 2 report according to Solomon and Solomon (2004) was that it focused on a stakeholder approach rather than the agency theory of corporate governance. The stakeholder theory moves from the premise that organisations are accountable to other groups of stakeholders other than their shareholders.

Public sector corporate governance requires embracing good behavioural management principles. Management is responsible to create and maintain mechanisms which not only ensure adequate corporate governance structures are in place but that the behavioural aspects are complied with. The seven characteristics as enunciated in King 2 (2002: 11-12) are both management-driven as well as value-driven, more so by the latter. These principles in King 2 have universal application as indicated in the principles of good governance of the UNDP.

King 2 (2002: 19) argues, similarly to the UNDP, that corporate governance as a mode of governance is about leadership. The report argues that the efficiency of leadership allows organisation's to compete in a global economy and create job opportunities, leadership for probity as this gives investors confidence and assurance of an organisation's management that is honest and has a level of integrity in regard to shareowners and others. Organisation's are called upon to address legitimate social concerns relating to their activities and this forces

responsibility on leadership and leadership that should be both transparent and accountable within a code or framework of principles.

However, the King 2 report neglected in one area critical to corporate governance according to Malherbe and Segal (2001: 50), namely that of the need for a non-executive officer in terms of oversight of appointed senior management. King 2 used the Cadbury Report (United Kingdom) as a guide for its work, however as the Cadbury Report requires a minimum of three non-executives directors to bear independent judgement on Boards. King 2 supported the Cadbury Report's recommendations but noted that there was not a sufficient pool of trained and experienced people available to serve as independent non-executive directors. The King Committee neglected the control situations by remaining silent. It is interesting that within the public sector this debate on the appointment of non-executive directors has not come to the fore.

In the opinion of the author the PFMA acts as a corporate governance framework in which the Internal Audit function, as an independent monitoring and assurance tool assists senior management toward improved accountability and transparency. According to Trevor Manual the National Minister of Finance, as cited the Western Cape Financial Governance Review (2003) the PFMA is an embodiment of good corporate governance and therefore the seven characteristics of good corporate governance found in the King 2 report. Corporate governance in terms of the PFMA relates to compliance and the enforcement of the code. This is achieved the liaison between the business community and the state to handle breaches of criminal law by directors and officers. Regulators can ensure a more pro-active enforcement of rules and regulations in monitoring organisational governance. Furthermore, using sub-committees to monitor the progress and addressing areas where there is insufficient action taken to comply (Pro Active Public Service College, 2005: 273).

2.3. Internal Audit

Literature relating to modern Internal Auditing as researched, found one common defined framework used by the Institute of Internal Auditors (IIA). The IIA defines Internal Audit as an independent, objective assurance and consulting activity designed to add value and improve the organisations activities. According to Woods (2001: 4) the Institute of Chartered Management Accountants (ICMA) recommends that the objective of Internal Audit is there to furnish them with analysis, appraisal, recommendations, counsel and information concerning activities reviewed and in this process assist senior management in the effective discharge of their responsibilities. Both definitions emphasize that Internal Audit is value-added resource for an organisation.

The King 2 Report (2002: 86) explains that Internal Audit plays an integral role in an organisation as it provides management with a reasonable assurance regarding the effectiveness of the organisations corporate governance, risk management processes and system of internal control. Furthermore, as a function it must be independent in order to realise the objective assurance as defined by the IIA. The Internal Audit team must have professional standing and command respect in the organisation. Similarly, Du Toit (1998: 2) argues that the professional standing of the Internal Audit function, including that of individual Internal Auditors, will be valued and maintained, based on the effectiveness and efficiency added to the achievements of goals and objectives of the organisation. Furthermore, the literature emphasised the importance of the Internal Audit function having independence. This can only be achieved by establishing an independent audit committee. Internal Audit would report functionally to the audit committee and administratively to the accounting officer.

2.3.1. Scope of Internal Audit

Internal Audit according to the COSO internal control framework (1992) covers the following three areas:

- Risk management: assist the board, directors and management in identifying, evaluating and assessing organisational risks and by providing assurance as to the effectiveness of the related control.
- Controls: assist the board, directors and management in the maintaining of effective controls by evaluating those controls to determine the effectiveness and efficiency, and by developing recommendations for improvement
- Governance: assist the board, directors and management in achieving goals of the organisation by evaluating and approving the process through which:
 - Goals and values are established and communicated;
 - Monitoring the accomplishment of these goals;
 - Ensuring accountability; and
 - Corporate values are preserved.

The Internal Audit function is an important part of corporate governance and acts as one of the mechanisms for checks and balances in an entity (King 2: 2000). The scope for Internal Auditing should include risk management, control processes and the governance processes. Furthermore, the following principles relating to Internal Auditing are set out in King 2:

- Entities are required to have an Internal Audit function that has the respect and co-operation of the audit committee and the management.
- The purpose, authority and responsibility of the function should be defined and be consistent with the aforementioned IIA definition and a audit charter approved by the accounting officer and the audit committee.
- The head of Internal Audit is to be appointed or dismissed in concurrence with the audit committee.
- A continuous risk assessment should form the basis of an Internal Audit plan. This can identify residual risk and emerging risk. The process should be conducted formally, once a year.

2.3.2. Role of Internal Audit

Internal Audit assists members of the executive and senior management in the effective discharge of their duties and responsibilities. This allows them to be furnished with an analysis, appraisal, recommendations, counsel and information concerning the activities reviewed. According to King 2 (2002) the role, function, scope and professional standards of the Internal Audit function are succinctly documented and codified by the IIA with reference to international best practices. Internal Audit should provide an entity with the assurance that management processes are adequate in identifying and monitoring risks. It should give confirmation on the effective operation of the internal control systems and that there is a credible process for feedback on risk management in place in an organisation. Furthermore, Internal Audit must give an assurance and an objective confirmation that senior management receives the correct quality assurance and information that is reliable.

The South African government employs the Committee of Sponsoring Organisations of the Treadway Commission (COSO)² framework for internal control, which emphasises accountability and transparency similar to section 38 (1) of the PFMA. COSO moves away from traditional controls in accounting and broadens its scope to involving control measures that achieve organisational objectives, management and employee competence and an overall internal control and risk management system.

2.3.3. Internal Audit as a Value Adding Management Tool

A key towards organisational performance monitoring and evaluation is performance auditing. The objective of a performance audit according to Pollitt *et al* (1999: 17) is to audit work that would reach a judgement on the level of performance of the audited entity. It has been developed to compliment and to replace financial audits. Barret (2003: 13) explains that a performance audit

examines and reports on the economy, efficiency and effectiveness of the operations of the administration and recommends ways in which this administration may be improved. Such audits are best described as an independent, objective and systematic examination of the operations of a body for the purposes of forming an opinion on whether.

- The operations have been managed in an economical, efficient and effective manner;
- Internal procedures for promoting and monitoring economy, efficiency and effectiveness are adequate; and
- Improvements might be made to management practices including procedures for promoting and monitoring performance

According to the American Institute of Certified Public Accountants as cited in Naidoo (2002: 13) defines performance auditing as a systematic review of an organisations activities in relation to specified objectives for the purpose of assessing performance, identifying opportunities for improvement and developing recommendations for further action. Pollitt *et al* (1999: 195) argue that there are parallels between the development of public sector management and the development of performance auditing as they proceed from the set of values that are intertwined within the same reform ethic of effectiveness, efficiency and economic use of resources.

Furthermore, Internal Audit can only considered as a management tool if it obtains support from the board, audit committee and management, acts as internal consultants, understands the vision, mission and strategic objectives of the organisation, understands the culture and audits in a top-down fashion. According to Naidoo (2002: 14) Internal Audit should initiate enterprise-wide risk management, with a focus on providing assurance regarding strategic risks

² COSO stands for the Committee of Sponsoring Organisations of the Treadway Commission. It is voluntary USA organisation dedicated to the improvement of the quality of financial reporting through business ethics, effectiveness of internal control and corporate governance.

facing the organisations. The Internal Audit unit should act as change agents within the organisation and should not think financially but operationally, so as to review the operational progress of the organisation in order to establish if the results are consistent with goals and objectives.

2.4. Internal Control

Internal control covers all activities and information related to achieving the objectives of an organisation. It implies that the Internal Audit function should transversely cover all line functions and staff of an organisation. Internal controls relate to the operational, performance, reporting and compliance issues, and are fully integrated with the entity's culture, structure and business processes. According to Grant Thornton Accountants and Business Advisors (2004: 1) the Internal Control Information Framework (ICIF) has defined internal control as a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations

2.4.1. COSO Internal Control Framework

The COSO internal control framework has been adopted by National Treasury as the internal control framework to be used by the South African public sector institutions. This framework in 1992 expanded the scope of internal control to include not only traditional controls of accounting but included other control measures that involved the achievement, management and employee competence and the evaluation of the overall process and systems of internal control and risk management. According to Moss and Bridge (2003: 1) COSO in conjunction with PricewaterhouseCoopers, developed an extensive study of internal controls on behalf of the Committee. The COSO framework has been

adopted as an international best practice as a framework for guidance on internal controls. It consists of the following five internal control components as illustrated in figure 1.

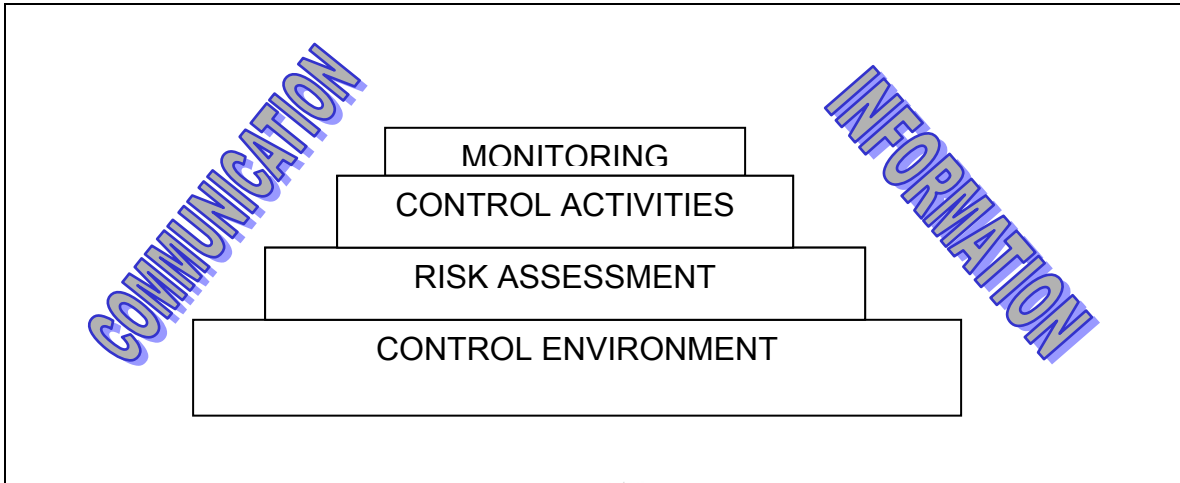


Figure 1: COSO Internal Control Framework (Source: www.grantthornton.com)

The diagram above depicts the interrelationship of the internal control components. The control environment, the foundation on which everything rests, has a pervasive influence on the way business is conducted. Control activities balance risks, optimally providing reasonable assurance that objectives will be met. This balance is unlikely to occur without the effective communication of pertinent financial and non-financial information. This ensures that the organisation continuously operates effectively in responding to change.

2.4.1.1. Control Environment

It forms the foundation for all the other components of internal control. According to the COSO internal control-integrated framework of 1992 it sets the tone of an organisation and influences the control consciousness of its people. It focuses on the following factors, namely integrity, ethical values and the competence of the entities management and employees, the management philosophy and operating style, the manner in which management assigns authority and responsibilities and its development programs. Similarly, Van der Westhuizen (2003: 2) argues that the control environment forms the foundation for all other components of

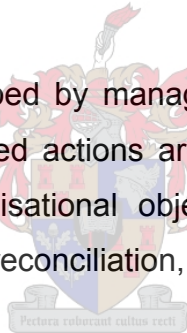
enterprise risk management. It influences how strategy and objectives are established, business activities are structured and risks are identified, assessed and acted upon.

2.4.1.2. Risk Assessment

Mechanisms should be established by management to identify and analyse the relevant risks that would hinder the organisation in achieving its objectives and determine the internal and external sources of risk, such as changes in economy, industry, regulatory and operating conditions. According to Sawyer *et al* (2003: 66) this component has been the most progressive Internal Audit activity, in that the assessment of inherent risk is a proactive means reducing and mitigating risk that impedes organisational strategic objectives.

2.4.1.3. Control Activities

Policies and procedures developed by management ensure that the directives are followed and that the required actions are taken to address risks that can impede the achieving of organisational objectives. Control activities include authorisation, verification, and reconciliation, security of assets, performance review and segregation of duties.



2.4.1.4. Information and Communication

Effective communication should flow down, across and up the organisation. Pertinent information must be identified, captured and communicated in a time frame that enables people to carry out their responsibilities. According to Sawyer *et al* (2003: 66) information and communication are essentially a management process as they cannot function without current intelligence as it provides management with information of substance on which evaluations of the effectiveness of the control process and operational effectiveness.

2.4.1.5. Monitoring

Internal controls need to be monitored in order to assess the quality of the systems over time. Management should monitor the internal control structure through ongoing evaluations of each activity in its operations. The scope and the sequence of the separate evaluations depend on the assessment of risk and the effectiveness of an ongoing monitoring procedure.

2.4.2. CoCo Internal Control Framework

The CoCo internal control framework was developed in response to COSO by the Canadian Institute of Chartered Accountants in 1995. This model is a widely used framework for internal control, particularly in the area of corporate governance. According to Sawyer *et al* (2003: 67) the model is orientated toward Internal Audit procedures and is easier to understand in terms of guide for Internal Auditing activities. The model provides a definition of control and risk, directly related to the achievements of organisational objectives. With COSO, CoCo is the most used internal control framework across the world.

These four components include: purpose, commitment, capability and monitoring and learning. The following flow diagram illustrates the interlinked nature of these components which form the essence of control by blending them together.

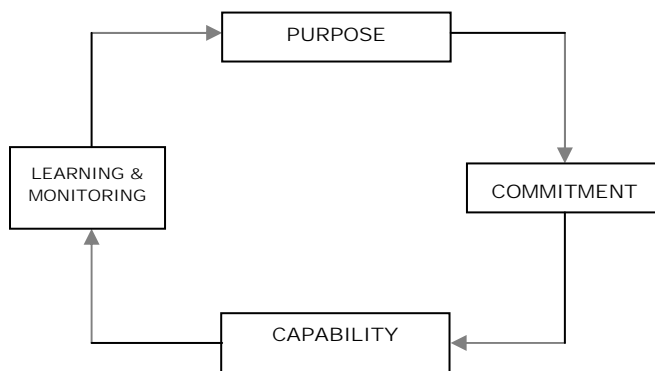


Figure 2: CoCo Internal Control Framework

PURPOSE	A person performs a task, guided by an understanding of its purpose, therefore the objective which must be achieved
CAPABILITY	Supported by capability (Information, resources, supplies and skills)
COMMITMENT	Commitment to perform the task well over time
MONITORING & LEARNING	Monitor the performance and the external environment to learn how to perform the task better and the changes to be made

Both COSO and CoCo have extended their definitions beyond financial control alone, however the definitions in respect of boundaries remains problematic. Similarly, this can be seen in the development of the Turnbull Report of 1999. The Turnbull report was a response in the United Kingdom to formalise a system of internal control which companies could use as a benchmark to develop their own internal control framework strategies.

2.4.3. Turnbull Internal Control Framework

This framework similarly, to that of COSO and CoCo, involves the identification and prioritisation of corporate risk. However, according to Solomon and Solomon (2004: 55) the Turnbull report differed from COSO as the report's focus was to connect internal control to corporate governance. The Turnbull Committee was established to address the combined code on internal control for companies in the UK in 1998. In its recommendations the Turnbull Report (1999) focused on providing an explicit framework on internal control for reference, on which companies and boards could model their individual systems of internal control. As such the Turnbull Report was a guideline and not a prescriptive code of practice for internal control.

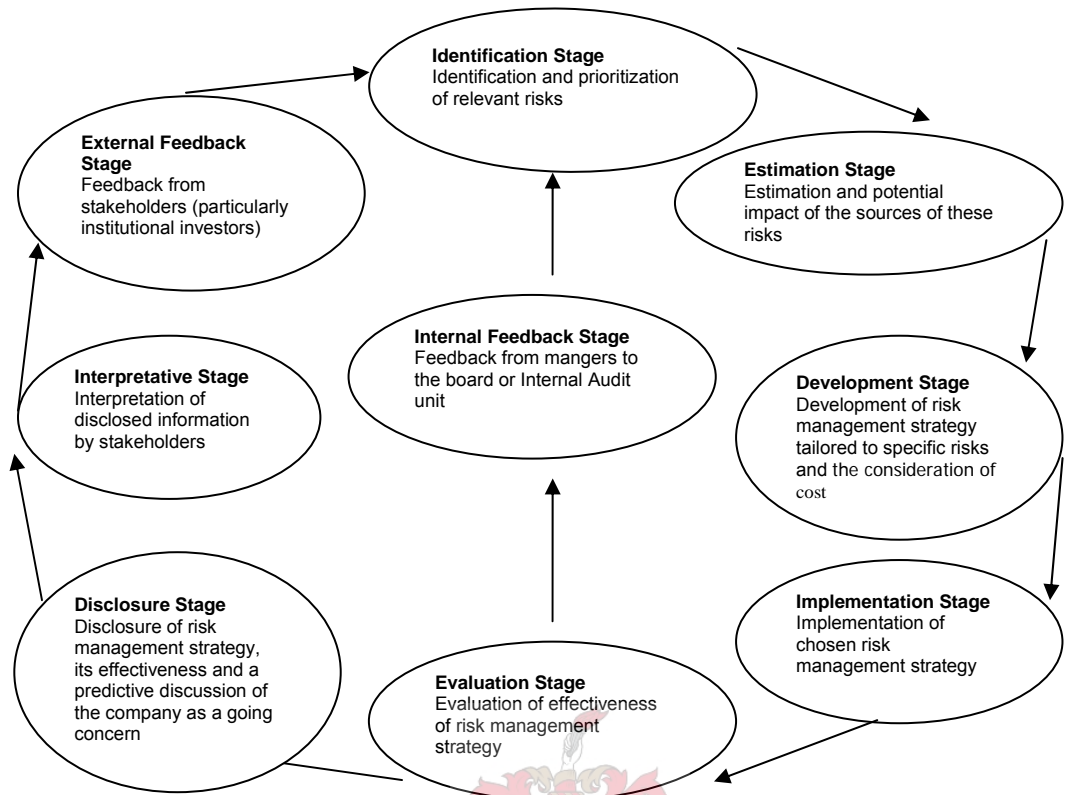


Figure 3: Turnball Internal Control Framework: Source: Solomon et al (2004) Corporate Governance and Accountability

The diagram by Solomon *et al* (2004: 126) indicates the interrelationships between the various stages of risk within the Turnball internal control framework towards improved corporate governance by making implicit risk disclosure explicit within an organisation. Similarly, interpretation of the IIA definition of internal control according Krogstad *et al* (1999) as cited in Spira and Page (2002: 651) found that the new definition recognises that controls do not exist in a vacuum but that their function is to assist organisations to manage its risk and to promote effective governance in the process.

2.5. Risk Management

Risk management is an integral component of good governance that underpins the organization's approaches to achieving both performance and conformance objectives. Barret (2004: 13) views risk management as involving the identification, analysis, treatment, monitoring and communicating of risks. In the

public sector, risks are generally taken to represent threats rather than opportunities. Risks are identified as events that may prevent the achievement of business objectives much more frequently than events that may provide the opportunity to achieve additional benefits.

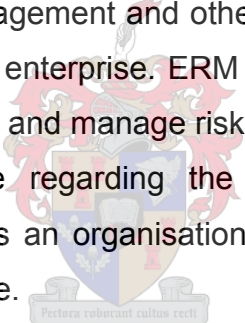
According to the King 2 (2002: 73) risk is defined as the uncertain events that could influence the achievement of an organisation's objective. This includes those risks that threaten strategic, operational, financial and compliance objectives. Risk is related to decision making and therefore to the governance. Similarly, Shaw (2003: 26) is of the opinion that governance is a process of decision-making under various degrees of certainty and uncertainty. Governance and decision-making are related to cause, risk, reward, effect and the outcome of a decision. In both the public sector and private sector there has been a convergence of risk and governance.

According to Barret (2004: 13) organisations in the public sector need to more frequently and comprehensively consider beneficial risks, as this would assist them to become less risk averse, and thereby enable them to more fully embrace the performance aspects of their conformance and performance objectives. Risk management is an essential element of sound management and governance practices. The COSO draft Enterprise Risk Management Framework (2003: 3) refers to risk management as a strategic process, affected by the organisation to identify potential events that can affect the organisation in order to give reasonable assurance that the organisation's objectives are met. It becomes more important as the public sector becomes more collaborative and networked with both the private sector and non-governmental organisations. An example of this type of risk is Public Private Partnerships.

The aim of risk management is to plan, organise and control activities and resources that can minimise the impact of uncertain events. It represents a strategic approach to risk that is particular to an organisation. According to Van der Westhuizen (2003: 3) management in an organisation would consider two

types of risks. Inherent risk is defined as the risk to an entity in the absence of any action management would have taken to alter the likelihood or impact. Residual risk is risk that remains after management responds to the risk. Risk management has become the mechanism to manage such risks so as to keep the negative consequences within acceptable bounds.

Fone and Young (2000: 33) suggest that the purpose of risk management is to develop a risk profile that best suits the organisation's goals and purpose. This view of these authors' moves away from the traditional conception that organisations should reduce risk. It is one dimensional and is limiting for organisations in today's globalised society. Similarly, the enterprise risk management as defined by COSO Enterprise-wide Risk Management Framework (ERM) argues that risk management is a process, effected by an entity's board of directors, management and other personnel, and is applied in a strategy setting and across the enterprise. ERM is designed to identify potential events that can affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievements of the entities objectives. Risk management is an organisation-wide function according to the views discovered in the literature.



According to Naidoo (2002: 12) risk management is an ongoing identification and evaluation of actual as well as potential risks and this is followed by a process of ongoing monitoring and managing the risk through a system of appropriate internal control. Furthermore, responsibility and accountability needs to be established for organisation-wide risks through identifying and assessing key and significant risks. These risks should be aligned to the business strategy of the organisation.

Risk management is not a single activity, but rather a series of activities that can be summarised as follows (National Treasury Draft Internal Audit Guidelines 2003: 3).

- Assessing, identifying, evaluating and monitoring or elimination of actual and potential risks that impede the achievement of the organisations goals;
- Risk management involves a process of accepting, reducing, mitigating or eliminating risks by implementing improved, appropriate internal controls that contribute to achieving the organisations objectives;
- Eliminating any management controls that no longer serve a risk function and inter alia affecting efficiency; and
- Identifying opportunities that may have been overlooked and considering exploitation of opportunities that were considered too risky previously.

Risk management is a proactive strategy of anticipating and enabling an organisation to achieve its strategic, operational, financial and compliance objectives. A differing argument by Spira and Page (2002: 644) is that the techniques and processes of risk management reduce accountability by masking responsibility, however within the debate of corporate governance, risk management as a strategy for meeting the demands of accountability. Furthermore, they argue that the evolution of risk management has been directly influenced by the phenomena of corporate governance.

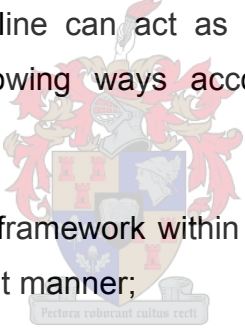
2.5.1. Risk Management in the Public Sector

According to Fone and Young (2000: 12) public risks are characterised as those pertaining to issues or processes that arise from the assertion of matters of public interest , those matters relating principally to the protection of rights, the balancing of interest, and the assurance of fairness in the political process. Risk in the public sector can be categorised as originating from various sources. They include the following environmental sources of risk:

- Physical environment: geological and climatic risks arise from the physical environment.
- Social environment: citizen's preferences, morals and values, and demographic factors can give rise to risks.

- Political environment: political institutions and decisions create responsibilities, interest and expectations which produce risks.
- Legal environment: the formalised legal system establishes rights and duties that create risk for organisations.
- Economic environment: while often influenced by the political, social and legal environment, the global economic system has a degree of independence that warrants separate analysis.
- Operational risks: the operational functioning of an organisation within the aforementioned environments influences this risk field.
- Cognitive risks: The management of organisations are influenced by information and its absence, attitude toward risk, misinformation and limitations as a result of competency levels

Risk management as a discipline can act as a value adding and pro-active management tool in the following ways according to the Sihulma Sonke Consortium (2004: 6):

- 
- The provision of a framework within which future activities can take place in a consistent manner;
 - Optimising operational efficiency;
 - Protect and enhance organisational assets;
 - Reduce volatility in service delivery;
 - Ensure more efficient resource allocation and utilisation;
 - Secure better understanding of service delivery activities, improved decision-making, planning and prioritisation of activities; and
 - Improve organisational knowledge base.

However, Van der Westhuizen (2003: 2) points out that enterprise risk management systems can only be as strong as the individuals who create, administer and monitor them in an organisation. Organisation risk management is a general management function that seeks to assess and addresses the causes and effects of uncertainty and risks on an organisation. According to

Fone and Young (2000: 41) the purpose of organisational risk management is to enable the entity to progress towards its goals in the effective, efficient and economic path. There are similarities between the ERM framework of COSO and the ORM framework as both models propose that risk management is an organisation wide function.

2.5.2. Internal Audit's Role in Organisational Risk Management

Internal Audit should assist management in identifying and evaluating significant risk and where appropriate provide the assurance as to the effectiveness of the related controls in place of the organisation. Internal Audit must evaluate the risk management strategy used by management to reduce the impact of threat. Hermansen and Rittenburg as cited in the IIA Research Opportunities in Internal Audit (2003: 35) regard the role of Internal Audit from a risk perspective as a monitoring function, but inclusive of all subsidiary steps of the identification, assessing the potential effect of risk, determination of the strategy, address the risk, monitoring the environment for new risk and the existing risk strategy and controls. In the aforementioned regard, Internal Audit plays a critical role in strategising towards developing new controls to mitigate risks in conjunction with management.

Risk management, which includes a related system of internal control, remains the responsibility of management within an organisation. This is clearly, alluded to in King 2 (2002: 75) where it is explained that management is accountable to the board for designing, implementing and monitoring the process of risk management and its integration into the day-to-day activities of an organisation. Internal Audit should be used to provide an independent assurance in relation to management's assertions surrounding the effectiveness of risk management and internal control. Similarly, the IIA (2003: 1) explains that Internal Auditing's core role with regard to Enterprise-wide Risk Management (ERM) is to provide objective assurance to the board on the effectiveness of the organisations ERM activities to help ensure key business risks are being managed appropriately and

that the system of internal control is operating effectively. The following table explains the various roles recommended by the IIA for Internal Audit in ERM.

Internal Audit Role In Enterprise-wide Risk Management (ERM)		
Core Internal Audit roles in regard to ERM	Legitimate Internal Audit roles with safeguards	Roles Internal Audit should not undertake
<ul style="list-style-type: none"> • Giving assurance on risk management processes. • Giving assurance that risks are correctly evaluated. • Evaluating risk management processes. • Evaluating the reporting of key risks. • Reviewing the management of key risks. 	<ul style="list-style-type: none"> • Facilitating the identification and evaluation of risks. • Coaching management in responding to risks. • Coordinating ERM activities. • Consolidating the reporting on risks. • Maintaining and developing the ERM framework. • Championing the establishment of ERM. • Developing risk management strategy for the approval of the board. 	<ul style="list-style-type: none"> • Setting the risk appetite. • Imposing risk management processes. • Management assurance on risks. • Taking decisions on risk responses. • Implementing risk response on management's behalf. • Accountability for risk management.

Table 1: Internal Audit Role In Enterprise-wide Risk Management (Source: www.theiia.org)

The table explains that Internal Audit's core role in relation to ERM should be to provide assurance to management and the board on the effectiveness of risk management. When Internal Audit extends its activities beyond the core role, it should apply certain safeguards. This includes treating the engagement as consulting services and applying all relevant International Standards for the Professional Practice of Internal Auditing. In that manner Internal Audit can protect its independence and objectivity as an assurance service.

2.6. Audit Committee

An audit committee can make an effective and valuable contribution to the process by which an organisation is directed and controlled. It is a fundamental component of the governance of public institutions. Sawyer *et al* (2003: 1323) explains that audit committees can assist their full board of directors in matters involving financial statements and control of financial operations. Furthermore, they strengthen the position of management by providing assurance that all steps have been taken to provide independent reviews of the management's financial policies and operations. The complete scope of the Audit Committees responsibilities is discussed in section 2.6.2.

2.6.1. The Role and Status of the Audit Committee

The audit committee has no executive status and acts in an advisory capacity to the Accounting Officer. It has non-executive powers and its responsibility toward the entity is to provide and make recommendations regarding their findings on any operational aspect of the management of a public sector institution. The Accounting Officer retains the responsibility for the implementation of such recommendations by the audit committee. Its role is that of an independent monitor of the activities within the entity.

A contractual agreement needs to be drawn up between all audit committee members and the entity. The audit committee according to the National Treasury Draft Guidelines on Internal Audit (2003: 26) should have the right to access records containing information needed to properly perform its duties and execute its powers, the right to seek independent advice and the power to investigate any matter within its ambit of its authority. The audit committee must have direct communication lines with the Accounting Officer, senior management, the relevant treasury and the Internal Auditors and external auditors.

2.6.2. Responsibilities of the Audit Committee

According to the National Treasury Draft Guidelines (2003) on Internal Audit, an audit committee should assist senior management in carrying out its oversight responsibilities in relation to the following functions within an organisation:

- Internal control: the audit committee should evaluate audit policies and its approval. The policies and procedures implemented by management with regard to internal control. Procedures with regard to financial reporting. The effectiveness and efficiency of Internal Audit function in respect of its audit approach, the quality of reports during the year, quality of personnel and the co-operation with external auditors. The satisfaction of management and the periodical review of the audit charter, Internal Audit budget and staffing, the compliance of the Internal Audit function with the Institute of Internal Auditors Standards for Professional Practice. The review and approval of the Internal Audit plan.
- Financial and other reporting practices: The audit committee has to assess the risk relating to financial reporting. Evaluate the adequacy of the accounting controls system by reviewing written reports from the Auditor General's office and monitor management's responses and actions to rectify noted deficiencies. Furthermore, the audit committee will review management's reports and cash flows, review and comment on the annual financial statements and annual reports.
- Compliance with laws, regulations and ethics: The most important contribution is to ensure ethical conduct in the interest of the organisational operations and its advocacy of high standard of behaviour.
- Other responsibilities: These include the identification of special projects or investigations deemed necessary. The receipt of reports relating to fraud and material irregularities and to ensure that appropriate action is taken to prevent a reoccurrence. Liaise or be represented on the risk management and fraud prevention committees.

According to Sawyer *et al* (2003: 1338) the monitoring function of the Audit Committee should go beyond a determination that Internal Auditors are performing reviews of financial and accounting records, reports and systems. It should monitor the organisational framework of the Internal Audit activity and its procedures in order to ensure a comprehensive scope. In terms of reporting relationship with the Internal Audit function, the head of Internal Auditing should have unrestricted access as this allows for independence in cases of fraud and misconduct involving senior management.

2.7. Summary

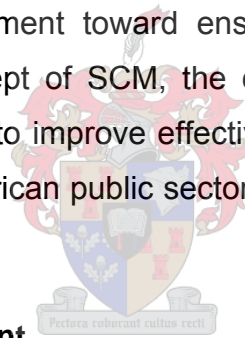
The role of the Internal Audit within the governance construct in organisations is to point out to management the weaknesses in the management arrangements and in their governance structures and to provide them with information on improved methods to consider in the development of best value and sustainability of services. Therefore, Internal Audit functions as an independent appraisal activity, which reviews operations as a service to the organisation by measuring and evaluating the adequacy of controls and the efficiency and effectiveness of performance. This makes Internal Auditors vital to matters related to organisational management and risk. The establishment of an audit committee, which acts as an independent oversight service to the organisation, further enhances its independence.

CHAPTER 3

SUPPLY CHAIN MANAGEMENT

3.1. Introduction

Supply Chain Management (SCM) is an integral part of procurement reform in South Africa. As an international commercial best practice, SCM has been adopted as a methodology of toward effective, efficient and economic use of public resources in South Africa. Furthermore, the construct of supply chain management is directly linked to preferential procurement for broad-based economic empowerment of the historically disadvantaged in South Africa. Both the concepts of SCM and empowerment are interlinked in the policy expressions by the South African Government toward ensuring a better life for all. This chapter will discuss the concept of SCM, the creation of value on the supply chain, and the agility required to improve effectiveness and the risks associated with SCM. Finally the South African public sector SCM context and its process of SCM will be explained.



3.2. Supply Chain Management

As globalisation increases, businesses are confronted with new strategies to improve their operational excellence, customer relations and supply chain integration. Corporations have increasingly turned to global sources for their supplies. Globalisation has resulted in corporations looking for more effective ways of co-ordinating the flow of materials into and out of the corporation. Continuous competition exists based for distribution channels that are competitive, timely and of high quality. A requirement today is defect free product that gets to the client faster and reliably. This is a competitive advantage in today's market as customers demand faster, timely and high quality products. This would require a closer coordination with supplier and distributors.

According to Nix (as cited in Mentzer *et al* 2001: 4) the global orientation and increased performance based competition combined with rapidly changing technology and economic conditions all contribute to marketplace uncertainty. Furthermore, this uncertainty requires greater flexibility on the part of individual companies and distribution channels, which in turn demands more flexibility in channel relationships. The aforementioned factors have made SCM important to organisation.

Chopra and Meindel (2001: 3) argue that a supply chain consists of all stages involved, directly or indirectly, in fulfilling a customer request. This not only includes the manufacturer and suppliers, but also transporters, warehouses, retailers and customers. Turban *et al* (2003: 242) explains that the goal of SCM is to reduce the uncertainty and risks in the supply chain, thereby positively affecting the inventory levels, cycle time, and business processes and customers services.

According to Pinkerton as cited in Burt *et al* (2003:Foreword) SCM has evolved from a passive-reactive purchasing function which was focused on paper trails and inward orientation, to a proactive strategic supply chain concept which integrates the supply functions over the entire distribution channel. Changes in the supply chains are transforming the design and structure of organisations.

3.2.1. Prerequisites for Supply Chain Management

Senior management within organisations must realise that a supply chain is much bigger than procurement and logistics. It is an entire new way of thinking and organising the total life cycle from raw materials to use in the final product or service by the ultimate user or consumer. Similarly, the Harvard Business Review Spotlight for October 2004 (2004: 100) is of the opinion that senior manager's agenda for the 21st century is being shaped by the concept of supply chain management. According to Pinkerton (as cited in Burt *et al* 2003: Foreword) the following is required to be in place in order to implement the supply chain concept:

- Understanding of senior management and commitment: Supply chain management is driven from the top of an organisation.
- The quest for excellence: Organisations who embrace continuous improvement in quality, service and personnel effort.
- Effective and efficient communications.
- Relationships instead of exchanges: A relationship requires partners involved to commit and trust each other rather than a vertical relationship.
- Cross functional teams.
- Teams, partnership and alliances.

The concept of relationship building within a SCM framework is vital as it moves from a vertical relationship to a horizontal form of relationship. SCM in terms of the requirements of Burt *et al* (2003) has common parlance with Wind and Main's (1998) idea of establishing high performance organisations as discussed in Chapter 1.

3.2.2. Components of the Supply Chain

Mentzer *et al* (2001: 8) explains that the objective of SCM is to integrate and manage the sourcing, flow, and control of materials using a total system perspective across multiple functions and multiple tiers of suppliers. Turban *et al* (2003: 243) suggests that the supply chain consists of three parts:

- Upstream supply chain: This part includes the organisation's first tier suppliers and their suppliers.
- Internal supply chain: This is the process inside the organisation that transforms the upstream supply into outputs, from the time the material enters the organisation until it is distributed outside the organisation as a product or service.
- Downstream supply chain: This involves delivering the final product to the customer

The supply chain is more than just the movement of intangible inputs, since it includes the movement of information and money and the procedures that support the movement of a product of the chain as well. The success of the supply chain is interlinked with the value creation on that supply chain.

3.2.3. Value Creation on the Supply Chain

SCM is about competing on value, collaborating with customers and suppliers to create a position of strength in the marketplace based on the value, which is delivered to the end consumer. Therefore, the objective of supply chain management is to ensure an increase in the competitive advantage of the whole supply chain, rather than to increase advantage for an individual organisation. Walters and Lancaster (2000: 178) define “*supply chain management as the interface of relationships among key stakeholders and enterprise functions that occur in the maximization of value creation*”. This is driven by customer needs satisfaction and facilitated by efficient logistics management and the management of activities and costs occurring within the supply chain. This definition explains that the supply chain as a whole can be considered a complete value system for delivering products and services to the end customer.

According Slater and Naver, Woodruff, Locander, Barnaby and Nix (as cited in Mentzer 2001: 65) by understanding the entire supply chain the organisation can identify and deliver value that improves the competitiveness on the entire supply chain. In improving the efficiency or effectiveness of a product or service, customer value is created that is superior to ones competitors and enhances customer satisfaction. Furthermore, value is created at different points on the supply chain in making the organisation at the first tier or upstream more effective in serving its markets, or more effective or cost effective in its operations.

3.2.3.1. Value Chain

In understanding the entire supply chain, key areas can be identified to adding value to a product or a service that is important to the customer and how it matches to the individual organisation's capability of achieving that customer satisfaction. The Porter Value Chain Model brings all the organisational activities that work together toward producing a product or a service. The value chain is a tool to disaggregate a business into strategically relevant activities. Its value chain is part of a larger stream of activities carried out by other members of the channel-suppliers, distributors and customers (Walters and Lancaster: 2000: 160). Similarly, the White Paper on the Management of Provincial Property (2004: 6) argues that a value chain is a number entities working together to satisfy market demands, while managing the value chain entails maximising total performance and added value across an entire process by reviewing all internal and external operations including the links between them.

Berndt (2003: 3-4) explains that the value chain becomes important for a number of reasons. Firstly, the value chain gives strategic direction in organisations as they derive value proposition and mission from the value chain. Secondly, the value chain enables the organisation to identify the key components that would give a competitive edge in the market place. Thirdly, it enables organisations to focus on activities that add value by identifying the core activities and outsourcing the balance to other parties to focus on.

Burt *et al* (2003: 28) argued that a world class organisation expects their supply management function to focus on five value-adding outputs of proactive procurement or supply management:

- Quality: The quality of purchased materials and services should be defect free;
- Cost: The focus of supply management must be on strategic cost management;

- Time: The supply management function and its outside suppliers must play active roles in reducing the time required to bring new products on the market;
- Technology: Two responsibilities are key to this area. One, organisations should ensure that their supply base provides appropriate technology in a timely manner. Secondly, the technology must be aligned to the core competencies of the organisation and carefully controlled when dealing with outside suppliers; and
- Continuity of supply: Supply trends must be monitored, appropriate supplier relationships must be developed and mitigating the risk of supply chain disruptions by taking action.

An important concept in the value chain is the value proposition. The value proposition is a statement of how value is to be delivered to customers (Walters and Lancaster 2000: 160, Berndt 2003: 3). It is important both internally and externally to the organization. Internally it identifies the value drivers that it is attempting to offer a target customer group and the activities involved in producing the value together with the cost drivers involved in the value-producing activities. It functions as a primary organising principle externally.

In the public sector value is perceived differently. This is because the notion of value proposition according to Niven (2002: 299) is often new to the public sector agencies that are more accustomed to simply meeting budgets and not creating any significant control issues. Furthermore, Niven suggests that public sector agencies do not only have to depend on operational excellence propositions, but with vision and captivating leadership customer intimacy can be developed or a new product developed.

Value chain management according to Lancaster and Walters (2000: 178) is about coordinating management process in which all of the activities including the suppliers involved in delivering customer value satisfaction are integrated such a way that the customer satisfaction is maximised and the objectives of the

stakeholders involved are optimised such that no preferable solution may be found. Successful value chain management needs to identify the customer value criteria and understand the key success factors which are necessary for creating both a competitive advantage and resultant success. Therefore, Walters and Lancaster argue that the value chain is managed by two principle processes in the supply chain, namely relationship management and information management and the success of the value chain operationally is dependant on these functions. The SCM concept requires a balanced emphasis by an organisation and this needs strategic planning driven toward a macro conception by the top management of an organisation in order to add value. In the opinion of the author, value can only be added on the supply chain if the ultimate customer perceives that value is created in terms of the end product. Similarly, Svensson (2003: 394) argues that nothing in the value chain attains value in a supply chain context until it reaches the ultimate customer. The supply chain and logistics management are functions that are supporting activities in the overall value chain.

3.2.4. Information Chain on the Supply Chain

A key aspect of SCM is the ability to make strategic decisions based on accurate data quickly; this requires an efficient and an effective information system. The sharing of information is important when integrating the supply chain. This leads to the conclusion that it plays a critical role in an effective and efficient supply chain. Spekman and Davis (2004: 415) concur by arguing that the extended enterprise is linked to the idea of the learning organisation, in which knowledge becomes the currency of exchange.

SCM is about sharing information in order to benefit all members of the supply chain. Withholding information from other supply chain members prohibits supply chain wide learning. Nix (as cited in Mentzer *et al* 2000: 312) argued that a functional integrated supply chain is required to develop information systems that manage the product flow, information flow and cash flow from end to end on the

supply chain. In sharing electronic information, it facilitates collaborative planning, which allows organisations to co-ordinate production with demand, reduce inventory and cycle times, manage logistics better, improve customer satisfaction and reduce their overall cost.

Within a supply chain it is necessary for suppliers, customers and the third party providers to share information and plans to ensure a more effective, efficient and competitive channel. Chandra and Kumar (2000: 106) similarly argue that relationships built on the exchange of information lead to a successful customer vendor relationship. Information systems provide organisations with the agility and flexibility to survive but also to be responsive to create efficiency.

3.2.5. Agile Supply Chain Management

According to Lee (2004: 102) organisations that create successful supply chains respond to sudden and unexpected market changes. Furthermore, in a rapidly changing environment most supply chains cope by playing off speed against the actual costs. The organisation that is agile can respond to these changes quickly and cost effectively. Similarly, Chandra and Kumar (2000: 101) explain that a flexible organisation is an important attribute for a supplier from the perspective that the organisation that supports plant and distribution networks can achieve operational efficiency through quick line changeovers, and savings by avoiding back hauling and enhanced product realisation. A reason for the breakdown of an efficient supply chain according to Lee (2004: 104) is that the supply chain becomes uncompetitive, as they cannot adapt to the changes in the market place.

Lee (2004: 105) further argues that there are three criteria essential for a successful supply chain management system. This will be illustrated in the table below.

Agility	Adaptability	Alignment
Objectives: Respond to short-term changes in demand or supply quickly, handle external disruptions smoothly	Objectives: Adjust supply chain design to meet structural shifts in markets, modify supply networks to strategies, products, and technologies	Objectives: Create incentives for better performance
Methods: <ul style="list-style-type: none"> • Promote flow of information with suppliers and customers • Develop collaborative relationships with suppliers • Design for postponement • Build inventory buffers by maintaining a stockpile of inexpensive but key components • Have a dependable logistics system or partners • Draw up contingency plans and develop crisis management teams 	Methods: <ul style="list-style-type: none"> • Monitor the economies all over the world to spot new supply bases and markets • Use intermediaries to develop fresh suppliers and logistics infrastructure • Evaluate needs of ultimate consumers-not just immediate customers • Create flexible product designs • Determine where companies' products stand in terms of technology cycles and product life cycles. 	Methods: <ul style="list-style-type: none"> • Exchange information and knowledge freely with vendors and customers • Lay down roles, tasks and responsibilities clearly for suppliers and customers. • Equitable share of the risks ,costs and the gains of improvement initiatives

Table 2: Agile Supply Chain Management: (Source: Harvard Business Review October 2004)

The three criteria as proposed by Lee (2004: 102-113) do not require further technological and capital investment. It requires organisations to change the attitudes and adopt a new culture by only concentrating on efficiency which can be counterproductive. Organisations must be prepared to continuously change networks and take responsibility for the entire chain rather than emphasising self-interest.

This approach toward SCM as proposed by Lee (2004: 102-113) has common parlance with the concept of agile governments. According to www.atkearney.com as a strategy, governmental institutions must anticipate the needs of citizens and business to understand their effect on policy decisions and operations. They should adapt to changes and align political, human, technological and organizational resources to act flexibility and decisively to ensure that intended objectives materialise. Furthermore they are required to

accelerate these processes by instilling the ability to adapt and anticipate new ways of doing business and to closely monitor how these strategies are driving the dynamics of agility.

3.2.6. Supply Chain Risk Management

Zsidisin (2003) explains that risk in a supply chain management context is related to the potential occurrence of an incidence associated with inbound supply which results in the inability of the purchasing organisation to meet the customer demand. However, according to Spekman and Davis (2004: 415) this definition focuses on the traditional view of supply chains with the emphasis on the physical movement of goods.

Spekman and Davis (2004: 415-416) further propose five other types of risks associated with supply chain management:

- The flow of information;
- Risk related to the flow of monies on the supply chain such as stable pricing, timely payments of bills;
- The security of internal information systems where access to that information and the risk associated with sharing information outside of the organisations on the supply chain;
- Risk associated with relationships forged on the supply chain. Here as a result of interdependence amongst partners, individual members of the supply chain can engage in activities that can be detrimental to the supply chain members; and
- Corporate social responsibility and the extent to which other supply chain member's reputation can be tainted by actions of another member who engages in activities that can cause liability along the supply chain.

The management of supply chain risks is much broader. Normal practice would be to use measures such as buffer stocks, improving inventory management or using alternate sources of supply. The underlying source to supply chain risk is the choice of a partner. According to Spekman and Davis (2004: 423) these risks

as mentioned above can be mitigated through development programs. The intention with certification and development programs is to improve the performance of suppliers in achieving a level of performance that supports and aligns the processes and goals with the buying firm that initiated the program. The concept of value proposition as discussed earlier relates to the selection of a supply chain partner. Members of a supply chain should be chosen not only for the effectiveness and reduction of costs but for the value they add. Development programs have an empowerment notion and in the context of the South African supply chain initiative, development programs have relevance.

3.3. Supply Chain Management in the South African Public Sector

According to Fortin *et al* (2000: Introduction) contracting, along with privatization and deregulation, constitutes a determinant element in major public sector reforms in which the primary objective of this type of reform is to re-ignite the economy by enabling the private sector to better cope with domestic and international pressures under optimal conditions. Government like the private sector is often faced with making a choice as to whether to manufacture or provide the service themselves or to outsource the function to an outside vendor. This decision is usually made on the basis of a cost benefit analysis as it would not be cost effective to manufacture or provide the service themselves.

Government as the largest buyer in the country is responsible for ensuring that the procurement policy supports and attains its overall economic objectives. Visser and Erasmus (2002: 148) argue that a key element in government employment creation and income generation strategy is the promotion of small, medium, and micro enterprises. This was in direct response to the tender system which favoured larger, established business which made entry for new businesses into the tendering system difficult. Similarly, Devries (as cited in Buthelezi and Le Roux (2002: 17) argued that state procurement policy is an important instrument to leverage government expenditure in order to meet socio-economic goals.

Procurement reforms in South Africa were supported by the introduction of number legislative measures, which include the PFMA and the PPPFA discussed in Chapter 1. According to Bayat *et al* (2004: 2) a uniformed implementation approach to procurement was required as studies such as the Report on Opportunities for Reform of Government Procurement in South Africa (2000) and Joint Country Assessment Review (CPAR) conducted by the World Bank during 2001/2002 indicated that there were divergent interpretations of government's objectives and strategies. The difficulties highlighted were that there were inadequate provisions for capacity building for disadvantaged enterprises to successfully compete for government contracts. Furthermore, preferential procurement policies have not been clearly formulated and targets are not set for the introduction of sunset and graduation provisions once targets have been achieved. The performance of these initiatives did not take place in a holistic evaluation environment.

The introduction of an integrated Supply Chain Management Function (SCMF) intends to address the division between the current outdated provisioning and procurement process in government which causes the present system to be inefficient in its methods of procurement, contract management, assets control and obsolescence planning. The SCMF is an attempt by government to leverage its resources to draw disadvantaged communities into the economy of South Africa and to ensure governance principles are applied.

In the opinion of the author the SCMF gives effect to efficiency, effectiveness, economic use of resources and equity. Similarly, Pauw *et al* (2002: 242) argue that equity is more than numerical equality. It relates to the exclusion of the majority of South African citizens who did not benefit from economic resources of the country. Therefore, policy expressions such as the PPPFA enable Government to purchase public goods and services in a way that eradicates inequity and establishes economic empowerment.

3.3.1. Empowerment

The legal and institutional framework inherited by the African National Congress (ANC) government was fragmented and inappropriate for the reconstruction and development of the broader South African society as it lacked the capacity to deliver services in an efficient, effective, economic and equitable manner. The Reconstruction and Development Programme of 1994 speaks of empowerment of as meaning the political enfranchisement of all South African's inclusive of extension of equal citizenship in all aspects of the socio-economy. Similarly, the UNDP explains that empowerment is related to the "*expansion of people's capacities and choices; their ability to exercise choice based on freedom from hunger, want and deprivation, and the opportunity to participate in, or endorse, decision-making that affects their lives*". In the opinion of the author empowerment goes beyond those previously disenfranchised to including the empowerment of the public institutions who act as the mechanism of service delivery. According to Mokgoro as cited in Meyer *et al* (1995: 88) it does not matter how well policies are developed, unless effective institutional mechanisms are put in place to implement these policies, no meaningful development can take place. Empowerment in the South African context is political, technical and institutional.

According to Cook as cited in Fitzgerald *et al* (1997: 282) empowerment of people is a prerequisite in the development of people to be sustainable. Therefore, the application of the concept of empowerment cuts across those who receive services from public institutions to those who ensure the delivery of those services. Empowerment has a clear connotation with the word power. Therefore, empowering people according to Cook as cited in Fitzgerald *et al* (1997: 283) operates at three levels, namely:

- Level one: The empowerment of the individual in an absolute sense where individuals are able to direct their lives and are more likely to succeed.

This happens in the training of individuals to improve their skills in order to move ahead.

- Level two: People can be empowered by their relations with specific people. Mentors and personal coaches are appointed to ensure that their protégés advance further and quicker than others.
- Level three: Empowerment can happen in a context of one group relative to another. Affirmative action is an example where a group previously excluded from the mainstream of society is favoured in relation to another group who benefited from their exclusion.

According to Fetterman (2003: 1-3) the empowerment processes are processes in which attempts are made to gain control, obtain needed resources, and critically understand the social environment. The process is empowering if it helps people develop skills so they can become independent problem solvers and decision-makers. Empowering processes will vary across levels of analysis. For example, empowering processes for individuals might include organisational or community involvement; empowering processes at the organisational level might include shared leadership and decision-making; and empowering processes at the community level might include accessible government, media, and other community resources.

Fetterman argues that empowered outcomes refer to the operationalisation of empowerment so we can evaluate the consequences of citizen attempts to gain greater control in their community or the effects of interventions designed to empower participants. Empowered outcomes also differ across levels of analysis. When we are concerned with individuals, outcomes might include situation specific perceived control, skills, and proactive behaviours. When we are studying organisations, outcomes might include organisational networks, effective resource acquisition, and policy leverage. When we are concerned with community level empowerment, outcomes might include evidence of pluralism, the existence of organizational coalitions, and accessible community resources.

Both the concepts of empowerment processes and empowerment outcomes as enunciated by Fetterman have a direct relevance to the SCMF broad policy focus of preferential procurement towards socio-economic empowerment of the previously disadvantaged. It becomes important that the empowerment levels achieved are measured and that the evaluation process of these initiatives are a co-operative venture between individuals and public sector institutions.

3.3.2. Black Economic Empowerment

The vision of the economy is to meet the needs of society in a more equitable manner and was encapsulated as far back as the ANC's Freedom Charter of 1955. It was redefined with the Reconstruction and Development Programme (1994) and subsequent to that the South African government has outlined broad economic strategies to transform the economy by 2014.

The Black Economic Empowerment Commission (BEEcom) was established in May 1998 under the auspices of the Black Business Council, an umbrella body representing 11 black business organizations. The Commission conducted extensive research and embarked on wide-ranging consultations. A consultative conference was held on 30 September 2000. A definition on Black Economic Empowerment (BEE) was adopted at this conference by the delegates as part of a report. The BEEcom definition states that "*BEE is an integrated and coherent socio-economic process, which is located within the context of the country's national transformation programme, namely the RDP..... Furthermore, it is aimed at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa's financial and economic resources to the majority of its citizens.....It seeks to ensure broader and meaningful participation in the economy by black people in order to achieve sustainable development and prosperity*".

The definition as used by the South African Government in the Department of Trade and Industries Strategy for Black Economic Empowerment (2003: 15) defines BEE as an integrated and coherent socio-economic process that directly

contributes to economic transformation of South Africa and brings about significant increases in the numbers of black people that manage, own and control the country's economy, as well as significant decreases in income equalities. From this definition the process of BEE will include elements of human resource development, employment equity, enterprise development, preferential procurement, investment, ownership and control of enterprises and economic assets. However, this definition of BEE is considered as narrower than that of the BEEcom according to Bukula (2004: 17). It consolidates the work and progress made by the BEEcom and follows a strategy of core components being:

- Direct empowerment through ownership and control of enterprises and assets;
- Human resource development and employment equity; and
- Indirect empowerment through preferential procurement and enterprise development.

This strategy would introduce a balanced scorecard as a key measuring tool of empowerment progress in relation to the three key performance areas. Loyiso Mbabane former executive director of the BEE Commission has criticised the use of a performance measurement tool. His position was that it can lead to a reductionist and quantitative approach in its application because of the system used in scoring BEE (Bakula 2004: 18).

According to Bukula (2004: 18) questions were raised at the BMF symposium held in August 2003 about the effectiveness of this scorecard. At this conference it was pointed out that the monitoring and evaluation is much broader and that there a number of variables to consider. Furthermore, there are no clear institutional responsibilities and parameters which measure the three variables as eluded by the BEE strategy of 2003. The concept of BEE is broad and can be interpreted in a narrow manner. Similarly, Edigheji (2000: 3) argues that the concept of BEE has been used to cover a wide range issues as mentioned in the previous definition. Therefore, the South African government's strategy for BEE

endeavours to look beyond the redress of past imbalances to situating BEE as a mechanism to broaden the economic base and accelerate growth, job creation and poverty alleviation.

3.3.3. Procurement Strategies Towards Black Economic Empowerment

According to Bayat *et al* (2004: 5) the South African Government has initiated a number of strategies over a broad front to ensure structural change in the economy. The extent to which black people benefit is a fundamental criterion of operation and success of government programs. Actions and policies that will effect black economic empowerment will impact all spheres of society and the economy. In this context the supply chain management activities of government have a major role to play as a collective instrument of policy. It integrates a number of policy expressions by government to ensuring broad based black economic empowerment.

According to Devries (as cited in Buthelezi and Le Roux 2002: 7) South Africa as an emerging market has the unique responsibility of building an economically and politically stable environment through sustainable entrepreneurship. In the South African context entrepreneurship should not be viewed in terms of production but from a socio-political perspective. This can advance and enhance the economic empowerment project in South Africa as a key factor toward the transition of the economy.

Devries (2002: 9) explains that government is often the biggest buyer of goods and services in the market and would effectively influence the activities of entrepreneurs in society. In that sense the supply chain management framework acts as a broad catalyst in which effectiveness, efficiency, economic use of resources and equity can be achieved toward empowerment and sustainability of entrepreneurs. However, it is important to evaluate the achievement of empowerment policy expressions of the South African government. The direct

monitoring of procurement reform within public sector institutions and its expected proximal and distal outcomes needs to be evaluated.

3.3.4. Supply Chain Management as a Process

The management philosophy of SCM calls for organisations to go beyond traditional functional silos to include cross-functional disciplines and external entities, such as customers and suppliers. According to the Policy Guideline for the Issuance of Supply Chain Management Framework in terms of Section 76 (4) (c) of the PFMA by the National Treasury (2002:9) SCM is integral to financial management as it seeks to breach the gap between traditional methods of procuring goods and services and the balance of the supply chain and simultaneously addressing procurement issues of strategic importance. The process of SCM has four functional areas, namely; demand management, acquisition management, logistics management and disposal management.

3.3.4.1. Demand Management

According to Burt *et al* (2003: 625) the practice of demand management seeks to estimate, control, smooth, coordinate and influence the demand and supply for an organisations products and services in an effort to reduce total costs for the organization and its supply chain. Demand Management is an essential discipline in developing best practice within SCM. It is a stage where research and planning takes place. According to the Policy Guideline for the Issuance SCM Framework in terms of Section 76(4) (c) of the PFMA (2002:11) demand management is first stage in the SCM process whereby a needs assessment is determined and the following functions should take place:

- Understanding future needs;
- Identifying critical delivery dates;
- The frequency of the need;
- Linking the requirement to the budget;
- Completing an expenditure analysis based on past expenditure;

- Determining the specifications;
- Completing a commodity analysis (checking for alternatives); and
- Completing an industry analysis

The Pro Active Public Service College (2005:48) explains that demand management is a cross functional exercise with the goal of ensuring that resources that are required to fulfill the needs identified in the strategic plan of an organisation are delivered at the correct time, price and place and that quantity and quality will satisfy those needs. Demand management has a primary role in coordinating demand between the buying and supplying firm. This requires open, honest, trusting and collaborative relationships between customers and suppliers throughout the supply chain. According to Burt *et al* (2003: 632) demand management requires a shift in focus from component or commodity level planning to a strategic product level planning to become relevant in the management of the supply chain.

3.3.4.2. Acquisition Management

Acquisition management or procurement strategies can be defined as a plan of action with the objective of supplying goods and services by efficiently applying resources in a manner that would ensure that the purchasing objectives are met and opportunities are utilised by making use of the competitiveness of the market and minimising risks.

The Policy Guideline for the Issuance SCM Framework in terms of Section 76(4) (c) of the PFMA (2002:11) explains that acquisition management is the stage where:

- The preferential policy objectives are identified that could be met through a specific contract;
- The strategy of how the market is to be approached is determined;
- Depreciation rates and total cost of ownership principles are applied, e.g. life cycle cost;

- The bid document would be compiled, attaching all necessary required documents and conditions;
- The bid evaluation criteria is determined;
- Bids would be evaluated and recommendations tabled;
- Contract documents are compiled and signed;
- Contract administration is done; and
- Contract information is used to kick-start the logistics management process

According to the Pro-Active Public Service College (2004:306) government acquisition rests upon the five pillars of acquisition to be successful. These pillars are:

- Value for money: Best value means the best available outcome when all relevant costs and benefits over the acquisition period is considered;
- Open and effective competition: Effort and research need to be applied to ensure the best possible outcome from the suppliers and the market;
- Ethics and fair dealings: All government staff associated with acquisition must comply with high ethical standards;
- Accountability and reporting: Individuals and organisations are answerable for the plans, actions and outcomes; and
- Equity: The application and observance of government policies that are designed to enhance persons or categories of persons from disadvantaged by unfair discrimination.

Acquisition management is critical to SCM process as it involves the direct contact with the private sector partners.

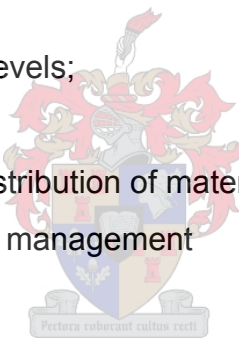
3.3.4.3. Logistic Management and Disposal Management

According to Burt *et al* (2003:634) logistic management deals with the handling, movement and the storage activities within the supply chain, beginning with suppliers and ending with the customer. Logistics is an integral part of the SCM

process that plans, implements, and controls the efficient, effective flow and storage of goods and services, and related information from point of origin to point of consumption for the purpose of conforming to customer requirements. Similarly, the Council for Logistics Management as cited in Mentzer *et al* (2004:1) explains that logistics management is that part of SCM that plans, implements, and controls the efficient, effective forward and reverse flow and storage of goods, services, and related information between the point of origin and the point of consumption in order to meet customer needs.

In the process of logistic management the following functions are performed according to the Policy Guideline for the Issuance SCM Framework in terms of Section 76(4) (c) of the PFMA (2002: 12):

- Coding of items;
- Setting of inventory levels;
- Placing of orders
- Receiving and the distribution of material;
- Stores or warehouse management
- Expediting orders;
- Transport management; and
- Vendor performance



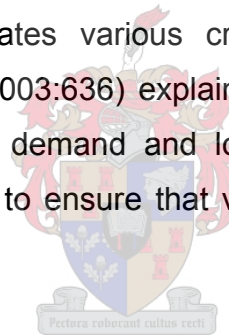
Logistic activities and processes must be integrated into the strategic level thinking and planning of an organisation. Burt *et al* (2003:636) explains that all organisational functions should integrate to ensure a successful supply chain. However, as a result of this lack of collaboration of between logistics and supply management it will affect the efficiency and effectiveness of organisations.

3.3.4.4. Disposal Management

This is the final process when an institution does away with unserviceable, redundant assets. The Policy Guideline for the Issuance SCM Framework in terms of Section 76(4) (c) of the PFMA (2002:12) suggests the following takes place at this stage in the supply chain.

- Obsolescence planning or depreciation rates per item requires to be calculated;
- A data base of all redundant material is kept;
- Material is inspected for potential re-use;
- A strategy must be determined of how items should be disposed of; and
- The physical disposal should take place

SCM as a process incorporates various cross-functional competencies as discussed above. Burt *et al* (2003:636) explains that by integrating the various functional disciplines such as demand and logistics management an optimal supply chain can be achieved to ensure that value is added across the supply chain.



3.4. Summary

Supply chain management calls for organisations involved to go beyond traditional functional silos to include cross-functional disciplines and external entities which include customers and suppliers. In effect this requires of supply chain managers in organisations to become pro-active in developing competencies resident in other functional disciplines. Similarly, the Internal Auditor within an organisation has to develop competencies outside of their traditional functional disciplines especially in the public service.

The role of managers in the supply chain within the South African public sector context becomes even more dynamic as the supply chain construct has direct implications for BEE both in terms direct and indirect empowerment. According to Burger (2004:3) the benefit of linking empowerment to SCM, is that not only is

the scope of empowerment opportunities expanded, but that the processes and activities it encapsulates are also identified and analysed in order to ensure that the often subtle inherent impediments to empowerment are eliminated from such processes and activities. These include spatial and social arrangements and legacies in society, and sometimes even in families and households.



CHAPTER 4

The Case Study: Westerns Cape Education Department's Learner Transport Service

4.1. Introduction

The Learner Transport Service (LTS) is an initiative by the WCED to provide transport to needy learners in the Western Cape who attend public schools. This research topic was chosen for a number of reasons. Firstly, the LTS is the second largest expenditure item in the WCED other than personnel expenditure and has had significant growth in terms of expenditure allocation over the last eight years. Secondly, regulatory audit reports by the office of the Auditor-General and the Performance Audit Report (PR 188/2003) on the LTS in October 2003 indicated irregularities. Finally, as it operates within the SCM construct of Government and provides an ideal case for exploring governance and supply chain management at operational level. The study proposes to research how Internal Audit plays an active role toward measuring the proximal and distal outcomes as an independent operational function in the WCED of the broader contextual construct of SCM in South Africa as discussed in the previous chapter.

4.2. Background

The LTS originates from the previous House of Representatives (HOR): Administration of Coloured Affairs. The LTS was carried over into the services of the WCED after the amalgamation of the various Education Departments in the Western Cape in 1995. The LTS by default became a preferential procurement initiative as the majority of its contractors were historically disadvantaged individuals (HDI).

The case study is an example of a procurement initiative which underperformed in terms of the objectives as set out by the WCED strategic plans. This lack of performance has been documented in the Auditor-Generals Performance Audit

Report (PR 188/2003) of October 2003 and annual reports of Auditor-General to the Provincial Parliament for the financial years 2001/2002 and 2002/2003. The details of these documented findings are discussed further in the chapter. At the time writing the report has not been tabled for comment with the Standing Committee on Public Accounts of the Western Cape Legislature.

According to Guam (WCED Online, 2002: 1) the former MEC of Education for the Western Cape, the WCED provides learners in poor communities who live more than five kilometers with transport to the nearest school in order to guarantee access to schooling. This transport service is provided free for eligible learners in the Western Cape. Furthermore, the LTS provides transport predominantly in rural education in the Western Cape. Currently the total amount of learners transported in the rural areas makes up 83% of this service offered by the WCED. The transport of learners is in line with the constitutional obligation as prescribed in section 29 (1) (a) and (b) of the Constitution, 1996. Section 29 (1) (a) states that: *“Everyone has the right to education...”* Furthermore, in the opinion of the author, the LTS allows the WCED to comply with section 29 (1) (b) of the Constitution. This section states: *“That to further education, which the state, through reasonable measures, must make education progressively available and accessible.”* The transport of learners can be considered as being that reasonable measure which ensures that these needy children receive an education.

Section 195 of the (1) (a-i) of Constitution, 1996 is applicable to this particular service. This section of the Constitution enumerates the basic values and principles governing public administration. According to Devenish (1998: 264) in terms of section 195, the public administration must be governed by, inter alia, the democratic values and the cognate principles of transparency and efficiency enshrined in the Constitution. The context of LTS is about the delivery of public services which are enshrined in governance values and are inseparable from the constitutional arrangements in which they are embedded.

4.2.1. Financial Expenditure of the LTS

Currently the WCED has contracted 435 service providers to service 51511 children using this service. The following graph illustrates the expenditure over the Medium Term Expenditure Framework period for the last four financial years.

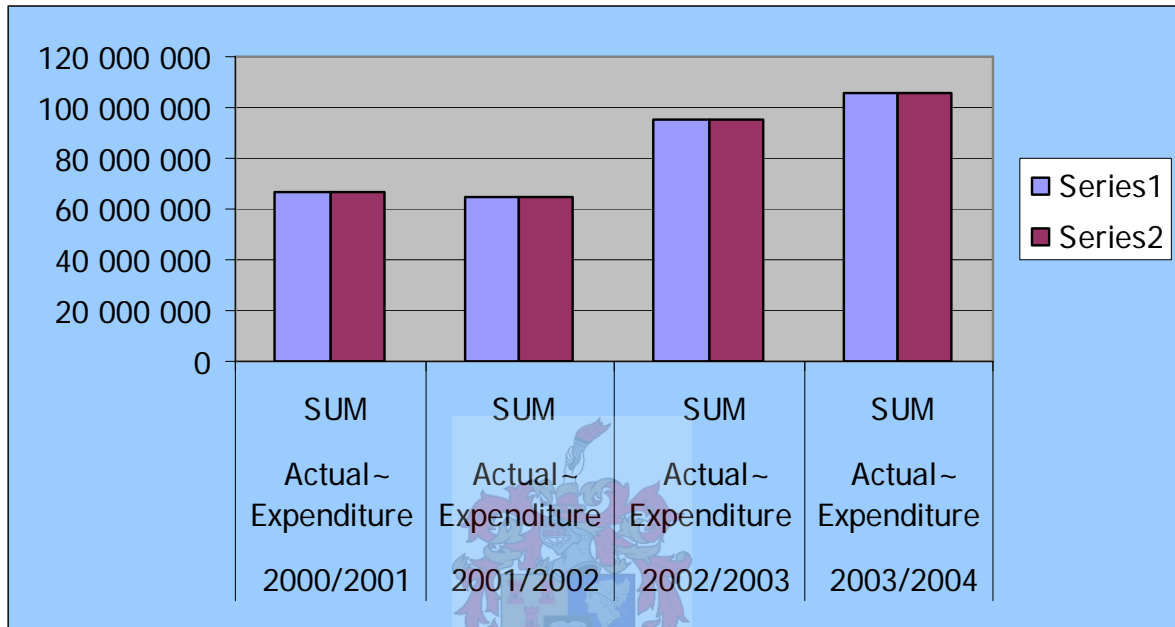


Figure 4: Learner Transport Service MTEF 2000/01-2003/04 Source: WCED Budget Directorate

This scheme is the second largest expenditure item outside of personnel expenditure which makes up 90% of the budget. As alluded to earlier, the increase in expenditure for LTS has been significant and whilst audits have been conducted both by the Office of the Auditor-General and a subsequent internal investigation by the WCED themselves. The impact in respect of the broader notion as expressed by SCMF and service delivery for pro-poor development has not been evaluated for this initiative.

It should however be noted that this amount is not static and there is continuous inflow of new applications and cancellations. The budgeted amount for the financial year 2003/2004 was R110 094 million but actual expenditure was R105

297 284. The chart below indicates the expenditure pattern until November 2004 for the current financial year of 2004/05.

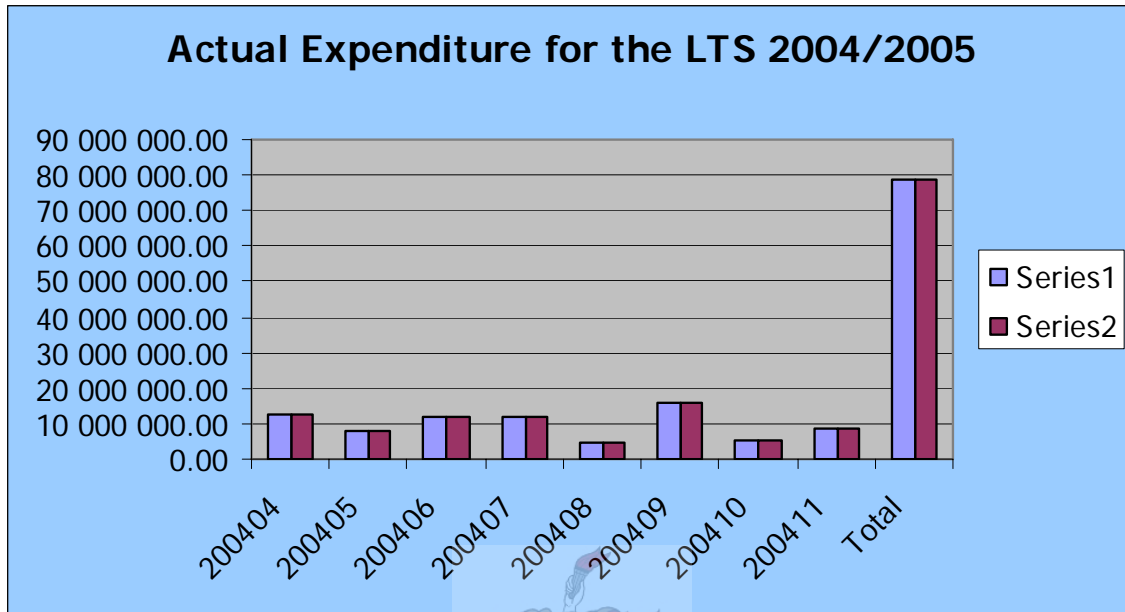


Figure 5: Learner Transport Service: Current Expenditure 2004/05: Programme 2: WCED
Source: WCED Budget Directorate

4.2.2. Regulatory Framework for the LTS: 1994-2004

The LTS is a procurement initiative by the WCED, and it operated in accordance with the now repealed Western Cape Provincial Tender Board Law, 8 of 1994, the KST 36 Regulations and KST 37 Procedures. The KST 36 regulations were the general tender conditions and procedures of the Western Cape Tender Board. KST 37 was directives issued by the Tender Board in respect of procurement. During the period 1994-2003 the LTS functioned in accordance with the aforementioned and associated circulars of the WCED regarding LTS. From the 1 January 2004 the procurement of service providers for LTS functioned in accordance of the Accounting Officer Supply Chain Management (AOSCM) System of the WCED.

A draft policy on learner transport has been initiated in 2004 as a consequence of an investigation by a team of WCED officials on the LTS and the findings of the Auditor-General Performance Audit (PR 188/2003) of 2003. The investigation by

this team started in November 2002 and ended in June 2004. The details of these findings are noted in the following section. At the time of writing the thesis the draft policy for LTS was not completed by the WCED (personnel communication with anonymous administrator in WCED 28/9/2004).

4.2.3. Findings of the Investigation by the WCED

The findings have relevance in that, according to the report of the investigation team of WCED, officials detected that 1450 pupils were using the LTS illegally. The findings of the investigation by the WCED officials lead to the following findings:

TABLE OF FINDINGS OF THE WCED INTERNAL INVESTIGATION	
Principals at the schools not taking responsibility for the LTS	Reneging on service level agreements
<ul style="list-style-type: none"> • No records were kept • Prescripts not followed when application were made for additional learners to be transported • Learners were transported past schools • Grade R learners were transported 	<ul style="list-style-type: none"> • Transporting learners with unlicensed vehicles • Vehicles not roadworthy • Vehicles overloaded • Specified vehicles in the contract were not used to transport learners • No alternative vehicles used as agreed in contracts • Busses did not arrive on time • Did not follow specified routes and adults were transported
Calculation and the payment of contractors	Implications
<ul style="list-style-type: none"> • Circular 13/2/8/17/2B was not applied strictly • Calculations for additional learners were made by the EMDC's without consulting the contract agreement • Calculations differed from the EMDC 	<ul style="list-style-type: none"> • Unauthorised learners were transported for whom claims were submitted and paid • Contractors reneged on service level agreements • Lead to unauthorised expenditure as defined in the PFMA

<ul style="list-style-type: none"> • Learners names not provided at pick-up points which made control impossible • Shortage of manpower to monitor in the field 	<ul style="list-style-type: none"> • LTS not taken seriously and exposed learners to physical risk of injury.
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Table 3: Findings From WCED Investigation 2002-2004

4.2.4. Concept Draft Policy for LTS

The draft policy was a consequence of the Auditor-General's findings in the Performance Audit Report (PR 188/2003) and the WCED's findings in respect of there internal investigation. The draft policy has two sections. Firstly, the criteria which learners require to meet in order to qualify for this service. Secondly, the procedures prospective vendors must follow when applying to become a service provider to the WCED's LTS. The following are extracts from the WCED's LTS concept draft policy (2004)

The conditions that apply to learners who can qualify for the LTS:

- Learners are required to live further than 5km from a suitable school
- Cost effectiveness used in determining when service is implemented. This is directly weighted against hostel or transport bursaries.
- LTS is implemented only in areas where there is no public transport.
- Learners who do not attend the nearest school to there home may not use LTS. It becomes the responsibility of the parent to fund a learner's transport to a school.
- The implementation of LTS is based on the approval of LTS committee at head office with the Directorate Physical Resource Planning.
- Length of the rout may not exceed 120km per day.
- No exceptions on the minimum 5km radius may be considered

Procedures that have been developed for prospective vendors must adhere to include the following:

- Only a complete application for a tender by the vendor will be accepted.
- Time schedules are to be instituted in which all role players are required to adhere to. This would reduce the problems experienced with route specifications which were not received in time for advertisements of new contracts and extensions to such contracts. e.g.

Type of application	Receipt of application from EMDC	At bus committee	At Deputy Director General: Operational Education Management	At the Director Logistical Services
Application for LTS contract	6 months ahead	Within 7 days of receipt	Within the following 7 days	Within the following 7 days if authorised by ADG: operational education management

- As the principals determine the initial requirements at the school they have to adhere to the time schedules as proposed for a LTS.
- A new service will only be provided for at the start of a new school year.

The draft policy has not been finalised according to an official of the WCED (personnel communication with anonymous administrator at the WCED 2/11/2004) as a result of the two important factors. Firstly, Cameron Dugmore the incumbent MEC for Education in the Western Cape (30th September 2004 in the Cape Argus) has proposed to change the required distance for learner transport to 3 kilometers. This would have a direct impact on budgeted expenditure of LTS for the current financial year. Secondly, the application of the LTS within the AOSCM system of the WCED has had influence on the draft policy on LTS as there has been a continuous re-drafting of AOSCM system. Uniqueness, of the current situation is that certain aspects of the draft policy are in use at the WCED.

4.2.5. Procurement Process

The WCED tenders for contractors in an open bidding process based on the following formula:

- **Price per year/200 school days per year/number of authorised learners/by the indicated distance=price per learner per kilometre per school day**

Contracts were recommended in the WCED by a Departmental Tender Committee for approval by the Western Cape Tender Board. During this period contracts were approved for a three year period. Two systems of procurement administration currently apply to the LTS. According to the Treasury Circular 36/2003 paragraph 2.6 and 2.7, all contract agreements on LTS prior to the implementation of Supply Chain Management, are standing in terms of the Western Cape Tender Board Law, 8 of 1994 and the KST 36 regulations and KST 37 procedures. New contracts will be procured in terms of the Accounting Officers Supply Chain Management (AOSCM) System as of January 2004.

The roll out of the procurement process for the LTS as of 1/4/2004 is in terms of the AOSCM system. A brief explanation of the roll-out of the LTS in terms of the AOSCM system will be given here. For a more detailed description refer to Annexure A. Tenders for the LTS are based on the aforementioned formula and bids are approved against a pricing structure designed by the WCED based on market related prices. This pricing structure is known as the cost curve. This cost curve was in use prior to the shift to the AOSCM system. Prospective contracts have been improved to a period of five years for the LTS.

Furthermore, the 80/20 and 90/10 preference points system is applied in terms PPPFA regulations for contractors where the service is required in terms of the WCED's Preference Procurement Policy. See annexure B for the detailed application of the preference point system used in respect of the 80/20 and 90/10 principle. The Departmental Bid Committee consider and recommend the

acceptance of bids by the delegated persons with the view to conclude contracts and service level agreements with service providers.

4.3. The Auditor General's Performance Audit Report

According to the Auditor-General's Performance Audit Report (PR 188/2003), the performance audit was as a consequence of known deficiencies within the LTS and regulatory audits conducted for the 2001-2002 financial year which indicated material irregularities had occurred. This information was further corroborated by the AG during an interview on the 5th October 2004.

4.3.1 Purpose of the Performance Audit

The performance audit was initiated after a contact meeting with senior officials of WCED Logistics Directorate. In April 2002 management was informed of the intent by the Office of the Auditor-General to commence a performance audit in respect of LTS. The WCED indicated that it had revised the policy and internal control measures were implemented to improve the functionality of the LTS. The Auditor-General reached consensus that the performance audit would evaluate the adequacy of the new internal control measures and the new contracts awarded in terms of the revised policy.

4.3.2 Scope of the Performance Audit

The performance audit focused on the following areas owing to the new policy and internal control measures:

- New tenders awarded with effect from the first quarter of the 2002 academic year.
- The objectives were to audit in order to determine if the tenders were awarded in terms of the set criteria.
- To assess the roadworthiness of the vehicles being utilized
- To determine if the payments were being administered in terms of the guidelines that was set by the WCED.

- To determine if schools were experiencing problems with LTS.
- The review of relevant policies, tender documents and procedures to evaluate the awarding and monitoring of the LTS.

4.3.3 Findings of the Performance Audit Report

Key Findings of the performance audit	
Review of tender procedures	It was found that tenders were awarded to transport contractors notwithstanding their failure to submit critical information. Subsequent to this, numerous requests were made to contractors to provide critical information. Even final reminders regarding the aforementioned were sent certain contracts were still in force
Contract administration	The audit revealed that guidelines issued to schools by the WCED in which it stipulated that only the approved vehicle can be used to transport the learners was adhered to. Furthermore, it was found that breakdown of vehicles resulted in learners not being able to attend school.
Licensing and roadworthiness of learner transport	During the audit it was found that a number of drivers were not in possession of the required licences and permits for the transportation of learners. The audit revealed that buses did not maintain the required roadworthiness as stipulated in the contract. The audit revealed that at least 12 buses failed the required roadworthiness test.
Transportation of learners	The tender documents stipulated that contractors should transport learners together as a group and not part of a group and thereafter the rest. However, it was found that both private and contracted learners were transported simultaneously.
Transportation of Grade R learners	According to the policy Grade R learners should be excluded from the scheme. This however, was not adhered to by the WCED. The performance audit conducted found that Grade R learners were being transported.
Administration and maintenance of the learner transport records	Lack of adequate administration of records in terms of LTS policy in which the authorisation of forms were not updated annually. The prescribed application was not completed by the parent or guardian and the failure of principals in the above regard meant that learners were transported illegally.

Table 4: Findings of the Auditor-General's Performance Report 2003

4.4. Summary

This chapter outlined the case study from its historical background until the current procurement processes used in contracting for the scheme. The case study of the LTS by virtue of the Auditor-General's Performance Audit Report (PR 188/2003) indicated irregularities that were caused by the lack of internal controls and pro-active risk assessment of a project with such a large budgetary allocation. These irregularities were further substantiated by an internal investigation by the WCED from November 2002 until June 2004. These findings lead to the drafting process of a policy document that could collectively integrate the various directorates involved in the transport of needy learners by the WCED. The case study and the Auditor-General's Performance Report (PR 188/2003) and the annual reports by the Auditor-General gave consequence to the research questions and the methodology to be used in order to obtain further information from experts in the field regarding the purpose of the Internal Audit in SCM outcomes.



CHAPTER 5

EXPERT INTERVIEWS

5.1 Introduction

This chapter introduces the expert interviews that were conducted based on the research methodology and design explained in the introductory chapter. Throughout the field work, the research questions were kept in mind to give direction in terms of the interviews that were conducted. The expert interviews conducted for this research study attempted to determine the level of insight which the respondents have regarding the functionality of Internal Audit and its role toward SCM for empowerment. It was already discussed in previous chapters why and how Internal Audit should support outcomes such as empowerment. The purpose of this chapter is to assess the level of understanding and agreement amongst role players in Internal Audit involved with this particular case study. This was a deliberate attempt to extract information that would enable the researcher to triangulate and compare the opinions of the respondents.

The challenge was to ensure that the individuals interviewed as representatives of their organisations had expert knowledge in both Internal Audit and SCM as both concepts are relatively new to the public sector. LTS is used in this thesis to explore the value-adding potential of Internal Audit.

5.2. Compiling the Interview Questions

To compile questions for the interview process, a quality and in-depth study regarding Internal Audit, governance and SCM was completed. The individuals with whom interviews were conducted were sampled by using purposive sampling. Welman and Kruger (2001: 63) explain that purposive sampling is used in research to deliberately obtain units of analyses that is regarded as

representative of the relevant sample. The reason for this is twofold. Firstly, the newness of the information and secondly, preference was given based on the experience of the sampled individuals. The researcher decided to use semi-structured interviews. The reason for this choice of interviewing techniques is related to the views of Welman and Kruger (2001: 161) that semi-structured interviews have varying degrees of structuredness possible because of the following factors:

- The topic was sensitive;
- The respondents were from divergent organisations; and
- Experienced and expert interviewers are available for conducting the interviews.

An interview guide was used and involved a list of topics and aspects that have a bearing on the given themes such as Internal Audit, supply chain management and governance and which were raised during the course of the interview. The basis for the questions was found in primary data which was obtained from within the WCED in the directorate's budget administration, logistical services and physical resource planning and development. Furthermore, the Auditor-General's regulatory reports on the WCED from 2001-2003 were used and the Performance Audit Report of 2003 (PR 188/2003) and the literature which covered the aspects related to the research project.

5.2.1. The Case Study

The research involved the case study of the LTS of the WCED in order to validate the research questions posed in the research proposal of the study project. The researcher took into consideration the following aspects relating to the use of a case study in research projects as prescribed in Welman and Kruger (2001: 183-184):

- The case study of the LTS had a clear boundary which was defined by the researcher. These included the Auditor-General's Performance Audit

Report (PR 188/2003) and regulatory audits that indicated irregularities and poor performance. Based on the aforementioned there were no reasons to adjust the issues to be researched.

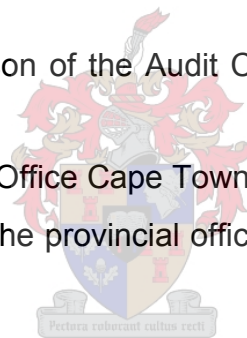
- An inductive method was used during the interview process to search for recurring patterns and consistent regularities. Both the independent and dependant variables required an in depth understanding and based, on that, expert interviews were held both with WCED officials and external foci related to functions in the WCED.

The method of triangulation was used to discern the patterns and to corroborate the information found in the research process. According to Welman and Kruger (2001:184) triangulation is an inductive method which allows the researcher to identify recurring patterns and consistent regularities. In this research study, tape recordings of the semi-structured interviews, the Auditor-General annual reports and the Performance Audit Report (PR 188/2003) and other static data was used to corroborate findings. The information was coded and corroborated with static primary data and literature on the independent and dependant variable. After decision was taken as to the required technique to use, the research in respect of the secondary data was conducted during September 2004 and October 2004. The semi-structured interviews were carried out with various role players responsible for the Internal Audit function at the WCED. Furthermore, external role-players such as the Auditor-General who conducted the performance audit and regulatory audits were interviewed. The chairperson of the Audit Committee for the WCED, Nick Nicholls was interviewed. In section 5.4. of this chapter a description of the themes used in the interviews is explained in relation to the literature review and the case study for the thesis.

5.3. Interviews Conducted

The interviews were conducted with the sampled experts and the process was audiotape recorded. These audiotapes are available to validate any questions that readers may have regarding the interview questions and the findings which are discussed in Chapter 6. However, only R.G. Nicholls who is the Audit Committee chairperson was prepared not to remain anonymous. Interviews were conducted with senior staff of the office of the Auditor General who requested individual anonymity. However, they indicated that the interview responses were that of the AG. The officials at the WCED based in the Chief Directorate Financial Management requested anonymity as they felt that their views were not necessarily that of the WCED. The following interviews were conducted in September and October 2004:

- R.G. Nicholls: Chairperson of the Audit Committee for the WCED on the 28 September 2004.
- WCED officials at Head Office Cape Town: 15 and 19 of October 2004.
- The Auditor-General at the provincial office in Bellville, Cape Town on the 5th of October 2004.



These interviews may be characterised as performed in an atmosphere of confidentiality and anonymity by those who requested it.

5.4. Interview Guide

The following themes were used in conducting the interview process to guide and direct the research information gained for easier analysis at a later stage.

Internal Audit as a valued added service: The definition of Internal Audit as used by the IIA was a broad guide in the question being formulated. This definition states that Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations.

Internal Audit as a change agent in reducing risk and increasing accountability: The Internal Audit unit should act as change agents within the organisation and should not think financially but operationally, so as to review the operational progress of the organisation in order to establish if the results are consistent with the goals and objectives. Therefore the question posed to the interviewees was based on the aforementioned and the fact that, as “likelihood” change agent they should assist the entity in risk materialising by recommending improvements to the system of internal control to achieve its objectives.

Its role in relation to external auditors: The case study and more specifically the Auditor-General Performance Report of 2003 (PR 188/2003) had direct bearing on this particular question. Even though a specific section in the literature study was not allocated for this. Performance auditing has parallels with the development of public sector management as they proceed from the set of values that are intertwined within the reform ethic of effectiveness, efficiency and the economic use of resources. This type of auditing is essential in monitoring organisational performance and evaluation.

Internal Audit as a proactive consulting mechanism in the WCED specifically in relation to new projects: The findings of the Auditor-General Performance Report of 2003 and the literature as researched in terms of the definition of Internal Audit indicated that Internal Audit can only have impact when it proactively evaluates risks. This is even more prevalent in the public sector that is demand-driven. The questions posed in the various interviews were rationalised in terms of the above.

The role of Internal Audit toward improved governance: The literature study on governance and the COSO Internal Control Framework indicates toward a governance framework by sensitising management of their accountability towards shareholders, and in this particular thesis, toward the taxpayer.

Its role in relation to the WCED's Supply Chain Management Framework:

- What Internal Audits impact would have been on the LTS; and
- Internal Audit as a mechanism to keep the process on track.

The questions formulated from this guide were sourced from literature on SCM but more specifically the South African Government's procurement reform view that focuses on two broad based areas, namely good governance and preferential procurement for socio-economic empowerment. The research questions by virtue of these questions could be answered by the selected sample.

The questions posed in the various interviews for this thesis was based on this interview guide. It should be noted that semi-structured interviews allowed the interviewee to answer the questions, but also allowed them to elaborate on these questions. Therefore, some of the findings are not necessarily discussed in the literature review. These could be seen in the findings that follow in Chapter 6.

5.5. Table of Interview Questions

The following questions were raised with expert interviewees for the research study for each of the sampled individuals.

Interview Questions for Audit Committee Chairperson: R.G. Nicholls

23/9/2004

1. What in your opinion is “value-adding service” from an Internal Audit function within an organisation?
2. Can Internal Audit be viewed as a change agent to assist management in reducing risk and improving accountability?
2. Should Internal Audit focus only on traditional audit practices or should their activities include proactive consulting with other business units in the WCED?
3. How involved should Internal Audit be in evaluating new projects or initiatives?
4. Is management sophisticated enough at this stage in the WCED to differentiate between risk management and financial compliance?
5. How can an effective Internal Audit function compliment external audits performed by independent audit offices?
6. If an Internal Audit function had been decentralized to the WCED what would its impact have been in light of the Auditor Generals material findings of the performance report of 2003 regarding the Learner transport service?
7. The implementation of the Supply Chain Management Framework legislation came into effect 1/1/2004. In light of the previous question what should the role of Internal Audit be given the two broad focus areas fundamental to SCM in the South African public sector, namely:
 - The principles of good governance?
 - Preferential procurement practices for socio-economic empowerment?
8. Is Internal Audit a mechanism to keep SCM within the WCED on track and should it be auditing the success rates of empowerment initiatives such LTS, given that the supply chain management function has been decentralised to institutional level?
9. How has the Audit Committee been accepted as an oversight tool by senior management in the WCED?
10. Is Internal Audit a perquisite for governance in the public sector?

Table 5: Interview Questions: Chairperson of the Audit Committee

Interview Questions for the Office Auditor-General : 5/10/2004

1. What was the catalyst for performing a performance audit on the Learner transport service?
 2. There were major shortcomings in respect of efficiency, effectiveness and economic use of resources relating to this project. Do you feel that the response from the Accounting Officer was adequate?
 3. Osborne and Gaebler in the book Reinventing Government (1993) argue that corruption is difficult when a contracting system meets four criteria:
 - ❖ In which the bidding process is competitive,
 - ❖ Competition is based on hard information about cost and quality of performance
 - ❖ Contractors are monitored carefully
 - ❖ Relatively non-political body is set up to perform such a task
- Would you agree or disagree with the statement based on material findings of the performance audit?
4. Supply Chain Management Framework has two broad focus areas namely the establishment of good governance principles in the procurement of goods and services in the public sector and introducing a preference system to address socio-economic objectives. Is Internal Auditing the mechanism to keep the LTS within the SCM framework on track?
 5. How can an effective Internal Audit function compliment or facilitate the external audits performed by independent audit offices.
 6. From your perspective as the Auditor General, has Internal Audit and risk management received the same level of priority as budgeting and accounting systems reform. Has this lack prioritization adversely affected the performance of projects such the LTS?
 7. How can the external auditor strengthen the position of Internal Audit?
 8. Is Internal Auditing a prerequisite for governance?
 9. Is it a value-adding tool for senior management?
 10. Can it be viewed as a change agent to assist management in reducing risk and increasing accountability?

Table 6: Interview Questions: Auditor General

Interview Questions for a WCED Official: 15/9/2004

1. What in your opinion is a "value adding service" from an Internal Audit function within an organization such as the WCED?
2. Can Internal Audit be viewed as a change agent to assist management in reducing risk and improve accountability?
3. Should Internal Audit focus only on traditional audit practices or should their activities include proactive consulting with other business units in the WCED?
4. How involved should Internal Audit be in evaluating new projects or initiatives?
5. How can an effective Internal Audit function compliment or facilitate the external audits performed by independent audit offices?
6. Learner transport service is a contentious topic within the WCED. If an Internal Audit function had been decentralized to the WCED what would its impact have been in light of the Auditor General's material findings of the performance report of 2003 regarding the Learner transport service?
7. The implementation of the Supply Chain Management Framework legislation came into effect 1/1/2004. In light of the previous question what should the role of Internal Audit be given the two broad focus areas fundamental to SCM in the South African public sector, namely:
 - ❖ The principles of good governance?
 - ❖ Preferential procurement practices for socio-economic empowerment?
8. Is Internal Audit a mechanism to keep SCM within the WCED on track and should it be auditing the success rates of empowerment initiatives such as LTS, given that the supply chain management function has been decentralized to institutional level?
9. Is Internal Auditing a prerequisite for governance of public sector institutions?

Table 7: Interview Questions: WCED Official

Interview Questions for a WCED Official: 19/10/2004

1. What in your opinion is “value-adding service” from an Internal Audit function?
2. Can Internal Audit be viewed as a change agent to assist management in reducing risk and improving accountability?
3. Should Internal Audit focus only on traditional audit practices or should their activities include proactive consulting with other directorates in the WCED?
4. How involved should Internal Audit be in evaluating new projects or initiatives?
5. How can an effective Internal Audit function compliment external audits performed by independent audit offices?
6. Had the Internal Audit function been decentralized to the WCED what would its impact have been in light of the Auditor Generals material findings of the performance report of 2003 regarding the Learner transport service?
7. Supply Chain Management Framework has two broad focus areas namely the establishment of good governance principles in the procurement of goods and services in the public sector and introducing a preference system to address socio-economic objectives. Is Internal Auditing a mechanism to keep the LTS within the SCM framework on “track”?
8. What is the role of Internal Audit?
 - ❖ Driving accountability and thereby contribute toward more effectiveness by replacing ineffective managers or
 - ❖ Does Internal Audit assist the auditee by recommending controls that reduce risks?
9. Should an evaluation of the governance process precede any audit?
10. Is Internal Audit a prerequisite for governance of public sector institutions?

Table 8: Interview Questions: WCED Official

5.6. Data Analysis

According to Mouton (2001: 108) the analysis of data involves the deconstruction of the data into manageable themes, patterns, trends and relationships. Its purpose is to link the data by inspecting the relationship between the concepts and variables in order to determine patterns or trends in the data obtained. Similarly, Riley *et al* (2000: 111) views qualitative research as intellectual

craftsmanship in which the researcher frames their questions in a manner that would answer the research question, the identification of patterns and categories in order to relate them to the findings to concepts and theory in practice.

The researcher followed the same pattern in terms of the semi-structured interviews in which an interview guide was used as the classification framework to analyse and interpret the data that can link the independent variable and the dependant variable. In this particular research project, the dependant variable acts as an intermediate toward the construct of empowerment. Therefore, interview questions were posed in terms of the guide and this resulted in the data being analysed in accordance with the guide. Information was coded immediately after an interview. However, three questions were posed to the Auditor General's office which was not used in the other interviews. These questions related to the actual performance audit report on LTS in 2003.

5.7. Summary

This chapter established the research design and methodology used during the collection of primary and secondary data for the research study. The research question could only be addressed by expert knowledge as both the independent and dependant variables are relatively new management practices in the public sector. The case study was used as a measure and to validate the research questions and the applicability of the independent variable towards the broader outcomes of the dependant variable. The following chapter analyses the findings of the research conducted during the field work.

<p style="text-align: center;">CHAPTER 6</p> <p style="text-align: center;">FINDINGS, CONCLUSION AND RECOMMENDATIONS</p>
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6.1. Introduction

The issues raised by the research questions were supported by the feedback obtained from the expert interviews during the research. This chapter will discuss the interpretation of the research data obtained from the expert interviews conducted. The research study will be concluded and recommendations based on the research findings are given.

6.2. Discussion of the Findings

The analysis of the information obtained during the interviews has been divided into classification in order to structure the information:

- Internal Audit as a value-adding service;
- Internal Audit as a change agent and proactive consulting mechanism for new projects;
- Role of Internal Audit in relation to external auditors;
- Role in relation to the supply chain management function; and
- Role in improving governance.

The interview results were analysed in accordance with the aforementioned classification. The interpretation of the results will be discussed in the following sub-heading.

6.2.1. Internal Audit as a Value Adding Service

There was general consensus amongst the interviewees that Internal Audit is a value adding service. The following is a break down of the key findings of the interviews regarding the aforementioned information:

Risk-based approach to Internal Audit: A general view was held that a risk based approach enables the Internal Audit function to assess all the controls that would be able to mitigate the exposure to risk of the WCED. Internal Audit has the responsibility to identify areas of inefficiency in the systems of the WCED and to recommend to management corrective measures. The assessment of risk becomes an important task as a value adding service. Similarly, the COSO Internal Control Framework emphasises a risk-based approach for Internal Audit that covers risk management, controls and governance as discussed in 2.3.1.and 2.4.1. In following a risk based approach the Internal Audit function can prioritise the risks for management as their programmes become to busy.

Reduce audit costs both internally and externally: A value-adding service from an Internal Audit function enables an organisation to reduce external audit costs. According to Nicholls, the level of functionality of Internal Audit function at the WCED had a direct cost impact. The Auditor-General had to audit work outside of its responsibility of assignments related to regulatory and compliance audits. The LTS is an example of this, where a performance audit was performed to evaluate efficiency, effectiveness and economic use of resources. The WCED official's opinion was that the Internal Audit function needs to assess and recommend to management about controls based on a cost benefit analysis in high risk areas. Furthermore, Internal Audit should streamline internal controls by identifying duplication of controls that can reduce cost.

Auditing realised risk: According to Nicholls, Internal Audit needs to focus on what he terms auditing "realised" risk. There is a tendency to concentrate on auditing inherent risk. Inherent risk as defined by Van der Westhuizen (2003: 3) is risk in the absence of any action management would have taken to alter the likelihood or impact. As a value-adding service Internal Audit should evaluate that which the audit client does not know, rather than focusing on what the audit client knows. Similarly, King 2 explains that risk assessments should not only identify residual risk but emerging risk. See Chapter 2 (2.3.1) in the literature study. Therefore, Internal Audit would audit and assess risks in areas that have gone

wrong in the organisation. In this manner Internal Audit can make a contribution without influencing its independence.

Building capacity: One of the primary objectives of the co-sourced Internal Audit unit is to build the capacity of Internal Audit at the various Provincial departments within the Western Cape. According to Nicholls the area of concern for the Audit Committee relates to the contextual understanding of the public sector of the co-sourced Internal Auditors. Internal Audit has a background found in accounting in South Africa and in an environment such as education the Internal Audit function would have to recruit educationalists onto their team. However, an opposing view was given by the Auditor-General. The Auditor-General argued that the consortium members especially the bigger firms, such as PricewaterhouseCoopers and Ernst and Young have relevant expertise to drive the process. They act as service providers to the Auditor-General and complete audits on their behalf in government departments. They have the expertise in respect of research capabilities, which departments do not have, and they have necessary technological resources.

Independence: According to the Auditor-General the fact that Internal Audit is co-sourced allows for that level independence which is critical for Internal Audit. Firms involved can rotate staff to enhance independence. This view was substantiated by Pott (2000: 10-11) who views the danger of permanent Internal Auditors within departments is that they can become too friendly with the staff, or complaisant with the status quo, which is a real danger to objectivity. Independence is a critical characteristic of any effective Internal Audit department Internal Audit should be free of organisational pressures which limit its objectivity in selecting areas to be examined or in evaluating and reporting upon those areas.

Summary

The interviewees were all in agreement that the risk-based approach to Internal Audit will be a significant step. How capacity will be built by the consortium given the contextual difference between private and the public sector remains debatable. The research found no proof that the consortium can build contextual capacity for an Internal Audit function in the WCED as the function has been recently implemented.

6.2.2. Internal Audit as a change agent in reducing risk and increasing accountability and being a proactive consulting mechanism for new projects

Internal Audit has a role to play as a change agent in reducing organisational risk through evaluating control measures to ensure that organisational objectives are met. In Chapter 2 (2.3.3) Naidoo explains that, as a change agent within the organisation and should Internal Audit should not think financially but operationally, so as to review the operational progress of the organisation in order to establish if the results are consistent with the goals and objectives. As a proactive consulting mechanism it functions as an additional tool to management on new projects in identifying risk areas. As a change agent it must be seen as an investment in the future.

Corrective Mechanism: Nicholls argues that as a change agent, Internal Audit needs to drive a mechanism which performs corrections. This would be based on giving recommendations to management rather than being part of the process. Internal Audit would compromise its independence if it was functionally part of such a corrective mechanism in a department. If Internal Audit was to adopt such an approach it would have adopted legitimate safeguards as per the IIA ERM table in Chapter 2 (2.5.2). An example of this could be to coach management in responding to risk if management has not responded to correcting a key risk identified in an annual report.

The Chief Financial Officer (CFO) at the WCED and his directorates are not tasked with corrections as their role is to provide yearly financial statements of the financial performance for the organisation. Currently inspections are being performed and no corrections are performed within state departments. This can be seen in annual reports of the Auditor-General. The WCED has no department which performs corrections. Similarly, an official of the WCED argued that value is added when corrective steps are taken to solve a problem. Therefore, for Internal Audit to become a change agent the approach to auditing in the public sector needs to change from compliance auditing to more substantive auditing. Corrections are pro-active and it reduces the qualified external audit reports and the costs associated with it.

Public Finance Management Act: The requirements of the PFMA in terms of section 38 (1) and (2) have made Internal Audit a prerequisite. The Auditor-General argues that in complying with the requirements of the PFMA it assists the accounting officer of the WCED in reducing risk but also enhances accountability. Internal Audit assists in improving the governance of the organisation. An interviewee argued that as a change agent Internal Audit can reduce risk but this dependant on the “*management style*”. In an environment where management is compliance orientated the lack of understanding the advantages of risk management can influence the delivery of services. Change remains an obstacle even though there is financial legislation driving that change. The establishment of the audit committee as per Section 76 (4) (d) and 77 of the PFMA enhanced the independence of the Internal Audit function, but it also enhances accountability and transparency of the WCED by evaluating financial reports, compliance with legislation and regulation. In Chapter 1 (1.7.3.2) the legislative requirements and Chapter 2 (2.6.2) the responsibilities of the Audit Committee is discussed in detail. The literature similarly indicated that the establishment of audit committee enhances the independence of the Internal Audit function.

Proactive consulting for new projects

The study indicated that two interviewees, namely Nicholls and a WCED official regarded the relative size of a project related to financial expenditure as acting as a determining factor for the involvement of the Internal Audit function. Internal Audit needs to be involved to give management the assurance through its quasi-consultation role what the risks are in relation to the project. In order for Internal Audit to act as a change agent the traditional role of evaluating post-hoc cannot add value. However, environmental understanding is crucial to the success or influence of Internal Audit in relation to the project.

The research indicated a contrasting opinion regarding the aforementioned. The interviewee was of the opinion that Internal Audit should not be involved in new projects as it can compromise management discretion. Internal Audit's role should be controls and quasi-consultation and not to question the viability of the management prerogative. Furthermore, accountability remains a management responsibility and by involving Internal Audit it can lead to a situation where management can hold Internal Audit accountable for wrongly informing them. The contrast in opinion is significant as the Internal Audit function according to Van der Westhuizen (2003: 4) is an integral part of the management team in assisting the entity in the discharge of responsibilities, promoting the establishment of cost effective controls, assessing and mitigating risks by recommending control measures.

6.2.3. The Role of Internal Audit in Relation to External Auditors

Reliance of audit work: The general opinions of the interviewees were that Internal Audit must assist in the reliance of opinion given regarding audited work. The Auditor General would review the work done on testing of controls by the Internal Audit function. According to the Auditor-General, at this stage of the implementation process of Internal Audit, they would not place reliance on the Internal Audit opinion. Furthermore, the Auditor-General has identified that there are no system descriptions in place at the WCED or other government

departments. Nicholls argued that trust and confidence in the Internal Audit function, would be crucial to the Auditor-General. This was substantiated by the fact that as a result of the level of functionality of the Internal Audit the Auditor-General became responsible for audits of the WCED.

Cost of External Audits: The findings indicated that audit cost would not necessarily be reduced in creating an Internal Audit function. According to the Auditor-General the continuous changes brought about by new auditing standards has a cost implication. Furthermore, the cost of establishing an Internal Audit function needs to be weighed against other factors related to budgetary constraints the WCED. The constraint on budgets remains an issue for establishing a decentralised Internal Audit function.

6.2.4. Role of Internal Audit in Relation to the WCED's Supply Chain Management System:

- **Its impact on the Learner Transport Service**
- **Internal Audit as a mechanism to keep the process on track**

The collective opinion was that as a result of the maturity of the Internal Audit function, its role would depend on a number of factors in relation to evaluating the SCM system of the WCED. There was an opinion that in hindsight that it would have had an impact on the LTS given the findings of the Auditor-General's Performance Report (PR 188/2003) and WCED LTS investigation in 2003.

Understanding the market that you serve: A WCED official explained that Government is demand-driven and there is a tendency not to do adequate research regarding a new project imperative to supply our market. Demand management as one of the pillars for SCM in the public sector is an essential discipline. It is a cross-functional exercise with the goal of ensuring that resources are that are required to fulfil the needs identified in the strategic plan of the organisation are delivered at the correct time, price and place and that the

quantity and quality would satisfy those needs. Chapter 3 (3.3.4.1) gives a detailed explanation of the demand management process.

Risk should be identified at the beginning of a project by using a risk-based approach. This links up with the pro-active and value-adding role that Internal Audit should play and makes a full analysis of all the factors related to the project done before implementation. Similarly, in Chapter 3 (3.2.7) Spekman and Davis explain the six types of risk associated with a supply chain and this indicates toward a broader risk evaluation of the supply chain.

Auditing security issues: According to Nicholls, a risk-based approach would be valuable in a procurement environment. The establishment of security and environmental controls should be completed first and this would be followed by general controls. Similarly, two other interviewees held an opinion that had a risk-based approach been followed it would have had an impact on the results of LTS. Nicholls opinion is that security audits are non-existent in the WCED. The position is that risk cannot be audited without auditing security first, especially in a procurement environment. Viability of business to provide service must be evaluated. Forensic and security audits have become paramount in a procurement environment.

Monitoring capacity: There are limited controls over the LTS in the field as a result of the lack physical capacity to monitor the scheme given the vast geographical area of the Western Cape. Similarly, an internal investigation by the WCED 2002-2003 found that irregularities were common in relation to the vast geographical area to be covered and monitored. These findings were discussed in chapter 4 (4.2.3 and 4.3.3). According to the Auditor-General, the maturity of the Internal Audit function in the WCED would not enable to act as a mechanism to keep supply chain on track. Furthermore, there no performance criteria established as yet by the WCED for a procurement initiative such the LTS. This performance measurement tool must be implemented and this requires maturity before Internal Audit can act. The Auditor-General questioned the capacity of

Internal Audit to perform such a role. Furthermore, the Auditor-General asked the question, should the Internal Audit function be responsible to evaluate the outcomes of empowerment initiatives in government contracting.

Decentralisation of the Supply Chain Office: According to Nicholls, the SCM should not at this stage have been decentralised. The argument is that the WCED can be exposed further as security audits are non-existent. He is of the opinion that the Internal Audit function is not strong enough or capacitated at this stage to make a contribution at that level of evaluating empowerment of procurement initiatives. In an initiative such as LTS Internal Audit can make a contribution if it is correctly constituted. For example, if there were irregularities a team of Internal Auditors can be assisted by forensic auditors.

Monitoring function: Internal Audit has to be capacitated both in terms of knowledge and human resources. The Auditor-General is of the opinion that at present the Internal Audit function is busy with risk assessments and is not capacitated to be able to function as the mechanism to keep LTS on track. The five big firms involved in the consortium have contracted for work with Auditor-General. The Auditor-General is of the opinion that these firms have sufficient knowledge of the public sector. A differing opinion by a WCED official was that Internal Audit does have a role to play if the responsibility toward empowerment is decentralised at the level of departments. WCED policy should have an evaluating mechanism in place in terms of empowerment levels achieved. According to the interviewee it would not be difficult to monitor if the criteria is put in place by the responsible directorate.

6.2.5. The Role of Internal Audit in Governance

The majority of the interviewees indicated that Internal Audit can improve organisational governance and one indicated that it is an assumption that Internal Audit would improve governance in an organisation. A variety of opinions allowed for the aforementioned generalisation.

According to a WCED official there is a greater awareness of constitutional rights within the public domain. The access which the public has in respect of information means that they would scrutinise far more often than not. Public sector should become more governance-orientated and the Internal Audit function enhances better governance of public sector institutions.

According to the Auditor-General the fact that it is a prerequisite in terms of section 38 (2) of the PFMA obliges public sector institutions to be more governance orientated. The PFMA acts as corporate governance framework for public sector institutions according to the Auditor-General. According to a WCED official Internal Audit provides for an independent view on the overall control environment of the WCED and it plays a key part in governance of an organisation. Within the corporate governance construct the element risk management and controls are essential. This would enhance accountability and transparency in line with accepted principles of good governance. Trevor Manuel the National Minister of Finance, similarly explains in Chapter 2 (2.2.4.4) that the PFMA embodies the principles of good corporate governance as found in King 2.

However, one of the interviewees reasoned that Internal Audit function can only improve governance if it has the personality and maturity. It requires independence and a management that understands its importance in being an assurance tool and a tool that criticises management. The fact that it is still being established an assumption cannot be made that it would improve the WCED's governance. Governance according to Nicholls can improve in public sector organisations by appointing non-executive directors as an oversight tool.

6.2.6. Summary

The result of the data collected is that there was a collective opinion that Internal Audit can be a value-adding tool to organisational governance. From the data it is the interpretation over the research that the persons with more experience in the field of auditing highlighted the problem areas that the Internal Audit function can confront in relation to the studies research question. These issues were capacity,

maturity, personality and independence to add value to the organisation. Furthermore, the Internal Audit function must be constituted correctly to have an impact not only in terms of procurement, but the broader understanding of the mission of the WCED.

6.3. Conclusion

Public sector reform is potentially a means to multiple ends, such as improving the economy, quality, efficiency and effectiveness of the public service. Burger (2003: 2) explains that a different interpretation of these multiple ends is applicable to the South African context and this is not necessarily congruent with the universal understanding of public sector reform. In the South African context development and equity is a fundamental concern. The application of management methods such as Internal Audit and SCM cannot be used in the same context as they are universally applied.

Internal Audit must develop where it can take a leadership role in helping organisations implement, assess, conceptualise risk management and control processes within an organisation as limited by the IIA Standards and the King 2 report. In a supply chain environment according to (Roth: 2002 as cited in Research Opportunities in Internal Auditing 2003: 78) the Internal Audit function needs to assume a process-orientated approach as well to act as value-adding service. In assessing and evaluating inherent risk and realised risks that effect the efficiency of the organisation it can meet the developmental and equitable challenges as alluded to in the SCMF. The Internal Audit function can play a vital role in evaluating the supply chain by assessing the information along the value creation process and add value for external parties too. It would be a superfluous exercise to audit only the performance of procurement initiatives without evaluating the expected outcomes and impact within the context preferential procurement. In the case of the WCED it would have to evaluate the empowerment levels achieved both directly and indirectly in the procurement initiatives in relation to a performance management mechanism.

The research indicated that Internal Audit can be considered a change agent and a value-adding mechanism if it used in a pro-active manner in an organisation. Maturity is a drawback for the Internal Audit function at this stage. However, it should be seen as an investment toward improving the efficiency of the WCED within a context of development. In that regard it will take time to develop. It is hoped that with this research further debate is stimulated in both the management constructs of Internal Audit and SCM in the public sector. This should not only relate to processes of these constructs, but a broader potential role they have towards achieving the vision of policy expression by government towards outcomes that impact on society in the creation of a better life for all.

6.4. Recommendations

The findings indicated that broad knowledge regarding the Internal Audit function and its application in terms of the IIA standards. Knowledge in respect of the SCMF and its broad focus areas of good governance and socio-economic empowerment through preferential procurement seem less expert. The focus was more toward the process of SCM than its broader consequence as expressed in the legislative framework. The following recommendations are made in light of these findings and revolve around the pro-active role Internal Audit can take in assessing the risk exposure and controls available to meet the required objectives of procurement initiatives and the broader objectives of the organisation.

6.4.1 Building Capacity of Internal Audit and the Supply Chain Management Function in the WCED

One the objectives of the co-sourced Internal Audit unit established is to build capacity in establishing a functional Internal Audit unit. This was alluded to in the signing of the Audit Charter in May of 2004. According to Nomvalo (2004: 1) a survey conducted in 2001 for the National Treasury on financial competencies in the public sector concluded that there are significant gaps in the financial competence of existing staff. Furthermore, this problem is more apparent

amongst middle-managers where many financial and supervisory functions are supposed to be performed. This lack of middle management effectiveness adds to the workload of already overburdened senior managers, and at the same time, denies mentorship and development to more junior staff, who are themselves frequently lacking in basic financial competence.

From the aforementioned the recruitment of staff in an Internal Audit function and a supply chain office remains problematic as internally finding competent staff with the relevant qualifications seems unlikely. The co-sourced function is important but must realise that an accounting background will not sufficiently add value in order to understand the context of education. LTS is an example where the context is political, technical and institutional. According to Nicholls (2004) that it is an imperative for the establishment of an Internal Audit unit within the WCED that educationalists are recruited in order to give balance to the Internal Audit team.

6.4.2. Increase Budget for Internal Audit

For an Internal Audit function to deliver an effective and efficient service the National Treasury should appropriate more monies for the Internal Audit function. Firstly, cost of capacitating audit functions in relation to IIA audit standards if it expects that Internal Audit uses those standards. Secondly, remunerate Internal Audit staff in relation to market standards as it is a scarce skill in the public service. According to Mashaba (2002: 9-10) the inability to recruit the right calibre person at the right remuneration package results in the appointment of unskilled and incompetent Internal Auditors.

6.4.3. Auditing Security Related Risks

Procurement in the public sector is an essential tool through which departments and organisations satisfy their requirements to obtain the necessary tools to execute their tasks effectively and efficiently. The risk surrounding the outlay toward procurement requires initiatives to detect security risks and the

performance of that contractor. Therefore, in project such as LTS with such a huge expenditure a security audit is required. The following approach is based on the opinion of Nicholls (2004) that “*if security fails nothing else would succeed*” Similarly, Butler (2003) explains that:

- Security Controls: These are controls that protect the organisations systems, its facilities, the hardware and software, the information and data of the entity against theft, damage, misuse, etc. During an audit it would be important to include forensic auditors as there field of specialty is fraud.
- Environmental Controls: Internal Auditor will review the compliance with regulations, laws and policies, determining the propriety of the accounting for environmental issues and ensuring that proper disclosure is made (Sawyer *et al*: 2003). Also see Chapter 2 (2.5.1) for a detailed discussion on environmental risks.
- General controls: These are controls that establish an overall framework of control within an organisation, e.g. organisational controls, personnel practices, etc.
- Application and specific controls: These are controls that control the input, processing and output of information relating to a specific application, to ensure that the information is valid, accurate and complete.

For Internal Audit to play a value adding role it must assess the risk in procurement initiatives such as LTS. Risk management is an essential process for organisational management. According to Van der Westhuizen (2003: 6) Internal Audit should be pro-active in ensuring that the risk management process incorporates all aspects of control. Furthermore, government in South Africa implement processes and controls without assessing risk first and that many of the systems of internal control relied on are manual and archaic information systems. If one assesses the LTS scheme and refers to the performance audit of the Auditor General of 2003 then it is a perfect example. In assuming a process orientated role to auditing, Rudd as cited in Research Opportunities in Internal

Auditing (2003: 78) argues that Internal Auditors can also add value to external parties to the organisation by improving the internal processes.

6.4.4. Senior Management Service Agreements

The senior managers in the WCED are appointed on a performance contract. The SCM office has been decentralised to the departmental level. A direct linkage in respect of targeted outcomes should be set as criteria for the managers involved with LTS and other procurement initiatives. The success of SCMF is dependant on managers that can perform within in set performance criteria. Targets have to be tied to the contracts of senior managers so that greater effect can be given to the targets rather than leaving it up to their discretion. In terms of the PPPFA no measurement of targets are required.

Internal Audit plays a role by evaluating management and their decision-making processes in relations to cost and the performance of preferential procurement initiatives. Value can be added by assessing the governance process, where management receives assurance that values and goals have been established, that the accomplishment of values and goals are being monitored, and that accountability is ensured so that the value system is preserved. Van der Westhuizen (2003: 6) argues that Internal Audit which functions as that independent review can assist the accounting officer to ensure that critical objectives are aligned with the legal mandate provided for that specified process. The broad objectives of SCM in the South African public sector are improved governance and preferential procurement for socio-economic empowerment. Internal Audit can play a role within an organisation to assist the Accounting Officer in aligning his objectives with expected outcome of a policy.

6.4.5. Appointing a Non-Executive Director

The role of a non-executive director can have a positive influence on senior management performance in the WCED. Non-executive directors can be appointed through community members and this can improve accountability and

transparency of the WCED. It allows for the communities to participate in holding senior management accountable.

6.4.6. Appointing a Compliance Officer

The compliance officer would oversee a compliance program for the WCED, functioning as an independent and objective body that reviews and evaluates compliance issues and concerns within the organisation. A Compliance Officer can ensure that the HOD and the senior management and employees are in compliance with the rules and regulations and that policies and procedures are being followed, and that behaviour in the organisation meets the required standards of conduct within the policy expressions of National Government. The Compliance Officer acts as staff to the HOD and by monitoring and reporting results of the compliance and ethics efforts of the WCED and in providing guidance for the HOD and senior management team on matters relating to compliance. The Compliance Officer will interact with the Internal Audit function and other directorates on matters related to illegal and unethical behaviour. Although, the WCED has an internal control function it operates directly to the Chief Financial Officer in the WCED. In having an ombudsman function like a Compliance Officer it can enhance organisational governance.

6.4.7. Independence of the Internal Audit Function

The Internal Audit team but more specifically the head of the Internal Audit function must be given a standing in the department that commands respect. The Internal Audit head and the Internal Audit unit must be seen as an aid to senior management to control their business.

6.4.8. Management Attitude

The Internal Audit function within the departments are new and require marketing of the function throughout the organisation, with the aim of ensuring a better understanding by management of the services provided by this component. This could be done by information sessions that can act as a marketing tool about

their responsibility to a department. Furthermore, the head of the Internal Audit function in a department must be part of senior management meetings in order to add value to the strategic planning.



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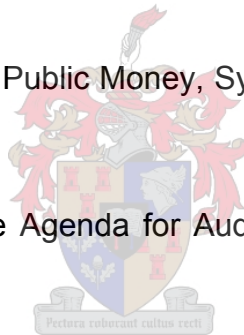
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ANNEXURE A

THE PROCUREMENT OF LEARNER TRANSPORT SERVICES FOR THE WCED

1. Learner Transport Schemes

- 1.1 No learner will be transported over a distance of less than 5 km, in other words a learner must reside 5 km or more from the nearest school that he or she attends.
- 1.2 A learner who does not attend the school nearest to his/her home, may not make use of a contractual transport scheme. Where a learner attends a school of his/her parent's choice, it is the responsibility of the parent to make transport arrangements in this regard and to pay for such transport cost.
- 1.3 Transport schemes are introduced only in areas where no public transport (buses, taxis, trains, etc.) is available.
- 1.4 The introduction of a learner transport scheme is subject to the approval of the Deputy Director-general: Operational Education Management.
- 1.5 Learners who are being transported may not receive a boarding or transport subsidy from the WCED.
- 1.6 For the extension of an existing learner transport scheme, there should be at least 10 learners who reside 5 km or more from the nearest pick-up point of the route. No changes must be made to the route description without the prior approval of the Head Office of the WCED.
- 1.7 A learner transport contractor may only transport authorized learners. If unauthorized learners are transported, the contractor would do it at his/her own risk and will receive no remuneration for that.

- 1.8 The contract period will be for a period of 5 years.
- 1.9 Special conditions, other than the General Conditions of Contract as set out by the System, may only be set on recommendation of the Departmental Bid Committee and with the approval of the delegated person.
- 1.10 Bidders will offer a price per learner per kilometer per day.
- 1.11 Preference will be given to the bidders of the area where the service is required in terms of the Preference Procurement Policy of the WCED.
- 1.12 Where bidders indicate insufficient vehicle seating capacity in their bid documents to transport all the learners that must be transported, the SCM can request them in writing to offer the required vehicle seating capacity.
- 1.13 In instances where learner totals have increased, the DBC may recommend that bidders, whose bids are strictly to specification, be approached in writing to ascertain whether they can provide additional vehicles to transport the learners concerned.
- 1.14 Where the individual bidders did not offer sufficient vehicles to transport all the learners, the WCED will negotiate with the bidders who jointly have sufficient vehicles to transport the learners.
 - 1.14.1 In the event that no bids were received for a transport service, the WCED may negotiate with the existing contractor to enter into a contract to render the service for a further five year contract period, provided that the bidder has a good service record.

- 1.15 Learner transport contractors will be allowed to do double trips with their vehicles in cases where the total single distance of the route does not exceed 12 km.
- 1.15.1 Bids for learner transport schemes will be invited by means of the open bidding process. However, in cases where a transport service is urgently required, (within an extremely limited time, for instance where a school has burnt down) bids will be invited by means of the limited bidding process. The Electronic Procurement System will be used.
- 1.16 The following penalties will be levied if the contractor does not comply with the time schedule for the transportation of learners as agreed to with the principal:
- (a) 20% of the daily tariff per bus for learners that are dropped off late in the mornings or picked up late in the afternoons; and
 - (b) 30% of the daily tariff per bus where learners are dropped off or picked up more than 30 minutes after the agreed times.
- 1.19 The sub-bid committee responsible for negotiating with bidders for acceptable prices will do so only in instances sanctioned by the Departmental Bid Committee and the delegated person where prices are too high or for the extension of contracts. Requests for clarification and the bidder's response, must be in writing.
- 1.20 The following procedure must be strictly adhered to when negotiating with bidders for acceptable prices:
- 1.20.1 Negotiate for a price that is lower or equal to the cost curve.
 - 1.20.2 Start the negotiation with a price that is lower than the cost curve.
 - 1.20.3 The negotiated price may not be higher than the cost curve.
 - 1.20.4 The negotiation team must prior to negotiations determine strategies to best affect a successful negotiation. Information

available regarding the budget, previous prices and the affordability of prices with regard to the budget must be available to for a corcus meeting to analyse and draft a proposal.

- 1.20.5 During negotiation the contents of the applicable file must under no circumstances be made available to the bidder.
- 1.20.6 During negotiations distances and vehicles may not be discussed since this is a function of the Bid Committee.
- 1.20.7 No promise of, or agreement, to future price adjustments may be made.
- 1.20.8 During negotiations the interest of the WCED will at all times be considered top priority.
- 1.20.9 The various cost components from which the bidder's price consist must be submitted by the bidder, and where necessary, it must be used to affect a reduction in price by the bidder.
- 1.20.10 High fuel cost, bad roads and high salaries may not be accepted as valid reasons for bidders not lowering their prices.
- 1.21 In terms of Section 21(1)(e) of the South African Schools Act, 1996 (Act 84 of 1996), the governing body of a school may apply to the Head of Education in writing to be allocated any function consistent with the Act and any applicable provincial law. The devolvement of the function of transport of learners to a Non-section 21 school should not be seen as an application for section 21 status.
- 1.22 The cancellation of bids must be recommended by the DBC and approved by the delegated person. It can only be considered while the bid is still valid and the reasons for the cancellation must be communicated to the bidders in writing.
- 1.23 The procedures for the Breaching of Contract and Remedies for Breach are applicable as contained in paragraph 5.4 of Annexure A.

ANNEXURE B

Annexure A: WCED Point systems as applied to the Learner Transport Services in terms of the Preferential Procurement Policy Framework Act, (Act 5 of 2000)

LEARNER TRANSPORT SERVICES VALUED BETWEEN R50 000 AND R500 000 (80:20)

80 = Price

10 = HDI (People of Colour (5), Women Owned Equity (3) and Disability (2))

4 = Promotion of Small including Micro Enterprises (4) and Medium Enterprises (3).

2 = The promotion of enterprises located within the Western Cape Province. This includes an enterprise whose head office may be situated in another province, but has established a fully-fledged branch within the Province. Enterprises located outside the borders of the Province and who only appoint agents and / or commission warehouses in the Province are expressly excluded from claiming points for this goal.

4 = The promotion of enterprises located within a specific municipality. This includes an enterprise whose head office may be situated elsewhere, but has established a fully-fledged branch within a specific municipal area. Enterprises located outside the borders of the specific municipal area and who only appoint agents and/or commission warehouses in the municipal area are expressly excluded from claiming points for this goal.

LEARNER TRANSPORT SERVICES IN EXCESS OF R500 000 (90:10)

90 = Price

4 = HDI (People of Colour (2), Women Owned Equity (1) and Disability (1))

2 = Promotion of Small including Micro Enterprises (2) and Medium Enterprises (1).

2 = The promotion of enterprises located within the Western Cape Province.

This includes an enterprise whose head office may be situated in another province, but has established a fully-fledged branch within the Province. Enterprises located outside the borders of the Province and who only appoint agents and / or commission warehouses in the Province are expressly excluded from claiming points for this goal.

2 = The promotion of enterprises located within a specific municipality. This includes an enterprise whose head office may be situated elsewhere, but has established a fully-fledged branch within a specific municipal area. Enterprises located outside the borders of the specific municipal area and who only appoint agents and/or commission warehouses in the municipal area are expressly excluded from claiming points for this goal.

