

**THE DEVELOPMENT OF A RISK MANAGEMENT MODEL SUPPORTING
CORPORATE GOVERNANCE IN THE CITY OF CAPE TOWN**

By

PETER D. WILLIAMS

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Supervisor: Professor APJ Burger

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DECLARATION

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

SIGNATURE

DATE

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ABSTRACT

Good governance, improved service delivery and sound fiscal management are some of the key initiatives of the National Government to create a better life for all South Africans as stated in the preamble of the **Constitution of the Republic of South Africa**, 1996 (Act 108 of 1996). Municipalities, in particular, have a specific reference framework in this regard. In each of these initiatives there is a certain amount of inherent risks which may hamper the Government's overall service delivery programmes. In terms of the **Municipal Finance Management Act**, 2003 (Act 56 of 2003) for Local Government, councillors and municipal managers are, *inter alia*, responsible to ensure good corporate governance, ensure effective, efficient and transparent systems of financial - and risk management, internal control as well as the managing and safeguarding of assets and to ensure sustainable service delivery to communities.

Rendering services of a high standard, economically and utilising resources efficiently remains a challenge for South Africa as a whole and in particular for local government. The absence of a corporate mechanism or model for the City of Cape Town makes it difficult to ensure that risks are addressed in an integrated manner. The development of a risk management model supporting corporate governance for the City of Cape Town will endeavour to reduce and/or minimise its risks. The question that arises and which this research study seeks to provide an answer to is "How can the City of Cape Town deal with risks relating to corporate governance in order to fulfil its constitutional and legislative obligations to its community in a sustainable manner?"

The findings of applicable risk management models and/or approaches implemented at organisations representing semi-private and private sectors were analysed for consideration during the development of a proposed risk management model for the City of Cape Town. Legislative requirements and

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specific developments on risk management in the public sector have been researched in an attempt to determine what local government is expected to do in addressing their risks.

When addressing the issue of corporate governance, Chief Executive Officers should reassess their organisations' corporate culture and set the "tone from the top". In the City of Cape Town's case the City Manager has a critical role in balancing the need to address competitive forces and the need to consistently do the right things. Top Management should constantly evaluate the completeness and appropriateness of corporate governance policies and practices as well as critical processes, internal controls and other risk management practices. Furthermore, the quality and competence of all staff need to be examined to determine if they understand government's challenges with regard to corporate governance. The development of a risk management model for the City of Cape Town will enable the organisation to pro-actively address its risks in this regard to fulfil its constitutional and applicable legislative requirements.

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OPSOMMING

Goeie regering, verbeterde dienslewering en gesonde finansiële bestuur is van die vername inisiatiewe van die Nasionale Regering om 'n beter lewe vir alle Suid-Afrikaners te skep soos vervat in die aanhef van die **Grondwet van die Republiek van Suid-Afrika**, 1996 (Wet 108 van 1996). In hierdie verband het munisipaliteite, in besonder, 'n spesifieke verwysingsraamwerk. In elk van hierdie inisiatiewe is daar 'n sekere mate van inherente risiko's teenwoordig wat die Regering se algehele diensleweringprogramme kan kortwiek. In terme van die **Wet op Munisipale Finansiële Bestuur**, 2003 (Wet 56 van 2003) vir Plaaslike Regering is, onder andere, raadslede en munisipale bestuurders, verantwoordelik om goeie korporatiewe bestuur te verseker, doeltreffende, voordelige en deursigtige stelsels vir finansiële - en risikobestuur, interne beheer asook die bestuur en beskerming van bates te verseker en om volhoubare dienslewering aan gemeenskappe te verseker.

Die lewering van dienste van 'n hoë standard, ekonomies en die voordeligste gebruik van hulpbronne is 'n uitdaging vir Suid-Afrika in breë en spesifiek ook vir plaaslike regering. Die afwesigheid van 'n korporatiewe meganisme of model maak dit moeilik vir die Stad Kaapstad om te verseker dat risiko's op 'n integrale wyse aangespreek word. Die ontwikkeling van 'n risikobestuursmodel ter ondersteuning van korporatiewe bestuur vir die Stad Kaapstad sal poog om risiko's te verminder en/te beperk. Die vraag wat ontstaan en wat deur hierdie navorsingstudie beantwoord moet word is "Hoe kan die Stad Kaapstad risiko's ten opsigte van korporatiewe bestuur aanspreek ten einde te voldoen aan die konstitusionele en wetlike verpligtinge aan sy gemeenskap op 'n volhoubare wyse?"

Die bevindinge van toepaslike risikobestuursmodelle en/of benaderings wat deur semi-privaat en private ondernemings geïmplementeer word, is ontleed vir oorweging gedurende die ontwikkeling van 'n voorgestelde risikobestuursmodel vir die Stad Kaapstad. Wetlike vereistes en spesifieke

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ontwikkelinge rondom risikobestuur in die openbare sektor is nagevors in 'n poging om vas te stel wat van plaaslike regerings verwag word tydens die aanspreek van hul risiko's.

Wanneer die kwessie van korporatiewe bestuur aangespreek word, behoort Hoof Uitvoerende Beamptes hul organisasies se korporatiewe kultuur te herevalueer asook die voorbeeld in hierdie opsig te stel. In verband met die Stad Kaapstad het die Stadsbestuurder 'n kritieke rol te speel om 'n balans te handhaaf tussen die behoefte van kompeterende magte en die behoefte om konstant die regte dinge te doen. Topbestuur behoort die deeglikheid en toepaslikheid van korporatiewe bestuursbeleid en praktyke asook kritieke prosesse, interne beheer en ander risikobestuurspraktyke gereeld te evalueer. Voorts behoort die gehalte en bevoegdheid van alle personeel nagesien te word om te bepaal of hulle die regering se uitdadings ten opsigte van korporatiewe bestuurs verstaan. Die ontwikkeling van 'n risikomodel vir die Stad Kaapstad sal die organisasie instaat stel om pro-aktief sy risiko's aan te spreek en sodoende aan sy konstitusionele en toepaslike wetlike vereistes te voldoen.

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CHAPTER 1: INTRODUCTION

1.1 Background

Good governance, improved service delivery and sound fiscal management are some of the key initiatives of the National Government to create a better life for all South Africans as stated in the preamble of the **Constitution of the Republic of South Africa**, 1996 (Act 108 of 1996). Municipalities, in particular, have a specific reference framework in this regard. According to the **Municipal Finance Management Act** (MFMA), 2003 (Act 56 of 2003) for Local Government, councillors and municipal managers are responsible, *inter alia*, to:

- (a) ensure good corporate governance;
- (b) exercise political control over the financial affairs of the municipality;
- (c) oversee expenditure and revenue collection to prevent overspending of the budget;
- (d) ensure effective, efficient and transparent systems of financial and risk management as well as internal control;
- (e) manage and safeguard assets; and
- (f) ensure the provision of services to the communities in a sustainable manner.

In addition to the above requirements, municipalities are expected to report annually on its financial position as well as organisational performance to National Government. This will give an indication to the communities, businesses and other relevant stakeholders whether or not municipalities are delivering and fulfilling its constitutional and legislative obligations.

In each of these initiatives there is a certain amount of inherent risks which may hamper the government's overall service delivery programmes. This study envisages developing a mechanism or model that will focus on reducing or minimising risks facing local government, the City of Cape Town (CCT) in particular, to render its constitutional and relevant legislative obligations to the community.

1.2 Importance of the research

Rendering service of a high standard and economically as well as to utilise resources efficiently remains a challenge for South Africa as a whole and in particular for local government. The absence of a corporate mechanism or model for the City of Cape Town makes it difficult to ensure that risks are addressed in an integrated manner. Enhanced and increased service delivery brings about more risks.

In terms of new developments (statutory requirements and community needs) the fundamental importance and practicality of this study is therefore to establish how a holistic risk management model can contribute to create a better life for all citizens within the jurisdiction of the CCT.

1.3 Problem statement

The development of a risk management model for the CCT will endeavour to reduce and/or minimise its risks. Against the backdrop of literature published on risk management, the research question that arises and which the study seeks to provide an answer to is:

"How can the CCT deal with risks relating to specific areas of corporate governance in order to fulfill its constitutional and legislative obligations to its community in a sustainable manner?"

1.4 Aim of the study

The primary aim of this study is to develop a risk management model to enable the CCT to address its specific areas of corporate governance in order to fulfil its constitutional and applicable legislative obligations.

1.5 Constructs defined

Some of the constructs, based from a risk management perspective, used in this study are defined as follows:

Corporate governance: refers to the corporate business risks to achieve specific goals and objectives. (This study will however exclude risks pertaining to disasters, emergency and security services. This does not exclude the departments responsible for these services in the CCT, which will be subjected to the proposed risk management model in terms of its corporate business processes).

Enterprise risk management: refers to a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of the entities objective. (as defined in a Draft Report on Enterprise Risk Management Framework, 2003 by the Committee of Sponsoring Organisations known as COSO of the Treadway Commission.

Governance: refers to the structures and processes for decision-making, accountability, control and behaviour at the top of organisations (private and public organisations). In terms of public organisations it includes political structures.

Governance risk management: refers to the risks associated with governance as described above and how these risks should be managed.

1.6 Research methodology

The research methodology followed a qualitative approach with an empirical study method. The empirical study included aspects such as evaluation research, content analysis as well as methodological studies on risk management models or approaches. As far as the research procedure for this study is concerned, observation, unstructured interviews, searching the Internet and documents were used to collect and analyse data.

The unit of analysis included human and personal documents such as policies, procedures and manuals. A non-probability sampling type and specifically the purposive sampling method were used to obtain individuals with whom interviews were conducted. In addition accidental samples were utilised which included cases that happened to cross the researcher's path and added value to the subject on risk management. Preference was given to Senior Managers and High Level Specialists based on their positions and experience in the field of risk management. The data obtained from these individuals were analysed by means of systematic coding through content analysis.

1.7 Outline of the study

The outline of the study consists of the following chapters:

Chapter 2: A literature overview on risk management will be provided and the researcher will address some definitions and a few concepts on risk management as well as criteria for risk management models or approaches. Lastly, the researcher will also make a few deductions of the specific literature studied on whether or not it provides sufficient

information to develop a governance risk management model for the CCT.

Chapter 3: Based on the literature overview, the researcher will discuss related models and/or approaches as well as possible “best practices” of risk management implemented at organisations representing semi-private and private sectors. These findings will be analysed for consideration when discussing the development of a proposed risk management model for the CCT.

Chapter 4: In this chapter the focus will be placed on risk management in the public sector. Legislative requirements and specific developments on risk management will be researched in an attempt to determine what local government is expected to do in addressing their risks.

Chapter 5: The main focus of this chapter will consist of developing a proposed risk management model supporting corporate governance in the CCT with its envisaged benefits. An overview of the current reality will be provided and a “gap analysis” in comparison to the proposed risk management model will be highlighted.

Chapter 6: Specific recommendations will be made in terms of the risk management model and final comments on the study will round off the report.

CHAPTER 2: LITERATURE OVERVIEW ON RISK MANAGEMENT

2.1 Introduction

This chapter will cover a literature review on related theoretical aspects on risk management. It will firstly address a few definitions on risk management. Secondly, the author will focus on certain risk management concepts. Thirdly, the researcher envisages to determine criteria for risk management models or approaches.

2.2 Definition

The term risk management was not formally used since the early 20th century. Snider (1956) complained about the lack of literature and suitable courses on this subject. Since then, a comprehensive body of knowledge on risk management emerged and is still emerging. To define the constructs in respect of risk management, the author will elaborate on the emerging body of knowledge to set a platform for further investigation.

The definitions on risk management varies, of which the following is evident:

Valsamakis *et. al.* (1992:27) proposed the following definition:

“Risk is defined as the presence of uncertainty, where there may be uncertainty as to the occurrence of an event producing a loss, and uncertainty as regards to the outcome of the event; where the degree of risk is interpreted with reference to the degree of variability and not to the frequency with which the event will occur or to the probability that it will display a particular outcome”.

Daniell (2000:15) describes risk as a function of four interrelated variables:

the scale of the potential harm *adjusted by*
the likelihood of that harm occurring *net of*
the ability of an effective response to be put in place *adjusted by*
the likelihood of that response mechanism being deployed effectively

Dickson (1989:18) defines risk management as the identification, analysis and economic control of those risks that threaten the assets or earning capacity of an organisation.

Picoult (1998:1) describes the term risk management from a financial viewpoint as (a) the potential loss and (b) the standard deviation of the potential revenue of an investment portfolio over a period of time.

Conrow (2000:20) defines risk management as the act or practice of dealing with risk. It includes planning for risk, assessing risk issues, developing risk handling options, monitoring risks to determine how risks have changed, and documenting the overall risk management program.

In a study by Briers (2000:8) a new definition for risk management is proposed, namely, "Risk Management is the process on interventions in economic and behavioural risk dynamics so that the value of the organisation is enhanced".

The King II Report on Corporate Governance for South Africa (2001:97) defines risk management as:

"The identification and evaluation of actual and potential risk areas as they pertain to the company as a total entity, followed by a process of either termination, transfer, acceptance (tolerance) or mitigation through system appropriate internal controls".

In view of the above definitions, the researcher's opinion is that there is no right or wrong in these statements. A specific definition can be applied depending on the business environment in which private companies or public sector finds itself. In other words it does not matter how an organisation defines risks, but it is of critical importance that top executives, senior managers and employees have a common understanding of what is meant by managing risks in their own business environment.

In a business or government environment, risks, put in simple terms, are those events that cannot be predicted which could have an impact on the attainment of an organisation's goals. These risks could be present in strategic-, financial-, operational- and/or compliance objectives. In the light of the aforementioned, risk management, therefore, refers to the total set of interventions and processes of deciding which risks should be avoided, controlled, transferred or accepted.

2.3 Concepts

2.3.1 *The relationship between uncertainty and certainty*

According to Valsamakis *et. al.* (1992:2) the concept of risk management originated in the United States in the early 20th century. Risk management developed from highly sophisticated techniques that were used to control macro-risks such as, for example, nuclear catastrophes. As these techniques became known they were adapted and successfully introduced within business organisations and later in the public sector.

Uncertainty exists when there is doubt in or of something. Uncertainty arises from a person's imperfect state of knowledge concerning future events. It normally exists in situations where there is a lack of complete knowledge, sufficient information or understanding concerning a

decision and its potential consequences. Uncertainty consist of two elements, namely-

- whether an event will occur (probability / likelihood)
- what the outcome of the event will be if it does occur (impact)

The perceived level of uncertainty depends on information that an individual can use to evaluate the likelihood of outcomes as well as the individuals ability to evaluate this information. The levels of uncertainty is illustrated in the following table:

Table 1: The Certainty-Uncertainty Continuum

LEVEL OF UNCERTAINTY	CHARACTERISTICS	EXAMPLES
None (certainty)	Outcomes can be predicted with precision	Physical laws, natural sciences
Level 1: Objective uncertainty	Outcomes are identified and probabilities are known	Games of chance: cards, dice
Level 2: Subjective uncertainty	Outcomes are identified but probabilities are unknown	Motorcar accidents, fire, investments
Level 3: Total uncertainty	Outcomes are not fully identified and probabilities are known	Space exploration, genetic research

Source: Williams, C A (Jr), Smith, M L Young and P C.: *Risk Management and Insurance*, Seventh Edition, 1995

According to Valsamakis *et. al.* (1992:3) the above Table 1 indicates that where a substantial lack of understanding and knowledge of a specific situation exists, it results in a low level of confidence and assurance. In such situations the prediction of possible outcomes is impossible. The same authors also argue that there is a perception that uncertainty gives rise to risk. This is as a result of the presence of risks

where the outcomes of events are clouded with uncertainty. Willet (1951:8) makes the following distinction between risk and uncertainty:

“...it seems necessary to define risk with reference to the degree of uncertainty about the occurrence of a loss, and not with reference to the degree of probability that it will occur. Risk...is the objective correlated of the subjective uncertainty. It is the uncertainty considered as embodied in the course of events in the external world, of which subjective uncertainty, then, is in the objective and subjective aspects of variability in the outcome of events.

2.3.2 “Universalistic” risk management model

Briers (2000:27-82) did a survey on the aspects of risk thinking, as the body of knowledge on risk is extensive. The result of this survey, the author argues, could be categorised into pure risk, financial risk, corporate failure and risk-taking. An overview of each school of thought will now be provided:

2.3.2.1 Pure risk

The pure risk school of thought includes the practices of insurance and risk finance, loss prevention and risk control. Sub-sets of risk control consist of security risks, fraud prevention, human safety, environment management, legal risks, fire engineering, engineering reliability and safety, emergency preparedness, occupational health and hygiene. There is also a specific body of knowledge under this school that deals with risk analysis.

2.3.2.2 Financial risk

Financial risk is entirely preoccupied with the risks associated with money in its different forms. It is quantitative in nature, and includes risks associated with credit, equity, currencies and commodities. The

field of financial risk is characterised by a high degree of computerised technology involvement, which has become a key enabler of risk management measures, as well as contributing to the globalisation of financial risk as a discipline.

Due to the large amounts of capital involved financial risk management usually enjoys a high degree of attention and focus from board of directors as well as top management of the corporate sector. High volumes of trade in financial markets also give prominence to the field of financial risk.

2.3.2.3 Corporate failure

This school implies that extreme outcomes such as the bankruptcy of a corporate company can be predicted, prevented and managed. Corporate failure analysts exhibit many of the constructs that are prevalent in other schools on risk management.

The identification and evaluation of causes of failure, recommended best practices for the prevention of failure and financial solutions are all part of the corporate failure framework. It is common practice to justify the corporate failure school of thought within the context of risk management because the concept of failure is so strongly interrelated with risk.

2.3.2.4 Risk-taking

Risk-taking is the logical start of the risk process. Taking risks creates risk exposures. This school of thought is fundamentally different from the previous three because it deals exclusively with the positive processes of moving towards a desired benefit. The conventions of risk management focus mostly on controls, protection and prevention, with not much attention to enhancing the achievement of positive outcomes (except for the financial risk perspective). Risk-taking is different

because it looks at the processes of decision-making and human behaviour that interact with the environment and confront uncertainty.

In his research paper Briers (2000) seek to establish a holistic, integrated "universalistic" risk management model, which proposes thirteen (13), dimensions to the concept of risk. These are in no particular order the following: reward, interest, assets, value, time, information, actions, change agents, influences, triggers, risk position, probability and human origins.

The proposed "universalistic" risk management model has specific implications for risk theory across all four schools of thought. Briers highlighted that the research results showed that the existing body of risk theory was found incomplete. The research findings also imply that each of the existing schools of risk should broaden its approach to risk management.

2.3.3 *Speculative, diversifiable and nondiversifiable risks*

Williams (Jr), Smith and Young (1998:4-8) highlights three aspects of risks, namely, speculative, diversifiable and nondiversifiable risks. Speculative risks exist when there is both a chance of gain and loss present. An example of this is an investment in a capital project that could be profitable or it might prove to be a failure.

It is sometimes possible that certain risks may affect all human beings at the same time, for example, a depression in the global economy or a terrorist attack in a major role-player in world economy which could hamper the economy of other role-players to a certain extend. Unless the phenomenon of risks affects organisations or individuals in the same way and at the same time, the possibility exists for the respective entities to reduce their risk through pooling or sharing agreements.

A risk could be diversifiable if it is possible to reduce risk through pooling or risk-sharing agreements. A risk is nondiversifiable if pooling agreements are ineffective in reducing risk for the participants in the pool. The authors also make a valuable distinction between diversifiable and nondiversifiable risks because it affects the usefulness of either pooling or risk-sharing agreements.

2.3.4 *Enterprise risk management*

In recognising the need for guidance on enterprise risk management, Committee of Sponsoring Organisations (COSO) of the Treadway Commission initiated a project to develop a conceptually sound framework providing integrated principles, common terminology and practical implementation guidance supporting entities to develop their enterprise risk management processes. In terms of COSO's Draft Report on Enterprise Risk Management Framework (2001: 1-2), enterprise risk management is applied in strategy setting and across an entity's activities. It allows management to identify, assess and manage risks in the face of uncertainty and supports the value creation and preservation.

Furthermore, enterprise risk management provides enhanced capabilities to align risk appetite and strategy, link risk with growth and return, enhance risk response decisions, minimise operational surprises and losses, identify and manage cross-enterprise risks, provide integrated responses to multiple risks, seize opportunities and rationalise capital. The report highlights that the underlying premise of enterprise risk management is that every entity exists to provide value for its stakeholders. As all entities face uncertainty, the challenge for management is to determine how much uncertainty the entity is prepared to accept as it strives to grow stakeholder value.

2.3.5 Corporate governance

It should be borne in mind that when discussing corporate governance in terms of the King II Report it is applicable to the private/business sector but the underlying practices are equally relevant to the public sector. According to Valsamakis *et. al.* (1999:74), corporate governance refers to the relationships between the management of a corporation, its board, shareholders and other relevant stakeholders as well as the specific responsibilities of boards of directors and management to ensure and maintain such relationships.

The board of a company (cabinet or council in the public sector) and its management is firstly accountable to its shareholders (public). The main objective of any business organisation is to maximise the long-term benefits to its shareholders (public) in terms of profits (service delivery) and cash flow as well as minimising risks. Secondly, the board (cabinet or council) and management have a responsibility to other stakeholders by establishing long-term relationships with employees, customers, suppliers and the local community by accommodating and promulgating their interests. The aforementioned authors also highlights that the Committee on the Financial Aspects of Corporate Governance (also known as the Cadbury Committee) in a report published in 1992 recommended specific principles of corporate governance. These principles can be viewed at Appendix A.

According to the Standards Australia and Standards New Zealand, Australian/New Zealand Standard (1999:9), corporate governance is perceived as a system by which an organisation is directed and controlled. Corporate governance activities are represented as four principal components namely, direction, executive action, supervision and accountability. In addition sound risk management is an essential component of good corporate governance. Sound risk management not only contributes to good governance, it also provide protection for Boards of Directors (cabinet or council) and Corporate Executives in

the event of adverse outcomes. This protection may occur on two levels. Firstly, the adverse outcomes may not be as severe as it might have been. Secondly, it can be used to demonstrate that proper level of diligence has been exercised.

In the report of the Standards Australia and Standards New Zealand, Australian/New Zealand Standard (1990:10) it is argued that there is considerable scope to enhance corporate governance practices by building on the linkages between risks, returns and resources. Formal integration of these and other governance practices, such as corporate planning, quality assurance, annual reporting and internal audit, within a co-ordinated management cycle would possibly achieve this.

In the King II Report, corporate governance is to be understood as a competitive advantage if correctly applied. It is argued in this Report that should corporate governance be applied as a "form ticking" exercise or as something performed once a year it may as well spell the end of such as a company or business.

Furthermore, the King II Report mentioned that should corporate governance principles be applied to assist in the process of achieving objectives by managing the associated risks, then it actually imply that sound and good corporate governance is evident in such a company or business. The Board of Directors is urged to go beyond compliance and disclosure to designing and implementing the appropriate structure and processes whereby effective risk management practices can be achieved. Risk management in a corporate governance context mean that it is the board (cabinet or council) and its management's responsibility to identify and assess risks in such a way in order to achieve business objectives, develop and prioritise action plans to minimise the risk to an acceptable level. It is also expected to monitor and report on the process.

In a paper released by the Basel Committee on Banking Supervision in September 1999 it is stated that good corporate governance should provide incentives for the board and management to pursue objectives that are in the interest of the company and shareholders. It should also facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.

The following points are regarded as sound corporate governance practices:

- Establish strategic objectives and a set of corporate values that are communicated throughout the organisation.
- Set and enforce clear lines of responsibility and accountability throughout the organisation. This is in line with one of the primary characteristics of good corporate governance namely, accountability, which the King II Report refers to as those who make decisions and take actions on specific issues that should be accountable for such decisions and actions. Mechanisms must be in place and effective to allow for accountability.
- Ensure that board members are qualified for their positions, have a clear understanding of their role in corporate governance and are not subjected to undue influence from management or outside concerns. According to the King II Report (2001:14), responsibility pertains to behaviour that allows for corrective action and penalising mismanagement. In addition responsible management would, when necessary, put in place what the Board of Directors is accountable for to the company, what it must act responsively to and with responsibility towards all stakeholders of the company.
- Ensure that there is appropriate oversight by senior management. The King II Report refers to this as corporate discipline. Corporate

discipline is a commitment by a company's senior management to adhere to behaviour that is universally recognised and accepted as correct and proper.

- Utilise the work conducted by internal and external auditors effectively in recognition of the important control function they provide. This practice is referred to as independence and fairness as part of characteristics of good corporate governance in terms of the King II Report. Independence is the extent to which mechanisms have been put in place to minimise potential conflicts of interest that may exist. These mechanisms include the composition of the Board, appointments in committees of the Board and external parties such as auditors. The decisions made as well as internal processes established should be objective and not allow for undue influences. Fairness refers to systems within a company that must be balanced taking into account all those who have an interest in the company and its future.
- Conduct corporate governance in a transparent manner. Transparency, as referred to in the King II Report, is the ease with which an outsider is able to make meaningful analysis of a company's actions, its economic fundamentals and the non-financial aspects pertinent to its business. This is seen as measurement of how good management is at making information available in an open, accurate and timely manner. It also reflects whether a true picture of what is happening inside the company can be obtained.

Corporate governance should be viewed as the way in which an organisation conducts its business to achieve its objectives and goals. The question that beacons is "What is the essence of risk management within the context of corporate governance?" The answer as stated in the King II Report is that it is the responsibility of the board (cabinet or

council in the public sector) and senior management to identify and assess the risks that may impact on achieving business objectives. This could be achieved by developing a prioritised action plan to minimise risks to an acceptable level followed by consistent monitoring and reporting of the process.

The Public Accounts Committee in the United Kingdom noted in their Report on the Proper Conduct of Public Business (1994) that a framework was required which must include effective systems of control and accountability, as well as responsible attitudes of those handling public money. As a result, the Committee of Sponsoring Organisations of the Treadway Commission launched a study designed to provide guidance in helping organisations to manage their risks.

In the South African context, the Government introduced the **Public Finance Management Act** (PFMA) 1999, (Act 1 of 1999) aiming to regulate financial management in both the national and provincial government. The MFMA, which was based on the principles of the PFMA, is applicable to local government. These legislation implies therefore that a need exist to control by law financial management in the various spheres of government.

According to the Standards Australia and Standards New Zealand, Australian/New Zealand Standard (1999: 41-42), managing risks should become part of every organisations' business philosophy, goals and accepted practices. It should be an integral part of the organisation's business plans and training programmes. The implementation of risk management programmes especially at corporate level is a challenge for all Chief Executive Officers. Effective leadership can shape organisational culture by encouraging the application of risk management through organisational recognition and reward systems. It is further mentioned that managing risks provides opportunities for managers and staff at every level to continuously improve performance in meeting the challenges of the organisation.

The Standards encourages everyone in an organisation to take initiative to apply risk management practices as a way of improving individual and corporate performance, whilst ensuring that statutory requirements are being met, corporate values are not compromised and good quality client service is achieved.

2.4 Criteria for risk management models/approaches

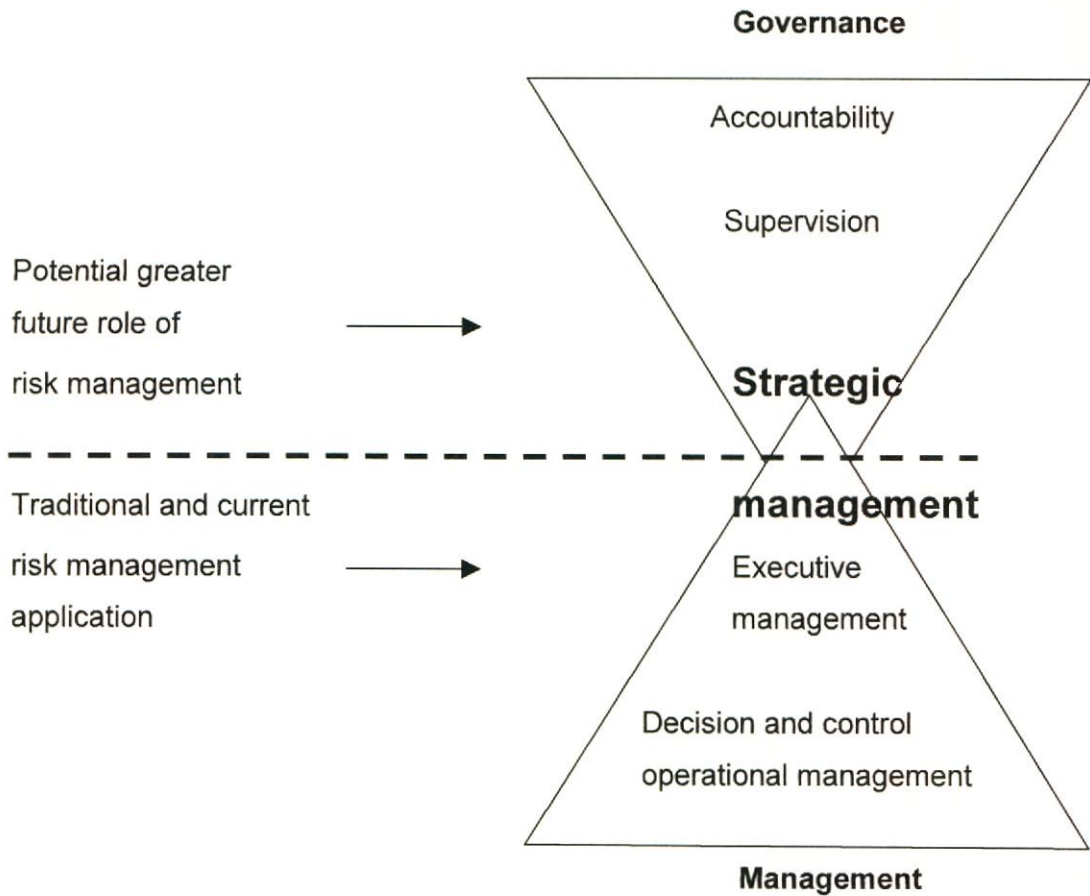
The value of the above concepts will be reflected in the chapters following this chapter when discussing the various organisations risk management models or approaches. These models or approaches will also be evaluated against, *inter alia*, the following criteria as determined by Valsamakis *et. al.* (1999: 76):

- ❑ The approach to risk management should be holistic in nature and business risks should be incorporated into the assessment process
- ❑ A sound system of risk management should be in operation with regular reviews of the effectiveness of the risk management process
- ❑ Risk management reports should include risk identification, measurement and mitigation and must cover all aspects of internal control

These authors also stressed that compliance to corporate governance principles places greater emphasis on an integrated risk management function than in the past.

The integration of the various aspects discussed in the literature overview can be summerised by the relationship between management, risk management and corporate governance as illustrated in Figure 1. It highlights the need for risk management to be undertaken at a strategic level of any organisation.

Figure 1: Relationship between Management, Risk Management and Corporate Governance



Source: Standards Australia and Standards New Zealand, Australian/New Zealand Standard 4360: 1999: *A Basic Introduction to Managing Risks*, 1999.

2.5 Summary

The literature overview shows that the scope of the risk management field is vast and not specific to a particular risk. However, it can be concluded that the emerging body of knowledge in respect of risk management provides sufficient information to develop a risk

management model for any form of business (private– or public sector).

The next chapter will focus on how risk management is implemented in the semi-private - and private sectors. The researcher would seek to determine possible “best practices” of risk management to incorporate these in the development of a proposed corporate governance risk management model for the CCT.

CHAPTER 3: RISK MANAGEMENT MODELS / APPROACHES IN THE SEMI-PRIVATE – AND PRIVATE SECTORS

3.1 Introduction

In the previous chapter an overview of the risk management field was provided and analysed. The literature overview revealed that the scope of risk management is vast and not specific to a particular risk aspect. It was concluded that the emerging body of knowledge in respect of risk management provides sufficient information to develop a risk management model for any form of business (private– or public sector).

This chapter will focus on how risk management is being implemented in the semi-private - and private sectors. The researcher would seek to determine what approaches and/or models are implemented by these sectors for consideration when developing the proposed corporate governance risk management model for the City of Cape town (CCT).

3.2 Risk management models / approaches followed

Semi-private entities visited were Telkom and Eskom to obtain first hand knowledge of what approaches / models are being followed to address their respective risks. The reason for visiting these entities is twofold. Firstly, these institutions provide for services such as telecommunication and electricity. Secondly, these institutions also provides for infrastructure. Both these services can be compared to some of the services that the CCT renders such as electricity, water, community participation (emphasis is on communication) and other community-based functions. In addition the City also provides for the development of infrastructure such as roads, water and sanitation as well as land development.

The visits at these entities were considered to be of value to determine the level of appetite that exists for risk management, as this aspect is not currently regarded as a main focus area within the public sector as yet. This was done in order to determine if “best practices” are implemented at these companies.

The South African Breweries (SAB) and ABSA Bank were also targeted as these industries represent respectively a production - and banking industry. The City is to a certain extent involved with production functions such as solid waste (including recycling) while its financial functions can be compared to that of a banking industry because of the large amount of funds it handles. The City's annual budget is about R 10 billion plus other investments, cash reserves, property and assets.

3.2.1 *Telkom and Eskom*

Personal interviews were arranged with the Regional Risk Managers of both entities. Interviews were conducted on 19 May 2003 with the Regional Risk Manager of Telkom and on 13 June 2003 with the Regional Risk Manager of Eskom. The results of these interviews revealed that Telkom and Eskom follow the same risk management model. The risk management model is based on the relationship between certainty and uncertainty as described in Chapter 2 by Valsamakis *et. al.* (1992). In terms of the model, these entities risks are managed by two essential activities namely risk control and risk financing.

Risk control, which broadly aims to –

- prevent loss from occurring;
- minimize the magnitude of loss, should the event occur; and

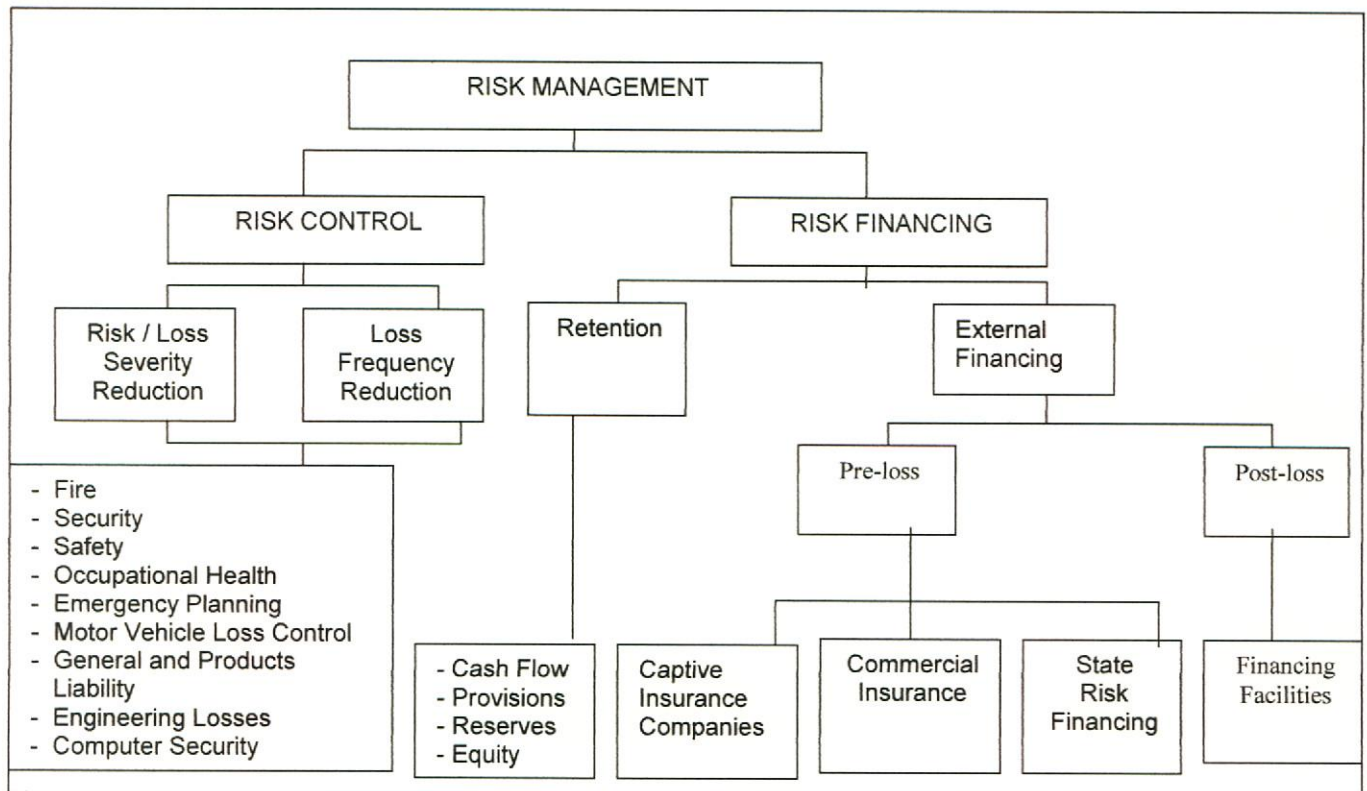
- deal with the event while it is occurring, in an attempt to recover from the loss with the least possible economic/financial consequence.

Risk financing identifies accessibility to funds via –

- an organisation's own resources; and
- the resources of a third party for example insurance or state funds.

The model can best be explained by means of a diagram as depicted in the following figure:

Figure 2: Risk Management Model of Telkom and Eskom



Source: Valsamakis, A.C, Vivian, R.W, & Du Toit, G.S.: *Theory and Principles of Risk Management*, 1992.

The model represents a process by which risks are managed at Telkom and Eskom. The process consists of the following steps:

- Risk identification
- Risk evaluation and assessment
- Risk control
- Risk financing

A brief discussion will be provided on each of the above steps according to Valsamakis *et. al.* (1992: 64 – 67):

Risk identification

Before risks can be managed, it has to be identified first. Risk identification is achieved from both a macro- and micro perspective. Macro perspective implies the identification of major perils within the organisation. This is especially necessary from a risk financing viewpoint as losses needs to be financed through either insurance or suretyship. The macro-identification usually involves the review of risks that are treated by insurance which gives rise to the following:

- Loss or damage to assets.
- The consequential losses that arise from loss or damage to assets.
- Legal liability claims in circumstances where a court of law would hold a company liable to pay compensation.
- Losses suffered by personnel.

- Pure financial losses.

These losses can arise from various perils such as fire, crime or sale of products.

The identification of major perils is followed by the micro-identification, which entails the identification of sub-perils within the macro perspective. The micro-identification aims to identify derivative perils within the main peril class. This means the identification of the various and possibly numerous sources of fire and the steps to be taken to avoid or mitigate the risk.

Risk evaluation and assessment

This step is the foundation for planning, organising and managing risks to reduce the impact of possible losses. In both entities the risk evaluation step entails quantifying the risk and determining its possible impact on the organisation. This process consist of the following:

- The evaluation of both loss frequency and loss severity. This is an analysis, which provides the measures of expected average loss and maximum possible loss.
- An analysis of the financial strength of the organisation, which entails the assessment of the company's, risks retention capacity.

Both entities make use of a numeric assessment of risk exposure during the risk evaluation process. The likelihood of a particular lost expressed in a numeric manner implies the frequency and probability of loss. Loss frequency is the measure of the number of events that occur in a predetermined cost interval. The loss probability can be determined after the loss frequency has been measured. This implies that the likelihood of an event or the certainty of an occurrence can be determined. Based on such information the respective organisations

are in a position to introduce pro-active measures and/or to plan for such losses.

Risk control

The next step in the risk management process is to minimise the risk practically through design and implementation of a physical risk management programme. This programme envisages to achieve the following goals:

- The reduction of the magnitude of the exposure.
- The reduction of the frequency of the loss-producing events.
- The dealing with loss-producing events.
- The recovery from loss-producing events.

Although these programmes are designed at a central point in the organisations, line management is responsible for the implementation and monitoring of such programmes.

Risk financing

The final step in the risk management process is to do financial provision for losses that may occur. In order to select the most efficient method of providing for the consequences of risks, the following options can be introduced, namely-

- the retention of risk under a deliberate self-insurance.
- the combination of risks to obtain the benefit of greater certainty in predicting the loss occurrences.

- the transfer of risk costs to other parties by means of insurance.

The model assist the two entities to treat their respective risk management process to perfection while occurring incidents are being addressed immediately. Reporting on risk management is performed at various management levels and to facilitate this committees/reporting mechanisms are introduced or in the process of being established. It was observed that although the two entities introduced the same model they are internally differently structured.

It is noticeable that occupational health and safety risks are regarded as the major risks at these entities. As a result of this it appears if a holistic approach in addressing risks is not followed, which the researcher identified as the main shortcoming of this particular risk management model followed. The risk element, occupational health and safety, would however be considered when developing the proposed corporate governance risk management model for the CCT.

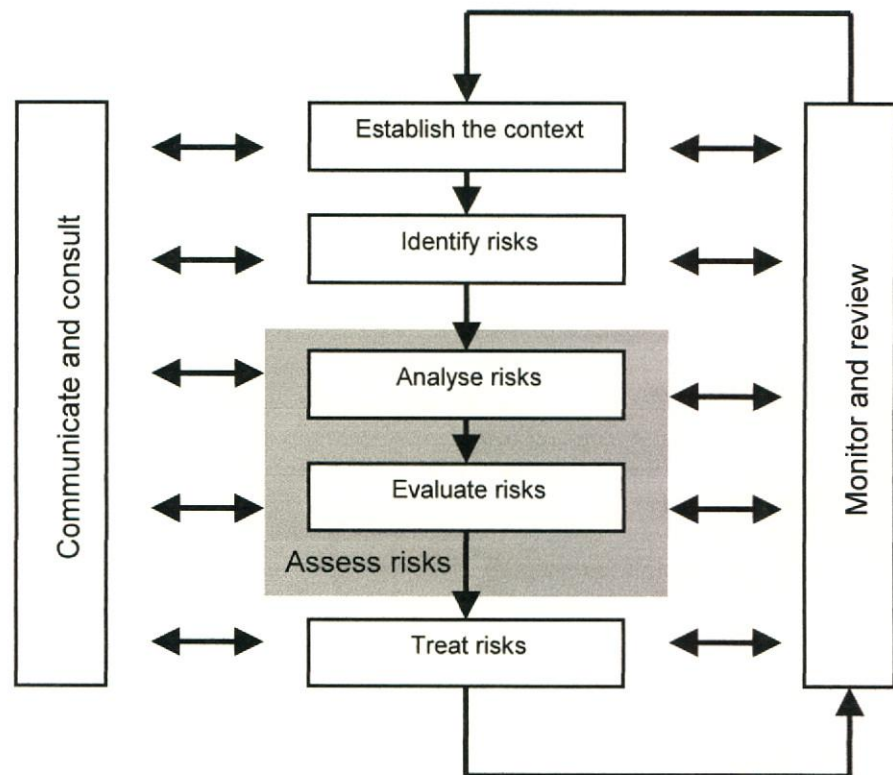
3.2.2 *South African Breweries*

During an interview held on 18 June 2003 with the Regional Risk Manager it was mentioned that the SAB does not follow a specific risk management model. However, the researcher discovered that the approach followed by the SAB is based on Standards Australia and Standards New Zealand, Australian/New Zealand Standard as discussed in Chapter 2. The way risks are being managed by SAB is that it forms part of the organisation's business philosophy, goals and everyday practices. Risk management practices are applied in such a way that it improves individual and corporate performance, meeting statutory requirements and that corporate values are not being compromise. The company's approach to risk management can be categorised as follows:

- (a) Identify risks per service area
- (b) Assess the impact of risks
- (c) Monitor and evaluate the risks
- (d) Address gaps continuously

This approach can be illustrated as follows:

Figure 3: South African Breweries: Risk Management Approach based on the Australian/New Zealand Risk Management Approach



Source: Standards Australia and Standards New Zealand, Australian / New Zealand Standard 4360: 1999: *Risk Management*, 1999.

The risk management approach as outlined above consists of seven steps namely, establish the context, risk identification, risk analysis, risk evaluation, risk treatment, monitoring and communication and consultation, which will be discussed, in more detail:

Establish the context

The risk management process occurs within the framework of the SAB's strategic, organisational and risk management context. This is necessary to define the basic parameters within which risks must be managed and to provide guidance for decisions. The process will now be discussed in more detail:

Establish the strategic context

The establishment of the strategic context refers to defining the relationship between the organisation and its environment, identifying its strengths, weaknesses, opportunities and threats. The context includes the financial, operational, competitive, political (public image), social, client, cultural and legal aspects of the SAB's functions. This step is focused on the environment in which the organisation operates. During this step the SAB seek to determine the crucial elements that might support or impair its ability to manage the risks it faces. The strategic context confirms that a close relationship must exist between an organisation's strategic objectives and the management of all its risks.

Establish the organisational context

It is necessary to understand the business rules of the organisation, its capabilities, goals and objectives as well as the strategies that are in place to achieve them. This context must be understood before embarking on a risk management process due to the following reasons:

- (a) Risk management takes place in the context of the wider goals, objectives and strategies of an organisation.
- (b) Failure to achieve the objectives of an organisation is risks that must be managed.
- (c) The organisational policy and goals help to define the criteria by which it is decided whether a risk is acceptable or not and form the basis of options for treatment.

Establish the risk management context

After the two previous contexts are established the risk management process should be undertaken with the need to balance costs, benefits and opportunities. The following aspects should be considered when the scope and boundaries of a risk management process are being set up:

- (a) Defining the project or activity and establish its goals and objectives.
- (b) Defining the extent of the project in time and location.
- (c) Identifying any studies needed and their scope, objectives and resources required.
- (d) Defining the extent and comprehensiveness of the risk management activities to be carried out.

Develop risk evaluation criteria

Decisions concerning risk acceptability and risk treatment may be based on operational, technical, financial, legal, social, humanitarian or other criteria. These are dependent on the organisation's internal policy, goals, objectives and interests of stakeholders. Internal and external perceptions and legal requirements may affect risk criteria. It should be borne in mind that although risk criteria are developed as part of establishing the risk management context, it might be further

developed and refined when other risks are identified and risk analysis techniques are chosen.

Define the structure

The defining of the structure involves separating the activity or project into a set of elements. These elements provide a logical framework for identification and analysis, which helps ensure significant risks, is not overlooked. The structure chosen depends on the nature of the risks and the scope of the project.

Risk identification

This step seeks to identify the risks to be managed. Comprehensive identification using a well-structured systematic process is critical because a potential risk not identified at this stage is excluded from further analysis. Identification should include all risks whether or not they are under the control of the organisation.

The aim, during this step, is to generate a comprehensive list of events that might affect each element of the structure mentioned earlier. Having identified a list of events, it is necessary to consider possible causes and scenarios. Approaches used to identify risks include checklists, flow charts, brainstorming, systems analysis, scenario analysis and systems engineering techniques.

Risk analysis

The objective of analysis is to separate the minor acceptable risks from the major risks and to provide data to assist in the evaluation and treatment of risks. This step involves the consideration of sources of risk, their consequences and the likelihood that those consequences may occur. Factors, which affect consequences and likelihood, may be

identified. Risk is analysed by combining estimates of consequences and likelihood in the context of existing control measures.

The type of analysis use by the SAB is known as the qualitative analysis. The qualitative analysis uses word form or descriptive scales to describe the magnitude of potential consequences and the likelihood that those consequences will occur. Qualitative analysis is used -

- as an initial screening activity to identify risks which require more detailed analysis
- where the level of risk does not justify the time and effort required for a full analysis
- where the numerical data are inadequate for a quantitative analysis

The following tables are examples of how the SAB practically address its likelihood and consequences of risks:

Table 2: Qualitative Measures of Consequence

Level	Descriptor	Example detail description
1	Insignificant	No injuries, low financial loss
2	Minor	First aid treatment, on-site release immediately contained, medium financial loss
3	Moderate	Medical treatment required, on-site release contained with outside assistance, high financial loss
4	Major	Extensive injuries, loss of production capability, off-site release with no detrimental effects, major financial loss
5	Catastrophic	Death, toxic release off-site with detrimental effect, huge financial loss

Table 3: Qualitative Measures of Likelihood

Level	Descriptor	Description
A	Almost certain	Is expected to occur in most circumstances
B	Likely	Will probably occur in most circumstances
C	Possible	Might occur at some time
D	Unlikely	Could occur at some time
E	Rare	May occur only in exceptional circumstances

Table 4: Qualitative Risk Analysis Matrix-level of risk

Likelihood	Consequence				
	Insignificant 1	Minor 2	Moderate 3	Major 4	Catastrophic 5
A (almost certain)	H	H	E	E	E
B (likely)	M	H	H	E	E
C (moderate)	L	M	H	E	E
D (unlikely)	L	L	M	H	E
E (rare)	L	L	M	H	H

Source: Standards Australia and Standards New Zealand, Australian/
New Zealand Standard 4360: 1999: *Risk Management*, 1999.

An example of the Western Cape Region of the SAB's risk analysis and priority ranking table is displayed at Appendix B.

Risk evaluation

Risk evaluation involves comparing the level of risk found during the analysis process with previously establish risk criteria. Risk analysis and the criteria against which risks are compared in risk evaluation should be considered on the same basis. This will result in qualitative

evaluation that involves the comparison of a qualitative level of risk against qualitative criteria.

The output of a risk evaluation is a prioritised list of risks for further action. The objectives of the organisation and the extent of opportunity, which could result from taking risks, should also be considered.

Risk treatment

Risk treatment involves identifying the range of options for treating risk, assessing those options, preparing risk treatment plans and implementing them. The following options can be explored for risk treatment namely -

- ☐ avoid the risk by deciding not to proceed with the activity likely to cause risks
- ☐ reduce the likelihood of the occurrence
- ☐ reduce the consequences
- ☐ transfer the risk
- ☐ retain the risk

Options should be assessed on the basis of the extent of risk reduction and the extent of any additional benefits or opportunities created. Options may be considered and applied either individually or in combination. When selecting the most appropriate option the cost of implementing each option should balance with the benefits deriving from it.

Treatment plans include how the chosen options will be implemented. The plan normally identifies responsibilities, schedules, expected

outcome, budgeting, performance measures and the review of the process set in place. The plan also includes a mechanism for assessing the implementation of the options against performance criteria, individual responsibilities and other objectives as well as to monitor implementation.

The successful implementation of the risk treatment plan requires an effective management system that specifies the methods chosen, assigns responsibilities and individual accountabilities for actions. The plan is also used to monitor progress against specified criteria.

Monitoring and review

The risk management approach needs to be monitored consistently by evaluating the effectiveness of the risk treatment plan, strategies and the management system to control implementation. It is also necessary to regularly repeat the risk management cycle. At the SAB this is prevalent, as there are always factors present that may affect the likelihood and consequences of an outcome. Factors may also affect the suitability or costs of the various treatment options.

Communication and consultation

Communication and consultation are an important consideration at each step of the risk management approach. A communication plan must form an integral part of the risk management process, as it should address issues relating to both the risks itself and the process to manage it. A clear understanding is required between all stakeholders regarding the roles and responsibilities when implementing the risk management plan.

In the case of the SAB the identifying of risks and the assessing of the impact of risks are a rolled up process from the bottom to the highest level within the organisation to compile a "Top 10 Priority Risk

Checklist" based on criteria determined beforehand. A copy of the SAB's Top Ten Risks is attached as Appendix C. This is achieved to channel the organisation's resources efficiently and effectively as not all risks can be addressed at the same time. However, should the company's budget allow for it, medium risks are being addressed at operational level. The risk management approach is maintained according to standards such as, NOSA which includes quality, safety, health and environment, AXA systems (systems audit and maintenance schedule), ISO 9000, Fire protection, Chlorine, Ammonia assessment as well as Production flows.

The approach followed by the SAB is in line with the criteria mentioned in Chapter 2. Aspects identified includes that a holistic approach is being followed, a sound system of risk management is in operation with regular reviews to improve effectiveness as well as the reporting of risks which covers aspects of risk identification, measurement and internal control. This approach could serve as input when implementing the proposed risk management model for the CCT.

The SAB is currently gearing itself to go beyond upholding and implementing the standards set for risk management to a "what if" analysis. This process is called Business Continuity Management (BCM) by taking into account potential treats to the organisation, the need for disaster prevention planning and to actively manage the continuity of the business in order for all systems and processes to operate at a continuously constant level. The envisaged steps of the BCM include the following:

- ❑ Risk Management
- ❑ Disaster Recovery
- ❑ Facilities Management

- ❑ Supply Chain Management
- ❑ Quality Management
- ❑ Health and Safety
- ❑ Knowledge Management
- ❑ Emergency Management
- ❑ Security
- ❑ Crisis Communications and
- ❑ Public Relations

It would be worthwhile to monitor the progress of the BCM process at the SAB as this could add value not only to other private sectors but also the public service.

3.2.3 *ABSA Bank*

A discussion held on 23 July 2003 with the Regional Risk Manager for the ABSA Group indicated that the Group is currently going through a process of re-assessing its risks. In terms of addressing its risks the Group's focus until recently were mainly on complying to legislation by implementing policies and processes. The Internal Audit Department was tasked to ensure that policy and processes were implemented and failing in doing so resulted in the termination of employment.

The Board of Executives and Senior Executives realised with time that a different approach was needed. The role and name of the Internal Audit Department changed to that of Enterprise Risk Management with its focus on addressing ABSA's risks with regard to uncertainty and

values. Uncertainty presents both risk and opportunity, with the potential to either erode or enhance value. Factors such as globalisation, technology, regulation, restructuring, changing markets and competition created an amount of uncertainty for the Group. These uncertainties affected also the values of the Group, as management decisions regarding strategy to operational issues were not always accepted in a positive way. These two issues contributed to the re-assessment of how the Group should address its risks.

According to the Regional Risk Manager, no formal risk management model or approach has been followed during the initial stage of the re-assessment phase. The Company went through a process where potential risks with regard to the uncertainty and value factors mentioned above have been identified and assessed. These risks were prioritised and action plans are currently being compiled for discussions before final decisions are made. It was highlighted that one of the priorities determined by the Group was that of people management. People management includes, *inter alia*, talent management, performance management, job competencies, appropriate job grading levels and reward management.

The Governor, Susan Bies, of the United States Federal Reserve Bank remarked at an Annual International Symposium on Derivatives and Risk Management, 8 October 2002, that due to the rapid changes that occur, so-called "people risks" arises. Bies sited that these risks are related to training employees in new products and processes. Employees who join the banking industry need to learn the culture of Banks and its control environment. Employees unfamiliar with their new roles and responsibilities, the systems they use, the services they provide to customers, the oversight expected by supervisors and members of internal control functions are all likely to create control breaks.

It can be concluded that banks worldwide are following the trend where the focus is shifting to address risk issues relating to people management. Policies and processes still need to be followed but employees must be trained and retrained to acquire skills, knowledge and attitudes to contribute to the practicing of good corporate governance in the banking industry. The aspect of people management was interpreted by the researcher as a valuable input in developing a corporate governance risk management model for the CCT.

3.3 Summary

This Chapter provided an opportunity to analyse particular cases on how the private sector is addressing their specific risks. The study revealed that the sectors do not adopt one specific risk management model or approach. The conclusion is made that depending on the specific business needs a risk management model or approach is followed that suits the company best.

The next chapter will focus on how the public sector is addressing its risks. This will create the opportunity to determine what the CCT as a Municipality and an integral part of the public sector should do to manage its corporate governance risks.

CHAPTER 4: RISK MANAGEMENT IN THE PUBLIC SECTOR

4.1 Introduction

In the previous chapter the researcher focussed on how risk management is addressed in the semi-private and private sectors. It was found that these sectors do not follow one risk management approach or model but that a model or approach was based on the entities' business needs.

This chapter will address the issue of risk management within the public sector, the risk management approach as well as certain elements of the risk management approach. The Western Cape Provincial Government (WCPG) will be used as an example of how risk management is implemented in the public sector in South Africa.

4.2 The public sector context

The public sector plays a major role in society and good governance in the public sector can encourage the efficient use of resources, strengthen accountability for the stewardship of those resources, improve management and service delivery, and thereby contribute to improving peoples' lives. Good governance is also essential for building confidence in public sector entities, which is necessary if public sector entities are to be effective in meeting their goals and objectives.

According to an International Public Sector Study (Study 13, August 2001) by the International Federation of Accountants, common principles and recommendations were established concerning the governance of public sector entities. These principles are attached as Appendix D. The objective of this study was to provide guidance to assist governing bodies or "top management" of public sector entities to develop or review governance practices in such a way to enable them to operate in a more effective, efficient and transparent manner.

The principles outlined are applicable to all public entities, including national, regional – (for example state, provincial, territorial) and local governments (for example city, town), related government entities (for example agencies, boards, commissions) and government business enterprises.

The study emphasised that the public sector is complex, and public sector entities do not operate within a common legislative framework or have a standard organisational size. The diversity of the public sector and the different models of governance that apply in different countries and sectors should be recognised. This requires special attention, which may impose different sets of accountabilities.

4.3 Current situation in the South African public sector context

The object of the **Public Finance Management Act** (PFMA) 1999, (Act 1 of 1999) is "...to ensure transparency, accountability and sound management of revenue, expenditure, assets and liabilities of the institutions to which this Act applies". The PFMA stipulates the rules and regulations that should be followed to enhance and achieve the object. The content of the Act establishes fundamental "best practice" management principles. The implementation of these principles is left to the Accounting Officers and their managers of the various government departments and entities.

Section 38 of the PFMA prescribes the general responsibilities of accounting officers and other officials in departments, trading entities or constitutional institutions. These delegated responsibilities provide the framework for the accountability duty of government officials. The following must be done in order to be accountable:

- General and specific responsibilities must be met.
- The meeting of such responsibilities must be demonstrated by way of reporting on operating and financial results.

- Programmes should be executed economically, efficiently and effectively.
- Management must take informed and calculated risks and demonstrate the proper management of risks.
- Personnel and activities must be controlled by means of various preventative, detective and corrective internal controls.

In terms of Section 76 of the PFMA the National Treasury must issue Treasury Instructions or Regulations in order to support the fundamental principles of the PFMA. The legislation, regulations and instructions concerned, in total, constitute part of the control environment within which programmes (services) must be executed and managers involved must function. However all activities must take place through internal control measures as well as the application of specific management principles and techniques.

The Guide for Accounting Officers, 2000 provide specific guidelines relating to the implementation of the PFMA and the Treasury Instructions. Each Accounting Officer must prepare an implementation plan to address the priorities of their departments. The issues to be addressed include the following:

- ❑ The system and processes that will allow the monitoring and reporting of monthly budgetary performance.
- ❑ The effectiveness of existing internal controls based on an assessment of the risks facing the department.
- ❑ The extent to which the internal audit unit and the audit committee are approximately capacitated and functional.
- ❑ The appointment of a suitable and qualified Chief Financial Officer.
- ❑ The extent to which systems and processes can ensure efficient and effective management of revenue, expenditure, liabilities and assets.

- ❑ Delegation of responsibilities to managers and relevant officials within the department.
- ❑ Proposals to ensure suitable oversight of any public entities controlled by the department.

From the above it can be concluded that the PFMA requires that Accounting Officers must address their department's specific risks. The rest of this chapter will focus on how the WCPG (Department of Social Services and Poverty Alleviation) is addressing their risks.

4.4 Essential elements of the risk management approach followed by the Western Cape Provincial Government (Department of Social Services and Poverty Alleviation)

The ex-Head of Internal Audit from the Department of Provincial Administration Western Cape suggested that a study be done at the Department of Social Services and Poverty Alleviation (DSSPA). This study would provide the researcher with sufficient information on how the DSSPA addresses their respective risks in with specific relation to corporate governance. The researcher conducted various telephonic discussions with the Risk Manager of the DSSPA to obtain information on what approaches the Department is adopting to address its risks.

The essential elements of the risk management approach followed by the DSSPA is based on the components of enterprise risk management as explained in the Draft Report on Enterprise Risk Management Framework (2003: 12-13). These components include the following eight points:

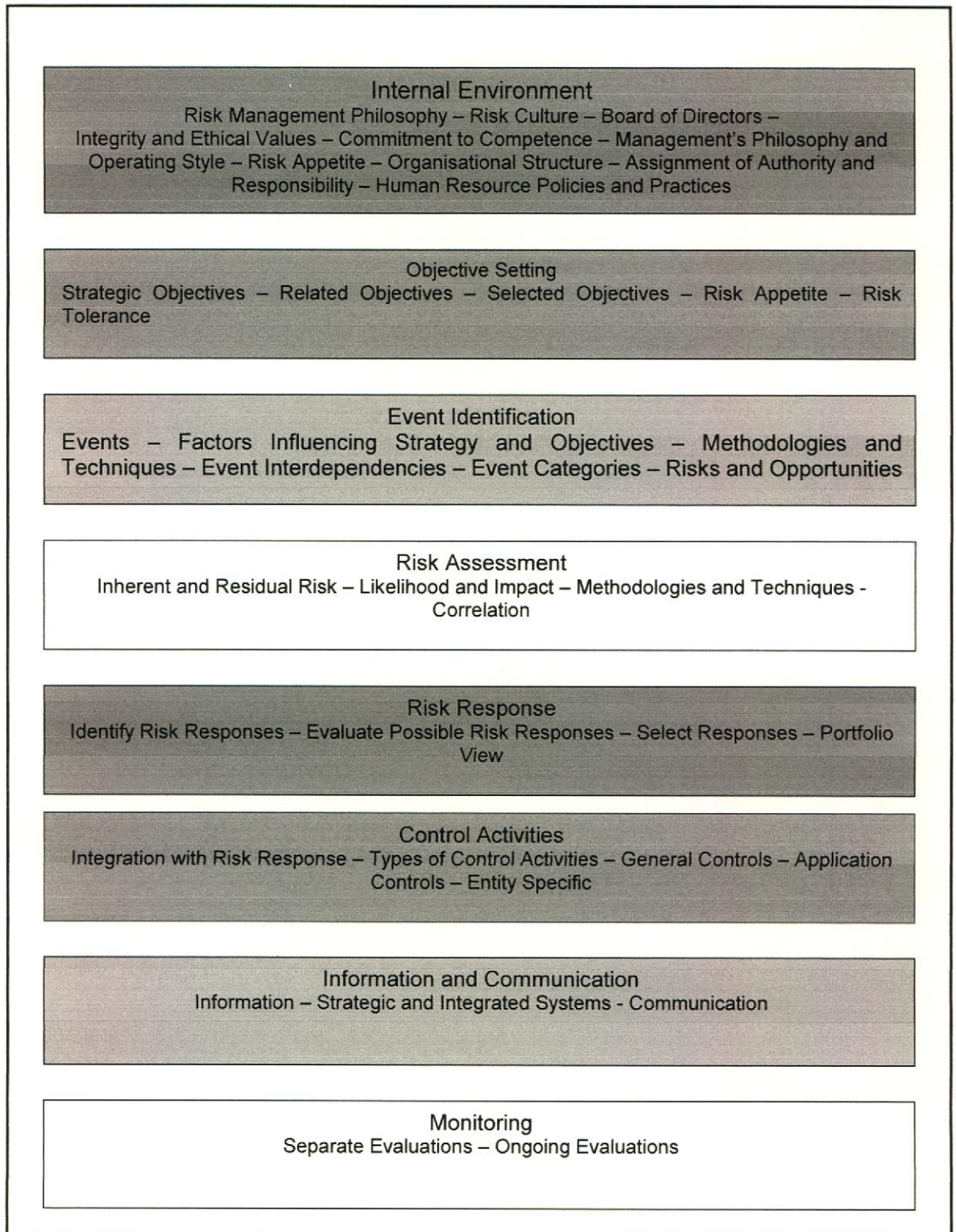
- **Internal environment:** Management must set a philosophy regarding risk and establishes a risk appetite. The internal environment also sets the foundation for how risk and control are viewed and addressed by a company's people. The core of any

business concern is its people and the environment within which they operate.

- **Objective setting:** Strategic objectives must exist before management can identify events to achieve the set objectives. These strategic objectives in turn must support and be aligned with the vision and mission of the business.
- **Event identification:** Potential events must be identified that might have an impact on the entity. Event identification includes internal and external factors (risks) that influence how potential events may affect strategy implementation and the achievement of objectives.
- **Risk assessment:** Identified risks are analysed in order to form a basis for determining how it should be managed. Risks are assessed on both an inherent and a residual basis and the assessment considers both the likelihood and impact.
- **Control activities:** Policies and procedures are established and executed to help ensure that the risk response management selected are carried out effectively.
- **Information and communication:** Relevant information is identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information is needed at all levels of an entity for identifying, assessing and responding to risk.
- **Monitoring:** The entire enterprise risk management process must be monitored and changes made when necessary. Monitoring is accomplished through ongoing management activities and evaluations of the enterprise risk management processes.

The components explained can be depicted as follows:

Figure 4: Components of Enterprise Risk Management



Source: The Committee of Sponsoring Organisations of the Treadway
Commission: *Draft Report on Enterprise Risk Management, 2003.*

4.5 The risk management approach followed by the Department of Social Services and Poverty Alleviation (DSSPA) in the Western Cape Provincial Government

The approach followed by the Department of Social Services and Poverty Alleviation (DSSPA) regarding addressing its risks is based on the components Objective Setting, Event Identification, Risk Assessment and Risk Response mentioned in the Draft Report on Enterprise Risk Management by the Committee of Sponsoring Organisations (COSO) of the Treadway Commission. These components mentioned in the draft report will be briefly discussed hereunder.

4.5.1 *Objective setting*

Objective setting is a precondition to event identification, risk assessment and risk response. Objectives must first be established before management can identify risks to their achievement and take the necessary actions to manage risks. The DSSPA's objective setting consists of the following:

- ✓ Mission
- ✓ Strategic objectives
- ✓ Strategies
- ✓ Related objectives

Strategic objectives are high-level goals, aligned with and supporting the Department's mission and vision. The strategic objectives reflect management's decisions as to how the organisation will seek to create value for its customers and stakeholders. In considering alternative strategies to achieve its strategic objectives, management identifies

risks associated with a range of strategy choices and considers their implications.

Establishing the right objectives that support and are aligned with the selected strategy, relative to the entire Department's activities, is critical to success. By focussing first on strategic objectives and strategy, the organisation is in a position to develop related objectives at operational levels, achievement of which will create and preserve value. These related objectives can be categorised as follows:

- Operations objectives: These pertain to the effectiveness and efficiency of the Department's operations.
- Reporting objectives: Refers to the reliability of reporting, which include internal and external reporting.
- Compliance objectives: These objectives pertain to the adherence to relevant legislation and policy.

4.5.2 Event identification

An event is an incident or occurrence emanating from internal or external sources that could affect implementation of strategy or achievement of objectives. Events may have positive or negative impacts, or both. As part of event identification, management recognises that uncertainties exist, but does not know when an event may occur or its outcome should it occur. Management would initially consider a range of potential events – affected by both internal and external factors – without necessarily focusing on whether the potential impact is negative or positive. Internal factors include aspects such as infrastructure, personnel, processes and technology, while external factors consist of issues such as business and economic, natural environment, political and social.

4.5.3 Risk assessment

Risk assessment allows management to consider the extent to which potential events might have an impact on the achievement of objectives. Management assess events from two perspectives namely likelihood and impact. The positive and negative impacts of potential events are examined individually or by category across the organisation. Potentially negative events are assessed on both an inherent and residual basis.

4.5.3.1 Inherent and Residual Risk

Inherent risk is the risk to the Department in the absence of any action management might take to alter either the risk's likelihood or impact. Residual risk is the risk that remains after management responded to the risk.

In assessing risk, management considers the impact of expected as well as unexpected potential events. Many events are routine and recurring, which are addressed in the Department's budget and programmes. Events that are unexpected often have a low likelihood of occurrence but may have a significant potential impact for example, the loss of pension grants (money) due to robbery. In such cases unexpected events are usually responded to separately. However, uncertainty still exists in terms of both expected and unexpected potential events as each has the potential to affect strategy implementation and achievement of objectives. Risk assessment is usually applied first to the inherent risks. Once risk responses have been developed, management will use risk assessment techniques to determine residual risks.

4.5.3.2 Likelihood and Impact

Uncertainty of potential events is evaluated from two perspectives namely, likelihood and impact. Likelihood represents the possibility that a given event will occur while impact represents its effect. Likelihood and impact of occurrence are assessed in terms of high (H), moderate (M) or low (L) based on the following table:

Table 5: Likelihood and Impact of events

LIKELIHOOD	IMPACT
High: A high chance of occurrence; likely to occur soon and/or often.	High: A material financial impact on the organisation is likely; significant impact on the organisation's viability or its objectives; significant political and/or community sensitivity.
Moderate: A moderate chance of occurrence – below x% and above y%; likely to occur rather in the medium term and/or not that often.	Moderate: A major financial impact (but less than that of high) is likely; moderate impact on the organisation's viability or its objectives; moderate political and/or community sensitivity.
Low: A low chance of occurrence (below a certain percentage); has not occurred in the past; would be surprise if it occurs and/or will not occur often, if at all.	Low: The financial impact is likely to be low; minimal impact on the organisation's ability or its objectives; minimal political and/or community sensitivity.

Source: South African Institute for Government Auditors:
Internal Control and Risk Management, 2000.

Each risk identified are evaluated according to the above table and positioned in the following matrix:

Table 6: Risk Matrix on Likelihood and Impact

IMPACT	LIKELIHOOD		
	Low	Moderate	High
Low	Risk 1: ... Risk 5: ...		
Moderate		Risk 2: ...	Risk 3: ...
High	Risk 6: ...		Risk 4: ...

Source: South African Institute for Government Auditors: *Internal Control and Risk Management*, 2000.

Based on the above tables, the risks can be prioritised as 4; 3; 2; 6; 1/5 and 5/1 and the risk assessment matrix, based on management agreement of the percentage chance for likelihood of occurrence and financial values for impact, can be expressed as follows:

Table 7: Risk Assessment Matrix on Likelihood and Impact

Likelihood		Impact	
75% - 100%	4	Material	4
50% - 74%	3	High	3
25% - 49%	2	Noticeable	2
0% - 24%	1	Slight	1

Source: South African Institute for Government Auditors: *Internal Control and Risk Management*, 2000

4.5.4 Risk response

Risk response is an indication of how management will respond after assessing risks. Responses include risk avoidance, reduction, sharing and acceptance. When considering its responses management considers costs versus benefits and selects a response that brings expected likelihood and impact within a desired risk tolerance. According to the Draft Report on Enterprise Risk Management (2003: 53-55) risk response consist of two elements namely, identifying and evaluating. These two elements will be broadly discussed hereunder.

4.5.4.1 Identifying risk responses

The risk responses fall within the following categories:

Avoidance: Action is taken to exit the activities giving rise to risk. Risk avoidance may include terminating a function or combining departments.

Reduction: Action is taken to reduce the risk likelihood or impact, or both. This may involve a myriad of business decisions.

Sharing: Action is taken to reduce risk likelihood or impact by transferring or sharing a portion of the risk. This could include buying insurance, pooling risks or outsourcing a specific function.

Acceptance: No action is taken to affect likelihood or impact.

4.5.4.2 Evaluating risk responses

Inherent risks are being analysed and responses evaluated with the intent of achieving a residual risk level aligned with the department's risk tolerances. Management considers how individual responses or combinations of responses interact to affect potential

events. When evaluating response options, management considers the effect on both risk likelihood and impact differently. The potential response to the assessment of likelihood and impact may consider past events and trends as well as possible future scenarios.

Since there are always constraints on resources (financial and human), management must consider the costs and benefits of risk response options. Cost and benefit measurements for implementing risk response options are made with different levels of precision. The researcher supports the view of the authors of the Draft Report on Enterprise Risk Management Framework that although this option is challenging in nature the cost-benefit analyses should be performed at a level sufficient to evaluate risk responses on an individual risk or portfolio basis.

According to the Draft Report on Enterprise Risk Management Framework (2003: 56), event identification describes how enterprise risk management identifies events that affect achievement of objectives, either positively or negatively. Those with positive potential impacts represent opportunities and are channelled back to the strategy or objective-setting processes. Management may also identify innovative responses, which could be new to the Department or Government as a whole. Such opportunities normally surface when existing risk response options are becoming less effective or further refinements may only bring about slight improvement to a risk impact or likelihood. In this regard the DSSPA identified service delivery, financial sustainability and people as its key risk areas and is currently in the process of developing action plans to address these risks.

4.6 Summary

From the above discussion it can be concluded that the Department of Social Services and Poverty Alleviation of the Western Cape Provincial

Government (WCPG) is moving in a direction to address and manage their respective risks as outlined in the PFMA. However, it should be mentioned that although the Enterprise Risk Management approach has been designed by the Internal Audit unit for the WCPG not all Departments introduced it as yet. This is due to various reasons such as lack of capacity, knowledge, training, skilled personnel or management's commitment to manage their risk.

In the next Chapter the researcher will mainly concentrate on the development of the proposed corporate governance risk management model for the City of Cape Town with its envisaged benefits. An overview of the current reality will be provided and a "gap analysis" in comparison to the proposed risk management model will be discussed.

CHAPTER 5: THE PROPOSED RISK MANAGEMENT MODEL FOR THE CITY OF CAPE TOWN

5.1 Introduction

In the previous chapter the researcher discussed the approach followed by the Department of Social Services and Poverty Alleviation at the Western Cape Provincial Government is following in terms of risk management. The implementation of the concept corporate governance as explained in Chapter 2 is a relatively new concept to the public sector. The **Public Finance Management Act** (PFMA) 1999, (Act 1 of 1999) is applicable to the public service and the **Municipal Finance Management Act** (MFMA) 2003 (Act 56 of 2003) which is applicable to local government are legislation, which serves as cornerstones to the broader public sector to comply with the principles of corporate governance.

This chapter will focus on an overview of the current reality within the City of Cape Town, the development of the proposed risk management model for the CCT with its envisaged benefits. Where applicable “best practices” discussed in Chapters 3 and 4 will be considered to determine this risk management model as well as a “gap analysis” in comparison to the envisaged risk management model.

5.2 Current reality within the City of Cape Town

Based on interviews conducted with relevant High Level Specialists within the City and studying of certain official documents the researcher will seek to provide a broad overview of the current reality within the CCT instead of giving attention to too much detail. This overview will consist of a background, the City’s challenge and the way forward.

5.2.1 *Background*

Currently the CCT is operating differently and under difficult circumstances than prior the year 2000. At the heart of these circumstances were changes of the political control and –system, market economy, profile of the population as well as new life challenges. In an unpublished document “Our City, Our Pride: The Plan for Cape Town, 2003 – 2005”, it is mentioned that local government in the Cape Town Metropolitan area has achieved much since 1995, including the consolidation of local democracy, the extension of services and the completion of major restructuring. There are also sporadic examples of innovation and good practice.

These achievements, however, should not create a false sense of well being. It may be argued that the CCT is facing a challenge in bending key socio-economic trends in a positive direction. In order to achieve this a different approach to managing the City is required. The City need to radically re-organise and re-gear its arrangements to address its complex, competitive and changing environment characterised by growing demands with limited increases in resources.

The above-mentioned document highlights that since the establishment of the new CCT in December 2000, it has made slow progress in fulfilling its leadership and developmental obligations. In an attempt to refocus the organisation towards its development challenge, the new political coalition, ANC/NNP, prepared a new strategic focus, including priority programmes and projects for the financial year 2003 – 2004.

5.2.2 *The City of Cape Town's challenges*

It should be borne in mind that the challenges facing the City of Cape Town is an enormous task, which need to be address in a holistic manner. In the document “Our City, Our Pride: The Plan for Cape

Town, 2003 – 2005”, the following main challenges were identified to be addressed:

- Experience sound socio-economic growth, but many citizens remained trapped in poverty.
- Enjoy high levels of basic service infrastructure in most communities, but positive and sustained social outcomes are low.
- Remain a centre of creativity, innovation, culture and diversity, but lacks common vision and purpose.
- Are custodians to assets of location, nature, human and financial resources, but have a tendency to undervalue and waste them.
- Possesses enormous opportunity, but have the capacity to undermine this that result in underperforming.
- Exhibit staff and other resources unmatched by any other local authority in South Africa, but have not yet maximised its impact on servicing the City.
- Plan exhaustively, but fail to follow through in service delivery.
- Consistently produce examples of innovation in service delivery, excellence and moving staff commitment, but have not mainstreamed and grown these initiatives into the organisation as a whole.

In addition to the above the City identified the following financial challenges as presented by the City Manager to Top Management on 5 August 2003:

- ❑ Due to the City's financial situation at present it is drawing loans of R 600 million
- ❑ Salaries as from September 2003 would possibly be funded from the General Insurance Fund
- ❑ Despite drawing the R 600 million loan, the City would still need to borrow a further R 1.2 billion for this financial year

- ❑ Extrapolating this suggests a borrowing requirement of R 3 billion by the end of 2005 which seems unaffordable and unlikely to be secured
- ❑ The nature of these challenges can be contributed to –
 - cash reserves being depleted at the end of 2000
 - extent of unfunded mandates
 - relative high cost of staff and administration
 - decrease of income collection rates

The City's Integrated Development Plan (IDP) also reflects the result of an institutional analysis of the organisation. This analysis was done with the objective to understand the environment within which the City operates and how it influences the programmes and projects envisaged for the financial year 2003 – 2004. The following table reflects the swot analysis for the CCT:

Table 8: Swot Analysis for the City of Cape Town

STRENGTHS
The majority staff possess the necessary skills and are passionate about their work
Good partnerships with the private sector and other spheres of government
Good infrastructure for electricity distribution network, water distribution network, and depots
WEAKNESSES
Poor focus on communities and poor public relations
No system to monitor and manage its performance on service delivery
Officials negative towards new Information Technology system although old system often resulted in incorrect billing of customers
Inadequate internal communications and co-ordination between departments which hampers poor service delivery to communities
Poor staff compliment profile

OPPORTUNITIES
Cape Town is a brand name which should be exploited to encourage people to live and work, visit, invest and trade
Growth rate higher than the average national growth
City is a large property owner (land, building, equipment valued at R 70 billion) and there is potential for income generation to fund critical projects
Enhance existing partnerships and build new partnerships with the private and other public sectors to assist in improving service delivery
Opportunity to design a new organisation in terms of structure, culture, values, goals and strategies
The adoption of a new political system, Executive Mayoral system may enable the City to speed up decision-making to fast track service delivery
The IDP and Medium Term Income and Expenditure Framework requirements allow the City to plan strategically for the future to ensure sustainability and to align the budget to the IDP
CHALLENGES
The City's high unemployment rate (19.7%) may have negative effects such as poverty, crime and public dissatisfaction
High levels of crime reduces investor confidence, reduced public confidence and portray a negative image of the City
The HIV/Aids and TB epidemic poses a serious threat in terms of increased health care costs, reduced productivity and an increase in the number of orphans
Growth of informal settlements and the inability to service such areas
Non-payment of services and inappropriate spending poses a risk to financial sustainability

Source: City of Cape Town: *Integrated Development Plan*, 2003 - 2004

5.2.3 *The way forward*

The City's Executive and Top Management are committed to address those issues that pose a risk to the organisation in fulfilling its constitutional obligations. The vision of the City is to establish Cape Town as a City that is:

- ✓ Sustainable - a city that offers a future for the children and their children
- ✓ Dignified – a tolerant, non-racist and non-sexist city
- ✓ Accessible – a city that extends the benefits of urban society to all and builds the capacity of its people
- ✓ Creditable – a well govern city trusted by its people
- ✓ Competent – a city with skills, capabilities and a competitive edge
- ✓ Safe and caring
- ✓ Prosperous, known for its ability to compete in the global environment

To give effect to the vision the following strategic objectives has been identified:

- (a) Poverty reduction
- (b) Economic development, tourism promotion and infrastructure development
- (c) Land release and improvement of service delivery
- (d) Good governance
- (e) Improving health, safe and security

- (f) Financial sustainability
- (g) Partnerships
- (h) Human resource development, care for the disabled and people with special needs
- (i) Communication

With regard to being a creditable City and who endeavours to practice good governance the City adopted the King II Report on Corporate Governance during April 2003. In terms of the IDP, corporate governance is acknowledge as a "lever to address converging interests" of financial sustainability, environmental and social responsibility. It is envisaged that good governance would provide an effective mechanism in combating inefficiency and corruption.

Good governance would facilitate alignment with the MFMA, which will, *inter alia*, enforce stringent provisions for financial reporting and accountability. In this regard the City envisages to establish a Standing Committee on Public Accounts with a suitable terms of reference. Furthermore, the development of a risk management model supporting corporate governance would allow the City to address its potential and inherent risks in a holistic and integrated manner.

5.3 The proposed risk management model for the City of Cape Town

In Chapter 1 it was mentioned that good governance, improved service delivery and sound financial management is some of the key initiatives of the national government to create a better life for all South Africans. Municipalities have a significant role to play in these initiatives. In each of these initiatives there are a certain amount of inherent risks which may hamper the government's overall service delivery strategies and goals.

In Chapter 2 it was mentioned that corporate governance could be viewed as the way in which an organisation conducts its business to achieve its objectives and goals. “What the essence of risk management within the context of corporate governance is?” is the question that needs to be answered. Senior management, *inter alia*, must identify and assess risks that may impact on achieving business objectives.

Chapter 3 focussed on how risk management is being implemented in the semi-private - and private sectors. The researcher investigated what approaches and/or models are implemented by these sectors for consideration when developing the proposed corporate governance risk management model for the CCT. In terms of the criteria for risk management models/approaches mentioned in Chapter 2 the following was established:

- It was noticeable that the major risk element at Telkom and Eskom is the occupational health and safety risk.
- It appeared as if a holistic approach in addressing risks is not followed, which the researcher identified as the main shortcoming of the risk management model followed by the two entities.
- Despite the above shortcoming the risk element, occupational health and safety would nevertheless be considered when developing the proposed corporate governance risk management model for the CCT.
- The SAB follows a holistic approach and a sound system of risk management is in operation with regular reviews to improve effectiveness as well as the fact that risk management reports covers aspects of risk identification, measurement and internal control.

- The approach followed by the SAB could serve as input when implementing the proposed risk management model for the CCT.
- Banks worldwide are following the trend whereby the focus is shifting to people management. Policies and processes still need to be followed but employees must be trained and retrained to acquire skills, knowledge and attitudes to contribute to the practising of corporate governance in the banking industry.
- The aspect of people management was interpreted by the researcher as a valuable input in the development of a corporate governance risk management model for the CCT.

Chapter 4 addressed the issue of risk management within the public sector, the risk management approach as well as certain elements of the risk management approach. The WCPG (DSSPA) was used as an example of how risk management is implemented in the public sector in South Africa. The following was established based on the criteria for risk management models/approaches mentioned in Chapter 2:

- The risk management approach followed by the Department is in line with the criteria as it attempts to address risks in a holistic manner.
- Regular reviews of the effectiveness of the risk management process are present despite the fact that the Department is currently in its initial stage.
- Service delivery, financial sustainability and people were identified amongst others as some of the key risks areas that will serve as input when developing the corporate governance risk management model for the CCT.

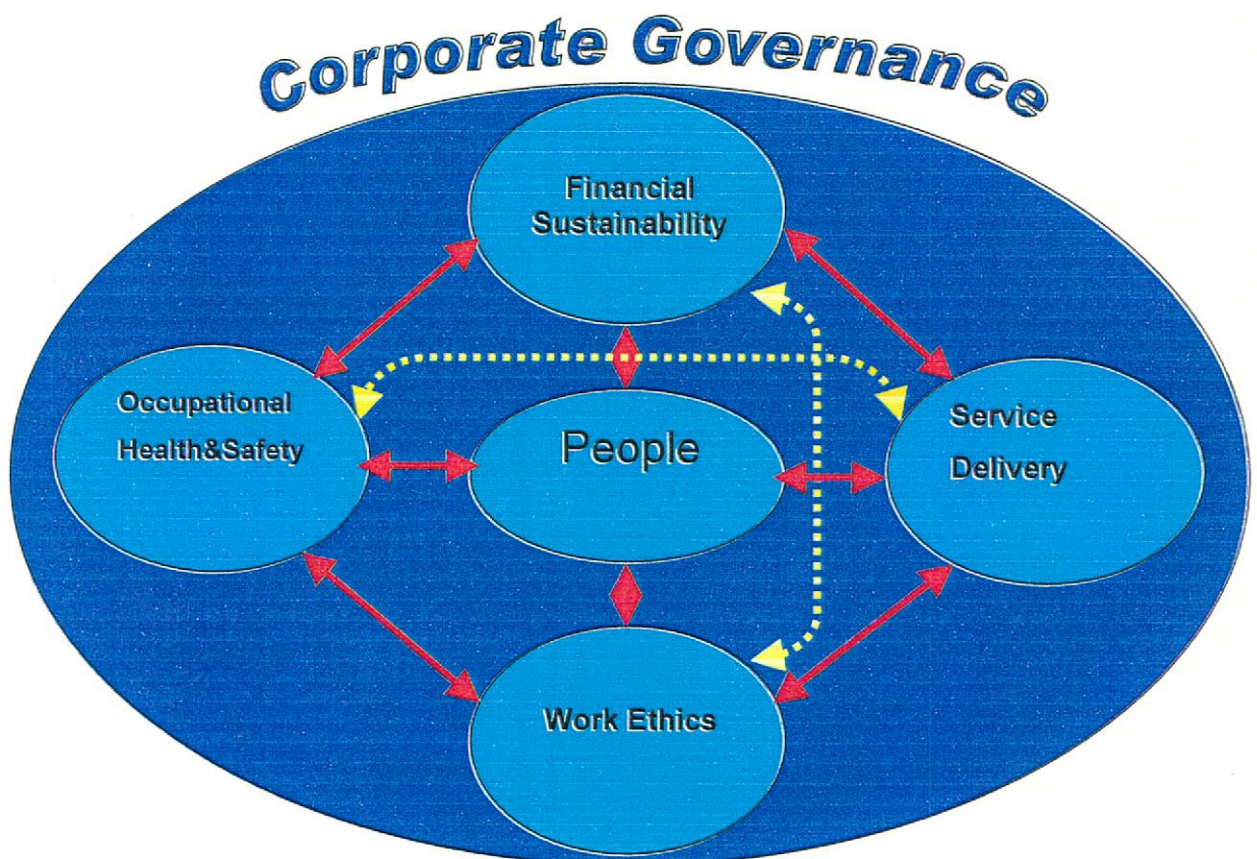
The two critical questions to answer in this Chapter are the following:

- How can the CCT deal with risks relating to specific areas of corporate governance in order to fulfill its constitutional and legislative obligations to its community in a sustainable manner?
- Whether the proposed risk management model complies with the criteria for risk management models/approaches highlighted in Chapter 2?

The proposed corporate governance risk management model for the CCT consists of five (5) key elements namely, people, service delivery, financial sustainability, occupational health and safety and work ethics.

The envisaged model can be illustrated as follows:

Figure 5: City of Cape Town: Proposed Risk Management Model



Although corporate governance consist of many aspects or elements as mentioned in Chapter 2, the researcher is of the view that the five (5) elements reflecting in the proposed risk management model represents the key focus areas for any public sector organisation to implement good corporate governance. These focus areas will be discussed broadly to provide an understanding of how the CCT should go about addressing its corporate governance risks.

The following discussion will focus on the interpretation of the proposed model. The questions formulated are main questions determined by the researcher whereby the organisation should be able to assess it by providing sufficient evidence.

Element 1: People

The cornerstone of any organisation is its people. In Chapter 3 it was mentioned that the trend in the banking industry is to focus more on people management. According to Denton and Noemdoe (2001: 6), organisations over the world are operating in an environment that is experiencing tremendous change and turbulence. These factors are having a major effect on the way people management within organisations will be perceived and managed. The authors argue that the current trend is to move to the contribution that progressive people management is making to organisational effectiveness. The current trend recognise that -

- ❑ people matters;
- ❑ people impact on the bottom line and make the difference between a successful organisation and its failure;
- ❑ people are the only assets that appreciate in value the more they are used; and
- ❑ people control the organisation's capacity to drive innovation, entrench continuous improvement and deliver customer satisfaction.

The conclusion can be made that people is expected to add value to the effectiveness of organisations. In addition a certain amount of risks relating to the risk element people could be present which may have an impact on the proposed corporate governance risk management model. In this regard the researcher determined the following questions, which may be appropriate for organisations to address the risk element surrounding managing people:

- ❑ Does the City demonstrate that it has a succession planning system for all employees in place?
- ❑ Management at all levels displays the ability to recognise talent and then to nurture and develop it?
- ❑ The City demonstrates that it is concern about training and developing its staff in that each employee has a developmental plan that is aligned with the needs and budget of the organisation?
- ❑ The City shows signs of commitment in achieving its strategic objectives and business plans by aligning these with the staff's key performance areas and competencies?
- ❑ The City design and apply innovative recognition systems to sustain involvement, empowerment and achievement?

The researcher is of the view that although there are many issues relating to this risk element the above questions can be interpreted as some of the most critical ones, which could pose a threat to any organisation.

Element 2: Service Delivery

This element has a close link with the risk elements people and financial sustainability. Municipalities are compelled by the **Constitution, Municipal Systems Act, 2000 (Act 32 of 2000)** as well as other applicable legislation to ensure equitable provisioning of services to communities. Service delivery and strategies must relate to the vision and mission of an organisation. These aspects are normally

incorporated into a performance management system. Any performance management system must, however, consist of the following key aspects:

- ❑ It must be aligned with, and support the vision, mission, strategic objectives and critical success factors of the organisation.
- ❑ Assist in workflow streamlining, maximising throughput as well as eliminating waste and frustration.
- ❑ Minimise surprises.
- ❑ Reflect strategic, tactical and operational-level realities.
- ❑ Provide reasons for the root causes of poor performance.
- ❑ Contain information, both on what needs to be measured and what the unit of measurement must be.

In an article published in the Hologram Newsletter (2003), Atkinson *et.al.* mentioned that municipalities have to be structured along the following guidelines:

- ✓ Municipalities must be primarily “output-based”. In such a way it would focus on developmental outputs for example infrastructure, poverty alleviation, community-based projects and investment promotion.
- ✓ In such an output-orientated manner municipalities’ corporate (support) functions should aim at primarily supporting the developmental functions. The allocation of resources would be substantially programme- and project orientated.
- ✓ To focus on developmental functions municipalities should employ highly specialist, knowledgeable, experienced and competent staff in developmental management, programme or project management.
- ✓ Municipalities will have to co-operate and co-ordinate activities during the implementation of projects preferably via a corporate project office or department.

In view of the above the following main questions were determined to address the possible risks relating to service delivery:

- ❑ Does the City of Cape Town's service delivery framework demonstrate that the needs of the community have been considered?
- ❑ How does the City ensure that sufficient resources are allocated for sustainable service delivery?
- ❑ How does the performance management – and measurement system link to the performance of financial and non-financial performance indicators?
- ❑ Does the City demonstrate that it is serious about the improvement of service performance?
- ❑ How does the City of Cape Town display a positive interface with the communities its serves and its relationship with stakeholders?

Element 3: Financial Sustainability

The object of the MFMA is to ensure sound and sustainable management of the financial affairs of local government. The following norms and standards are envisaged to give effect for the requirements of the MFMA:

- ✓ transparency, accountability and lines of responsibility;
- ✓ management of revenues, expenditure, assets, liabilities and handling of financial dealings;
- ✓ budget and financial planning, processes and co-ordination with other spheres of government;
- ✓ borrowing; and
- ✓ the handling of financial challenges.

According to Carter (2003: 8), the above norms and standards can help to ensure that the budget focuses on achieving quality service delivery by requiring municipalities to deliver outputs within prescribed cost

limits and according to specific timeframes. This will also assist with the implementation of policies in order to achieve goals as the norms and standards provide policy makers with service delivery requirements that municipality's should strive towards. Furthermore, the MFMB place the following responsibilities on political leaders and municipal managers:

- exercise political control over the financial affairs of the municipality;
- oversee expenditure and revenue collection to prevent overspending of the budget;
- ensure effective, efficient and transparent systems of financial and risk management as well as internal control;
- manage and safeguard assets; and
- ensure the provision of services to the communities in a sustainable manner.

The following key questions has been determined to identify possible risk factors in terms of financial sustainability:

- What mechanisms do the City employs to align the municipality's budget with its business plans and integrated development plan?
- How does the City integrate financial risks within its strategic direction and -plan?
- The City demonstrates that appropriate monitoring and reviewing systems are in place to assess the viability and sustainability of the municipality's finances in terms of-
 - (a) credit worthiness;
 - (b) affordability of rates and service charges;
 - (c) feasibility of capital expenditure programmes; and
 - (d) responsibility towards municipal infrastructure maintenance programmes.

- How does the City prove that its financial ratios for debt management, asset management and profit management (operating expenses as a percentage of revenue) are in line with international financial ratios or better?
- The City demonstrates commitment to ensure effective, efficient and economical delivery of services to its communities?

Element 4: Occupational Health and Safety

This element is closely linked to the risk element people. The researcher is of the view that occupational health and safety warrants a separate key focus due to the ripple effect it have on individuals, households, society and the country as a whole. Whilst the risk element people focus is on development, occupational health and safety has to do with the protection of people and assets. The King II Report emphasised that organisations should be mindful of the following regarding occupational health and safety:

- (a) The severity and scope of the risk concerned;
- (b) The cost and benefits of removing that risk;
- (c) Decreased productivity through death, sick and compassionate leave;
- (d) Reduction in the available skills base; and
- (e) Diminished investor confidence in general.

The King II Report highlights, *inter alia*, the following concerning the issue of occupational health and safety:

- Corporate governance should reflect a commitment to prevent accidents and fatalities.
- The **Occupational Health and Safety Act**, 1993 (Act 85 of 1993), "... requires employers to provide and maintain a safe and healthy risk-free working environment. Directors and especially Chief

Executive Officers, can incur personal liability for failure to do this".

- The legislation relies on self-regulation from employer, making corporate governance practices important in this regard.
- There should be a regular measurement against an ongoing improvement objective, which should be disclosed to stakeholders.

The above extracts from the King II Report on corporate governance are some of the key reasons why Telkom and Eskom place a high priority on this risk element. In these organisations as well as the SAB, the principle of prevention applies. This principle underscore the belief that if people are educated, informed and taught life skills early in life, they will be in a better position to cope with a challenging life situation. In an article published in the HR Future (2003), this principle has an impact on cost, risk and coverage factors for organisations regarding people support and development programmes. Furthermore, this principle is especially of value for organisations to focus more on prevention than reaction, for example, work-related accidents, substance abuse as well as other socio-economic factors which impact negatively on an individual in the workplace.

In order to address occupational health and safety in a focussed and integrated manner the following main questions were determined by the researcher for organisations to address this risk element:

- ❑ How does the City demonstrate that it cares for its employees and assets?
- ❑ The City has appointed responsible persons and committees in terms of the Occupational Health and Safety Act?
- ❑ All departments have a prevention plan in place to protect staff and assets?

- Regular inspection is carried out and shortcomings are addressed on a continuous basis?

Element 5: Work Ethics

An integral part of practicing good corporate governance is that work ethics need to be firmly established and sustained in every organisation. Work ethics however must start with the individual. Work ethics is about distinguishing between right and wrong (HR Future, 2003). It is closely link to the organisation's vision, values, goals and the way forward towards achievement, motivation and growth.

Deceit, dishonesty, theft, fraud and corruption take place every day in the workplace. The above-mentioned article also refers to values that are enshrined in the way the organisation does business and the type of people it employs. Ethics deal with the philosophy of moral conduct and standards of acceptable behavioural and attitudinal traits. This element is together with the risk elements 1 and 3 are regarded as soft elements, which the King II Report would like to see all South African organisations comply with voluntary.

It is also expected from all employees to report any form of misconduct. If not, it creates the impression that people agrees with the unacceptable behaviour displayed. This form of reporting is often referred to as "whistle blowing." In this regard the **Protected Disclosure Act**, 2000 (Act 26 of 2000) provides relief to encourage a culture of whistle blowing. The aim of this Act is to "... create a culture of which will facilitate the disclosure of information by employees relating to criminal and other irregular conduct in the workplace in a reasonable manner by providing statutory guidelines for the disclosure of such information and protection against any reprisals as a result of such disclosure".

Disclosure as defined in the above-mentioned Act as “ any disclosure of information regarding any conduct of an employer, or an employee of that employer, made by any employee who has reason to believe that the information concerned shows or tend to show one or more of the following:

- ❖ a criminal offence has been, is being or is likely to be committed;
- ❖ a person has failed, is failing or is likely to fail to comply with any legal obligation to which that person is subject;
- ❖ the health or safety of an individual has been, is being or is likely to occur;
- ❖ the environment has been, is being or is likely to be endangered;
- ❖ any matter that is referred to above, is being or is being likely to be deliberately concealed”.

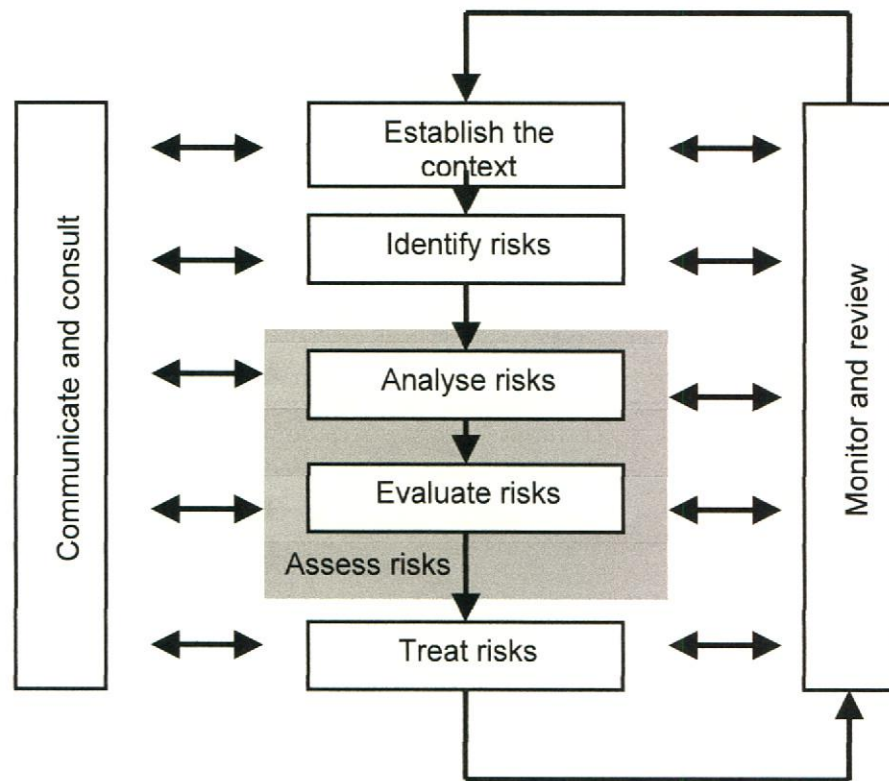
Legislation, policies, systems and procedures alone cannot be introduced as deterrent factors to reduce risks. The following questions were designed by the researcher in an attempt to address the risk element work ethics:

- ❑ The City of Cape Town has a Code of Ethics signed by all employees
- ❑ The City has developed a culture of eradicating all forms of corruption and unethical behaviour
- ❑ The City has introduced an ethical training course for all employees
- ❑ The City has programmes in place that reinforces ethical behaviour to all employees
- ❑ What control mechanisms are in place to ensure that assets and equipment are well protected and safe?

The above elements as described in the proposed corporate governance risk management model could serve as a basis to practice good corporate governance. The approach followed by the SAB as shown in Figure 3 and discussed in Chapter 3 could be applied when

developing a risk profile for the City. The following risk management approach could be applied when addressing the five key elements as identified in the proposed model:

Figure 3: South African Breweries: Risk Management Approach based on the Australian/New Zealand Risk Management Approach



Source: Standards Australia and Standards New Zealand, Australian/
New Zealand Standard 4360: 1999: *Risk Management*, 1999.

5.4 Benefits of the proposed risk management model

The proposed corporate governance risk management model will bring about the following benefits to the CCT:

- (a) It complies to the criteria for risk management models/approaches mentioned in Chapter 2.
- (b) Align risk appetite and strategy.
- (c) It is link to growth, risk and return on investments.
- (d) Enhances risk response decisions.
- (e) It will reduce and minimise operational surprises and losses.
- (f) It identifies and manages cross-enterprise risks.
- (g) Provide integrated responses to multiple risks.
- (h) It seizes opportunities when necessary.
- (i) It rationalises capital to the benefit of the organisation.

5.5 Gap analysis between the proposed model and the current reality within the City of Cape Town

The CCT acknowledged in its IDP the following gaps with regard to the King II Report:

- The absence of an organisational risk profile for the City of Cape Town.
- The absence of a risk management strategy in response to the risk profile.
- No reviewing mechanisms are in place to improve the City's ethical practices and organisational integrity.
- Limited progress is made by the Skills Development Plan in developing human capita.
- The non-existence of an Office of the Public Complaints Commissioner. Since the report writing of this thesis began such an Office has been established by the CCT.

In addition to the above the researcher would also like to mention the following shortcomings between the proposed model and the current situation:

- ❑ Council's expectations on the key elements of the corporate governance risk management model are not communicated to and followed by the all staff members.
- ❑ The lack of the above results in that risk management is addressed in an uncoordinated and fragmented manner.
- ❑ Few strategies are in place for Council to ensure that Top Management and employees acts in the best interest of the organisation.
- ❑ A lack of management information and knowledge about risks facing Council exists to put the City in a position to fulfill its constitutional and applicable legislative requirements to the communities in a sustainable manner.
- ❑ The absence of a risk management model for the City results that Council is not geared to take advantage of how to respond to crises, problems and successes from its experiences of risks. In addition, it does not provide Council the ability to have an oversight of risks and opportunities.
- ❑ There are limited mechanisms established where Council and Top Management "set the tone at the top" that reinforces the organisation's values and promotes a "risk aware culture".

5.6 Summary

This chapter focussed on the development of a risk management model to address specific areas of corporate governance for the City of Cape Town with its envisaged benefits. This proposed model focused on five (5) key elements namely, people, service delivery, financial sustainability, occupational health and safety and work ethics. Where applicable "best practices" discussed in Chapters 3 and 4 were considered to determine the proposed risk management model. The Chapter concluded with an overview of the current reality of the City as well as a "gap analysis" in comparison with the envisaged risk management model.

In the following chapter the proposed risk management model will be recommended for implementation by the CCT. The researcher will conclude the thesis by addressing issues such as possible future studies, the role of a chief risk officer and what the role of top management should be to achieve corporate governance.

CHAPTER 6: RECOMMENDATIONS AND CONCLUSION

6.1 Introduction

The main focus of this final chapter is to recommend the proposed risk management model as discussed in the previous chapter for implementation by the City of Cape Town (CCT). The researcher will conclude the chapter and thesis by addressing issues such as possible future studies, the role of a position of chief risk officer and what the role of top management should be to implement the principles of corporate governance.

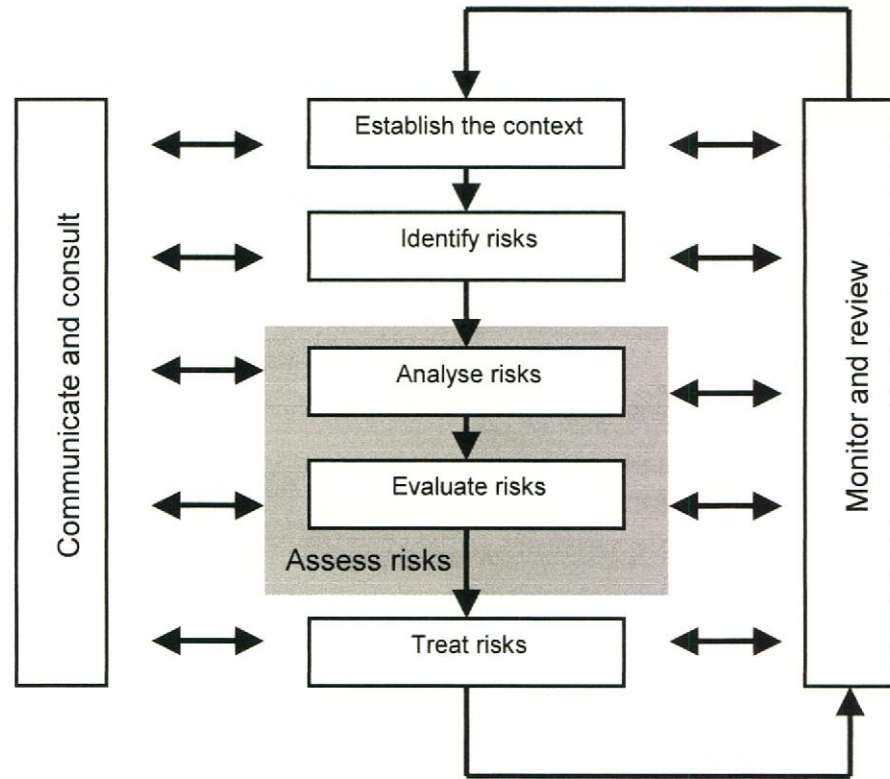
6.2 Recommendations

It is recommended that the CCT accepts the proposed Risk Management Model (Figure 5) for implementation. The proposed model was developed as a corporate mechanism to allow the CCT to address and manage its risks relating to corporate governance in order to fulfill its constitutional and other related legislative obligations to the community in a sustainable manner. The risk management approach (Figure 3) followed by the South African Breweries should be implemented when addressing the various risk elements. This approach can be summarised as follows:

- (a) Identify risks per service area
- (b) Assess the impact of risks
- (c) Monitor and evaluate the risks
- (d) Address gaps continuously

This risk management approach can be illustrated as follows:

Figure 3: South African Breweries: Risk Management Approach based on the Australian/New Zealand Risk Management Approach



Source: Standards Australia and Standards New Zealand, Australian / New Zealand Standard 4360: 1999: *Risk Management*, 1999.

6.3 Conclusion

The researcher would like to conclude the chapter and thesis by highlighting the following issues:

- ✓ Possible future studies
- ✓ The role of a Chief Risk Officer
- ✓ Top Management's role in achieving corporate governance

6.3.1 *Possible future studies*

The focus of this study was to develop a risk management model to enable the CCT to address its potential governance risks in order to fulfill its constitutional and applicable legislative obligations. A follow up on this study would, *inter alia*, include developing a tool to assist with implementing the proposed risk management model. Recommended practices and answers would need to be researched for the questions posed in each key risk element of the proposed risk management model.

6.3.2 *The role of a position of Chief Risk Officer*

In terms of the **Municipal Systems Act**, 2000 (Act 32 of 2000), a Municipal Manager is responsible for the overall organisation, management and staffing of the body and for its procedures in financial and other matters of the municipality. The Municipal Manager is accountable, *inter alia*, for processes, public resources and organisational performance. Based on these responsibilities and accountabilities of the City Manager for the CCT it is advisable that a position of Chief Risk Officer (CRO) should be considered.

The oversight role of a CRO is to pose tough questions to Top Management in order to assure themselves that risks has been fully considered during the strategic and business planning processes. In the City's case, this function is traditionally allocated to the Internal Audit Department, which need to be re-considered. The researcher support the views expressed in the King II Report and the Draft Report on Enterprise Risk Management Framework that internal audit is not risk management and visa versa. The reason for this is that this unit should be regarded as a role-player to assist when addressing risk management issues.

Some companies or organisations worldwide that realises the value of risk management have established a centralised co-ordinating unit to facilitate enterprise wide risk management. In the case of the CCT and depending on its risk appetite thought should be given to appoint a CRO to address and manage the City's risks. The following responsibilities mentioned in the King II Report as well as the Draft Report on Enterprise Risk Management Framework could be allocated to a CRO:

- ✓ Monitors a company's entire risk profile, ensuring that major risks are identified and reported upwards.
- ✓ Provides and maintains the risk management infrastructure to assist the City in fulfilling its constitutional and legislative requirements.
- ✓ Formulates risk management strategies, policies and processes that include defining roles and responsibilities and participating in setting goals for implementation.
- ✓ Framing accountability and authority for enterprise risk management in business units.
- ✓ Promoting an enterprise risk management competence throughout the organisation, including facilitating development of technical enterprise risk management expertise and helping managers to align risk responses with the organisation's risk tolerances.
- ✓ Guiding integration of enterprise risk management.
- ✓ Establishing a common risk management language that includes common measures around likelihood and impact as well as common risk categories.
- ✓ Overseeing development of organisation-wide and business unit-specific risk tolerances and working with managers to establish control activities and recommending corrective action where necessary.
- ✓ Reporting directly to the City Manager on progress and recommending action as required.

6.3.3 *Top management's role in achieving corporate governance*

In a newspaper article (Sunday Times, 2003), the importance of management's role in achieving good governance was highlighted. The researcher agrees to the following suggestions made to assist chief executive officers to strengthen corporate governance practices:

- (a) Chief Executive Officer's should reassess their corporate culture and the "tone from the top". In the CCT's case the City Manager has a critical role in balancing the need to address competitive forces and the need to consistently do the right things. Issues to consider include: "How open and candid is vertical and horizontal communication in the organisation? Do incentives reward right behaviour among all employees?"
- (b) Top Management should re-evaluate the completeness and appropriateness of corporate governance policies and practices. Does the organisation properly articulate each employee's responsibility? Ensure mechanisms such as hotlines are in place to give employees access to top management.
- (c) Re-evaluate the financial statement process. Organisations should identify and challenge who is responsible for determining asset valuations and other critical estimates, the quality of underlying data and the process for reviewing initial determinants.
- (d) Scrutinise the quality of accounting principles and the fullness of disclosure.
- (e) Re-evaluate critical processes, internal controls and other risk management practices.
- (f) Examine the quality and competence of all staff. Do they understand government's challenges, business risks and regulatory matters? Continuing education is vital.

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APPENDIX A

PRINCIPLES OF CORPORATE GOVERNANCE

The Committee on Financial Aspects of Corporate Governance (known as Cadbury Committee) established the following principles of corporate governance:

- The board of executive should exercise leadership, enterprise, integrity and judgment in directing the corporation so as to achieve continuing prosperity and act in the best interest of the business enterprise in a manner based on transparency, accountability and responsibility;
- Ensure that, through a managed and effective process, board appointments are made that provide a mix of proficient directors, each of whom is able to add value and to bring independent judgment to bear on the decision-making process;
- Determine the corporation's purpose and values, determine the strategy to achieve its purpose and to implement its values in order to ensure that it survives and thrives, and ensure that procedures and practices are in place that protects the corporation's assets and reputation;
- Monitor and evaluate the implementation of strategies, policies, management performance criteria and business plans;
- Ensure that the corporation complies with all relevant laws, regulations and codes of best business practice;
- Ensure that the corporation communicates with shareholders and other stakeholders effectively;
- Serve the legitimate interests of the shareholders of the corporation and account to them fully;

- Identify the corporation's internal and external stakeholders and agree on a policy, or policies, determining how the corporation should relate to them;
- Ensure that no one person or a block of persons has unfettered power and that there is an appropriate balance of power and authority on the board which is, inter alia,, usually reflected by separating the roles of the chief executive officer and Chairman, and by having a balance between executive and non-executive directors;
- Regularly review processes and procedures to ensure the effectiveness of its internal systems of control, so that its decision-making capability and the accuracy of its reporting and financial results are maintained at a high level at all times;
- Regularly assess its performance and effectiveness as a whole, as well as that of the individual directors, including the chief executive officer;
- Appoint the chief executive officer and at least participate in the appointment of senior management, ensure the motivation and protection of intellectual capital intrinsic to the corporation, ensure that there is adequate training in the corporation for management and employees, and a succession plan for senior management;
- Ensure that all technology and systems used in the corporation are adequate to properly run the business and for it to remain a meaningful competitor;
- Identify key risk areas and key performance indicators of the business enterprise and monitor these factors;
- Ensure annually that the corporation will continue as a going concern for its next fiscal year.



SOUTH AFRICAN BREWERIES: WESTERN CAPE REGION: RISK ANALYSIS AND PRIORITY RANKING TABLE

A.	VERY HIGH	COMMON - REGULAR OCCURRENCE
B.	HIGH	POSSIBILITY OF REGULAR OCCURRENCES (HAVE HAPPENED)
C.	MODERATE	ISOLATED INCIDENTS (COULD HAPPEN)
D.	LOW	NOT LIKELY - BUT NOT IMPOSSIBLE
E.	VERY LOW	RARE - PRACTICALLY IMPOSSIBLE

PROBABILITY
TABLE

Rating	Financial Impact	Health & Safety	Reputation & Public Image	Performance	Environment & Community	Employees	Effect on Product Sales	Production Loss / Damages
1. Catastrophic	< R50 million Sustained negative R01	Fatalities / permanent disabilities Public Enquiry / Inquests	Adverse national media coverage	Major milestone / deadline missed by > 1 year	Catastrophic irreversible environmental harm	Number of key executives / directors lost	Serious contamination, national recall	Loss of production facility / major damage
2. Critical / Major	R10-R50 million Negative R01 / growth	Single fatality / permanent disabilities	LSE require immediate press statement	Major milestone or deadline missed by 6-12 months	Major environmental harm caused - long term recovery	Some key executives are lost to the company	Severe contamination regional recall	Serious production disruption and damage
3. Serious	R500k-R10 million Zero R01 / growth	Serious health impact / injury / disabilities	Adverse local media coverage Concerns raised by shareholders	Major milestone or deadline missed by 3-6 months	Measurable environmental harm caused - medium term recovery	Poor reputation as an employer	Serious contamination, limited recall, brand damage	Production disrupted / some damage / downtime
4. Medium	R50-R500k Lower R01 / growth	Serious injury / health / safety impact on one person	Intra-industry knowledge of incident, no media attention.	Major milestone or deadline by 1-3 months	Medium term, immaterial effect on environment / community	General staff morale problems	Limited contamination, replacement of product	Production stoppage / minor damage
5. Minor / Negligible	<R50k Static R01 / growth	Transient safety / health - impact / basic first aid / no serious injury	Minimal impact on shareholder support	Major milestone missed by <1 month	Short term impact on environment / community	High staff turnover	Foreign object / single container contamination	Brief stoppage / minimal lost time

CONSEQUENCE TABLE

PROBABILITY

HIGH = 1 - 6
MEDIUM = 7 - 15
LOW = 16 - 25

	A	B	C	D	E
1	1	2	4	7	11
2	3	5	8	12	16
3	6	9	13	17	20
4	10	14	18	21	23
5	15	19	22	24	25

CONSEQUENCES

SOUTH AFRICAN BREWERIES: WESTERN CAPE REGION:

RISK MANAGEMENT PLAN – TOP TEN RISKS

Ref	Risk	Possible Impacts	Probability & Consequence	Inherent Ranking	Necessary Controls Currently in Place	Probability & Consequence	Residual Ranking	Management Actions	Target Date	Responsible
1	Unfavourable Usage. Specifically culllet and beer loss.	Financial Impact	A3	6a	Cullet measurement system and ongoing focus	B3	9	Ongoing focus	NA	PM
2	Quality of raw materials (malt specifically)	Financial Impact	B3	9	Monitor closely and report variances	B3	9	Report quality issues and claim where possible.	Ongoing	BM
3	HIV Aids	External - loss of sales. Internal - loss of skilled staff, increase in absenteeism and medical costs.	A3	6	Regional Aids Task Team undertaking ongoing projects.	B3	9	Ongoing initiatives to be implemented.	Ongoing	HRC
4	EBI Failure	Line downtime, negative media coverage Company image damaged	A3	6	Tightened process monitoring Supplier improvement programs. Trade quality services.	B3	9	Final decision on possible future CAPIN or maintenance regime	Jul-02	PM
5	Strategic People Resourcing. Ability to recruit and retain high calibre staff.	Loss of Business "memory". Loss of ability to achieve WCM status.	A3	6	Effective IMP processes	B3	9	Recruit trainees and bursars. Drive IMP processes. Investors in People accreditation	F03	HRC AL
6	Crime. Access control to parking areas.	Potential loss of life. Injury. Damage to property and theft. Morale	A3	9	Security patrols in carpark	B3	9	Access control booms and guardhouse to be installed	June F03	RM
7	Ammonia leak. Current reticulation system old. 28 tons on site.	Loss of life - internal and external. Damage to Brewery. Downtime. Pressure to relocate from local residence.	D1	7	M H I new regulations (end July). Maintenance Schedules. System audited by certified PV inspector	E1	11	New MHI compliance to be addressed. Thickness tests to be conducted on reticulation system.	Ongoing	EM
8	Fire. Water pressure and flow inconsistent. Local authority fire fighting service inadequate. Inadequate protection in Brewing PLC room and Silo block.	Loss of life - internal. Damage to Brewery. Downtime. Pressure to relocate from local residence.	C1	4	ASIB survey with actions. Sprinkler systems. Legal compliance	E1	11	Potential backup dam to guarantee water supply Integrated detection systems and CO2 systems to be installed.	Ongoing	EM RM
9	Dust explosion in silos.	Loss of life internal and external. Damage. Brewery downtime. Pressure to relocate from local residence	D1	7	Inspection by external experts every 2 years. Recommendations implemented	E1	11	Audit items receiving attention R100K F02 CAPIN	Ongoing	BM
10	Fraud - Loss due to white collar crime	Financial Loss	C3	13	Forensic audits. Ongoing focus on controls. Detailed reference checks.	D3	17	No specific actions.	Ongoing	FM RM

APPENDIX D

PRINCIPLES AND RECOMMENDATIONS ON GOVERNANCE FOR PUBLIC SECTOR ENTITIES

STANDARDS OF BEHAVIOR

Leadership

Members of governing bodies of public sector entities need to exercise leadership by conducting themselves in accordance with high standards of behavior, as a role model for others within the entity.

Codes of conduct

Governing bodies of public entities need to adopt a formal code of conduct defining the standards of behavior to which individual governing members and all employees of the entity are required to subscribe.

Objectivity, Integrity and Honesty

Governing bodies of public sector entities need to establish appropriate mechanisms to ensure that members of the governing body and employees of public sector entities are not influenced by prejudice, bias or conflicts of interest.

ORGANISATIONAL STRUCTURES AND PROCESSES

Statutory Accountability

Governing bodies of public sector entities need to establish effective arrangements to ensure compliance with all applicable statutes and regulations, and other relevant statements of best practice.

Accountability for Public Money

Governing bodies of public sector entities need to establish appropriate arrangements to ensure that public funds and resources are properly safeguarded and are used economically, efficiently, effectively, with due propriety, and in accordance with the statutory or other authorities that govern their use.

Communication with Stakeholders

Governing bodies of public sector entities need to establish the following:

Clear channels of communication with their stakeholders on the entity's mission, roles, objectives and performance.

Appropriate procedures to ensure that such channels operate effectively in practice.

Governing bodies of public sector entities need to make an explicit commitment to openness and transparency in all of the activities of the entity, subject only to the need to preserve confidentiality in those specific circumstances where it is proper and appropriate to do so.

Governing bodies of public sector entities need to report publicly the processes for making appointments to the governing body, and need to make publicly available the names of all governing body members, together with their relevant other interests.

Roles and Responsibilities

Balance of Power and Authority

There needs to be a clearly defined division of responsibilities at the head of public sector entities to ensure a balance of power and authority.

The Governing body of a Public Sector Equity

Every public sector entity needs to be headed by an effective governing body to lead and control the entity, and monitor the executive management.

Members of the governing body need to receive appropriate induction training on the first occasion of appointment to the governing body, and subsequently as necessary.

Governing bodies of public sector entities need to establish appropriate arrangements to ensure that they have access to all such relevant information, advice and resources as are necessary to enable them to carry out their role effectively.

To ensure that the direction and control of the entity is firmly in their hands, governing bodies of public sector entities need to establish and maintain an up-to-date framework of delegated or reserved powers that includes a formal schedule of those matters specifically reserved for the collective decision of the governing body.

To support them in carrying out their duties, governing bodies of public sector entities need to establish clearly documented and understood management processes for policy development, implementation and review, decision-making, monitoring, control and reporting; and formal procedural and financial regulations to govern the conduct of the governing body's operations.

There needs to be a formal and transparent process to ensure that appointments to the governing body are made in accordance with specified criteria of competence and on the basis of merit and the individual's ability to carry out a defined role within the organization.

The Chairperson of the Governing Body

The role of the Chairperson needs to be formally defined in writing, to include responsibility for providing effective strategic leadership to the governing body and to ensure the holder successfully discharges the overall responsibility for the activities of the entity as a whole.

Non-Executive Members of the Governing Body

Non-Executive members of public sector governing bodies need to provide an independent judgment on issues of strategy, performance, resources and standards of conduct. Apart from director's fees they may receive, it is appropriate that they are independent of management and free from any other relationships that may materially interfere with their role. Their duties, terms of office, remuneration and the review thereof, need to be defined clearly.

Executive Management

The Chief Executive needs to have line responsibility for all aspects of executive management, whether as a member of the governing body or not. He or she is accountable to the governing body for the ultimate performance of the entity and implementation of the governing body's policy.

In addition, a senior executive, whether a member of the governing body or not, needs to be made responsible for ensuring that appropriate advice is given to the governing body on all financial matters, for keeping of proper financial records and accounts, and for maintaining an effective system of internal financial control.

A senior executive, whether a member of the governing body or not, needs to be made responsible to the governing body for ensuring that governing body procedures are followed, and that all applicable statutes and regulations and other relevant statements of best practice are complied with.

independent review of the framework of control and of the external audit process.

Internal Control

Governing bodies of public sector entities need to ensure that a framework of internal control is established, operates in practice, and that a statement on its effectiveness is included in the entity's annual report.

Budgeting, Financial Management and Staff Training

Governing bodies of public sector entities need to oversee, and need to ensure that procedures are in place that will result in, effective and efficient budgeting and financial management.

Governing bodies of public sector entities need to ensure that training programmes are in place so that staff is competent to perform task at hand.

EXTERNAL REPORTING

Annual Reporting

Governing bodies of public sector entities need to publish on a timely basis an annual report (including financial statements), presenting an objective, balanced and understandable account and assessment of the entity's activities and achievement, and of its financial position and performance prospects.

Governing bodies of public sector entities need to include in their annual report a statement explaining (at a minimum) that they have the responsibility for:

- Approving the budget or financial plan to provide authorization for the acquisition and use of financial resources;

- The financial statements that fairly present the state of affairs of the entity as at the end of the financial year and the results of the operation for that year.
- Maintaining an effective framework of control;
- Ensuring the consistent use of appropriate accounting policies, supported by reasonable and prudent judgments and estimates; and
- Ensuring adherence to applicable accounting standards.

Governing bodies of public sector entities need to include in their annual report a statement on whether or not they have adopted standards or codes of governance. The statement should identify the standards or codes adopted, as well confirm compliance therewith, or if not, in what respect there has not been compliance.

Use of Appropriate Accounting Standards

Governing bodies of public sector entities need to ensure that the financial statements contained in the annual report are prepared in accordance with IPSAS's, or another authoritative and recognized set of accounting standards, and applicable legislation.

Performance Measures

Governing bodies of public sector entities need to establish and report relevant performance measures to ensure and demonstrate that all resources have been procured economically and are utilized efficiently and effectively.

External Audit

Governing bodies of public sector entities need to ensure that an objective and professional relationship is maintained with the external auditors.