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An Assessment of the Corporate Governance Practices within the Department of Public Works

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ABSTRACT Good corporate governance practices strengthen credibility and confidence in the public service. This study assessed corporate governance practices within the Department of Public Works (DPW) in South Africa in order to develop measures to align these with best practices. Corporate governance in South Africa and other countries as well as the application of corporate governance and King III in the public sector were reviewed. Data were collected by means of questionnaires as well as face-to-face discussions. The target population was three of the 11 DPW regional offices as well as Head Office. The sample consisted of 30 respondents from each office and included senior management, middle management, junior management and employees. The study found that, while the DPW has developed processes and systems to ensure good corporate governance practices, these are not being effectively implemented or are not working as intended. Many irregularities were observed pertaining to the implementation of corporate governance processes and procedures in the DPW. It is therefore recommended that the Director-General should establish a monitoring tool to monitor the implementation of corporate governance practices within the department.

INTRODUCTION

This study assesses corporate governance practices within the Department of Public Works (DPW) in South Africa. Corporate governance is associated with corporate responsibility and compliance with ethical standards. While the national DPW has introduced systems and procedures to ensure good corporate governance, implementation remains a problem. The DPW has received poor audit reports from the Office of the Auditor General due to irregular, fruitless and wasteful expenditure (Khumalo 2014). Poor corporate governance and internal control in the public sector has been singled out as one of the major causes of poor financial and operational performance. It is manifest in week internal control systems, excessive risk taking, and overriding internal control measures, the absence of or non-adherence to limits on authority, a lack of risk management processes, and insider abuse and fraudulent practices (Chanyatipsakul and Wongsurawat 2013). High profile cases of corporate fraud and organisational, technical and financial failure have been reported at the DPW (Chauhan 2015; Masson 2015). The public sector plays a crucial role in society, and effective governance can encourage the efficient use of resources, strengthen accountability for the stewardship of these resources, improve management and service delivery, and thereby improve people's lives. Effective governance is also essential to build confidence in public sector entities, which in itself is necessary if public sector entities are to be effective in meeting their objectives. An organisation with good corporate governance has the capacity to maintain high-quality services and deliver improvements (Mbedzi 2011).

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Problem Investigated

Government and other public sector entities raise resources from taxpayers, donors, lenders, and other suppliers for the provision of services to citizens and other recipients, as well as visible activities, such as regulation and policy development. These entities are accountable for their management and use of resources to those that provide the resources and those that depend on the resulting services (Limpopo Economic Development Agency 2012; Chung-Fun 2015). The national DPW has a mandate to deliver services to other state organisations and to the public as well as to account for its management and use of resources. In the past three financial years (2011/2012, 2012/2013 and 2013/2014), the department has received a disclaimer audit opinion from the Auditor General of South Africa, citing irregular, fruitless and wasteful expenditure, governance issues and a lack of internal controls. Members of the public, civil society and international financial institutions' demands for accountability and the effective and efficient use of public resources require public organisations to put appropriate systems and structures in place that are informed by corporate governance principles and values and subject these systems to periodic review (Basu 2014; National Empowerment Fund 2014).

Purpose of the Study

The aim of this study was to evaluate corporate governance practices within the public sector with a focus on the national DPW in order to recommend measures that could improve corporate governance and accountability within the DPW.

Research Objectives

- To identify the corporate governance practices applied within the national DPW;
- To determine whether corporate governance practices within the DPW are in line with best practices;
- To develop measure to align corporate governance practices at the DPW with best practices.

Research Questions

- What corporate governance practices are applied within the DPW?
- How do corporate governance practices within the DPW compare with best practices?
- What measures can be developed to align corporate governance practices at the DPW with best practices?

This study will help management in the public sector, especially the DPW to recognise the importance of corporate governance practices in enhancing organisational performance (De Salas and Huxley 2014). The study will identify corporate governance practices that can enhance service delivery. Moreover, the study will contribute to the body of knowledge on corporate governance and the performance of the public sector and also fill the knowledge gap on the relationship between these variables in the South African context (Limpopo Economic Development Agency 2014).

Literature Review

This brief literature review focuses on defining corporate governance, the development of corporate governance in South Africa; its application in the public sector; the King Reports and company law reform; separation of powers and accountability in the South African public sector, principles of corporate governance in the public sector and the application of the King III code in this sector.

Definition of Corporate Governance

Corporate governance is defined as the combination of processes and structures that inform, direct, manage, and monitor an organisation's activities towards the achievement of its objectives. The Limpopo Economic Development Agency (2014) describes corporate governance as the practice by which companies are managed and controlled by good corporate governance. Good corporate governance is essentially about effective leadership characterised by the ethical values of responsibility, accountability, fairness and transparency. In the public sector, corporate governance relates to the means by which goals are established and accomplished (Denman and Higuchi 2013; De Waal and Chipeta 2015).

Corporate Governance in South Africa

Corporate governance in South Africa was institutionalised by the publication of the King Report on Corporate Governance in November 1994. This report was superseded by the King II Code of 2002 and the recent King III. The Limpopo Provincial Government Department of Economic Development, Environment and Tourism (2015) note that, "in 1994 the King Report on

Corporate Governance (King l) was published by the King Committee on Corporate Governance, headed by former High Court judge, Mervin King." The purpose of the King Report is to promote the highest standards of corporate governance in South Africa. The King reports enhanced corporate governance in South Africa (Schroeder 2014). The release of the King III report on 1 September 2009 was a significant milestone in the evolution of corporate governance in South Africa and offers significant opportunities to organisations that embrace its principles (Limpopo Economic Growth and Development Plan 2015).

Application of Corporate Governance in the Public Sector

The concept of corporate governance is not confined to the private sector; as such, it is incumbent upon public sector organisations to embrace corporate governance with a view to improve their efficiency, effectiveness, accountability and reputation (Eric and Chong 2015). Effective governance in the public sector encourages better decision-making and more efficient use of resources and strengthens accountability for the stewardship of those resources. Such governance is characterised by robust scrutiny, which improves the public sector's performance and addresses corruption (Pekkola and Melkas 2010). Public sector organisations should therefore be highly transparent, and provide high quality information about all aspects of their performance (Edwards 2015; National Empowerment Fund 2014).

The Accounting Officer and Executive Management Team (EXCO) in the Public Sector

Public sector institutions do not have boards of directors. Board functions are performed by accounting officers and their executive management team in the form of an executive committee (EXCO). King III stated that the accounting officer and executive management team are responsible for ensuring the continued success of a department (Limpopo Economic Development Agency 2014). They are collectively responsible for the stewardship of the department, including:

- The adoption of a strategic planning process within the policy and resources framework laid down by Parliament, ministers and/or the regulator;
- The appointment, development and succession of senior management;
- The formal approval and adoption of the entity's annual report, including the financial statements;
- The implementation of an effective communication policy;
- The establishment of an effective system of internal control and information; and
- The identification and monitoring of the entity's principal risks and opportunities and ensuring that appropriate measures are in place to manage these risks (Limpopo Economic Development Agency 2013).

Audit Committees

King III of 2009 states that, "public sector institutions are required to establish independent audit committees." Section 38 of the PFMA, 1999 (Public Finance Management Act 1999), together with Treasury Regulation 3.1.8, of the act (Public Finance Management Act 1999), requires that every department, trading entity or constitutional institution have a system of internal audit under the control and direction of an audit committee that complies with and operates in accordance with the regulations and instructions prescribed in terms of sections 76 and 77. In terms of section 77 (b), the audit committee must meet at least twice a year (The Banking Association of South Africa 2013). The Act further requires that the audit committee must consist of at least one person from outside the public service and the majority may not be persons in the employ of the department, except with the approval of the relevant Treasury. The chairperson may also not be in the employ of the department. King III requires the audit committee to oversee integrated reporting (Public Finance Management Act 1999).

METHODOLOGY

This section describes the research methodology employed for this study.

Research Design

This study was based on a descriptive survey to address the defined research objectives.

Eriksson (2013) defines survey research as a "research technique in which a sample is interviewed in some form or the behaviour of respondents is observed and described in some way." A descriptive survey was appropriate because it met the objectives of the study; namely, to determine corporate governance practices applied within the national DPW, determine whether corporate governance practices within the DPW are in line with best practices and to develop measures to align corporate governance practices at the DPW with best practices (Parker 2014).

Justification for the Quantitative Research Method

Guercini (2014) contends that, one of the reason that quantitative research enjoys widespread support lies in the predictive advantages this method of inquiry possesses. Indeed, the ability to make correct predictions is one of the outstanding characteristics of a quantitative methodology. The qualitative researcher cannot "prove" that something exists in a particular way or that constructs and concepts relate in a particular manner, but he/she can (and does) propose and argue in support of a particular kind of relationship. Quantitative research tests the strength and persistence of relationships between distinct measures. As such, it depends on the ways that researchers choose to define the variables and what they elect to include within these variables. Based on the above discussion, the researchers chose to use a quantitative research method (Hair et al. 2014).

Stratified Random Sampling

The study employed stratified random sampling. This involves stratification (different strata are determined by different factors such as life stages, income levels, or management level) and a random sample is then drawn from each stratum. The aim of this study was to assess corporate governance practices within the national DPW. Lee (2014) states that, when a few characteristics are known about a population, stratified random sampling is appropriate as the population can be arranged in subgroups and a random sample is then selected from each subgroup. Only participants with knowledge and experience of corporate governance in the DPW were selected. These included participants at management level.

Target Population

The population consisted of all DPW employees with the relevant knowledge to participate in the study. These included senior management, middle management, junior management and employees. These employees are located at the DPW's 11 regional offices and at the administrative Head Office in Pretoria. The regions include Polokwane, Kimberly, Mthatha, Mmabatho, Bloemfontein, Cape Town, Durban, Port Elizabeth, Nelspruit, Pretoria and Johannesburg. In order to produce credible results, an initial sample of at least 120 respondents was targeted.

Sample Size

Once the population has been stratified in some meaningful way, a sample of members from each stratum can be drawn using either simple random sampling or a systematic sampling procedure (Leedy and Ormrod 2014). The regional offices at Polokwane, Pretoria, and Johannesburg as well as the Head Office were selected. Top management, middle-level management, lower-level management and supervisors from the regional offices and Head Office were included. Employees at managerial level were assumed to be knowledgeable on issues pertaining to the study. Thirty participants were selected from each office, making a total target population of 120 participants.

Data Collection

The questionnaire was mailed to employees stationed in the Pretoria and Johannesburg regional offices and the Head Office in Pretoria. Since the researchers were based in Polokwane, face-to-face discussions to complete the questionnaire were held with employees stationed at the Polokwane regional office. Nebojsa and Davcik (2014) maintain that, "the main advantage of mail questionnaire is that a wide geographical area can be covered in the survey." The researchers also conducted telephonic discussions with participants from Pretoria and Johannesburg in order to fast track the responses.

Data Analysis

Once data have been collected from a representative sample of the population, the next step is to analyse it to test the research hypotheses. Guercini (2014) state that, "before analysing the data to test hypotheses, some preliminary steps need to be completed." Since the data captured in this study was predominantly quantitative, the data analysis process adopted to analyse the data was as follows:

- The first part of the analysis involved ensuring that the questionnaires received from the respondents were complete,
- The second part involved data cleansing,
- Data was coded so that it could assume a numeric form to facilitate statistical analysis,
- Data were captured on a spreadsheet in readiness for analysis.

Thereafter, the data was analysed using the Statistic Package for Social Sciences (SPSS) version 18 to assist in answering the research questions. The data was analysed using descriptive statistics. Frequency tables were drawn and the data was presented in pie diagrams and bar graphs.

Pilot Study

A pilot study prior to the main study enables the identification of any weaknesses and allows time to make any necessary amendments before carrying out the study. Although a pilot study does not guarantee a study's success, it greatly increases the likelihood of success. Lee (2014) found that a sample size of ten-thirty percent of the sample size for the actual study is a reasonable number of participants to enroll in a pilot study. The pilot study was used to identify any flaws in the data collection plan and rectify these before the main research took place. All 10 participants completed the questionnaires and no question was changed as a result of the pilot study.

Ethical Considerations

Conducting research requires not only expertise and diligence, but honesty and integrity. The rights of human subjects must be respected and protected. This study upheld the participants' rights to self-determination, anonymity, confidentiality and informed consent. It only commenced after approval was received from the DPW Director-General (Leedy and Ormrod 2014). Participants' informed consent was obtained before they completed the questionnaires. They were informed of the purpose of the study and the procedures that would be used to collect the data, and were assured that there were no potential risks or costs involved. Anonymity and confidentiality were maintained throughout the study. The statistician produced the results independently of the researchers in order to avoid subjective collaboration. The closed-ended questions which were analysed by the researchers were also checked by the supervisor for confirmation of credibility.

OBSERVATIONS AND DISCUSSION

Laws and regulations alone will not improve corporate governance practices within the DPW. King III noted that good corporate governance is about effective, ethical leadership based on the universal governance principles of transparency, fairness, responsibility and accountability. Accountability is a crucial principle; as such, the effective implementation of corporate governance is the responsibility of the department's Director-General (Small Enterprise Finance Agency 2013). The challenges confronting corporate governance include: Ensuring that there are sufficient checks and balances in place to make directors and management accountable to shareholders; Ensuring that potential conflicts of interest between managers and shareholders do not prevail over those of the company, and to minimise agency costs; Allowing the necessary delegation of authority within the company whilst limiting potential for the abuse of that authority by, for instance, guarding against power being concentrated in the hands of any one individual; Ensuring that the right questions are asked of the right people and that managers are held responsible for the exercise of delegated authority and for the company's performance; Ensuring that the policies and structures in place are sufficiently flexible and agile to allow the company to achieve its purpose and to anticipate and respond appropriately to risk (Eric and Chong 2015). One of the most difficult tasks in implementing an effective system of corporate governance is achieving the optimal balance between power and accountability at all levels. Corporate governance goes beyond management; it includes governing and managing. It is not the role of the Director-General and the executive to run the department's operations on a daily basis; the Director-General has to delegate duties and responsibilities to managers. The primary purpose of the audit committee is to provide an in-depth focus on financial issues that are crucial to the department, but cannot be dealt with by the Director-General and the executive. The audit committee plays an important role in ensuring that adequate accounting records are maintained, that there are effective systems of internal controls, that reporting by the department is comprehensive and reliable and that the department generally complies with the principles of good governance.

Findings Emerging From the Primary Data

The study found that, while the DPW has internal systems and procedures in place to ensure that corporate governance practices are in line with good practices, the effectiveness of these systems and procedures was compromised due to a lack of monitoring. While committees, including the audit committee, are in place to monitor the adequacy and effectiveness of internal controls, it seems that these committees are not functioning as intended. To this effect, the study revealed some of the areas of corporate governance that require management intervention:

Effective Implementation of the Code of Conduct Improves the Running of the Department

While it is clear that the accounting officer has established a code of conduct to ensure good governance practices within the department, it has not delivered the expected results. Cases of fraud and corruption are reported to the office of internal audit for investigation. Therefore, one of the keys tasks of the accounting officer is to establish measurable objectives in the strategic plans and the outcomes need to be reported on a quarterly basis to the executive authority as per Treasury Regulations 5.3.

Compliance with All Applicable Rules and Regulations Improves Governance Practices

It is clear from the responses and practical experience that the DPW accounting officer has developed departmental policies as mandated by the PFMA and Treasury regulations. However, implementation and/or compliance with the Act and regulations as well as the department's policies are questionable. The department has received poor audit opinions from the office of the Auditor General due to non-compliance with the Act and applicable regulations, e.g., supply chain management policy. Non-compliance may result in the department receiving a disclaimer opinion from the Auditor General due to fraud and corruption, and fruitless, wasteful and irregular expenditure.

There Should Be Economic, Efficient and Effective Utilisation of State Funds

As a leader in the provision of government building infrastructure in South Africa, the DPW plays a critical role in providing an enabling environment for the effective provision of infrastructure. The department spends billions of Rands of state funds. The analyses of the respondents' responses revealed that state funds are utilised economically, efficiently and effectively. However, the department received poor audit opinions from the Auditor General, the Standing Committee of Public Accounts (SCOPA) and the Public Works Portfolio Committee. Poor corporate governance practices are the root cause of poor utilisation of state funds.

A Risk Management System Helps to Reduce the Level of Risk in the Department

It is clear from the responses and practical experience that the DPW accounting officer has developed a risk management system to ensure that risk is at an acceptable level. However, the system is not implemented effectively. The department is suffering financial losses due to poor management of risks. A number of high risk areas, such as the supply chain, are not effectively managed.

The Internal Audit Function Helps to Improve Corporate Governance in the Department

Internal audit helps the department to accomplish its objectives by adopting a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The majority of the respondents were not aware of the role of internal audit in the department. Irregularities, and fruitless and wasteful expenditure as well as fraud and corruption occur due to weaknesses in the control environment within the department. Internal audit is regarded as the control specialist to minimise high risk areas.

The Audit Committee Plays a Huge Role in Improving Corporate Governance Practices in the Department

The audit committee assesses the effectiveness of the department's governance, risk management and control framework and legislative and regulatory compliance. The study identified a number of weaknesses, including the effectiveness of internal control, poor implementation of the code of conduct, and a poor control environment. This raises the question of whether the audit committee is delivering on its mandate to ensure good corporate governance practices within the DPW. The majority of the respondents did not believe that the department has an effective audit committee.

Adequate Internal Control Measures are Required to Minimise Risks Within the Department

The majority of the respondents did not believe that the department has an effective system of internal control in place to minimise risks to an acceptable level. This is borne out by the Auditor General's reports. Findings relevant to internal financial controls include irregular, wasteful and fruitless expenditure. A department's accounting officer is mandated by the PFMA to ensure that the department has an effective system of internal controls.

The Department Should Maintain a Professional Relationship with the External Auditors

The majority of the respondents did not believe that department has a professional relationship with the external auditors; this was also noted in the Auditor General's reports. The department received a disclaimer opinion and one of the reasons was the limitation of scope.

CONCLUSION

It is clear from the analysis of the responses that the DPW has adopted corporate governance practices that are aligned with best practices; the challenge lies in effective implementation of these practices. The accounting officer is mandated to ensure the effective functioning of the audit committee, the internal audit section, risk committee and other stakeholders in order to improve corporate governance practices. Poor corporate governance practices lead to poor audit opinions from the office of the Auditor General, fraud and corruption, and irregular, wasteful and fruitless expenditure. This might result in poor service delivery to the community and other state organisations. The department's accounting office has put some measures in place to improve turnaround. While a number of consultants have been appointed to make improvements in areas of concern such as the immovable assets register, irregular expenditure, and fraud and corruption as well as the department's internal processes, the DPW continues to receive poor audit opinions. These challenges can be addressed by collaboration between the stakeholders in the department, including an active audit committee, effective internal and external audit, and public participation in the oversight of the accounting officer and the executive members.

RECOMMENDATIONS

Arising from the study's findings, the following recommendations are offered: the accounting officer and executive authority should provide effective leadership based on ethical principles. The Treasury has issued a code of conduct for supply chain management; the accounting officer should ensure that it is implemented in order that the department's activities are conducted in an ethical manner. Heads of departments should take practical steps to ensure that their department/branches comply with applicable regulations such as the PFMA, and Treasury regulations as well as internal policies. They should coordinate and monitor adherence to such regulations, taking into consideration recommendations from the office of the internal audit and Auditor General. The accounting officer should ensure that an effective risk management system is established as part of the framework of control. National Treasury has issued a Risk Management Framework that must be applied by all departments. Internal audit should assess the adequacy of corporate governance and the control environment, as well as the effectiveness of processes to identify, assess and manage risks in the department. The audit committee should provide oversight of the department's internal and external audit activities, including ensuring coverage and resources, approving the internal audit charter and audit plans, reviewing the performance of internal audit and external auditors and ensuring that there is a good relationship with external auditors.

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