Newcastle Municipality

Risk Management Policy

Version 3 - 2014

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APPENDIX A

1. EXECUTIVE SUMMARY

The underlying premise of enterprise risk management is that every entity (profit making or not) exists to provide value for its stakeholders. All public and private organisations face uncertainty and the challenge for management is to determine how much uncertainty to accept as it strives to grow stakeholder value (good service delivery). Uncertainty presents both risk and opportunity, with the potential to erode or enhance value. Enterprise risk management enables management to effectively deal with uncertainty and associated risk and opportunity, enhancing the capacity to build value.

Value is maximized when management sets strategy and objectives to strike an optimal balance between growth and return goals and related risks, and efficiently and effectively deploys resources in pursuit of the entity's objectives. Enterprise risk management encompasses:

1.1. Aligning risk appetite and strategy – Management considers the entity's risk appetite in evaluating strategic alternatives, setting related objectives, and developing mechanisms to manage related risks.

1.2. Enhancing risk response decisions – Enterprise risk management provides the rigor to identify and select among alternative risk responses – risk avoidance, reduction, sharing, and acceptance.

1.3. Reducing operational surprises and losses – Entities gain enhanced capability to identify potential events and establish responses, reducing surprises and associated costs or losses.

1.4. Identifying and managing multiple and cross-enterprise risks – Every enterprise faces a myriad of risks affecting different parts of the organization, and enterprise risk management facilitates effective response to the interrelated impacts, and integrated responses to multiple risks.

1.5. Seizing opportunities – By considering a full range of potential events, management is positioned to identify and proactively realize opportunities.

1.6. Improving deployment of capital – Obtaining robust risk information allows management to effectively assess overall capital needs and enhance capital allocation.

These capabilities inherent in enterprise risk management help management achieve the entity's performance and profitability (service delivery) targets and prevent loss of resources. Enterprise risk management helps ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity's reputation and associated consequences. **In sum, enterprise risk management helps an entity get to where it wants to go and avoid pitfalls and surprises along the way.**

2. PURPOSE

The purpose of this policy document is to provide guidance to Council, Management and staff of NEWCASTLE MUNICIPALITY on the management of risks facing the municipality. The contents must therefore be read and understood by all Councillors, the Municipal Manager, Senior Managers, Line Managers and Supervisors who will be responsible for implementing the relevant parts of the policy in their areas of responsibility. In addition this policy serves as a base to set the goals, regarding the level of risk management responsibility and performance that NEWCASTLE MUNICIPALITY will strive to achieve and against which all the municipality's operations and activities can be evaluated.

The objective of this policy document is to provide NEWCASTLE MUNICIPALITY with a developed capability in business risk management so as to create an instinctive and consistent consideration of risk and reward in day-to-day planning, execution, monitoring and provide reasonable assurance regarding the achievement of organizational goals.

3. LEGISLATIVE MANDATE

3.1 The Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) gazetted on the 13 February 2004 prescribes in section 62. (1)(c) and section 95.(c)(1) that the Accounting Officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose take all reasonable steps to ensure that the municipality has and maintains an effective, efficient and transparent system of financial and risk management and internal control.

The above is further supported by other sections of the Act, viz. Section 165. (2)(a); (2)(b)(iv) and Section 166 (2)(a)(ii).

3.2 The Public Sector Risk Management Framework published on 01 April 2010 also requires that an organization must have a Risk Management unit with the entire Risk Management infrastructure listed on the framework.

3.3 Section 41 of the Municipal Supply Chain Management Regulations with effect from 1 July 2005 also states inter alia that, a supply chain management policy must provide for an effective system of risk management for the identification, consideration and avoidance of potential risks in the supply chain management system.

4. RISK MANAGEMENT CONCEPT

4.1 Enterprise Risk Management (ERM) definition

- a continuous systematic process,
- effected by the entity's board **(council)**, management and other personnel,
- applied in strategy setting **(IDP)** and across the municipality,
- designed to identify potential events **(risks and opportunities)** that may affect the entity **(municipality)**, and
- manage risks **(internal controls)** to be within its risk appetite,
- to provide reasonable assurance regarding the achievement of entity objectives.

By viewing this as a continual loop, Councillors and Management of NEWCASTLE MUNICIPALITY are reminded of the need for thoughtful and regular feedback, as improvement is critical to successful risk management.

4.2 Inherent Risk

It is the risk embedded in the business before the consideration of any control activities or actions by management. Various alternative risk definitions are in use in the risk management context but Newcastle Municipality defines risk as:

"The uncertainty of an event occurring that could have an adverse impact on the achievement of objectives. Risk is measured in terms of impact and likelihood"

Source: *Institute of Risk Management South Africa Code of Practice.*

This definition will be engraved in Newcastle Municipality's Risk Policy as our view and perception of risk in the context our business and environment.

Examples of inherent risks may include:-
- insufficient funding for service delivery projects;
- non-compliance with policies, procedures and legislation;
- Unskilled personnel;
- unsafe environment;
- loss of image;
- ineffective financial management;
- fraud and corruption;
- poor quality projects;
- poor Information Communication Technology systems etc.

4.3 Risks and objectives

A risk is defined as the uncertainty of an event occurring that could have an impact on the achievement of objectives. Objective is what an organization wants to achieve and is aligned to the municipality's vision and mission.

Within the context of an entity's established mission or vision, management establishes strategic objectives, selects strategy, and sets aligned objectives cascading through the enterprise. This enterprise risk management policy and strategy is geared to achieving an entity's objectives, set forth in four categories:

- Strategic/KPA level – high level goals, aligned with and supporting the mission.
- Operations level – effective and efficient use of the municipality's resources.
- Reporting – reliability of reporting.
- Compliance – compliance with applicable laws and regulations.

Similarly, risks also occur at all these four (4) levels.

4.4 Risk appetite (RA)

Risk appetite is the level of risk the municipality is prepared to accept.

The risk tolerance level/risk appetite shall be set and approved by Council each year and must be in line with the materiality level of NEWCASTLE MUNICIPALITY.

4.5 Internal Control

Internal controls are actions, systems, policies, methods and procedures implemented by management to manage or reduce the likelihood and impact of the inherent risk. Internal controls are embedded in the daily activities of our municipality.

In accounting and organizational theory, Internal control is defined as a process effected by an organization's structure, work and authority flows, people and management information systems, designed to help the organization accomplish specific goals or objectives.

It is a means by which an organization's resources are directed, monitored, and measured.
It plays an important role in preventing and detecting <u>fraud</u> and protecting or safeguarding the organization's resources, both physical (e.g. computers and property) and intangible (e.g. reputation). At the organizational level, internal control objectives relate to the reliability of financial

reporting, timely feedback on the achievement of operational and strategic goals, and compliance with laws and regulations.

At the specific transaction level, internal control refers to the actions taken to achieve a specific objective (e.g. ensuring that the municipality's payments to third parties are for valid services rendered.) Internal control procedures reduce process variation, leading to more predictable outcomes.

Examples of controls may include:

- Policies and procedures, e.g. SCM policy, HR policies, Credit control policy etc.
- Registers e.g. attendance registers, payments registers, asset registers etc
- Forms e.g. requisition forms, order forms, cheque requisition forms, access controls to electronic funds transfer, leave forms etc.
- Reports e.g. payments reports, petrol expenditure report, telephone usage reports etc.
- Delegation of authority e.g. delegation by Council for approval of certain transaction at certain levels according to the structure of the municipality.
- Reconciliation statements e.g. bank reconciliation, creditors' reconciliation etc.

4.6 Residual risk

It is not always efficient to manage risks to zero residual risk or a very low residual risk threshold because of the time, cost and effort that will be required, and which could result in the cost/benefit dynamics to become skewed.

The residual risk is the risk that remains after implementing internal controls. As alluded to above that the risk is not eliminated in its entirety, it can only be reduced to an acceptable level. In other words, there will always be an amount of risk that remains. This is called residual risk. An illustration of the residual risk is presented below:
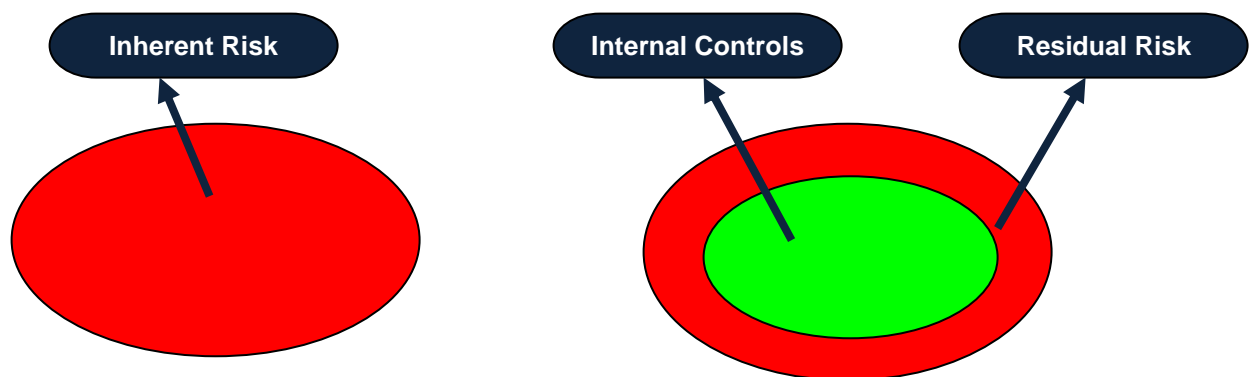
Inherent Risk: this is the risk that is built in to Newcastle municipality's business because of the nature of its business. It represents the extent of risk the council is exposed to in terms of its strategic and operational objectives.

Internal Controls: Given the risk exposure in circle 1, management ought to implement measures to reduce the extent of risk exposure to an acceptable level. The measures are represented by the green circle. These measures are referred to as **internal controls** i.e. policies, procedures, registers etc.

Residual Risk: After instituting control measures, management measures the strength of the internal controls against the inherent risk and then allocates a control strength rating. The balance of the inewrcent risk that remains after putting controls in place is called the **residual risk.**

5. RISK MANAGEMENT POLICY STATEMENT

The Accounting Officer has committed the Newcastle Municipality (NCM) to a process of risk management that is aligned to the principles of good corporate governance as supported by the Municipal Finance Management Act no 56 of 2003, Public Sector Risk Management Framework published on 1 April 2010, COSO Integrated Risk Management Framework and other various pieces of legislation applicable to local government.

NCM recognizes that the management of risks is an integral part of sound management and therefore adopts a comprehensive approach to the management of risk. The features of this approach are outlined in the municipality's Risk Management Policy and Strategy.

This policy statement declares and affirms our commitment to sound risk management. It is expected that all departments, operations and processes will be subject to the risk management strategy. It is the intention that these departments will work together in a consistent and integrated manner with the overall objective of reducing risk to a tolerable level.

Effective risk management is imperative to the NCM to fulfill its mandate, the service delivery expectations of the public and the performance expectations within the municipality. The realization of our IDP document depends on us being able to take calculated risks in a way that does not jeopardize the direct interests of stakeholders. Sound Management of risk will enable us to anticipate and respond to changes on our service delivery environment as well as make informed decisions under conditions of uncertainty.

Our commitment to ERM:

- NCM will ensure that all resources are applied economically and obtain the highest standards of service delivery.

- NCM will ensure that relevant risk policies are fully communicated to all employees and effectively integrated in their daily operations.

- NCM will ensure that significant risks that may impact NCM objectives are being continuously identified, assessed, managed, monitored and reported on.

- NCM will regularly monitor and review the progress being made in developing an appropriate risk management culture.

- NCM will educate and train all councilors, management and staff to ensure continuous improvement in knowledge, skills and capabilities which facilitate consistent conformance to the stakeholder's expectations.

The risk policy statement shall be reviewed annually to reflect the current stance on risk management.

6. PRINCIPLES OF NCM's ERM STRATEGY

The principles contained in this strategy will be applied at both strategic/organisational and operational levels of NCM. The strategy will also consider both internal and external risks and will include risks such as projects risks, interdepartmental risks, stakeholder risks, political risks etc.

6.1 Our positive approach to risk management means that we will not only look at the risk of things going wrong but also risks relating to not taking advantage of opportunities or not capitalizing on our inherent strengths as the municipality.

6.2 All risks and risk management activities will be aligned to the NCM's values and principles, strategic, functional and operational objectives, processes and procedures underpinning the business environment of NCM. This implies that risk management will not be performed in a vacuum or as an event, but it will be embedded to the strategy and operational day-to-day processes of NCM.

6.3 Our risk management approach will inform and direct our work to gain confidence on the reliability of control strategies and therefore provide reasonable assurance on the achievement of objectives. Managers and staff at all levels will have a responsibility to identity, evaluate, monitor and report on risks in their respective environment, and will be adequately equipped to do so.

6.4 We will anticipate, and where possible, prevent risks resulting in unwanted events rather than dealing with their consequences. However, for some risks where the likelihood of the risk is remote but the consequences are high, we will ensure that business continuity plans are developed and authorized by the Municipal Manager. This will allow us to contain the negative effects of unlikely events, which might occur. Examples of risks with a low likelihood may include natural disasters in South Africa.

6.5 In determining appropriate risk management controls, we will consider the impact of the risks occurring and the cost of implementing the controls and this will be weighed against the potential benefits of reducing such risk.

6.6 We will also ensure that all role players with critical roles in risk management processes are capacitated and work-shopped on the risk management policy, strategy and roles and responsibilities.

7. THE INTEGRATED RISK MANAGEMENT (ERM) FRAMEWORK ADOPTED BY NCM

NCM has adopted the Public Sector Risk Management Framework published on 01 April 2010 based on COSO Enterprise Risk Management Framework. In-order to give effect to the risk management policy, the risk management strategy shall be underpinned by eight interrelated ERM components. These are derived from the way management runs an enterprise and are integrated with the management process. These components are:

7.1 Internal Environment

The municipality shall facilitate and support an environment that is conducive for a robust and sustainable system of risk management through the following:

- **Tone at the top**
  The internal environment encompasses the tone of an organization and Senior Managers led by the Municipal Manager shall set the basis of how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity, ethical values, and the environment in which they operate. All management personnel shall provide their full support and shall be seen to be supporting the risk management programme.

- **Establishment of a fully-fledged risk management unit**
  The Municipal Manager shall establish the risk management unit reporting directly to the Municipal Manager to provide the required specialist expertise, support and guidance on risk management issues. **Please refer to 1.1 of the ERM Guidelines for the Risk Management Unit organisational structure.**

  The unit shall be responsible for establishing organisational norms and standards for risk management, support the line functions in the implementation of risk management processes and for centralized co-ordination of risk management across the municipality, refer to 1.2 of the **ERM Guidelines.**

  The unit shall be appropriately capacitated and shall be strategically placed and have the necessary authority and organisational status to enable it to fulfill its mandate.

7.2 Objective Setting

Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

- In terms of section 5.1 of the Treasury Regulations: "Each year, the Accounting Officer of an institution must prepare a strategic plan for the forthcoming MTEF period for approval by the relevant Executive Authority." The municipalities shall, therefore, establish strategic and operational objectives for its programs in its strategic plan.

- Objectives shall be consistent with the mission and vision of the municipality.

- The municipality shall avoid objectives for which the corresponding risks are unacceptable.

7.3 Event Identification

Annually and for each strategic business objective contained in either the IDP adopted by Council or Strategic Plan of NCM, Councillors and Managers shall identify the key risks that might impede the achievement of the respective business objectives. Risk identification will be performed as part of all major decision making processes.

Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. Opportunities shall be channeled back to management's strategy or objective-setting processes and risk shall be dealt in a manner below:

- Risks shall be identified and contextualized in terms of the objective to be achieved.

- The Accounting Officer and senior management shall apply appropriate technique(s) scenario planning, SWOT analysis, peer group benchmarking, etc) to obtain a thorough appreciation of the risks that have an impact on the municipality's strategic objectives.

- Line management and other officials shall be responsible for utilizing appropriate technique(s) to obtain a thorough appreciation of the risks within their areas of responsibility.

- The risk management unit shall provide central guidance, facilitation and co-ordination of the risk identification process.

- A formal process of risk identification, coinciding with the review of the organisation's strategic and operational plans, shall be undertaken at least annually to identify new or emerging risks and to remove from the risk register risks that are no longer applicable.

- All identified risks shall be recorded in the municipality's risk register, which shall be under the control of the Risk Manager and the Municipal Manager.

7.4 Risk Assessment

Once the risks have been identified, the likelihood of the risk occurring and the potential impact if the risk does occur must be assessed during the risk assessment.

The Councillors and Management shall agree on a scale to be used in rating the likelihood and impact of the risk. Risks are assessed on an inherent and a residual basis.

- Risks shall be assessed in terms of likelihood and impact, as a basis for determining how they should be managed.

- Risks shall be re-assessed annually, with particular emphasis on new and emerging risks, as well as existing high and medium priority risks.

- Risks shall be evaluated as a pre-control level to obtain an understanding of their effects on the objectives in the absence of active control mechanisms as well as at a post-control level to ascertain the efficiency of the active control systems.

Those risks are then depicted in a Risk Map or Risk Register which represents NCM's risk profile.

7.5 Risk Response

Once risks have been analysed, appropriate risk responses shall be determined by management to mitigate risks to an acceptable level (risk appetite) within reasonable costs. It is the responsibility of Council to set the risk tolerance levels or risk appetite but that can be delegated to the Accounting Officer assisted by senior management.

Management shall select from the following risk responses based on the impact and likelihood of the risk occurring:

- Mitigate/manage (steps taken to reduce either the likelihood or impact e.g. policies, procedures, registers etc.);

- Share (transfer the risk but not accountability i.e. steps taken to shift the loss or liability to others i.e. Insurance covers on vehicles, computers etc., transfer to another party that is more proficient at managing such risks);

- Exploit (steps taken to leverage opportunities e.g. strengthening relations with other department etc.);

- Avoid (steps taken to prevent the occurrence of hazards e.g. deciding not to embark on a project, activity because it is too risky and has highly hazardous impact); or

- Accept (an informed decision to accept both the impact and likelihood of risk event e.g. risk that NCM can do nothing about but live with them and just keep monitoring).

- Risk responses or treatment decisions shall be deliberated between the Council and Management during the risk assessment workshop.

- Action plans with clear lines of responsibility shall be developed to deal with the risks that fall outside the tolerance parameters and are not managed by the currently implemented controls.

7.6 Control Activities

Policies and procedures are established and implemented to help ensure the risk responses are effectively carried out.

- Line management being the real managers of risk shall implement or enhance control measures based on the assessment of risk and the appropriateness of risk responses.

- The risk management unit shall assist the responsible line management to develop the control systems required to manage risks.

- Management shall assign responsibility for the implementation of control action and shall also agree on timeframes within which such actions should commence and be completed.

- A report of action plans with time frames and responsible official shall be developed as part of the risk register.

- Action plans shall be attached to the SDBIP's as an addendum and shall be approved with SDBIP's.

- The risk management unit shall monitor the implementation of strategic and operational action plans on a monthly basis and report to MANCO, EXCO, COUNCIL and other relevant committees

7.7 Information and Communication

Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.

- **Roles and responsibility**

  Clear roles and responsibility for risk management shall apply to all officials and stakeholders refer **APPENDIX A**.

  Appropriate training shall be provided to all officials and stakeholders to enable them to effectively perform their risk management duties.

  Assigned roles and responsibilities shall be linked to the performance management system to ensure the integration of risk management into daily tasks, the development of an appropriate risk management culture and enhance accountability.

- **Risk Management Information System**

  An appropriate technology solution shall be identified and utilized to increase efficiencies in the collection, consolidation analysis and communication of risk management information.

- **Reporting**

  The Risk Management unit shall on a monthly basis report to the Accounting Officer on the implementation of the risk management plan.

  The Risk Management unit shall on a quarterly basis appraise the Audit & Risk Committee on the municipality's management of key risks and the level of adherence to this strategy.

  The Risk Management Unit shall distribute the risk registers to all management personnel.

  The Internal Audit shall on a quarterly basis report to the Audit & Risk Committee on the effectiveness of risk management systems and processes, including the management of key risks and the performance of the risk management unit.

- **Awareness and Training**

  The Risk Management Unit shall train all Councillors, management and staff on risk management processes.

  The Risk Management unit shall ensure that there are risk management policy statements displayed visibly on the municipality entrances, passages, chambers, meeting rooms etc.

  Risk management awareness and training initiatives shall be undertaken with the following objectives in mind:

> ➤ To create, sustain and enhance a culture in which employees of the municipality understand the principles of risk management appreciate its benefits and commit themselves to its implementation.
> ➤ To enhance municipal capacity on risk management.
> ➤ To reinforce awareness of risk management roles and responsibilities.

7.8 Monitoring

The entirety of enterprise risk management is monitored and modifications are made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

- The performance of risk management system shall be monitored to ensure that it functions as intended and continues to be applied at all levels and across the municipality.

- The Risk Management unit shall provide the Accounting Officer and Management with the relevant information to enable them to exercise their risk monitoring responsibilities.

- Risk management shall be incorporated into the municipality's performance management system to ensure that management of risk by management is evaluated annually.

Enterprise risk management is not strictly a serial process, where one component affects only the next. It is a multi-directional, interactive process in which almost any component can and does influence another.

8. BENEFITS OF ENTERPRISE RISK MANAGEMENT

The successful implementation of risk management at NCM will yield the following benefits:

- Effective Operational Performance: Policies are enhanced, less disaster and surprises, increase amount of positive feedback from community and other interested stakeholders i.e. Auditor-General, added value across service areas, improved number of targets achieved, improved internal controls, consistent management of risk and opportunities resulting in improved service delivery.

- Improve Financial Performance: Increased percentage of objectives achieved, reduced level of fraud, decreased number of and impact of critical risks etc.

- Improve Human Resources Management: Reduced staff turnover, absenteeism and stress.

- Improve Corporate Governance and Compliance Systems: Reduction in legal challenges, improved corporate governance statement which is better substantiated and demonstrated, increased public satisfaction and enhanced organizational image.

- Avoid certain adverse outcomes through taking proactive steps (fraud risk prevention etc.).

- Help organizations cope when actual incidents occur (business continuity plans, insurance etc).

- Increased probability of achieving objectives. Risk management is participatory and proactive and therefore helps management achieve the institutions' targets and assists with the prevention of loss of resources.

9. ACCOUNTABILITY

- The implementation of this policy will be the responsibility of the Municipal Manager.

- NEWCASTLE MUNICIPALITY's employees are responsible for applying the risk management policy and strategy and techniques in their planning, operating and reporting activities.

- The Council will actively participate in risk and control monitoring and analysis to consider and review the risk profile and management environment.

- Reporting of risk management performance against this policy and strategic targets will be conducted routinely as appropriate depending on the nature of the risk.

- This policy and underlying strategies will be reviewed annually by the council to ensure its continued application and relevance.

- A regular external independent review of the policy adoption and execution will be performed to provide objective feedback to the Council on its effectiveness.

10. INTERNAL AUDIT RESPONSIBILITY

- The Internal Audit shall, on an annual basis, prepare a risk based audit plan which will be approved by the Audit Committee.

- The internal audit plan shall focus on the system of internal control, compliance with policies and procedures, and other key processes that are implemented by the various departments based on the approved strategic and operational risk registers.

- Internal Audit unit shall have a charter approved by the Audit Committee and will, as part of its annual plan audit the key performance measures as contemplated in the Local Government: Municipal Planning and Performance Management Regulations and the Local Government Municipal Systems Act, 2000.

- Internal Audit shall provide an independent and objective assurance on the effectiveness of the Municipality's system of risk management as required by the MFMA.

11. ADMINISTRATION

This document shall be reviewed annually by the Chief Risk Officer within the Office of the Municipal Manager in order to keep it updated with the developments within risk management fraternity. The reviewed policy shall be approved by council by way of a resolution.