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Some Recent Professional Initiatives and Issues in Risk Management

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SOME RECENT PROFESSIONAL INITIATIVES AND ISSUES IN RISK MANAGEMENT

> *Excellence in risk management begins with the formulation of appropriate policies and procedures so that all risks are capable of being known and managed within guidelines established by the board.*[1]

1. INTRODUCTION

In the short time available, I thought I would draw your attention to risk management initiatives being taken by three professional bodies that are of interest, particularly to the public sector but by no means confined to it. As well, there are some issues in the current environment that such research and experience are showing still require our attention. They are quite basic, which indicates that, despite the focus on risk management as part of sound corporate governance in recent years, many of us have some more work to do.

Ironically, there are pressures on the public service to be more risk averse in the uncertain environment we are experiencing but, at the same time, to be more entrepreneurial and pro-active in addressing risk as an opportunity to enhance performance. This issue has been very well addressed by the Comptroller and Auditor-General of the United Kingdom in a landmark report entitled "Supporting innovation : Managing risk in government departments"[2] Not surprisingly, the report stresses how risk management can help departments improve their performance. On the other hand, it warns that:

> *If inappropriately applied, risk management could produce negative side-effects by accentuating already strong blame-avoidance imperatives in public organisations.*[3]

As well, there is also a timely warning from Sir Christopher Foster that:

> *To encourage a less risk-averse civil service requires political approval of a new structure of accountability, and an acceptance that some failings or shortfalls are inevitable if a radical or innovative policy proposal is to succeed*[4].

2. SOME RECENT PROFESSIONAL INITIATIVES

CPA Australia Risk Management Project

Later this month CPA Australia is scheduled to launch ***Enterprise-Wide Risk Management – Best Practice Guide for the Public Sector***. This guide forms part of a series of public sector risk management material for members of CPA Australia and people working within the sector. It was selectively released for comment in September. Some details were included in the November edition of the CPA Australia magazine.[5] The guide is directed at providing practical assistance to organisations seeking to effectively embed risk management. The guide will also communicate the results of research, which has been undertaken by CPA Australia through its Public Sector Centre of Excellence.

Among other things this research has identified that risk management:

- is increasingly being used as a key tool to reinforce values and ethical standards;
- is part of an effective approach to meet and management stakeholders' objectives and expectations. This includes assessment and response to risks that might impact on the achievement of stakeholders' objectives;
- is contributing positively as a tool to support decision making and in the identification and management of areas of concern; and
- has not been recognised widely yet for the contribution it can make in the management of upside risk.

A key challenge continues to be the integration of risk management into corporate and resource planning, in particular, establishing links between risk management objectives and corporate objectives.

The key best practice trends in risk management include:

- being viewed as an approach to contribute towards the achievement of business objectives;
- embedding and integrating risk management within existing management frameworks and processes;
- a broadening from compliance and business continuity to organisation wide operational and strategic risk;
- visible commitment and involvement by Chief Executive Officers (CEOs) and senior management;
- developing dedicated risk management functions and coordinators charged with the responsibility to facilitate, advocate and support the implementation of risk management and the development of organisational capability; and
- recognition that internal audit plays a key role in providing assurance in relation to controls to manage risk. (There is some evidence to support the view that internal audit should not be taking a key role in the implementation of risk management.)

The role of change as a driver of risk is being recognised. Many organisations believe that their risk exposures increased in the last five years due the change in their environment. Some of the factors involved in this change include the following:

- the devolution of responsibility to individual agencies;
- the new era of contestability following the introduction of National Competition Policy reforms;
- focus on the need for provision of quality customer service;
- increased reliance on contractors for the delivery of services; and
- the need to do more within existing budgets.

Comcover Benchmarking Project

Comcover's vision is working in partnership with member agencies in promoting a risk management culture across the Commonwealth. An important element of that vision is a Benchmarking Risk Management Program which was initially developed for Comcover fund members, but has now been extended to include all Australian Government organisations. Over one hundred organisations have registered an interest. Sixty-four organisations have completed the questionnaire, of which fifty-three were from the Commonwealth; six were State government agencies, three were from local government; and two were private sector organisations. Understandably, Comcover has been very pleased with the nature, size and complexity of organisations that are participating, including the Department of Defence. No published results are available at this time.

The program consists of an electronic application and assessment questionnaire which collects data contributing to ten Key Performance Indicators (KPIs) which inform the agency on the results of their efforts to implement risk management. Agencies that have made substantial progress in a particular area have far fewer questions to answer as the model is designed to collect data to build details and confidence about partial achievement.

The ten risk management KPIs developed to describe the characteristics of an organisation performing risk management at a level of 'best practice' are detailed in the Attachment.

Organisations will receive a rating from 1 to 3 for each KPI as well as an overall rating. A "1" indicates implementation has not commenced. A "2" indicates some progress, but clearly improvement is needed in some areas. A "3" indicates that risk management is a reality in the organisation. The ratings are mathematically derived and the calculation of the overall score has been developed with appropriate advice from experts and has been supported by the results in organisations involved in the pilot.

Standards Australia

There are several working parties involved with Standards Australia that are working on projects to support the uptake of risk management in 2001.

The first of these working parties is developing a document outlining a process to re-assure the Board or CEO that the organisation has in place the means to identify the significant business risks facing the organisation and procedures in place to manage that risk. The product is to be concise, easy to read, and tailored for busy people. It will include a set of criteria to assist the reader in forming an opinion quickly about the organisation's progress, as well as providing options for further reading on the subject.

The second working party is developing a document outlining the relationship between risk management, corporate governance and better outcomes for organisations. The hope is to find evidence of organisations making better use of opportunities rather than avoiding risk. Ideally the working party would like to provide some case studies, but the events of 2001 have made many organisations reticent to put themselves forward. There is very little Australian material on the subject and some of the British studies in this area have been inconclusive. Nonetheless, the working party will continue to strive to find the links to success as this is considered to be vital if Australia is to see an increase in the uptake of risk management practices by organisations. The working party has not met since some of the corporate impacts following the terrorist attacks of 11 September in the United States of America (US), but a revisit of emphasis is likely.

There is another working party developing a framework for the application of risk management in the sport and recreation sector. This team is developing a practical guide to the management of the unique risks and issues faced in sport and recreation. This will include an examination of the issues in using volunteers, which is topical considering that 2001 is the International Year of the Volunteer.

3. SOME CURRENT ISSUES

Private Sector

The private sector in 2001 has been dominated by the very public failures of HIH, One.Tel and Ansett and the corporate effect of terrorist attacks in the US. These events have renewed the interest of Boards, CEOs and Chief Finance Officers (CFOs) in risk management and, obviously, their focus on corporate governance. For many businesses, the events reiterated the need for a fully integrated risk management approach across the whole organisation.

The extent of fallout in the corporate sector is still being realised and should not be underestimated. With organisations such as Merrill Lynch offering voluntary redundancies to its 66,000 strong global workforce it seems that there is more yet to come as businesses and consumers indicate loss of confidence, particularly with the prospect of a world-wide recession.

There is already evidence of increasing efforts in the area of business continuity planning including resurgence in demand for the ANAO Better Practice Guide. It is hardly surprising that there is an increasing interest in risk management and, of course, governance matters in such an environment. There is also some indications that there will be re-examination of values by many people and organisations, including an increasing recognition of social responsibilities to communities.

The effects of corporate financial failures are not confined to the private sector. Several public sector agencies have been impacted by these events, including the Australian Prudential Regulatory Authority (APRA) as a regulator and Air Services Australia as a service provider, to name but two.

A recent global survey of banks in preparation for the new Basel Capital Accord, undertaken by the PA Consulting Group, indicates that gaining senior management buy-in is by far the greatest factor in achieving a successful implementation of risk-based management. The greatest obstacles to successful implementation are created by data, both in terms of quality and availability.[6] While not a finding of the survey, it has also been suggested that:

> *A lack of follow-up on identified risks can prove disastrous.*[7]

Public Sector

At the time that Comcover was formed, the key issues requiring immediate address were pervasive across the Commonwealth including:

- there was little or no general risk management training within departments and agencies; neither induction training, senior management level training, nor risk management awareness/mentoring at the executive level;
- there was no generally available source of specialist or event risk management (for example, Commonwealth Heads of Government Meeting (CHOGM), and the Sydney Olympics);
- risk management was either not specifically resourced (people or budget) or pursued in Commonwealth departments and agencies;
- loss/claims and incident registers were not generally being maintained (even for insured risks);
- very few departments had risk management plans in place (except for fraud control plans and IT Disaster Recovery);
- officers responsible for functions related to risk management (for example, internal audit, legal branch, insurance officers, corporate governance officers, OH&S officers) were isolated from one another (ie. little internal collaboration and cooperation);
- high level risk management policy statements and accountability chains (for example, by CEOs, Audit Committees, Chief Finance Officers (CFOs) or General Managers) were not generally in place in most organisations; and
- a systematic Whole of Government Risk Management Reporting Regime was also not in place.

These and related subsidiary issues were the subject of a comprehensive strategic and operation risk management roll out plan for 2000-2001. Implementation of the Commonwealth Risk Management Roll Out Plan had, as its centrepiece, the stretch goal that all Commonwealth Departments and Agencies would have a formal Risk Management Plan in place by March of 2001. This was to be followed by a Whole of Government Report prepared by May 2001.

Based on these initiatives, the Commonwealth first Whole of Government Risk Management Report was presented to Finance in May/June 2001. The result of the Whole of Government Report attests to the success of the Risk Management Program as follows:

- 88 per cent of Departments and Agencies (Members) reported that they had a well-established knowledge of risk management issues (30 per cent well established and 58 per cent recently established);
- 80 per cent of Members reported evidence of commitment to the exercise of management according to risk management principles (50 per cent recently established); and
- 75 per cent reported the use of risk management principles in Strategic and Operational Planning (55 per cent recently established).

The point here is that the program, when developed and implemented, did move 50 to 60 per cent of departments or agencies to embrace risk management. In varying degrees, a real start had been made.

The issues requiring attention are now considered to be as follows:

- adequate resourcing of the risk management function;
- appropriate reporting structures; and
- moving risk management into the front line of agency focus in a more integrated strategic management approach.

The CPA Australia Risk Management Project will reinforce the need for a more strategic, rather than a process oriented, approach to risk management by public sector managers.

Returning again to the UK National Audit Office Report mentioned earlier, Annex 2 provides a paper prepared by Professor Christopher Hood and Dr Henry Rothstein of the London School of Economics and Political Science on business risk management in government.[8] The paper concludes by observing that:

> *Intelligently applied business risk management approaches have the potential to increase public value by helping to ensure continuity and quality of public services.*[9]

Such approaches will be necessary as we move further into public-private partnerships including, in particular, greater use of private financing involving the 'appropriate' allocation of risk. In a recent survey on risk allocation on major Western Australian construction projects[10], 35 per cent of all respondents said that risks transferred to them were impossible to manage and risk was not allocated efficiently in about 42 per cent of contracts[11].

The Commonwealth Government has recognised risk transfer as adding value to a private financing proposal including innovation; improved asset utilisation, ownership and management synergies; and improved project management.[12] Furthermore, arrangements which offer little or no transfer of risk are unlikely to provide government with value for money given the relative costs of capital.[13] It is largely a matter of allocating risks to the party best able to manage them in order to achieve the optimum business outcome.

4. CONCLUDING REMARKS

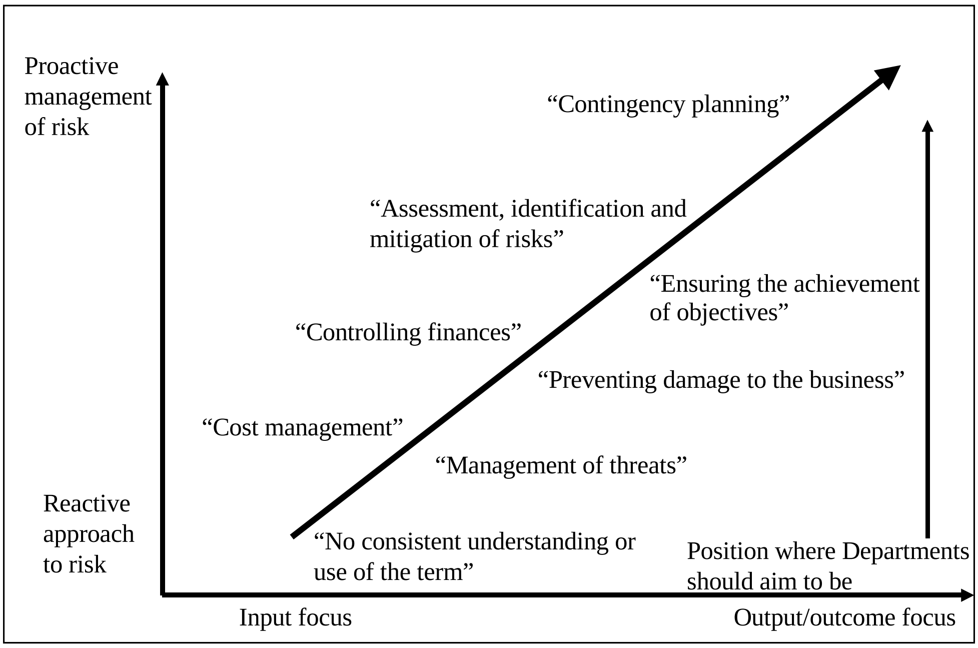
Recent events have encouraged both private and public sector boards and CEOs to look more carefully at their risk management approach as part of a sound corporate governance framework. In particular, the emphasis is on making their approach effective in order to achieve real value. In many cases the focus will be on minimising or avoiding risk. However, at a time when performance is under threat, the more difficult task of using risk as an opportunity to be more effective and achieve improved results becomes a real challenge. Nevertheless:

> *It would be foolish to suggest that boardrooms whose directors exhibit a genuinely proprietorial attitude will not make mistakes. Risks can break the wrong way, and it's not possible, or even desirable, to run a business without taking risks.*[14]

Therefore, it is very gratifying to see the range of groups that are undertaking surveys and reviews and developing practical approaches to assist organisations in implementing better, or best, practice in risk management.

I suspect that the situation identified by the UK Comptroller and Auditor-General and encapsulated in the following figure is illustrative of the still widely varying approaches being taken by governments in Australia and probably in the private sector as well. In short, the figure identifies the range of understanding of risk management from an input focused, reactive approach to a pro-active approach focusing more on outcomes that have to be achieved.

Figure



Source: NAO/PwC risk survey

The challenge for boards and CEOs is still how to change, and foster, the culture of their organisations to ensure risk management is endemic to all we do at whatever level we happen to be in the organisation. As part of such change, we have to develop the necessary processes and structures that are directed towards recognising and making effective responses to the risks and associated opportunities that can have an impact on an organisation's overall aims and objectives.[15]

ATTACHMENT

KEY PERFORMANCE INDICATORS FOR RISK MANAGEMENT

KPI 1. Integrated Risk Management Approach

An integrated approach to risk management, in an organisation, requires that risk management is an integral facet of all of its business processes. Its application is critical to the achievement of organisational objectives and governance responsibilities. Such an organisation has policies, strategies, and a comprehensive system to maintain a risk management culture. An integrated approach is also forward looking, requiring a focus on identifying opportunities, as well as avoiding or mitigating losses.

KPI 2. Committed and Led

The achievement of an integrated risk management approach and culture requires strong leadership and a commitment at the highest level/s within an organisation. There is an active and committed focus by all senior executives to 'champion' the practice of risk management to achieve business success.

KPI 3. Positive and Pro-active Focus

The organisation maintains a pro-active role in the identification, analysis and treatment of potential risks. It positively aims to provide optimum levels of protection, as well as optimising opportunities for the organisation at minimum cost.

KPI 4. Process-driven

The organisation has a framework capable of implementing risk management processes. The organisation has a clearly defined and documented risk management process, which is seamlessly integrated into all other business processes.

KPI 5. Planned for Continuous Improvement

There is a continuous application of risk management practice with a clearly defined risk planning process. Continuous control, performance monitoring, review and improvement of planning and practices are inculcated into the organisation's culture.

KPI 6. Audited and Documented

There are developed and applied mechanisms to ensure ongoing review of risks. The organisation has a well-developed audit, reporting and documentation system in place. It monitors and documents all levels within the risk management process.

KPI 7. Active Communication

Active communication and consultation occurs with internal and external stakeholders (as appropriate) at each stage of the risk management process and concerning the process as a whole. A communication plan has been developed at the earliest stage in the risk management process, with the plan addressing issues relating to the risks themselves and the process to manage it. There is a staff position responsible for communicating risk management policies and the risk management program.

KPI 8. Resourced

The organisation has identified and committed adequate resources to support the full implementation of risk management practices and processes on a continuing basis. The business is adequately protected, financially, operationally and contractually, against the risk of losses. Accountability for the management of risks rests with each line manager or business unit, with each unit having adequate risk management resources.

KPI 9. Trained and Educated

The organisation is committed to the training and the education of staff in risk management, and has an ongoing and funded training and education program.

KPI 10. Value-based Decisions

The organisation's business decisions incorporate a full risk assessment, including cost benefit analysis of the risks and business value, rather than on assessing the cost of risk alone. It links outcomes to the achievement of goals and objectives. Business decisions are value-based.

NOTES AND REFERENCES

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[3] Ibid. p.25.

[4] Foster, C.D. 2001. *The Civil Service Under Stress: The Fall in Civil Service Power and Authority*. Public Administration Vol 79 No 3. Blackwell Publishers. p.743

[5] Harris, Kathy and Thomas, Cheryl 2001. *Leaders of the pack*. CPA Australia magazine November. pp.46-47.

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[8] Comptroller and Auditor-General (UK) 2000. Op.cit. pp. 21-32

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[10] Yates, Athol and Sashegyi, Bill 2001. *Effective risk allocation in major projects: Rhetoric or reality? A survey on risk allocation in major WA construction projects.* Chamber of Commerce and Industry of Western Australia, and The Institution of Engineers, Australia. July.

[11] Ibid. p.16.

[12] Fahey John The Hon MP, 2001. *Commonwealth Policy Principles for the Use of Private Financing*. Canberra. October. pp. 11-12.

[13] Ibid. p.13.

[14] PricewaterhouseCoopers 2001. p.23.

[15] Comptroller and Auditor-General (UK) 2000. Op.cit. p.54.