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Engaging with Risk

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Engaging with Risk

Introduction

I am pleased to accept your invitation to speak to the ACT Division of the Institute of Public Administration on the topic of risk — an issue that pervades our lives and seemingly is now attached to almost every subject, e.g. regulatory, operational, financial, governance, reputation and so on. Today I have been asked to explore the topic of ‘Engaging with Risk.’ The central theme that will be running through my presentation today is this: *‘the management of risk is worlds apart from trying to avoid risk’*¹ — that is, we must engage risk and manage it taking into account not only the likelihood of risks eventuating but also their impact.

Before I start, let me share this anecdote with you which, I think, illustrates the point.

Geoffrey Robinson QC, the celebrated barrister, had a book published last year which gives a good example where risk was considered, engaged and lost. Titled *The Tyrannicide Brief*² it is about the war between King Charles the First and Cromwell’s forces, and the resulting trial and execution of the King. I have relied on Justice Michael Kirby’s book review for the facts.³

The issue that took my interest was when King Charles was captured in 1648 and brought back to London, most of the judges and leading barristers fled to the countryside fearing involvement in any prosecution of the King. John Cooke was offered and accepted the brief to prosecute the King — he was to be a junior to the Attorney-General, William Steele. When Steele opted out, Cooke took over. To quote Justice Kirby: *‘For Cooke this was a famous brief. The Parliamentary forces were all powerful. The prospects of royal restoration were tiny. The risks were tolerably small. And God had told him to do the job.’*⁴ As we now know, the monarchy was restored in 1660 and John Cooke paid for his role in the prosecution of the King with his life following his own trial at the Old Bailey. I mention this to emphasise the point that even when the risks are assessed as small, things can go awry.

Ricky Ponting would probably go along with this perspective following Australia’s defeat in the final one-day cricket match against South Africa, after setting a world record target, by a substantial margin, for South Africa to achieve.

Fortunately, in the world of public administration, we generally have more time to assess risks and mitigation strategies than available on the one-day cricket pitch.

Public sector managers engage with and manage risk every day, and have been doing so since Federation. The difference today compared to years gone by is that, for the more significant risks, risk management is expected to be more structured and disciplined. This partly reflects the evolution of risk management as a discipline. It also recognises that with principles based approaches replacing rules and procedures, and a stronger focus being given to outcomes, any gaps should be filled by a combination of stronger governance, key controls and risk management. Most would agree this has led to a more strongly performing public sector. Failure in any of the elements though can lead to sub-optimal outcomes and, in worse case situations, very severe outcomes.

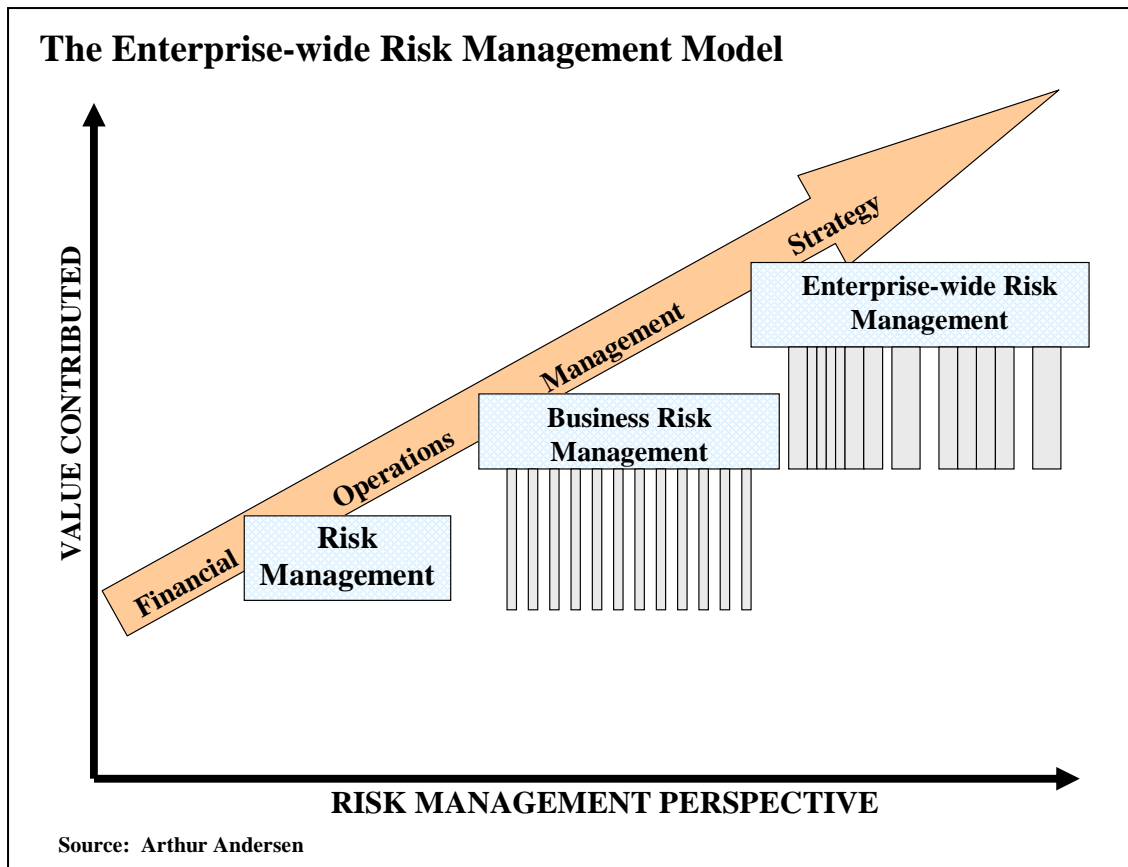
The debate on public sector risk management has reached an interesting stage. On the one hand, it is heavily promoted and there is no doubt it is no longer discretionary; indeed in some industries, entities are required to provide certification for regulators and other stakeholders in relation to their risk management practices. On the other hand, there is a concern that some risk treatments may have been excessive leading to too much red tape both within the public sector and in the regulation of various industries. For instance, in Australia we have had a Taskforce on Reducing the Regulatory Burden on Business tasked with identifying practical options for alleviating the compliance burden on business from Commonwealth Government regulation, and to examine and report on areas where regulatory reform can provide significant immediate gains to business. So, where does the balance lie so that risk is engaged for the benefit of the community, and for public sector entities?

In my presentation today, I will endeavour to:

- cover a range of different perspectives on risk management;
- mention some of the matters raised by ANAO reports that bear on risk management; and
- capture the elements of risk management that are worthy of attention by managers.

Setting the Scene

It is always helpful to have a point of reference or a framework in which to consider issues. The best way to view risk management, in my experience, is as a continuum. A succinct presentation of this view, commonly referred to as an Enterprise Wide Risk Management, is set out in the following diagram.



Risk management is everyone's responsibility but it will only be effective if it is integrated with an entity's strategies, processes and capabilities. An entity must continually assess the risks to the achievement of its outcomes and goals; and the opportunities to further its outcomes and goals.

At the end of the day, there are some fundamental choices to be made in relation to risk: you can avoid, retain, reduce, transfer or exploit them. And risk management is focussed on making informed choices in the interests of furthering organisational outcomes.

In the public sector, there are many illustrations of organisations engaging with risk.

Ric Smith, the Secretary of Defence, in an address to the United Services Institute, made the important observation that, in acquiring new military capability, the rapidly changing technological environment makes acquisition and procurement even more complex and difficult. Here, Defence faces the dilemma of looking to purchase capability which will have enduring utility, while minimising the risk of investing in unproven technology. This complexity could cause paralysis if Defence was to wait for its strategic circumstances to stabilise, or for technology advances to plateau.⁵ The Defence Secretary makes the point that at some stage we need to *jump into the swimming pool* (to use a General Cosgrove analogy). That is, we need to understand the risks and actively manage them — we can not just say the risk are too high and wear the consequences.

The Defence Secretary cites the Joint Strike Fighter decision as a case in point where Defence has taken a risk with the goal of gaining a cutting-edge capability and leap-frogging an expensive generation of combat aircraft. The alternative might have been to select a more proven platform, but there is the significant risk of investing in a capability which was obsolete before Defence had it in operation.⁶

From a whole-of-government perspective, Dr Henry, Secretary of the Treasury, in his recent address to Comcover's annual CEO forum⁷, identified the following three macro risks in the general public sector that need to be managed:

- ✚ Government as risk manager of last resort;
- ✚ Management of the general government balance sheet; and
- ✚ Operational risks associated with preparation of the annual Budget.

As a risk manager 'of last resort', Dr Henry said it was vitally important when considering its response to calls to lower or redistribute risk, that the Government had a complete picture of the nature and extent of the risk in question, and consulted with all relevant stakeholders. He said these included those currently holding the risk, those who may be required to shoulder the compliance and administrative burden of proposed solutions and those who ultimately bear the risk — where government intervention was significant, the latter was often the general taxpayer.⁸

However, he warned that advisers to government must take great care not to be captured by their stakeholders. They must be prepared to test the claims of particular groups of stakeholders against the interests of the wider community. Dr Henry went on to observe that macroeconomic volatility is an obvious 'macro' risk that governments typically seek to manage. Other macro risks include foreign relations, defence and quarantine. Government intervention in these cases seeks to reduce the risk to a large share of the population stemming from an adverse shock.⁹

The thrust of Dr Henry's address was that at the broadest level, governments are tasked with managing the risk so that our standard of living continues to improve from one generation to the next. With the ageing of the population, those risks have escalated. In recent years, Australian governments have focused on building transparent and credible medium-term macroeconomic policy frameworks and high integrity governance frameworks, designed to minimise those risks. Dr Henry noted that this year's Budget had listed five questions that should be asked of all policy proposals, namely:

1. Do they improve prospects of sustaining and improving the quality of our natural, man-made and human resources?
2. Do they improve the prospects of public and private resources being used more productively?
3. Do they promote participation in the paid and voluntary workforce?

4. Do they make the economy more resilient and adaptable to possible shocks and challenges?
5. Are they cost effective and sustainable in the long term, irrespective of whether their objective is achieved through taxation, expenditure or regulation?¹⁰

Dr Henry concluded that it is with these questions that risk management in the general government sector should start.

Tony Blair (the British Prime Minister) provided a further perspective on risk management in a recent speech to the Institute of Public Policy Research, when he raised the need for a sensible debate about risk in public policy making. He observed that:

In my view, we are in danger of having a wholly disproportionate attitude to the risks we should expect to run as a normal part of life. This is putting pressure on policy-making, not just in Government but in regulatory bodies, on local government, public services, in Europe and across parts of the private sector - to act to eliminate risk in a way that is out of all proportion to the potential damage. The result is a plethora of rules, guidelines, responses to 'scandals' of one nature or another that ends up having utterly perverse consequences.¹¹

In other words, there are trade-offs, dilemmas, balances between costs and benefits in every decision. Tony Blair gave the example of one piece of research into a supposed link between autism and the Measles Mumps & Rubella (MMR) single jab vaccination. This started a scare that, despite the vast weight of evidence to the contrary, makes people believe a method of vaccination used the world over is unsafe. The result is an increase in risk to children's health under the very guise of limiting that risk.¹²

In his paper, Tony Blair makes the point that public bodies, in fear of litigation or public/parliamentary scrutiny, act in highly risk-averse and peculiar ways. This is not unique to the UK. To illustrate his point Tony Blair cites the response of the US Congress to the Enron and Worldcom scandals — he makes the following observation:

The point about Sarbanes-Oxley was not that the underlying problems it was addressing were not real. It was quite right to put some distance between a company's auditors and its managers, between whom a severe conflict of interest had arisen. The problem was that the Act was not limited to the remedy of that specific defect. Inspired by the need for Congress to be seen to do something dramatic, Sarbanes-Oxley has imposed the threat of criminal penalties on managers and substantial new costs on American business: an average of \$2.4m extra for auditing for each company.

There is a delicious irony in this which illustrates the unintended consequences of regulation. Sarbanes-Oxley has provided a bonanza for accountants and auditors, the very professions thought to be at fault in the original scandals.¹³

While there are a range of perspectives on the merits of the Sarbanes-Oxley regime, most would agree there needs to be a proper and proportionate way of assessing risk and the response to it.

These perspectives highlight the importance of engaging with risk but not seeking to eliminate risk. They also show that risk mitigation strategies have both benefits and costs, and more consideration of these may be warranted in the public sector.

ANAO Experience

The ANAO is in a position to observe risk management by Australian Government public sector entities. There is no doubt that risk management has a higher profile today than in years gone by. Its application though is uneven particularly in the areas of programme management, contract management, tender evaluations and IT security.

We also see the 'form' of risk management being applied without quite as much substance. The message here is that, when you go through the effort of assessing risks: their impact, likelihood and any mitigation strategies, it is important to monitor the ongoing dimensions of risks and the effect of any mitigation employed. New risks, of course, can also arise which need to be monitored;

- it can sometimes be surprising just how quickly risks change. And in the public sector, we see examples of this just about every week.

In this context, I am reminded of a quote by the Chief Risk Officer, Enron:

A rattlesnake may bite us every now and again, but we knew it was there and how much it might hurt.¹⁴

If only risk management approaches were that reliable. The fact that formal risk management approaches are not without their own risks underlines the importance of a management culture that encourages managers to take a 360° view on issues of significance.

The ANAO reports to Parliament on issues related to risk management arising from both performance and financial audits, and our reports are available on our website.

It is noteworthy that the top 'key search' words on the ANAO website for the month of February were 'Risk Management'. For your information, the top 4 reports accessed for February were:

- Business Continuity Management (48)
- Best Practice Guide Public Sector Governance (21)
- Security and Control SAP R/3 (29)
- Contract Management (25)

Public sector managers can review audit reports on programmes to understand the extent of issues faced by some agencies where risk was not effectively managed. We also seek to capture the generic lessons from our work in Better Practice Guides and our newsletter AuditFocus as a way of increasing the leverage on our audit work for the benefit of the public sector as a whole.

In reading our reports, you will notice that agencies commonly adopt sound planning approaches to the programme or activity to be managed. It is in the implementation of programmes that issues arise. To assist agencies in better managing this element of their responsibilities, the ANAO and the Department of Prime Minister and Cabinet (PM&C) are jointly developing a Better Practice Guide on Implementation of Programme and Policy Initiatives.

The extent of issues raised in audit reports suggests public sector entities need to do more to promote the benefits of risk management in their organisations and actually engage with risk.

Risk Management — factors that make a positive contribution

Against this background, there is benefit in canvassing the factors that appear to make a difference in the successful implementation of risk management.

Despite its many complexities, risk management is essentially a management tool to help ensure that an organisation has the right controls in place to protect itself against adverse results.¹⁵ Anthony Atkinson and Alan Webb of the University of Waterloo, Ontario, elegantly define risk as: ‘*Uncertainty in achieving organisation objectives*’¹⁶, and go on to state that:

*the primary roles of risk management are to identify the appropriate risk return trade off, implement processes and courses of action that reflect the chosen level of risk, monitor processes to determine the actual level of risk, and take appropriate courses of action when actual risk levels exceed planned risk levels.*¹⁷
[emphasis added]

Sir John Bourn, my counterpart in the UK, has listed the following five key aspects of risk management which, in his view, contribute to better public services and increased efficiency:

- ✚ *Sufficient time, resource, and top level commitment needs to be devoted to handling risks;*
- ✚ *Responsibility and accountability for risks need to be clear and subject to scrutiny and robust challenge;*
- ✚ *Judgements about risks need to be based on reliable, timely and up to date information;*
- ✚ *Risk management needs to be applied throughout departments’ delivery networks;*

✚ *Departments need to continue to develop their understanding of the common risks they share and work together to manage them.*¹⁸

Let me now add to and build on these five points and flesh out what I believe are the key factors that appear to make a difference in the successful implementation of risk management.

Managing risk is everyone's business but it starts at the top

Increasingly, all organisations, both private and public sector, are being asked to show evidence of a systematic approach to the identification, analysis, assessment, treatment, and ongoing monitoring and communication of risk.

Risk management requires leadership from the top and it is important that agencies embrace risk management at all levels of their decision making. It cannot be treated simply as a checklist of hazards to be avoided or insured against. It should also take into account opportunities.

Risk management must not become compliance driven and the success of any risk management framework rests upon senior leadership attention. *'Risk management involves: a conscious assessment of risks, prudent decisions on how best to manage those risks and a willingness to be held accountable for our assessments and decisions'*.¹⁹

To paraphrase Dr Peter Shergold: Whatever we do in an organisation, whether we are working in corporate or enabling services, whether we are delivering programs directly or through contracted providers, or whether we are providing policy advice and developing policy initiatives for government - at everyone of those levels an understanding of risk and its management must be considered — *'Risk management becomes a way of organisational thinking'*.²⁰

It is quite clear that the benefits of risk management will never be fully realised unless we foster risk management knowledge, skills and professionalism in our people at all levels ensuring that risk management becomes a habit in the overall management of organisations. Managers at all levels are expected to manage strategic, environmental and operational risks. That is, managing risk is not someone else's responsibility any more – responsibility resides at all levels in an organisation. The goal is to have a 'self-regulating' organisation that learns from its collective experiences and adapts to meet its responsibilities in the most effective manner.

Having an 'enterprise-wide' approach to risk management

As mentioned earlier, an enterprise-wide risk approach (ERM) is increasingly being seen as the preferred approach to risk management — it is more strategically focused.

ERM calls for high-level oversight of an entity's entire risk portfolio rather than for many overseers managing specific risks – the so-called silo

approach.²¹ The contrast between the more traditional risk management approaches and ERM is well illustrated in the following table which is drawn from recent article published by the International Federation of Accountants in its *Articles of Merit Award Program*.²²

Traditional risk management	ERM
Risk as individual hazards	Risk in the context of business strategy
Risk identification and assessment	Risk portfolio development
Focus on discrete risks	Focus on critical risks
Risk mitigation	Risk optimisation
Risk limits	Risk strategy
Risk with no owners	Defined risk responsibilities
Haphazard risk quantification	
'Risk is not my responsibility'	'Risk is everyone business'

Source: KPMG as cited in *Enterprising Views of Risk Management*²³

A recent survey of risk management executives from a wide variety of industries through North America and Europe found that more than 90% were building, or wanting to build, enterprise risk management into their organisations. On the down-side however, only 11% reported that their companies have fully implemented ERM.²⁴

This supports Larry Rittenberg's (COSO's chair) view that US corporations (at least) have a way to go with implementing ERM. He made the point that organisations are holding up their hands saying '*We understand that we have to do a better job of dealing with risk*' with too many organisations not having comprehensive risk programs in place. He expects that the implementation of ERM will come gradually across organisations and believes that it has already started in pockets of many organisations and will spread to other areas as management finds it to be a useful way of analysing strategy and ensuring that the organisation has adequate controls. Boards and managers are like other human beings – they react to pressure points.²⁵

In the public sector, much of the approach to risk management continues to be intuitive rather than as a result of a strict application of the risk management standard (4360:2004 Standards Association of Australia). However, the good news is that there is a greater appreciation within agencies of the need to adopt an effective risk management approach. But, while it is easy to talk about a systematic approach to risk identification, risk assessment, prioritisation and risk treatment, the substantive issue is how are the various risks confronting organisations actually being addressed in ways that provide assurance (internally and externally) about performance and the outcomes (results) achieved. Implementation continues to be the real challenge and this is a continuing observation in our audit reports.

Risk management needs to be aligned to achieving an entity's objectives

Because managing risk is a strategic issue it needs to be aligned to strategic objectives, corporate governance arrangements, and integrated with business planning and reporting cycles. Put succinctly, risk should be treated as a strategic issue so that:

- ✚ planned business outcomes, outputs and activities do not expose the organisation to unacceptable levels of risk;
- ✚ use of resources is consistent with organisational priorities; and
- ✚ the risk management strategies are integrated with the management actions of staff at all levels in the organisation, including recognition that all staff have a responsibility to manage risks. ²⁶

Allan Hawke (a former departmental secretary) argues that clarifying an organisation's mission / objectives and establishing an organisation's values are a prerequisite to developing a risk management culture: the underlying values in organisations, critically impact on whether there are effective risk management cultures. ²⁷

Clearly, risk management is not about compliance because, in a sense, that undermines the whole culture of managing risk. The difficulty with a compliance culture is that it tends to drive a "tick-a-box" mentality. The challenge is to develop both a framework and a culture in which the assessment of risk, the management of risk and the planning for how to manage risk becomes 'built in'. That is the essential challenge. ²⁸

A compliance approach, however, may be an outcome of a risk management process. And we see examples of this in legislation and requirements established by central agencies.

A whole-of-government approach to risk is often required

As we have seen, the boundaries of risk management have expanded from the previous 'silo' approach to an agency (or enterprise)-wide risk paradigm — now, whole-of-government issues are coming into play. The boundaries between the public and private sectors are becoming more porous; and policies that demand whole-of-government approaches are becoming more common. A paper titled '*Risk: Improving government's capability to handle risk and uncertainty*' developed by the UK's Strategy Unit puts the proposition thus:

'Governments have always had a critical role in protecting their citizens from risks. But handling risk has become more central to the working of government in recent years. The key factors include: addressing difficulties in handling risks to the public; recognition of the importance of early risk identification in policy development; risk management in programmes and projects; and complex issues of risk transfer to and from the private sector.' ²⁹

A whole of government approach is essential for direct threats (terrorism); safety issues (health, transport); environmental (climate change); risks to delivery of a challenging public service agenda; transfer of risk associated with the private sector's involvement in the delivery of government programmes; and the risks of damage to the government's reputation in the eyes of the stakeholders and the public, and the harm this can do to its ability to deliver its programme.

Adopting a coordinated approach both to policy planning and to program delivery is crucial and involves managing risks in ways that go beyond those required within a single organisation. Dr Shergold observed recently that risk will be inadequately managed if we fail to consider the impact a particular policy or program is going to have on all interest groups and stakeholders, and then assess how to balance those interests.³⁰ The ANAO has also commented on the whole of government impact to ensure consideration of risks from both an enterprise-wide and a whole-of-government perspective.³¹

When implementing whole-of-government programs, the ANAO in a recent audit report³², highlighted the importance of leadership (ie appointing a lead agency) to integrate and link activities such as risk management and performance assessment of the implementation process, rather than relying solely on specific agencies' performance indicators.

An added complexity is the quickening pace of public administration, including policy development and implementation, which means that not all policy details may be settled before a policy is announced, nor are all implementation details bedded down before implementation commences. This requires an agile approach to risk management with experienced and senior managers overseeing the process. Indeed, those key judgements and risk assessments that are critical to the successful delivery of a program or policy require intensive scrutiny or to use the vernacular — the 'blow torch' applied to them.

Prudent risk management means decisions can be defended

Finally it is important for confidence in public sector administration that public servants are able to stand by the risk decisions that are taken. We are assisted in this regard by an effective system of parliamentary committees monitoring government and public service activities.

While it is often not easy to explain the concept of prudent risk management, part of our responsibility is to explain the basis of risk management and why decisions were taken — '*prudent risk management requires strategic rationale*'.³³ That said, Parliamentary Committees, in my experience, have generally been open to the explicit application of risk management by public sector entities. This point was also underlined by the United Kingdom's Committee of Public Accounts with its observation that:

Innovation to improve public service entails risk. We are rightly critical where risks are ignored, for example where major IT projects are poorly specified and managed; but we give due credit

where risks are carefully identified, evaluated and managed recognising that good management reduces but does not eliminate the possibility of adverse outcomes'.³⁴

It is when entities are not able to adequately explain their approach to risk management that issues arise from time to time. This is a key part of maintaining a strong culture of accountability.

Concluding Comments

Let me now draw some of the threads together. At the outset I wanted to make the point that risk management is not risk avoidance. The thrust of my presentation today is that those charged with the governance of an organisation, managers, and indeed all levels in the organisation must be concerned with the identification, evaluation and treatment of an organisation's risks. Risks encompass those relating to strategy, environment, operations, as well as those relating to compliance with laws and regulations and financial reporting.

A sound understanding of the major contributors to organisational risk assists in its management. The adoption of an enterprise or organisation-wide risk management approach based on a sound framework provides a focus for organisational efforts to manage risk. It also provides the appropriate assurance to Government, Parliament and other stakeholders that an agency has a formal, systematic and pro-active approach to the identification, management and monitoring of risk.³⁵

The idea of integrating risk across an organisation and risk management being embedded in its culture is essential to the success of the risk management process. Among the most critical challenges is determining how much risk an entity is prepared to, and does, accept as it strives to implement the government's agenda and/or create value in the public sector. Organisations that effectively amalgamate elements of their risk and compliance activities can reduce costs and increase clarity of their operations.

Risk management processes are increasingly well understood across the public sector, but the existence of the frameworks, and knowledge of the associated elements and processes, do not guarantee the proper treatment of risks across an organisation. Effective risk management requires a risk assessment culture that supports a holistic approach to the identification and management of risk throughout an organisation. The importance of the CEO and senior management taking a leadership role in this context should not be under-estimated.

Finally, risks do need to be actively engaged and managed. It is in the implementation of policy initiatives and programmes that require greater attention from a risk management perspective in the public sector. Organisations need to recognise their strengths and weaknesses and particularly recognise the need to compensate for weaknesses in capacity or capability. This '*organisational self-awareness*' is an important ingredient in effective governance and organisational performance.

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