Adapting Risk Management Principles to the Public Sector Reforms

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Every industry has unique challenges and managing risk for the public sector is no different. Public organizations, such as municipalities or public utilities, are generally large and slow-moving, making it difficult to get any sort of risk management plan up and running. Given their nature, public entities are also especially open to scrutiny from the media and the public. While this kind of oversight keeps people honest, it makes public entities more susceptible to defamation lawsuits, claims of unfair trade practices and reputation risk. Additionally, public entities often undertake high-risk activities that private firms never consider – from public gatherings to police departments, disaster response and water supplies – without receiving a decent profit to offset the risk exposure.

There are many definitions of risk management including: "the planned and systematic approach to the identification, evaluation and economic control of risk" and "the discipline by which organisations identify and deal with the uncertainties that threaten their success". Both definitions are valid for the public sector and they relate equally to insurable and uninsurable risks.

The importance of risk management is being highlighted and endorsed by many of the changes which are taking place in the public sector in the entire world. The sector – from central and local government and the police and fire services, through to social housing bodies, universities and colleges – has always appreciated the importance of risk management, as public sector bodies have always had controls and audit paths detailed in internal standing orders and financial regulations.

Risk management is now a readily recognised element of the management discipline; its application though is not always as recognisable. Against this background it is useful to have some points of reference to guide its application in the public sector.

Atkinson and Webb (2005) make the point that the fundamental nature and consequences of risk apply equally to for-profit and not-for-profit organisations:

- in for-profit organisations, risk is usually formalised as the uncertainty of financial returns;
- in not-for-profit organisations, risk is usually formalised as uncertainty in achieving the organisation's stated quality objectives.

Atkinson and Webb also 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."*

At a conceptual level, there are three major category of organisation risk:

- **Strategic risk**: the concern that major strategic alternatives may be ill-advised given the organisation's internal and external circumstances.
- **Environmental risk**: covering macro-environmental factors, competitive factors and market factors; and
- **Operational risk**: covering compliance risk and process risk.

The identification and management of risk is an integral part of a sound management and governance framework in both the private and public sectors. Those charged with governance are expected to act in the interests of their primary stakeholders and identify, evaluate and respond to the entity's risks – encompassing risks relating to strategy and programme or business operations, as well as risks related to compliance with laws, regulations and financial reporting. Stakeholders expect those charged with governance of an entity to manage strategic and environmental risks and to put controls in place to deal with such risks. Managers at all levels can also be expected to manage strategic, environmental and operational risks. Like that, managing risk is not someone else's responsibility any more – responsibility resides at all levels in an organisation.

A survey of public and private company directors by the National Association of Corporate Directors in the United States, suggests that boards of directors consider risk management one of their most important responsibilities. However results from the same survey show that less than 30% of directors believe their boards are highly effective in managing risk. Similarly, 36% of directors who responded to a 2002 survey conducted by McKinsey & Company indicated they did not fully understand the major risks their organisations face, and 42% did not understand fully which elements of the business created the most value for shareholders.[1]

For some years ago, many governments have been increasingly focused on achieving a better performing public sector. A major imperative has been a drive for greater efficiencies and effectiveness through providing services that are less costly, more tailored, better directed, and of higher quality to their customers or citizens. The boundaries between the public and private sectors are becoming more porous; and policies that demand whole-of-government approaches are becoming more common. Public sector organisations must not only manage their own risks but also the risks that come with joined-up government and inter-agency partnerships. Managing such complexity involves managing increasingly complex risks.[2]

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.

When implementing whole-of-government programs, the ANAO (Australian National Audit Office) in a recent audit report[3], highlighted the importance of leadership 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.

One of the greatest challenges to public sector risk management is the nature or organisation leadership. Elected officials typically have a short tenure and spend much of that time educating themselves about the nature of the risks they face. A frequently changing leadership, with ever-shifting priorities and initiatives makes it particularly tough for risk managers to get an upper – level advocate to ensure that their program gets the support it needs.

As corporate governance receives increasing attention it is becoming almost a given that effective risk management, as a corner stone of good corporate governance, results in better service delivery, more efficient use of resources, and better project management, as well as helping to minimise waste, fraud and poor value-for-money decision-making.

Increasingly an enterprise-wide risk approach (ERM) is seen as the preferred approach to risk management. ERM calls for high-level oversight of a company's entire risk portfolio rather than for many overseers managing some specific risks[4]. The contrast between the more tradition risk management approaches and ERM is illustrated in the Table 1.

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[1] Atkinson, Anthony A and Webb, Alan, *A Directors Guide to Risk and its Management*, p. 26

[2] Victorian Auditor General, 2004, Better Practice Guide, *Managing risk across the public sector*, Melbourne, June, p. 1

[3] ANAO Audit Report No 50 2004-05 *"Drought Assistance"* 2 June 2005

[4] Banham, Russ, 2005, *Enterprising Views of Risk Management*, International Federation Of Accountants, Articles of Merit, August, p. 14

Traditional RM vs. ERM: Essential Differences

Table 1

Traditional risk management	**ERM (enterprise-wide risk management)**
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
'Risk is not my responsibility'	'Risk is everyone business'

Source: Banham, Russ, 2005, *Enterprising Views of Risk Management*, International Federation of Accountants, Articles of Merit, August, p. 14.

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.[5] Notwithstanding the general recognition that good corporate governance steers management towards the better risk decisions – that is, well informed risk decisions as opposed to risk avoidance. Some commentators believe that in our current climate, a more risk-averse attitude is being generated with the increasing emphasis on compliance due to the responses from the corporate regulators around the world to the well-publicised recent spate of corporate collapses.

Good risk management is forward looking and helps to improve business decisions. It is not just about avoiding or minimising losses, but about dealing positively with opportunities.

In the public sector, for some projects where formal assessments should be in place, 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. However the good news is that there is a greater appreciation within agencies of the need to adopt an effective risk management approach. And, 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 problem.

From a public sector perspective the initial observation taken from a recent ANAO audit report is that e*ntities need to continue to build risk awareness; strengthen business practices and systems of authorisation … as part of the development of performance measurement frameworks.*[6]

Bourn (2004) mention that entities generally acknowledged that enhancements were necessary in increased risk awareness assessment and better management, including the use of performance management tools such as data metrics to monitor trends in risk and its treatment.

Bourn went on to identify ***five key aspects of risk management*** which, if applied more widely, could contribute to better public services and increased efficiency. They are:

- 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;

[5] Hughes, Peter, 2005, *Risk Management and Assurance*, Ernst & Young Risk Management Series, Fifth Edition, July , p. 7

[6] ANAO Audit Report No. 58, 2003-2004, *Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year Ending 30 June 2004*, Canberra, 26 June 2004, p. 49

- 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. [7]

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. A paper titled *"Risk: Improving government's capability to handle risk and uncertainty"*[8]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".*[9]

The paper sees risk in the public sector expanding to embrace: direct threats (terrorism); safety issues (health, transport); environmental (climate change); risks to delivery of a challenging public service agenda; transfer of risk; 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 program.

Taken together, these concerns have forced governments to reappraise how they manage risks in all its forms. The Strategy Unit's paper makes the strong point that governments also have clear roles in managing risk. Where individuals or businesses impose risks on others, government's role is mainly as regulator. Where risks cannot be attributed to any specific individual or body, governments may take on a stewardship role to provide protection or mitigate the consequences. In relation to their own business, including provision of services to citizens, governments are responsible for the identification and management of risks.

Governments need to make judgements in as open a way as possible about the nature of risk and how responsibilities should be allocated, recognising that there will always be some unavoidable uncertainty.

[7] Bourn, Sir John, 2004, UK National Audit Office Press Notice, *Managing Risks to Improve Public Services*, 22 October, found at www.nao.org.uk

[8] www.number-10.gov.uk/SU/RISK/REPORT/01.HTM

[9] The UK Government Strategy Unit, 2002, *Risk: Improving government's capability to handle risk and uncertainty*, p. 1

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