

Address to the ACT Chapter off the  
Australasian Institute of Risk  
Management

**Strategic Insights into  
Enterprise Risk Management  
(ERM)**

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# STRATEGIC INSIGHTS INTO ENTERPRISE RISK MANAGEMENT (ERM)

## I. INTRODUCTION

*'The Australian National Audit Office (ANAO), as part of its overall mission, is committed to promoting a best practice approach to organisation-wide risk management in government'*<sup>1</sup>

I thank the Canberra Chapter of the Australian Institute of Risk Management for the opportunity to speak on a topic that my Office, and I personally, have been championing since the late 1980s - the key role that risk identification and management plays in a robust management and governance framework. More recently, it is becoming increasingly evident that business processes, risks and controls across an organisation are interrelated. The traditional insular or 'silo' approaches left too many gaps and proved inadequate, with no credible way of evaluating an organisation's overall risk position. As one commentator has observed:

*'..this interconnectedness of risks across an organization can only be identified and managed, and [enterprise risk management] ERM can only emerge, when the organization begins to share risk and control knowledge systematically across its functions and departments'*<sup>2</sup>

The adoption of the Enterprise Risk Management approach shows just how far our thinking has come regarding risk management, particularly in the public sector, since it was first canvassed in the previous Finance Directions in the latter part of the 1980s. To illustrate, the following comment on Risk Management was inserted in 1989:

*'Risk management has become an up-market jargon term for good old-fashioned common sense'*<sup>3</sup>

While the trail is somewhat cold now, it seems that the amendment was influenced by an inquiry by the Senate Standing Committee on Finance and Public Administration into the Review of the Efficiency Scrutiny Program;<sup>4</sup> which in turn picked up on an ANAO suggestion that guidance be given to agencies on how to assess risk.<sup>5</sup>

Senator John Coates, the then chair of the Senate Standing Committee on Finance and Public Administration, cautioned about the common-sense approach being promoted at the time:

*'My experience in politics has been that for every common sense proposal that comes forward, there are two or three others that are hare-brained and four or five others in which serious traps lie under a plausible surface. Unfortunately ideas don't come with labels that identify their common sense content. The statement that risk management is just common sense*

*worries me because I don't think common sense is really all that common'.<sup>6</sup>*

Clearly, at that time, the thinking around the concept of risk management was 'pretty woolly' and had not reached any real level of sophistication or maturity. I started with these observations (drawn from an earlier paper of my former Deputy, Ian McPhee) to provide a backdrop to our current appreciation of risk management and to demonstrate, as I move through my paper, just how far we have come in the intervening period. The ANAO has played an important part in this advance through presentations such as this, participation in risk management forums, publications, Better Practice Guides, and importantly, highlighting risk management issues in our financial statement and performance audits.

Today I will focus on two aspects:

- the development of risk management and its increasing profile, including ERM, particularly in the public sector; and
- risk management issues raised in our performance audits.

The following observation draws together the threads of my introductory comments and establishes a platform for the remainder of my paper:

*'What can be said of the explosion of corporate governance-related guidance observed during the 1990s is that it prompted a commitment of increased time and investment in risk management but in the majority of cases organizations continued to treat risk management as a discrete exercise. Ultimately this failed to focus risk management activity on the strategic objectives that lead to improved organisational performance and, in turn, improved shareholder value. Observing the letter rather than the spirit of corporate governance guidance is something organizations should be wary of.'*<sup>7</sup>

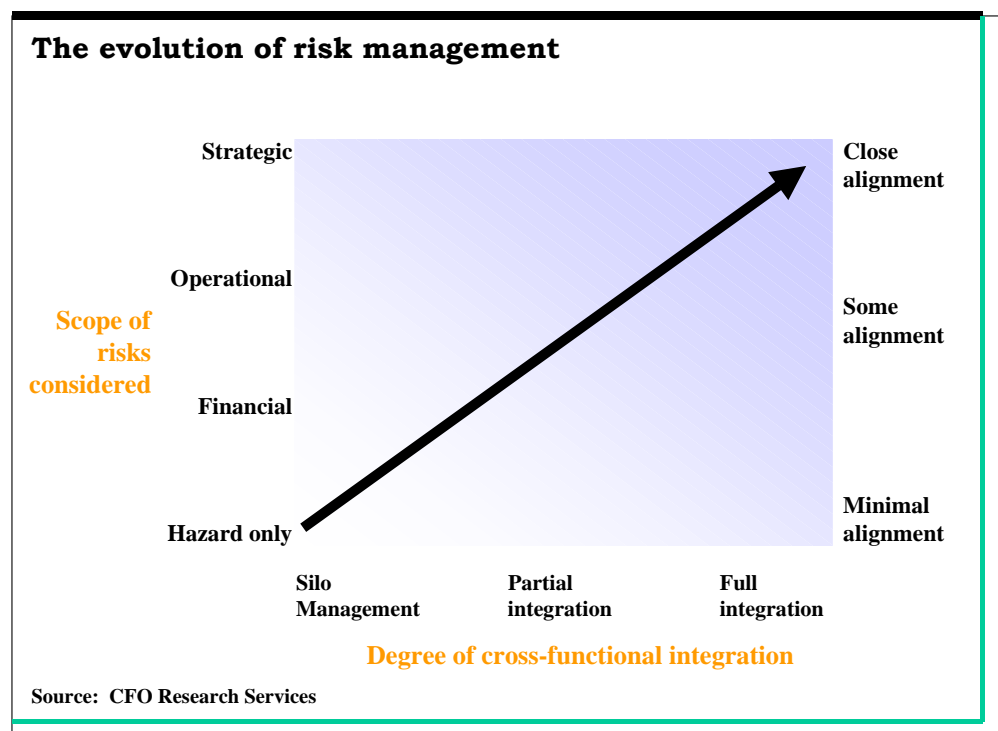
## **II. THE INCREASED PROFILE OF RISK MANAGEMENT**

Looking at the evolution and the increased profile of risk management, both in Australia and overseas, three themes emerge quite strongly. First, the recognition that risk management is a critical governance issue for any business or government agency; second the move from risk minimisation to risk optimisation focusing on the strategic objectives of an organisation; and third, the recognition that risks cannot be effectively managed by 'silos'. While risk management is still very much work in progress, the evolution is clearly moving in the right direction.

Figure 1 below, drawn from a recent research study conducted in Europe and the United States, <sup>8</sup> attempts to illustrate this evolution toward greater cross-

functional integration, coverage of a broader range of risks, and a more direct connection between risk and strategy.

FIGURE 1 – EVOLUTION OF RISK MANAGEMENT



Fundamentally, effective risk management contributes to better decision-making:

*‘because it develops a deeper insight into risks and their potential impact. It is a structured and disciplined approach: it aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces as it creates value.’<sup>9</sup>*

### **Theme One - Risk Management and Corporate Governance**

Formal risk management may have been viewed as discretionary in the past but is now accepted as an essential element of sound corporate governance and management practice. It is not a separate activity within management but an integral part of sound management processes, particularly as an adjunct to the control environment. Governing bodies need to embed a culture of risk management in organisations so that consideration of risks and risk mitigation strategies becomes second nature to managers at all levels. This is particularly important in the public sector as the nature and significance of risk changes as the role of the public sector itself changes. The latter may be the change in what is covered and/or the manner in which services are provided, for example with greater private sector involvement.

From a public sector perspective, I see risk management underlying many of the reforms that are currently taking place. A contemporary risk management

approach that encourages a more outward looking examination of the role of the organisation; increases the customer/client focus; provides a greater emphasis on outcomes, as well as concentrating on resource priorities and performance assessment; is an essential element of management decision-making. The risk management framework is also a useful means for management to gain assurance that risks are being systematically identified and treated, including being able to defend their decision-making publicly. I should also point out that “managing risk is implicit under both section 44 of the Financial Management and Accountability (FMA) Act 1997, and regulation 9 of the FMA Regulations.”<sup>10</sup>

Corporate governance is concerned with achieving results while taking account of risk. This makes formal risk management an essential part of sound corporate governance and management practice. It is becoming even more important as we move to a more networked, collaborative, or joined-up, government.

The growing recognition and acceptance of risk management as a central plank of good corporate governance is highlighted in the following extracts from the AIRM/ARIMA submission to the HIH Royal Commission:

*‘Evidence presented so far to the HIH Royal Commission has demonstrated that HIH and its predecessors failed to implement sound risk management, which provides the foundation for effective corporate governance’.*<sup>11</sup>

and

*‘All publicly listed companies are required by the Australian Stock Exchange to report on risk management in their annual reports....Boards of directors should be required to have a sound knowledge of risk management as a criterion for acceptance as a board member.’*<sup>12</sup>

and

*‘Risk management is integral to good business’.*<sup>13</sup>

A very recent survey conducted by the Institute of Internal Auditors and RMIT commented that:

*‘Organisations recognise that risk management and assessment is an essential part of effective corporate governance but they don’t invest sufficient time and resources into the function’. and ‘risk management and assessment [in Australia] is ranked as the second most important function after monitoring the effectiveness of internal controls. But organizations only devote 8.8% of their time to this task’.*<sup>14</sup>

As I noted earlier, the application of risk management is still largely work in progress, but at least the debate has moved on from whether risk management

is worth considering to one about how to implement it properly. It has been suggested that, in essence, there are three fundamental questions to be asked:

- ❑ Are we taking the right risks?
- ❑ Are we taking the right amount of risks?
- ❑ Do we have the right processes to manage them? <sup>15</sup>

However, the real challenge is to achieve the 'right balance' between prudence and innovation.<sup>16</sup> Determination of such a balance is an exercise in risk management itself.

The emphasis by regulators on the importance of good risk management is underlined by a reported comment by Dr Darryl Roberts of the Australian Prudential Regulation Authority (APRA) (in reference to those with statutory responsibility in the finance sector) that:

*If APRA detects a failure to exercise good risk management – for example, serious problems that are swept under the carpet – then we will not hesitate to deem board members and senior executives unfit for their roles and remove them<sup>17</sup>.*

Members of boards in Australia are likely to continue to receive 'encouragement' for more effective risk management. A recent survey by PricewaterhouseCoopers reported in the September edition of *Australasian Risk Management* indicates that boards in USA and Europe are already getting the risk management message. Some 57 per cent of the (large multinational) organisations responded to the survey by stating that their board will have more input in the key area of risk management as well other issues such as the company's structure and understanding of the transactions being entered into by the organisations.

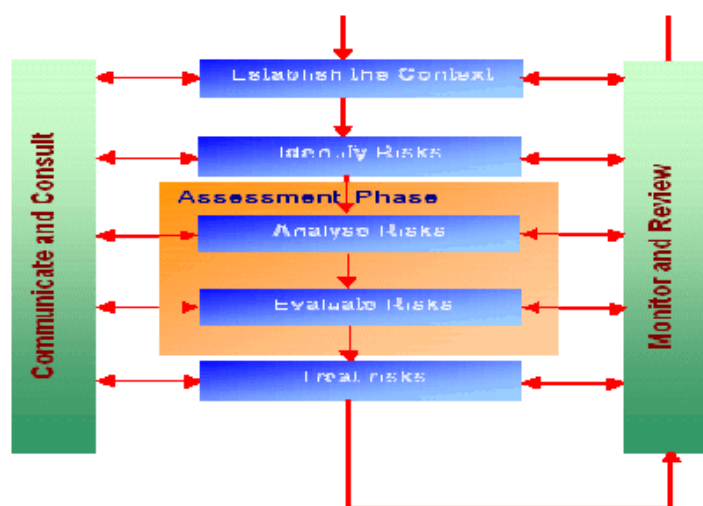
In the public sector, we have an encouraging result as shown in the CPA Australia survey of thirty-one public sector agencies from the three tiers of government (CPA Australia Risk Management Survey 2001). Commenting on the survey results, Adam Awty, the public sector policy adviser for CPA Australia, observed that:

*It [risk management] is now becoming entrenched within the public sector and is resulting in better performance. CPA Australia's survey results show that the public sector has moved to address risk management and is now more accountable, better managed and a better service provider than it was in the mid-1990s... The challenge for the future is to develop mature methodologies such as risk-performance indicators and benchmarking. Public-sector agencies also need more sophisticated skills to monitor, communicate and link risks directly with corporate objectives.<sup>18</sup>*

## **Theme Two – Risk Management and Strategic Objectives**

Risk management started to 'gain traction' in the Australian Public Service in October 1996 with the publication by the then Management Advisory Board (MAB) of the document *Guidelines for Managing Risk in the Australian Public Service (APS)* which was based on the 1995 version of risk management standard AS/NZS 4360. This standard has subsequently been updated and released as AS/NZS 4360:1999 shown in the figure below.

**FIGURE 2 - The risk management process – AS/NZS 4360:1999**



Source: CPA Australia Information Centre <sup>19</sup>

Although the MAB Guidelines focused on 'enhancing performance', risk management was often seen as a defensive strategy in keeping with the risk averse culture of the day. More recent literature and practice indicate that risk management should also be seen as a vehicle for identifying positive business opportunities. We have seen similar shifts in the private sector where, increasingly, risk management is being recognised as integral to generating sustainable shareholder value reflecting the understanding of the connection between well managed risk and improved performance or, to put it another way, the linkage between risk management and corporate goals. As one commentator has observed:

*'The contemporary view of risk management involves treating risk in the context of business strategy and senior finance professionals and chief risk officers are responsible for moving the agenda away from risk minimisation to risk optimisation so that the process drives performance and creates shareholder value. This is opposed to the traditional view, which has connotations of loss prevention and transfer through insurance mechanisms and the hedging of financial risks with derivatives'.* <sup>20</sup>

The creation of Comcover in 1997 added another challenge to the development of an enterprise risk management approach in the APS, particularly in the area of strategic management, including setting of objectives. Insurable risk was not

a subject most public servants had to deal with directly in their workplace management. In effect, the challenge was, and still is, how to deal effectively with the balance of risks and their treatment for the best results in terms of the outputs and outcomes to be achieved. The same observation applies to workers' compensation matters covered by Comcare under the *Safety, Rehabilitation and Compensation (SRC) Act 1988* and other associated legislation such as the *Occupational Health and Safety Act 1991*.<sup>21</sup>

On 27 October 1997, Cabinet agreed in principle that the Commonwealth non-insurance practice be replaced by a single managed fund covering all normal insurable risks. Cabinet was advised that the non-insurance policy, which had been in place since 1909, did not provide any comfort or direction to ensure that organisations were managing their risks effectively. It was envisaged that Comcover's establishment would, for the first time, require the systematic identification, quantification, reporting and management of risk across Commonwealth departments and agencies. The Commonwealth Government recognized that risk management via a managed fund is the preferred choice of most of the State Governments and a number of major corporations both within Australia and overseas.<sup>22</sup>

In 1999, Comcover launched a risk management program to provide Commonwealth organisations with assistance in risk management planning and education, including the release of a risk management guide. In 2000, Comcover requested agencies develop and implement risk management plans by 31 March 2001. The introduction of risk management plans was seen as necessary for effective identification and management of insurable risks and ensuring organisations had appropriate insurance in place.

To assist organisations to fulfill their responsibilities in relation to risk management and insurance activities, Comcover developed guidance material, which is available to members and the general public on the internet.<sup>23</sup> In late 2000, Comcover introduced a pilot risk management benchmarking program which was available to members, state and local public sector and private sector organisations. The purpose of the program was to enable participants to measure their performance in managing risk relative to other participating organisations. The program was officially launched in 2001. The first two cycles of benchmarking were completed in 2001 and 2002, and are based on organisations completing a self-assessment questionnaire. A third cycle is due for completion in 2003.

It is interesting to look at just how far attitudes to management of both insurance and non-insurable risks have changed in a relatively short time in both the public and private sectors. The latter risks are of greater significance and challenge, variously estimated at 60 to 70 per cent of an organisation's risk. The ANAO's current audit of 'Management of Risks and Insurance', due to be tabled next month, captures a lot of this attitudinal change.

The foregoing audit focussed on five small to medium-sized Commonwealth organisations, two governed by the *Commonwealth Authorities and Companies (CAC) Act 1997* and three governed by the *Financial Management and*



*Accountability (FMA) Act 1997*. In addition, a survey was undertaken of risk management and insurance practices in fifty Commonwealth organisations. While I obviously cannot talk about the audit findings now, it is clear that there is still some way to go in the alignment between strategic objectives and risk management in the public sector, as noted in a Research Report by the CPA Australia Public Sector Committee of Excellence in 2001.<sup>24</sup> Addressing strategic risks as part of an organisation-wide risk management plan is an on-going challenge, as illustrated earlier in Figure 1.

I will draw upon a recent research program in the United States and Europe, undertaken by CFO Research Services, to explore how companies align risk management with their strategic goals. The key finding was that few CFOs were satisfied with their current approach to risk but strategic risk management is gaining acceptance. In three years, 39 per cent intend to have integrated their risk management processes across the organization and only 12 per cent expect that they will continue manage risks in separate functions.<sup>25</sup> To quote from the report itself:

*'The more unified a risk management process is across the company, the more satisfied CFOs are with it. Likewise, the more closely risk management is tied to the strategic planning process, the more effective CFOs believe it is'.*<sup>26</sup>

*Over the past few years, companies have attempted to create such a system [a more comprehensive and forward-looking system of risk management] – these efforts have come under various names, including holistic, integrated, and more recently, enterprise risk management (ERM). ...the principles underlying these approaches (i.e., mapping all of a company's risks in a uniform way and applying a cross-functional approach to managing them) are gaining acceptance.*<sup>27</sup>

The report found that CFOs struggle with several main challenges to managing risk more strategically, namely:

- ❑ Lack of uniform metrics across the organization (33 per cent consider this to be a highly significant barrier)
- ❑ Too much time required for design and implementation (31 per cent)
- ❑ Incompatibility with corporate culture (25 per cent)
- ❑ Inadequate IT systems (25 per cent)<sup>28</sup>

The report saw strategic risk management representing a shift in thinking about risk. Previously, many viewed risk management as an activity separate from the company's real work; an after-the-fact effort to protect against dangers inherent in business operations. There is now a recognition that risk management should be inseparable from strategy development, capital allocation, and other core management processes. It follows that, if managers are to use risk

information to help steer the corporation, they need a view of that data unhindered by organisational divisions or definitional problems.<sup>29</sup> This requires real ownership and commitment at all levels of the organisation.

In summary, risk management strategies must flow into the corporate and business-planning approaches of entities so that they are fully integrated into the management actions of staff at all levels in the organisation. The challenge for public sector managers is to balance a range of objectives in a way that achieves the best overall program outcomes and other organisational goals, including a commitment to accountability.

### ***Theme Three – Risk Management: the ERM Approach***

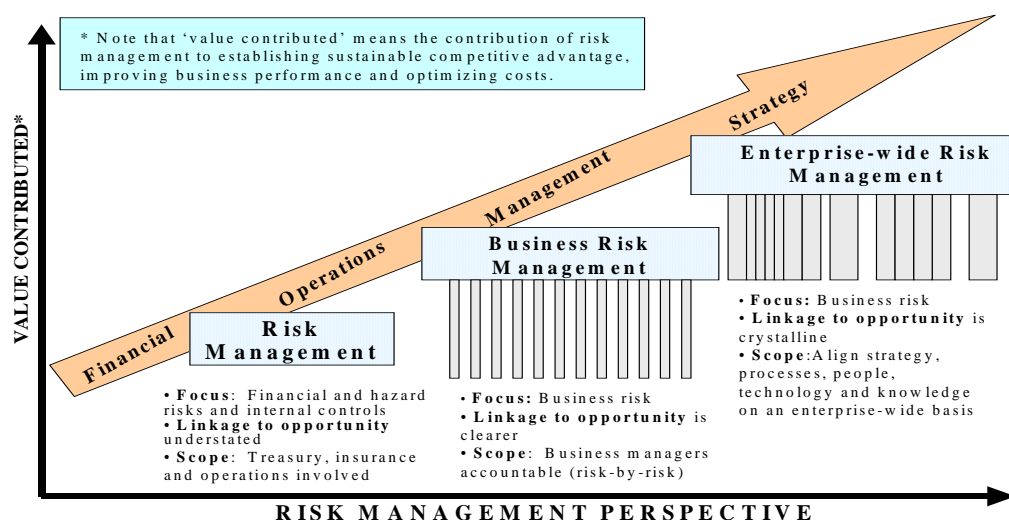
The final theme I wish to touch on in this section is the move away from managing risks by 'silos' to an enterprise risk management approach which is quickly becoming the best practice standard. In the 1990s, the idea of managing risk through an organisation was relatively novel with most still focusing on specific, mainly financial and insurable risks.

The traditional approach to managing risk has at best produced limited effective results. In the past, risk management was highly fragmented from an organisational perspective and, over time, it has been increasingly apparent that a fragmented approach, such as managing risk by silos, does not work because risks are highly interdependent. Moreover, a segmented approach does not provide senior management nor any board with aggregated risk reporting.<sup>30</sup>

The importance of taking a whole of organisation, or holistic, approach to the management of risk cannot be underestimated. James Deloach, an early pioneer and advocate of this approach, considers that an enterprise-wide approach to business risk management improves the linkage of risk and opportunity and positions the business risk management as a competitive advantage. He offers the view that current approaches are too firmly entrenched in command and control and thus rooted in the past. Such practices cannot adequately deal with an entity's continually evolving risks and opportunities. He proposed the Enterprise-wide Risk Management model shown in Figure 3. This approach:

*aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces as it creates value .<sup>31</sup>*

**FIGURE 3 - The Enterprise-wide Risk Management Model**



Source: Arthur Andersen

ERM has also been endorsed by CPA Australia in its publication *'Enterprise-wide Risk Management-Better Practice Guide for the Public Sector'*.<sup>32</sup> The CPA Enterprise-wide Risk Management approach applies risk management processes, structures and culture in a way that is:

- ❑ **truly holistic** – considers risk right across the business (strategic, operational, compliance and financial), the hazard, uncertainty and opportunity elements of risk and the objectives and needs of all stakeholders;
- ❑ **synergistic** – considers links with and interrelationships between risks and structures, strategies and processes;
- ❑ **integrated and aligned** – with business planning, objectives, decision making and other elements of the organisation's management framework; and
- ❑ **inclusive** – involves the whole organisation, from the board, to senior management and employees.<sup>33</sup>

The ERM approach is now widespread enough to be recognised as the emerging orthodoxy. However, the inter-connectedness of risks across an organisation can only be identified and managed when the organization shares risk and control knowledge across its functions. As one business writer has observed:

*'Gathering knowledge and information about the nature of business risks that face the organization, how those risks are managed, and to what extent they impact the organization's business processes and strategic goals is an inherent competency ..... and thereby greatly increase the company's ability to manage its risks effectively. In many of today's best-in-business, where sharing risk and control knowledge is widely known to be an effective risk management strategy ... is directly*

*...tied to the concept and practice of enterprise risk management (ERM)',<sup>34</sup>*

The public sector requirements for accountability, probity and emphasis on ethics combined with the scrutiny over the activities of public sector officials, particularly in the APS exercised by the parliamentary committee processes, have tended to reinforce a risk averse culture. However the tension that is created by this culture and the need to operate using modern risk management principles is well recognised now within the public sector and increasingly by our Parliamentarians, notably the Joint Committee of Public Accounts and Audit.<sup>35</sup>

Clearly, Enterprise Risk Management is not a fad, it has attracted significant coverage in both the public and private sectors and has helped to increase the profile of risk management. The idea of integrating risk across an organisation and risk management being embedded in the culture is essential to the risk management process. The ANAO is a strong advocate of this approach and while we have not published a Better Practice Guide specifically on the issue, my office contributed to the CPA Australia's publication *'Enterprise-wide Risk Management-Better Practice Guide for the Public Sector'*, mentioned earlier. The Office has also produced related Guides, such as those mentioned in the next section, and a *'Business Continuity Management'* Guide.<sup>36</sup> The ANAO will also table a follow-up audit on Business Continuity Management (BCM) next week, which discusses the integration of business continuity risk within the broader risk management and control frameworks of an organisation. One issue is to clarify the scope and boundaries of BCM, disaster recovery and emergency management within the overall risk management framework.

To conclude this section, I offer this telling observation made at the HIH Royal Commission:

*'A holistic approach to risk management is essential in any organization...However, for an insurer, particularly one writing long-tail business, it is even more imperative'<sup>37</sup>*

### **III. RISK MANAGEMENT ISSUES HIGHLIGHTED IN AUDIT REPORTS**

In this latter part of the paper, I will draw on the following ANAO's performance audits to highlight issues that are currently being addressed in the APS:

- No 12 of 1999-2000 *Management of Contracted Business Support Processes*;
- No 42 of 1999-2000 *Magnetic Resonance Imaging (MRI) Services – effectiveness and probity of the policy development processes and implementation*. Department of Health and Aged Care;
- No 21 of 2001-2002 *Developing Policy Advice*. Department of Education, Training and Youth Affairs, Department of Employment,

Workplace Relations and Small Business, and Department of Family and Community Services; and

- ❑ No 47 of 2000-2001 *Managing for Quarantine Effectiveness*. Department of Agriculture, Fisheries and Forestry – Australia.

### ***Contract management audit***

In the audit of the Management of Contracted Business Support Processes<sup>38</sup> across a selection of agencies, the ANAO examined the application of risk management to the contract management environment. The audit found that the organisations' risk management activities mostly focussed on those phases leading to signing the contract. Only a limited number of organisations formally recognised and assessed the risks associated with the ongoing management of contracts. There was limited documented evidence of risk assessments at the commencement, or during the life, of contracts.

The audit also reported that undertaking risk assessments, against an established risk framework that takes account of the costs and benefits of controls, assists contract managers apply consistent and defensible approaches to contract risk management. Risk assessments also enable appropriate management procedures and resources to be applied to contract management. This has been an area of some concern in the public sector, particularly with an evident lack of appropriate skills and experience.

In summary, the audit concluded that the selection of the most appropriate contract management style reflecting proper risk assessment would assist in the efficient and effective management of business support process contracts and help build the most appropriate relationship with suppliers.

This audit led to the preparation of a Better Practice Guide on Contract Management, which was well received both in Australia and overseas on its release in February 2001 and continues to generate interest in risk management in contracts.

### ***MRI policy development and implementation***

This audit examined the effectiveness and probity of the policy development processes for improved access to Magnetic Resonance Imaging (MRI) services by the Department of Health and Aged Care.<sup>39</sup> In this particular example, the ANAO commented on the application of risk management to the development of policy, which included the following aspects:

- ❑ The Department's approach to risk management in the development of the MRI policy measure was uneven. High-level risks relating to the linkage of the proposed measure to the processes for the Commonwealth Budget, funding options and MRI cost containment were in the overall context identified and managed. However, insufficient consideration was given to risk identification and management for some aspects of the policy development process and the measure itself, particularly in regard to the decision to include machines ordered by

Budget night. As a result there were exposures on both these fronts, which could have been better managed. This is not just a judgment made in hindsight but reflects the importance of risk identification and treatment as an integral part of management at all levels of an organisation.

- ❑ Negotiating new policy measures with professional and other organisations and third parties outside government can provide real benefits, for example, in generating better targeting and operational efficiency as well as acceptance of policy measures. However, it also presents challenges for Commonwealth officials and Ministers in managing budget sensitive matters, particularly where those involved may gain knowledge or insights into information which could benefit them financially. It follows that, in such situations, agencies should consider a suitable risk management strategy to preserve the integrity of sensitive information—in this way protecting the interests of all concerned.
- ❑ The absence of documentation on these matters was not consistent with good administrative practice. One challenge for the Department, as it is for all agencies, is to balance the major focus on results with appropriate accountability for those results, which is central to good risk management. In this situation, the pressure on the Department to progress sensitive consultations over a short time period actually demanded greater discipline in record keeping and accountability as part of a sound control environment which is integral to robust and successful corporate governance.

The ANAO has sought to establish some lessons learned from the experiences of the MRI policy development and implementation, drawing on the audit evidence and relevant practice. The major aspect of the policy process which underlies many of the concerns expressed in the Parliament and publicly relates to the risks associated with the negotiation process. The over-arching lesson is that agencies responsible for policy advice should develop and implement a sound risk management strategy to maintain the integrity of sensitive information—in this way protecting the interests of all concerned.

In managing the risks, it is necessary to strike a balance between the costs and benefits to be gained from any treatment. This requires developing a clear view on what is an acceptable level of risk. The latter is considerably assisted if such decisions are undertaken within a sound corporate governance framework, which both supports and reinforces the identification, prioritisation, analysis and treatment of risks as well as implementing appropriate monitoring and review mechanisms.

Another lesson from this audit is that risk management processes need to be systematic. This is to ensure that all risks, even those considered as obvious, are in fact identified and treated. This is especially the case in an environment of time constraints and stressful negotiation processes where the primary focus may be on the outcome to be achieved with an unrealistic expectation that

normal administrative processes will deal with any process/control issues. Alternatively, there may be a substantial discounting of the possible impact of such issues on the outcome achieved.

### ***Audit of Developing Policy Advice*** <sup>40</sup>

Adding to the work on the MRI audit referred to above, the ANAO conducted an audit of Developing Policy Advice in three Commonwealth departments with significant policy responsibilities.

The audit found, overall, that the departments had appropriate elements of a sound quality management system for developing policy advice for high order strategic issues but quality assurance procedures were not used consistently in all the policy advising projects examined as part of the audit. The ANAO concluded there was scope for departments to adopt more consistent approaches to policy advising processes in order to enable officials to demonstrate that they took all reasonable steps to provide the best possible advice. Since there will generally be varying time and resource constraints associated with individual projects, policy advisers need to assess which quality assurance procedures require more attention in each case. This is a good illustration of risk management. However all elements should be considered and, particularly in the case of high order strategic policy projects, applied to the maximum possible extent.

Making these good practices and approaches more explicit and embedding them into a quality management system would assist agencies to consider all relevant factors and make appropriate trade-offs, particularly when time or other resources are a constraint. Such assessments should be an integral part of risk management within the agency's governance frameworks.

Comprehensive risk management processes are now a requirement in all three departments examined and therefore documentation of these risk assessments could be expected for high order strategic policy development projects on the scale of the cases considered going forward.

For example, the Chief Executive's Instructions (CEIs)<sup>41</sup> for the then Department of Employment, Workplace Relations and Small Business on risk management stated that:

*Prudent risk management is to be a commonplace and continuing activity across the Department because all decisions involve management of risk—whether at the department, programme, team or individual level. Staff are to be able to demonstrate, and to document where practicable, that they have made appropriate decisions about management of risks based on a careful consideration of the likelihood and consequences of risk exposures and the benefits and costs of particular courses of action.*

Managing the risks associated with limited information is perhaps one of the most important tasks officials must undertake when developing policy advice. Dealing with limitations on information is primarily a risk management exercise. Officials must determine how best to treat the risks associated with what is unknown; whether to attempt to create data if it does not exist, whether to spend time and other resources to obtain it if it is not immediately available (and whether to do so immediately or later), or whether to accept the risk and manage without the information.

Ultimately, however, decisions about the degree of risk that can be accepted in this context rest with ministers. They must therefore not only be told what is known, but also what is not known and the potential impact this is likely to have on the advice provided.

Following this particular audit, the ANAO produced a Better Practice Guide, *Some Better Practice Principles for Developing Policy Advice*<sup>42</sup>.

### ***Managing for Quarantine Effectiveness***

In the report on Managing for Quarantine Effectiveness<sup>43</sup>, the ANAO assessed the setting of quarantine priorities through assessing and managing risk; management of the continuum of quarantine operations; and management of Import Risk Analyses to deliver and review quarantine policies.

Management of quarantine involves, inter alia, efficiently allocating available quarantine detection and inspection resources so as to minimise Australia's exposure to untreated quarantine risk material, a process referred to in the report as operational risk management. This is a challenging task, as the risk posed by a particular commodity can be difficult to estimate and can vary according to when, where, and in what volume it enters the country.

The Department of Agriculture, Fisheries and Forestry – Australia (AFFA) makes more extensive use of risk management practices within programs to profile quarantine risk material to assist in detection. Use of these profiles has substantially improved risk targeting and seizures of quarantine material, but their potential has yet to be fully exploited to maximise outcomes.

AFFA recognizes the need for operations to be risk-based and has in place a risk management plan for each quarantine operational program and a risk management plan for its quarantine output.

### ***NSW Audit Office experience***

In June 2002, the NSW Auditor-General tabled a performance report on Managing Risk in the NSW Public Sector.<sup>44</sup> In that report, the NSW Auditor-General identified that, while agencies were aware of the need to manage risk, their risk management fell short of better practice. Many agencies did not consider their risk management to be adequate. However, those agencies in the Public Trading Enterprise Sector have approached risk management in a systematic way and in accordance with the principles of better practice



standards, while others, mainly departments not subject to commercial imperatives, had yet to progress the management of risk beyond the traditional response of insuring against more common types of risk.

The NSW Audit Office considers that:

- ❑ there is clearly a role for greater consistency in the way risk management is considered and applied;
- ❑ agencies need to take a broader view of risk which goes beyond the insurance focus; and
- ❑ agencies need to recognise that being risk averse can deprive them of opportunities to improve efficiency and effectiveness.

#### **IV. CONCLUDING REMARKS**

The ANAO fosters the view that the intuitive, and often reactive, approach to managing risk that has characterised public sector management in the past is not sufficient for robust public governance. We all know that reacting 'after the horse has bolted' is often quite costly and damaging to the credibility of agencies and Ministers. Therefore, a more strategic approach is required to stay contestable in the new APS environment.

The ANAO reinforces the concept that risk management is endemic to good governance rather than being regarded as an "add on". Public sector agencies are increasingly adopting risk management practices but still more emphasis is required, particularly to highlight that risk management should be applied at the enterprise, business and operational levels of an organisation. It is not sufficient to simply create a risk manager position as some sort of universal panacea. Nevertheless, an experienced risk management adviser can provide considerable assistance at all levels of an organisation, particularly where concepts and approaches are not well understood.

In the public sector, we need to consider an agency's full range of responsibilities, including the particular responsibilities to their Minister(s). It is fairly well accepted that agencies should have in place adequate information sources and systems to inform Ministers in relation to their executive responsibilities, including those relating to policy development and the administration, including monitoring, of existing policies. This requires agencies to take a broad, rather than narrow, view of their responsibilities and the range of risks that potentially attach to them. To get this message across and embedded fully in the culture of the organisation, CEOs and senior managers must show leadership and commitment to the adoption of risk management. 'Tone at the top' is essential for the latter as it is for sound corporate governance more generally.

Finally, I make the observation that a well governed, progressive and financially sound organisation will be best placed to respond to unexpected shocks or opportunities. Risk management is an important element in ensuring organisations get to that position. The additional upside of a sound risk

management approach is an improvement in organisational efficiency and effectiveness, and limiting the potential for surprises. That is more risk avoidance. At the end of the day the issue comes down to our people. In that respect, most would agree that:

*'Good governance depends first and foremost on having good people in your organisation.'*<sup>45</sup>

Graham Bradley, CEO Perpetual

## NOTES AND REFERENCES

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- <sup>2</sup> Hala, Nancy 2002, 'Unlock the Potential' Internal Auditor, October, p 32
- <sup>3</sup> Commonwealth of Australia 1989 Finance Directions – Section 1
- <sup>4</sup> The Parliament of the Commonwealth of Australia, Senate Standing Committee on Finance and Public Administration, 1989. *Review of the Efficiency Scrutiny Program*, Australian Government Publishing Service, Canberra. April
- <sup>5</sup> I have drawn on an early paper by Ian McPhee, my former Deputy, entitled 'Risk Management – An ANAO Perspective' MAB/MIAC Seminar: Managing Risk, Canberra 1995, p1
- <sup>6</sup> Ibid, p.1
- <sup>7</sup> Sharman, Richard & Copnell, Tim 2002, 'Performance from Conformance - The practical application of corporate governance and risk management', Managing Risk to Enhance Stakeholder Value, International Federation of Accountants and the Chartered Institute of Management Accountants, November, p1
- <sup>8</sup> Strategic Risk Management – New Disciples, New Opportunities, A research Report available online at [www.cfo-research.com](http://www.cfo-research.com), p6
- <sup>9</sup> Parker, Jennifer 2002. *The rewards and challenges of effective risk management*. Journal of Chartered Institute of Secretaries Australia Ltd. Vol 54 No 11 December, p.662
- <sup>10</sup> Australian Government Solicitor 2003. *Managing Procurement Risk and Liability*. Legal Briefing No 66. Canberra, 12 May, p.1.
- <sup>11</sup> ARIMA-AIRM Joint Submission to the HHH Royal Commission, 15 July 2002, p2
- <sup>12</sup> Ibid p.3
- <sup>13</sup> Ibid p. 4
- <sup>14</sup> Fenton-Jones, Mark 2003, *Auditors identify risky business*, Australian Financial Review, 21 March , p 51
- <sup>15</sup> Taken from an overview of the 2002 IIA Enterprise Risk Management Conference by Felix Kloman found at [www.riskmanagement.com.au/RM/News/2002](http://www.riskmanagement.com.au/RM/News/2002)
- <sup>16</sup> Hicks, Carole 2002. *Risk Management in the Public Sector* in 'Managing Risk to Enhance Stakeholder Value', IFAC Financial and Management Accounting Committee IFAC/CIMA, New York/London, November. p.60
- <sup>17</sup> Tingle Laura, and Fabro Allesandra, 2002. *Auditors Face Tough Regime as APRA Attacks*. Australian Financial Review, 18 September, p.69
- <sup>18</sup> Awty, Adam, 2002. *A Check on Risky Business*, The Public Sector Informant, Supplement to the Canberra Times, April, p.11
- <sup>19</sup> Found at [www.cpaaustralia.com.au/01\\_information\\_centre/11\\_risk](http://www.cpaaustralia.com.au/01_information_centre/11_risk). Overview of the Process. p.1
- <sup>20</sup> Connell, Bill 2002, 'Risk Management – Overview', Issued by the International Federation of Accountants and the Chartered Institute of Management Accountants, p. v
- <sup>21</sup> The SRC Act establishes a fully-funded premium-based system and a licensed self-insurance system of compensation and rehabilitation for employees who are injured in the course of their employment. The SRC Act emphasises prevention, active claims management, rehabilitation and safe return to work. It has a comprehensive benefits structure with limited common law rights (see Comcare Annual Report for 2001-2002, p.42). Prevention includes the promotion of a risk-managed approach to Occupational Health and Safety (OHS).
- <sup>22</sup> The Hon John Fahey, MP (then Minister for Finance and Administration), 1998. *Responsible Risk Management for the Commonwealth Government*, Media Release, Comcover 60/98, Canberra, 30 June.

- <sup>23</sup> Refer to <http://www.Comcover.gov.au>
- <sup>24</sup> CPA Australia, Public Sector Centre of Excellence 2001. *A Research Report on Risk Management in the Public Sector*. Melbourne.
- <sup>25</sup> *Strategic Risk Management – New Disciplines, New Opportunities*. Op.cit.
- <sup>26</sup> Ibid, Research Summary, p.2
- <sup>27</sup> Ibid , Chapter 1, p.3
- <sup>28</sup> Ibid, p.18
- <sup>29</sup> Ibid, p.27
- <sup>30</sup> Lam James, 2000, *Enterprise risk management and the role of the chief risk officer*, found at [www.erisk.com](http://www.erisk.com), Erisk Research Centre, March, pp 2-3
- <sup>31</sup> Deloach, James. 2000. 'An Executive Summary of Enterprise-wide Risk Management –Strategies for linking risk and opportunity', Arthur Andersen, p. 5
- <sup>32</sup> CPA Australia 2001. 'Enterprise-Wide Risk Management – Best Practice Guide for the Public Sector'.
- <sup>33</sup> Ibid , p.9
- <sup>34</sup> Op cit, Hala, Nancy, p.30
- <sup>35</sup> Joint Committee of Public Accounts and Audit, 2000. *Contract Management in the Australian Public Service – Report 379*. The Parliament of the Commonwealth of Australia, Canberra. October. pp.80-87
- <sup>36</sup> ANAO 2000, Better Practice Guide, *Business Continuity Management* , January
- <sup>37</sup> Op cit , ARIMA – AIRM Joint Submission to the HIH Royal Commission, p.5
- <sup>38</sup> ANAO 1999. *Management of Contracted Business Support Processes*. Report No 12, Canberra, 14 October.
- <sup>39</sup> ANAO 2000. *Magnetic Resonance Imaging Services – effectiveness and probity of the policy development processes and implementation*. Report No 42, Canberra, 10 May.
- <sup>40</sup> ANAO 2001, *Developing Policy Advice*. Report No 21, Canberra, November.
- <sup>41</sup> CEIs are legally binding on the officers of a department/agency under FMA legislation. They are issued by the Chief Executive Officer under FMA Regulation 6, with authority also coming from section 52 of the FMA Act 1997.
- <sup>42</sup> ANAO 2001. *Some Better Practice Principles for Developing Policy Advice*. Better Practice Guide. Canberra, November.
- <sup>43</sup> ANAO 2001, *Managing for Quarantine Effectiveness*, Report No 47, Canberra, June.
- <sup>44</sup> Found at [www.audit.nsw.gov.au](http://www.audit.nsw.gov.au)
- <sup>45</sup> Quoted in Elliott, Geoff 2003. *ASX rules: Shut up and you're sweet*. The Australian (Business News), 1 April, p.21